

Loblaws (TSX: L)



Current Price

\$123

Price Objective

\$151

Holding Period

3-5 years

Margin of Safety

23%

1 Valuation Not Reflective of Fundamentals

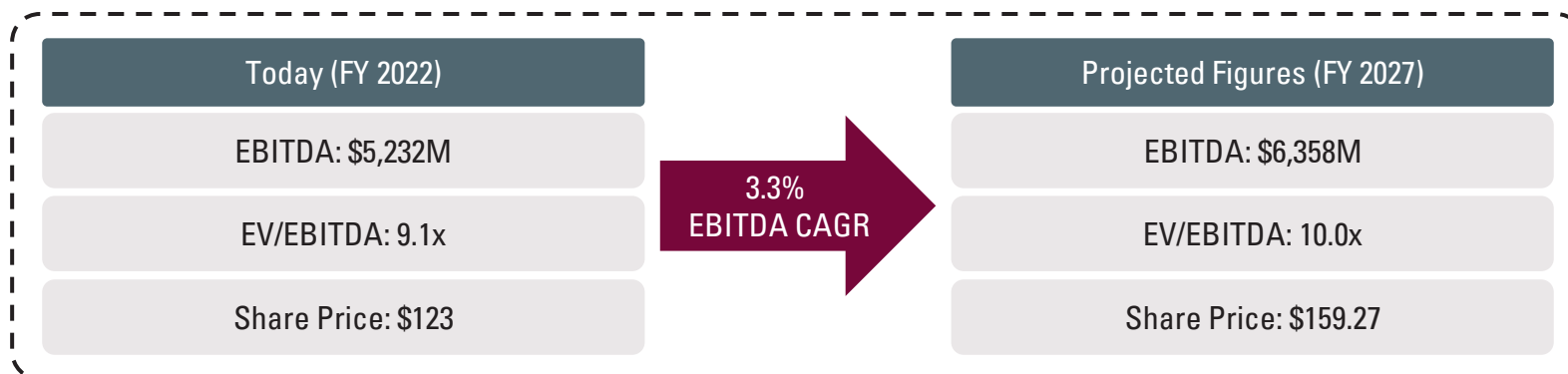
Loblaws is the largest food and pharmacy retailer in Canada with the strongest loyalty program and private label offerings along with the most diversified business model

2 Well-Positioned in Discount Retail Sector

Loblaws is an appealing defensive investment for the anticipated recession due to their unique positioning and extensive discount network

3 Most Dominant Player in High-Growth Pharmacy Industry

Shoppers Drug Mart is the largest pharmacy in Canada and their operations continue to bolster Loblaws' strong financial performance



LOBLAW OVERVIEW

Company Summary

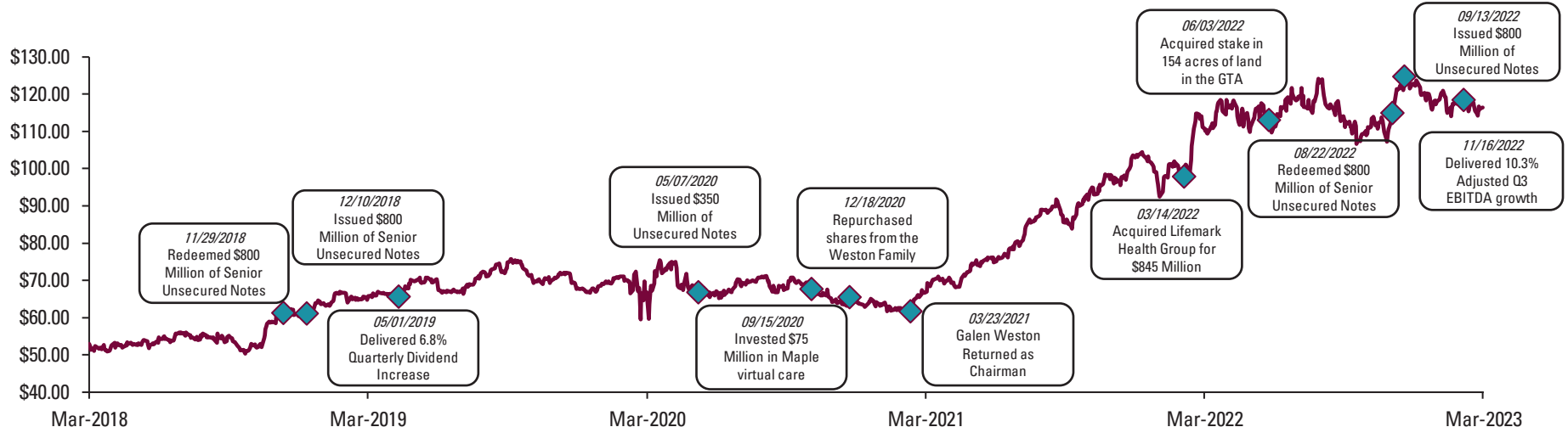
- Loblaws Companies Limited (“Loblaws”) is a Canadian-based grocer and pharmacy chain offering a range of products and services at various price points to meet the everyday demands of Canadian households
- Loblaws operates under 22 regional and market-segment banners, as well as pharmacies, banking, and apparel
- Loblaws has two main business segments: its food retail segment, which comprises the provision of fresh and dry goods; and its pharmacy retail segment, which comprises the sale of pharmaceuticals and beauty products
- The company was founded in 1919 and is headquartered in Brampton, Ontario

Market Cap \$37.58B	Revenue \$56.83B	EBITDA \$5.23B	EV \$53.88B
EV/EBITDA 9.1x	P/E 18.65x	Diluted EPS \$5.73	Retail Gross Margin 30.7%

Financial Metrics

	2019A	2020A	2021A	2022A	2023E
Revenues	\$48,295	\$52,956	\$53,451	\$56,830	\$57,213
Net Income	\$1,389	\$1,449	\$2,296	\$2,849	\$2,866
EBITDA	\$3,480	\$3,572	\$4,205	\$5,232	\$5,631
Interest	\$747	\$727	\$496	\$694	\$609
FCF	\$1,605	\$3,328	\$2,966	\$2,712	\$2,961
FCF per Share	4.46	9.51	8.72	8.42	9.20
Net Debt	\$15,761	\$14,671	\$15,483	\$10,733	\$6,569

Annotated Share Price Chart



Loblaws is the largest food and drug retailer in Canada, offering an array of products at various prices to meet the demands of Canadian consumers

Source: Refinitiv, Company Filings.

Note: All dollar amounts in CAD, unless noted otherwise.

LOBLAWS OVERVIEW

Segment Analysis

Food Retail

Discount Format Stores

Deliver fresh-led food shop with low costs



Market Format Stores

Leading fresh offerings, quality products and customer-centric service



Label Brands



Financial Services

PC Bank

PC Money Account

PC Mastercard

Consumer Lending



PC Insurance

Home and Auto Insurance



Pharmacy and Healthcare

Stand Alone Drug Stores



Owned Providers



Drug Distribution



Pharmaceutical Products



Electronic Medical Records

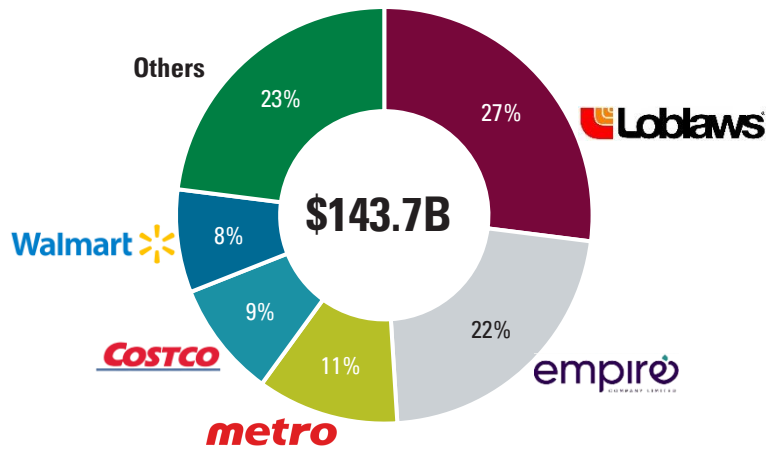
PC Health App

Access to healthcare resources and support to improve health and wellness

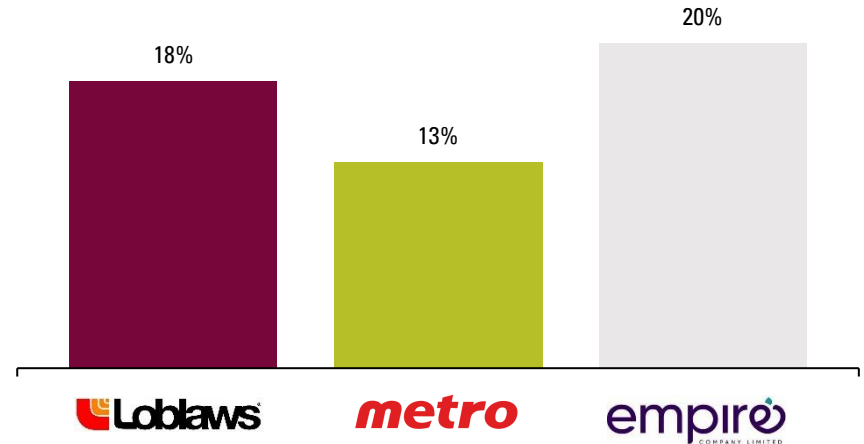
Loblaws key segments contain a range of diversified offerings, making it a key player in the food retail and pharmacy industries

FOOD RETAIL INDUSTRY OVERVIEW

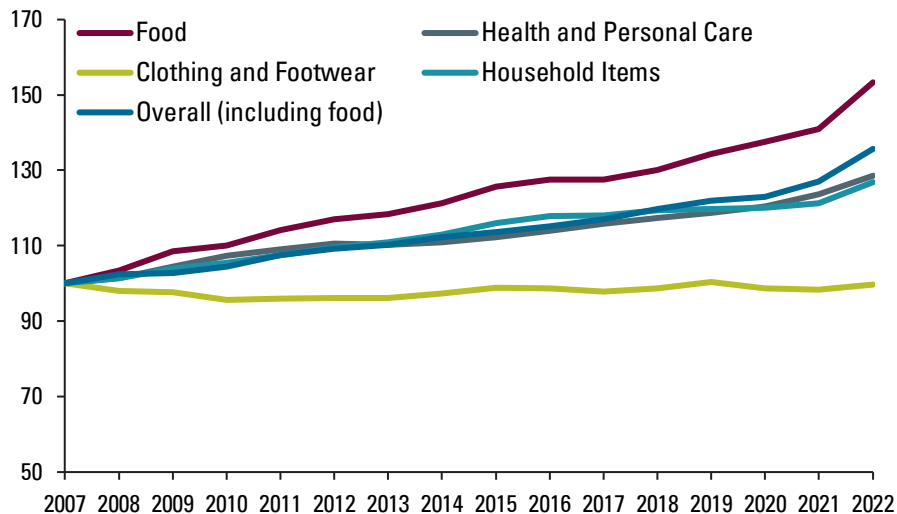
Food Retail Market Share Breakdown



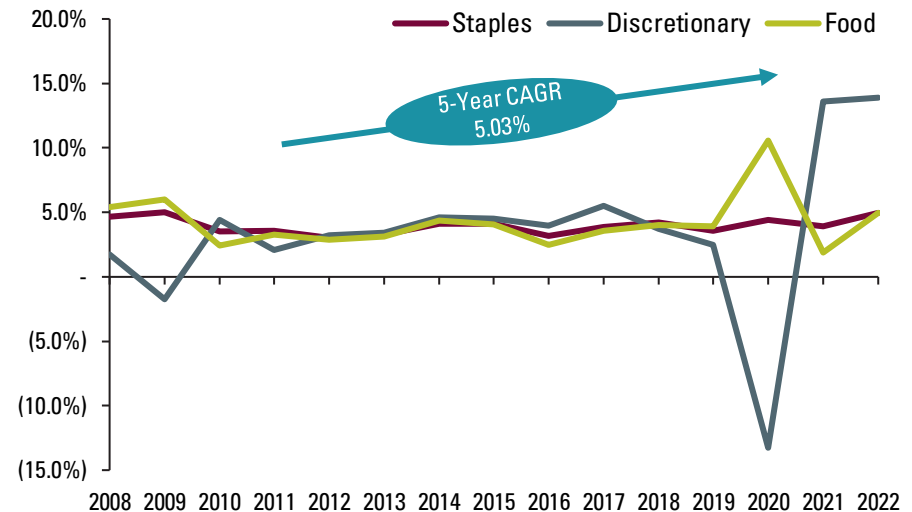
Revenue Growth Since 2019



Segmented CPI



YoY Change, Consumer Spending by Sector



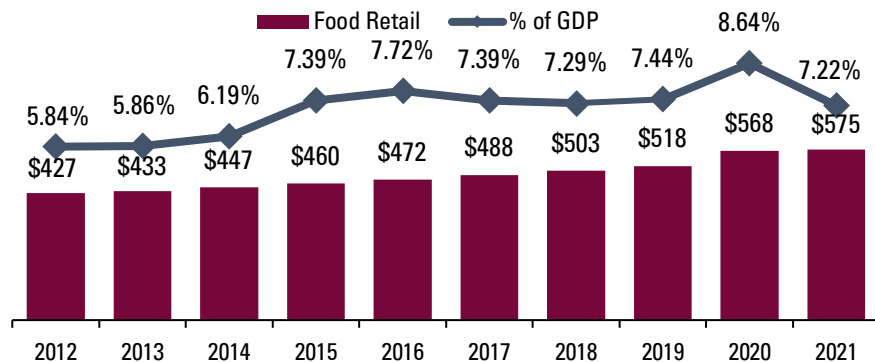
Staple consumption experiences less volatility, a promising outlook for firms in the food & drug retail industry during tighter economic conditions

Source: Bloomberg, Refinitiv, MSCI.

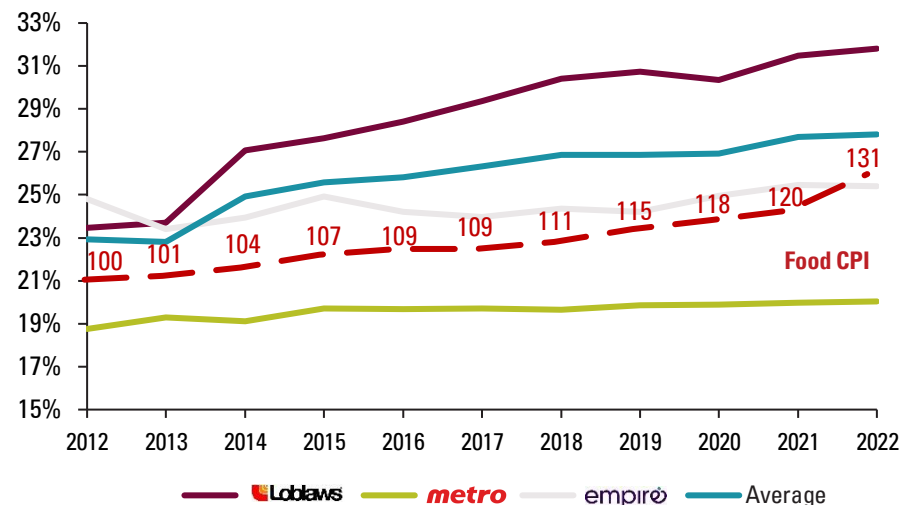
Note: All dollar amounts in CAD unless otherwise stated. Companies classified in the 'Other' category include: Metro, Weston, Albertsons, Grocery Outlet Holding Corp, Sprouts, North West.

FOOD RETAIL INDUSTRY OVERVIEW

Market Growth



Canadian Grocers' Gross Profit Margins and Food CPI



Why Grocers Can Pass Down Inflation?



Low Price Elasticity of Demand



Limited Competition & Market Power

Canadian Grocery Landscape



- 1,092 food retail stores and 1,344 drugstores offering various food products
- Extensive private label offerings, comprehensive loyalty program, broader target market
- Focus on Ontario and the West Coast



- 975 food retail stores, 645 pharmacies
- Operating mainly in Quebec and Ontario
- Offers private label products, albeit less-known than Loblaws'



- 1,200 food retail stores, 350 gas stations, and 400 pharmacies
- Operating mainly in West Coast and Atlantic
- Offering private label products, albeit less-known than Loblaws'



- Walmart has 402 stores in Canada with a focus in Ontario, Quebec and Alberta
- Costco has 107 stores with a focus in Quebec, British Columbia and Ontario

Food retail is well positioned for the upcoming macro environment with Loblaws being Canada's largest food retailer

Source: StatsCan, Company Filings.
Note: All dollar amounts in CAD, unless noted otherwise.

PHARMACY INDUSTRY OVERVIEW

Key Players

Retail Pharmacies



Stores and sells general medications
Key Advantage: Convenience in access to general and specialized medication

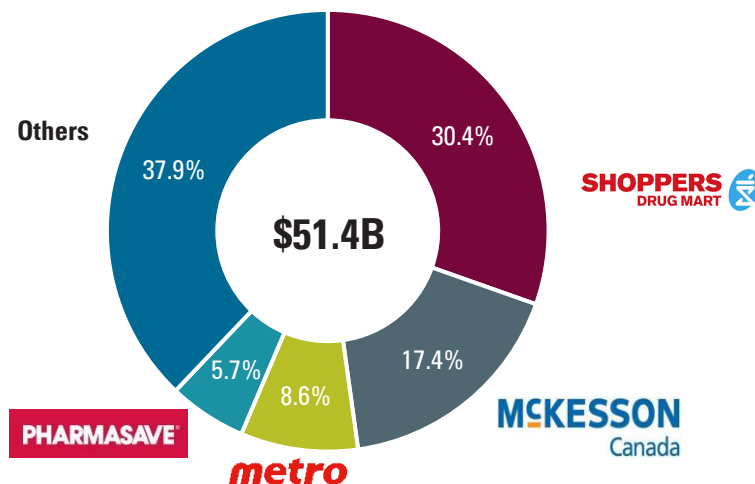
- Shoppers Drug Mart is Canada's leading pharmacy retailer
- More than 1,300 locations across the country
- Innovating health & wellness services since 1962
- Over 18 million PC Optimum members across Canada

Independent Community Pharmacies

PHARMASAVE

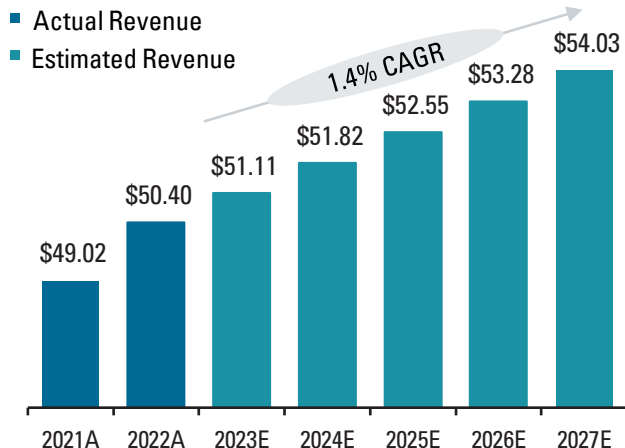
Not owned by a public company or part of a pharmacy chain
Key Advantage: Offers a specialized and wider range of medications

Market Share

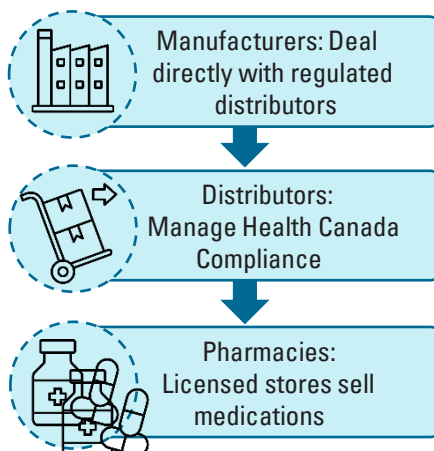


Industry Overview

Canadian Pharmacy and Drug Store Growth (\$B)



How Canadian Pharmacies Work



Industry Drivers and Trends

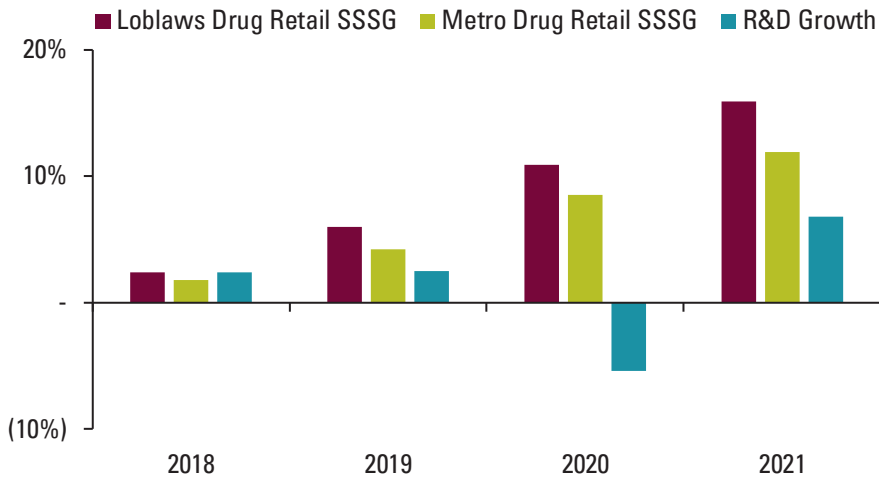
- Increased focus on digitization of healthcare and pharmacy services
- Aging population of adults aged 65+ growing quickly
- Patent cliffs have allowed strong revenue growth from generic drugs
- External competition has led to a diversification of private-label products

Shopper's Drug Mart holds a strong market share within in the pharmacy industry which continues to grow due to a range of drivers and trends

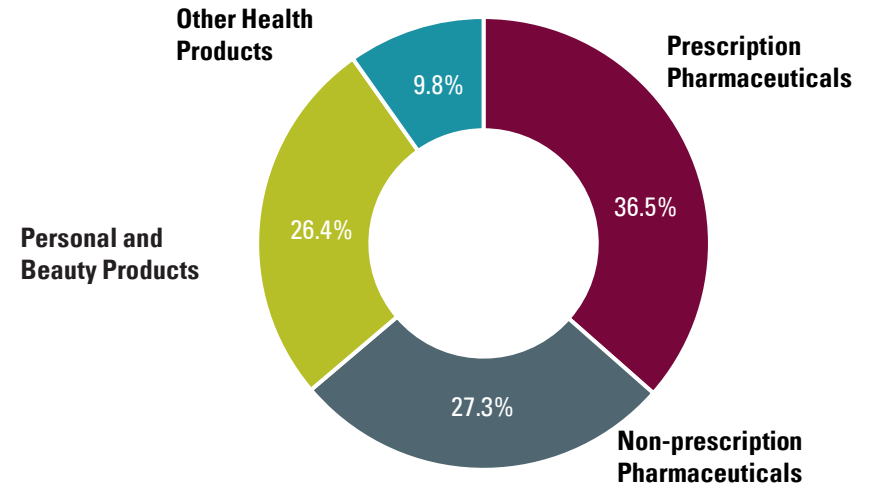
Source: IBIS World, Equity Research Reports.
Note: All dollar amounts in CAD, unless noted otherwise.

PHARMACY INDUSTRY OVERVIEW

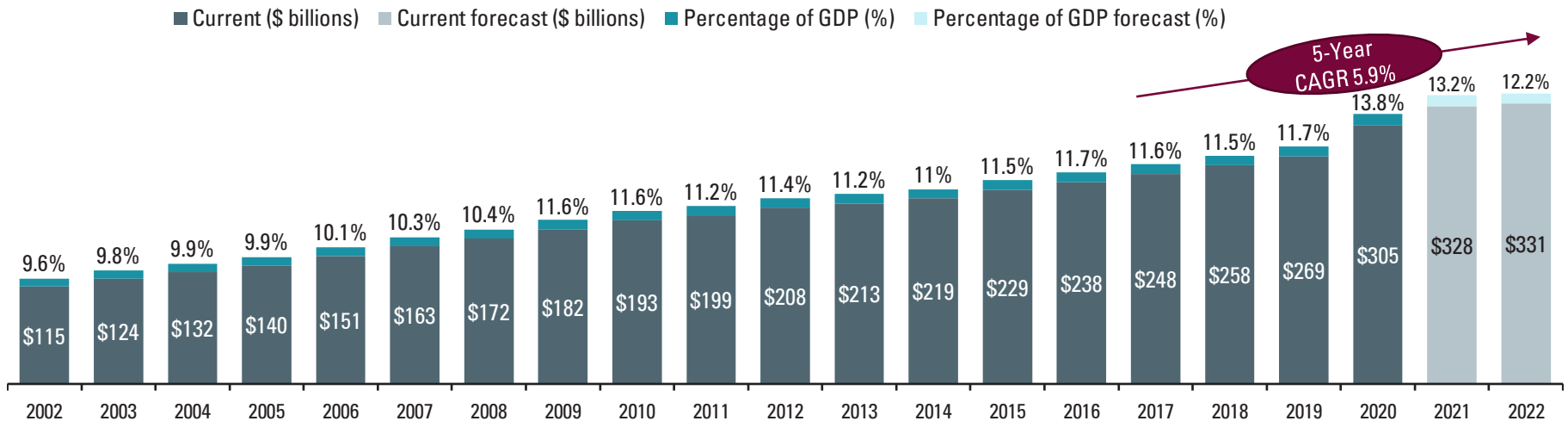
4 Yr Pharmaceutical R&D Growth and Grocers' Pharmacies SSSG



Product and Service Segmentation



Canadian Health Expenditure



As Canadian health expenditures increase, Loblaws' Drug Retail experiences strong growth with its diverse product and service segmentation

Source: Loblaws Annual Reports, PMPRB Annual Report 2021, IBIS World.
Note: All figures stated in CAD, unless noted otherwise.

VALUATION NOT REFLECTIVE OF FUNDAMENTALS

Key Strengths



Loblaws' PC Optimum loyalty program has over 18 million members and allows customers to earn and redeem points while purchasing goods at any Loblaws subsidiary



Strongest private label offerings in the industry with offerings at various price points, allowing customers to upgrade or downgrade without having to go to a different store

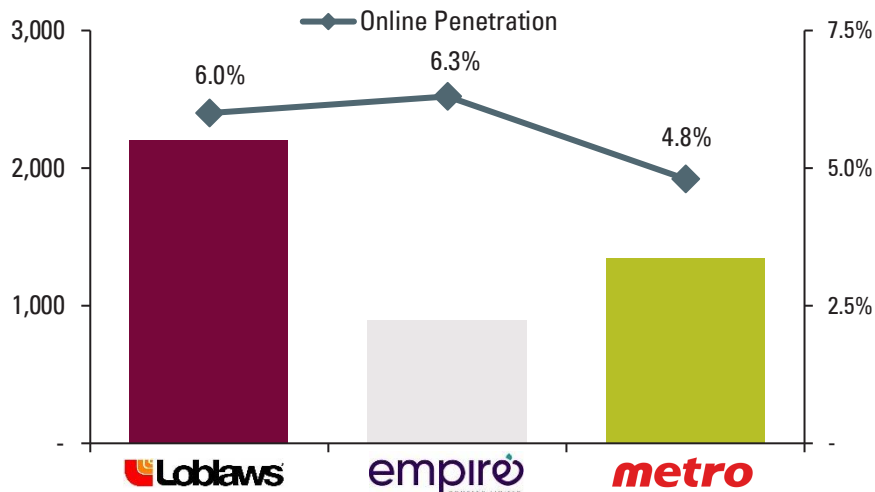


Strength of operations across all lines of business and high diversification bolsters favorable market position

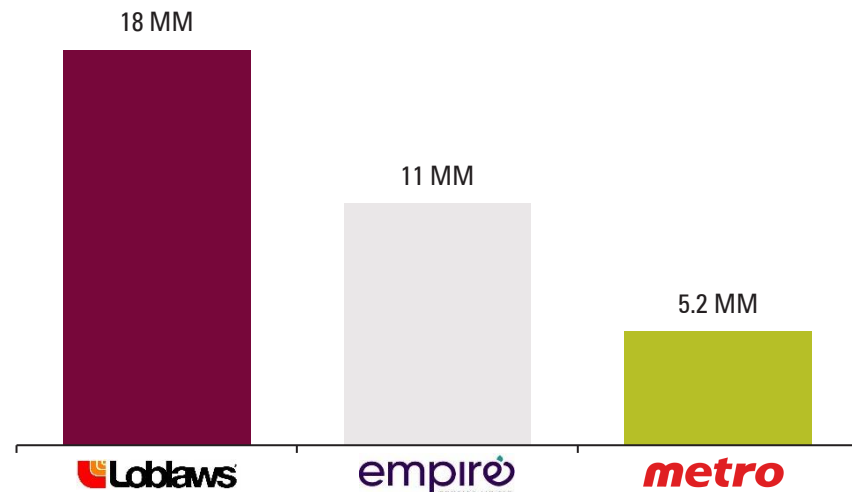
Canadian Grocers' Discount Retail Positioning



Canadian Grocers' Online Retail Revenue and Penetration (\$M, %)



Canadian Grocers' Loyalty Program Membership Since 2018

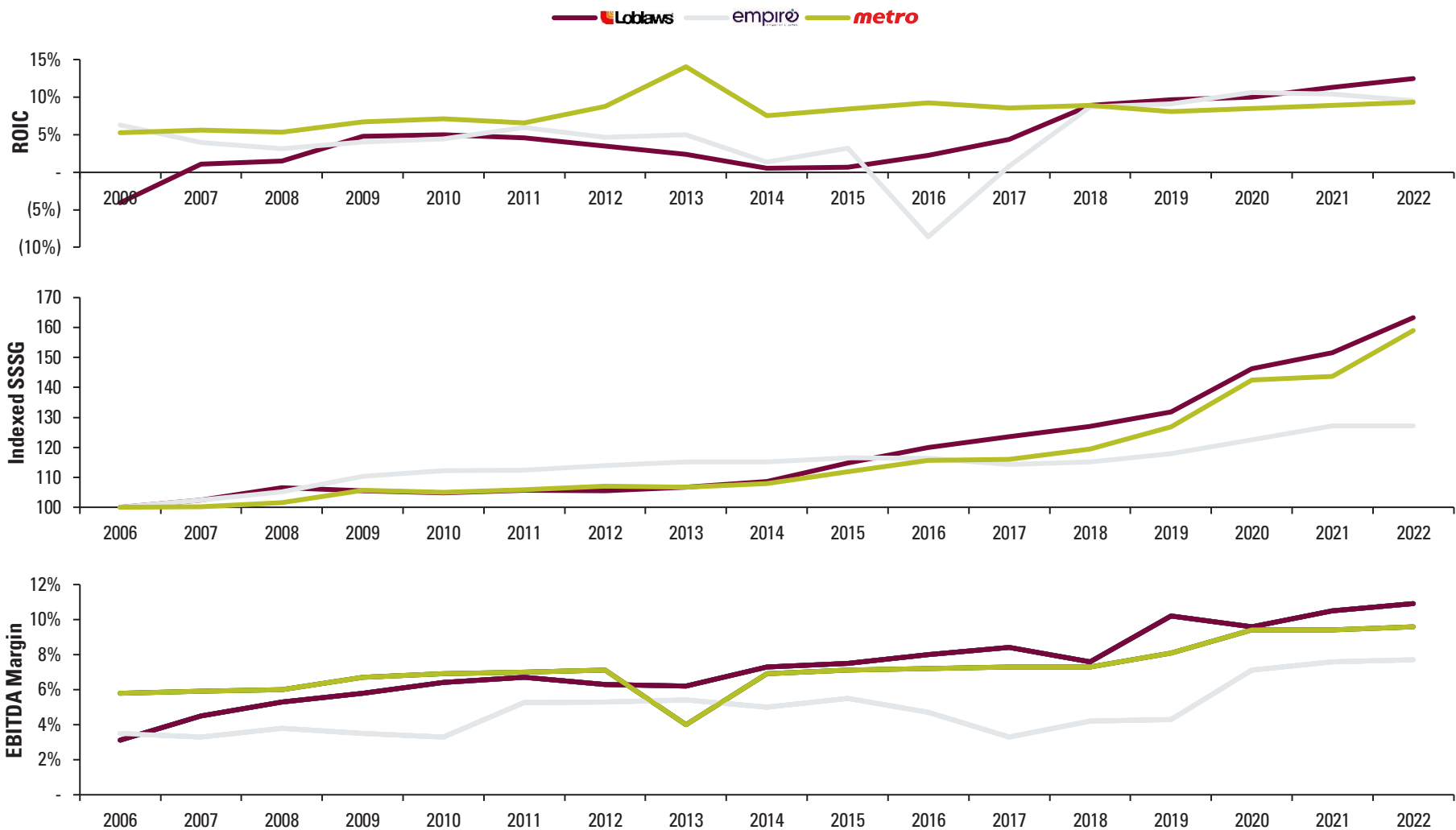


Loblaws remains the most prominent food and drug retailer in Canada due to its strong loyalty program, online penetration and exposure to discounts

Source: NBF, Refinitiv, company filings.
Note: All dollar amounts in CAD, unless noted otherwise.

VALUATION NOT REFLECTIVE OF FUNDAMENTALS

ROIC, YoY SSSG, and EBITDA Margin Amongst Canadian Food Retailers

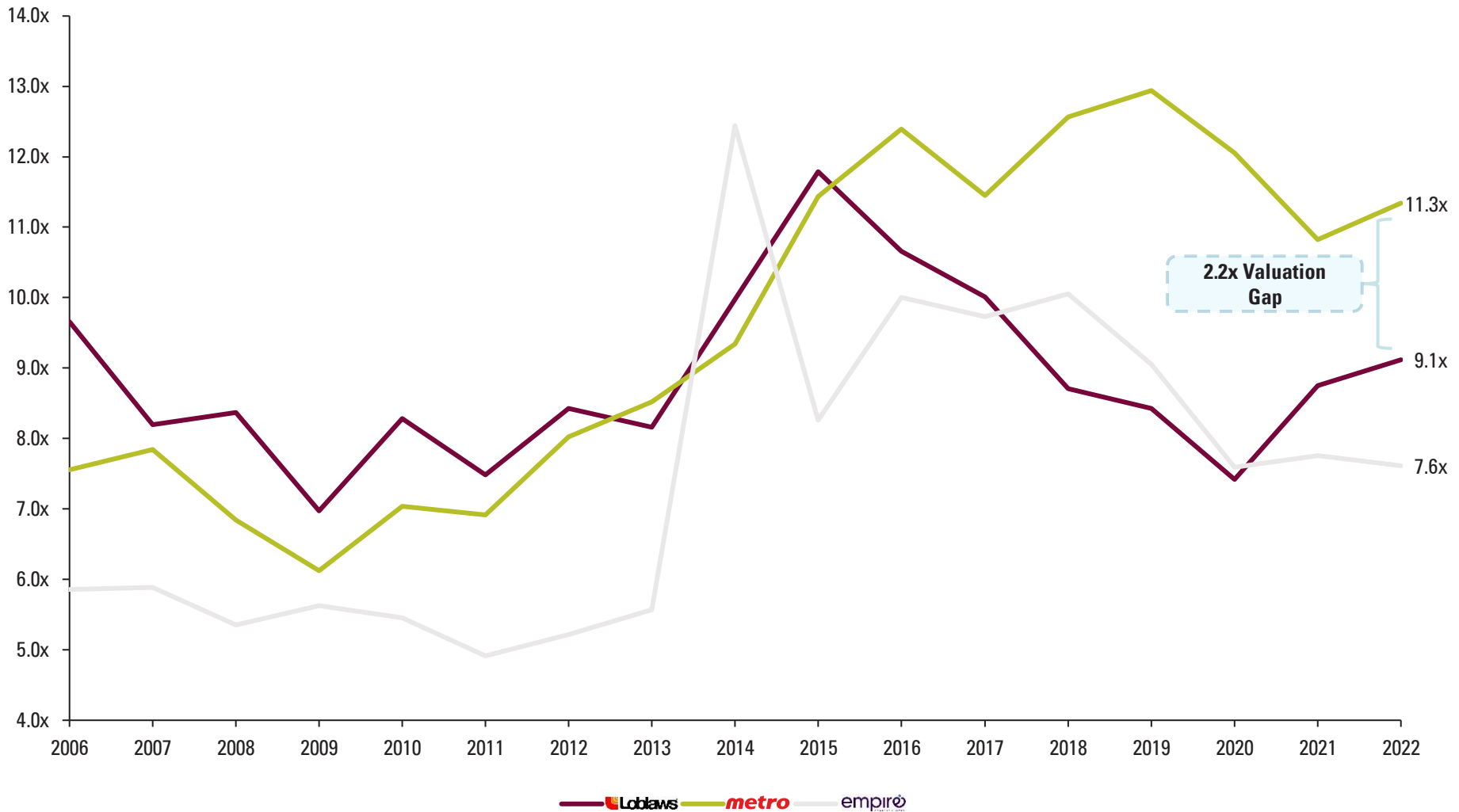


Loblaws has trumped Empire and Metro in terms of EBITDA margin for the majority of the last 16 years and has begun to distance itself from its competitors in terms of ROIC. Loblaws is on par with Metro on a same-store sales growth basis

Source: NBF, Refinitiv, Company Filings.
 Note: All dollar amounts in CAD, unless noted otherwise.

VALUATION NOT REFLECTIVE OF FUNDAMENTALS

Big 3 Canadian Grocers – Trailing EV / Adj. EBITDA



With consistently superior operating metrics and similar growth outlooks, it is our view that the valuations of Loblaws and Metro should converge - reflecting material upside for Loblaw shareholders

Source: Bloomberg Terminal.
Notes: All dollar amounts in CAD, unless noted otherwise.

DCF VALUATION

	2022A	2023E	2024E	2025E	2026E	2027E	
EBITDA	5,232	5,601	5,600	5,778	5,990	6,174	WACC Capital Structure Debt Weight 60% Equity Weight 40% Cost of Debt 5.53% Borrowing Rate 7.00% Tax Rate 21% Cost of Equity 9.77% Risk Free Rate 3.15% Beta 0.88 Market Return 7.00% WACC 7.22%
Less: D&A	1,024	1,494	1,342	1,272	1,205	1,142	
EBIT	4,208	4,107	4,258	4,506	4,785	5,032	
Less: Tax	793	927	887	898	925	990	
NOPAT	3,415	3,181	3,370	3,609	3,860	4,042	
Add: D&A	1,024	1,494	1,342	1,272	1,205	1,142	
Less: CAPEX	1,571	1,504	1,507	1,510	1,512	1,515	
Less: NWC Changes	156	190	59	132	660	426	
Unlevered FCF	2,712	2,981	3,147	3,239	2,892	3,242	

Target Price Derivation

Exit Multiple Method		Gordon Growth Method	
Final Year EBITDA	6,174	Final Year UFCF	3,242
EBITDA Multiple	11.3x	LT Growth Rate	3.00%
Terminal Value	73,437	Discount Rate	7.22%
Discount Rate	7.22%	Terminal Value	73,437
PV of Terminal Value	50,689	PV of Terminal Value	58,134
PV of Cash Flow	13,241	PV of Cash Flow	13,241
Net Debt (Cash)	15,483	Net Debt (Cash)	15,483
Equity Value	48,447	Equity Value	55,892
Shares Outstanding	353	Shares Outstanding	353
Target Share Price	\$137	Target Share Price	\$158

Scenario Analysis

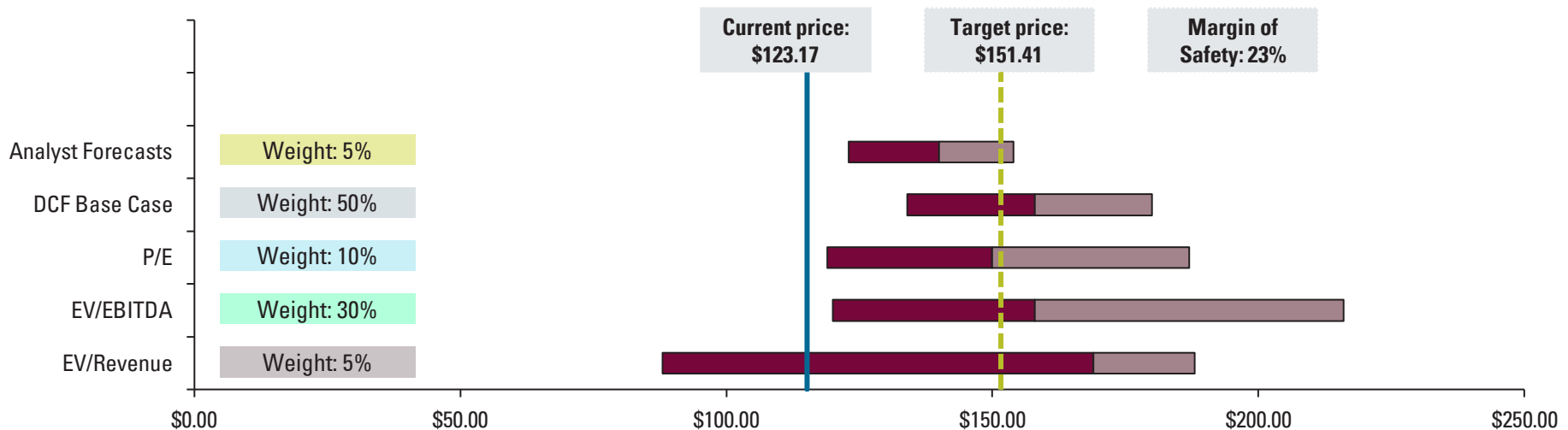
		WACC								
		7.62%	7.52%	7.42%	7.32%	7.22%	7.12%	7.02%	6.92%	6.82%
Growth Rate	2.60%	\$130	\$133	\$137	\$140	\$144	\$148	\$153	\$157	\$162
	2.70%	\$132	\$136	\$140	\$144	\$148	\$152	\$156	\$161	\$166
	2.80%	\$135	\$139	\$143	\$147	\$151	\$155	\$160	\$165	\$170
	2.90%	\$138	\$142	\$146	\$150	\$155	\$159	\$164	\$169	\$175
	3.00%	\$141	\$145	\$150	\$154	\$158	\$163	\$168	\$174	\$179
	3.10%	\$145	\$149	\$153	\$158	\$163	\$168	\$173	\$178	\$184
	3.20%	\$148	\$152	\$157	\$162	\$167	\$172	\$178	\$183	\$189
	3.30%	\$152	\$156	\$161	\$166	\$171	\$177	\$182	\$189	\$195
3.40%	\$155	\$160	\$165	\$170	\$176	\$182	\$188	\$194	\$201	
		WACC								
		7.62%	7.52%	7.42%	7.32%	7.22%	7.12%	7.02%	6.92%	6.82%
Multiple	9.3x	\$110	\$110	\$111	\$111	\$112	\$112	\$113	\$114	\$114
	9.8x	\$116	\$116	\$117	\$118	\$118	\$119	\$119	\$120	\$121
	10.3x	\$122	\$123	\$123	\$124	\$125	\$125	\$126	\$126	\$127
	10.8x	\$128	\$129	\$130	\$130	\$131	\$132	\$132	\$133	\$134
	11.3x	\$135	\$135	\$136	\$137	\$137	\$138	\$139	\$139	\$140
	11.8x	\$141	\$142	\$142	\$143	\$144	\$144	\$145	\$146	\$146
	12.3x	\$147	\$148	\$149	\$149	\$150	\$151	\$151	\$152	\$153
	12.8x	\$153	\$154	\$155	\$156	\$156	\$157	\$158	\$159	\$159
13.3x	\$160	\$160	\$161	\$162	\$163	\$163	\$164	\$165	\$166	

We derived implied prices of \$137 and \$158 from our DCF using the Exit Multiple & Gordon Growth Methods, respectively

COMPARABLES ANALYSIS

	Share Price	Mkt Cap	EV/Revenue			EV/EBITDA			P/E		
	C\$	C\$B	Current	FY1	FY2	Current	FY1	FY2	Current	FY1	FY2
Empire Company	36.82	9.52	0.54x	0.54x	0.51x	7.61x	7.15x	6.82x	12.81x	13.06x	11.82x
Metro	71.05	16.75	1.09x	1.04x	1.02x	11.34x	10.65x	10.29x	19.62x	16.75x	15.86x
Parkland	30.34	5.32	0.37x	0.34x	0.36x	6.78x	7.52x	7.05x	19.16x	12.67x	11.48x
Alimentation Couche-Tard	63.16	63.11	0.76x	1.47x	0.75x	0.77x	9.90x	9.84x	16.96x	16.39x	16.64x
The North West Company	35.78	1.73	0.92x	0.92x	0.89x	7.72x	7.50x	7.45x	14.30x	13.84x	13.57x
Premium Brands Holding Corp.	97.85	4.38	1.20x	1.16x	1.09x	18.39x	13.59x	11.73x	26.18x	20.41x	17.70x
Dollarama	80.77	22.29	5.25x	5.36x	4.60x	18.54x	17.55x	15.14x	29.12x	29.56x	27.68x
25th Percentile	35.78	4.38	0.54x	0.54x	0.51x	6.78x	7.50x	7.05x	14.30x	13.06x	11.82x
75th Percentile	80.77	22.29	1.20x	1.47x	1.09x	18.39x	13.59x	11.73x	26.18x	20.41x	17.70x
Average	-	17.59	1.45x	1.55x	1.32x	10.16x	10.55x	9.76x	19.74x	17.53x	16.39x
Loblaws	115.20	36.30	0.98x	0.97x	0.93x	9.12x	8.89x	8.53x	18.65x	17.46x	15.94x

Valuation Assessment: Football Field Chart



We have derived a base-case, weighted average target price of \$151.41, implying a ~23% upside case as of March 31st, 2023 closing price

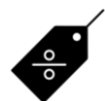
Source: Bloomberg, Company Filings, Equity Research.
Note: All dollar amounts in CAD, unless noted otherwise.

CATALYSTS & RISKS

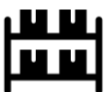
Catalysts	Likelihood	Description
Expansion into e-commerce		Loblaws has been investing heavily in its e-commerce partnerships with Instacart, and investments in digital platforms like PC Express are expected to drive online sales
Distribution Network Investment		Loblaws is focusing on initiatives to improve margins and profitability such as investing \$1.6 billion into its stores and distribution network in 2023. This efficiency program will deliver significant cost savings in the coming years
Diversification & Acquisitions		Loblaws is continuously acquiring companies, recently Lifemark, the leading provider of outpatient physiotherapy and rehabilitation. These investments, alongside the current portfolio, maintain customer loyalty

Risks	Likelihood	Description
Inflation & Economy		Economic declines and rising inflation could lead to changes in customer consumption habits. Customers may be likely to spend less money on non-essential products, which could cause Loblaws' profits to decline
Healthcare Regulations		Changes to laws and regulations, including the potential implementation of a national pharmacare system, and changes in the models used to fund prescription drugs, could adversely affect the performance of Loblaws
Distribution and Supply Chain		Loblaws is highly dependent on its supply chain which is vulnerable to natural disasters, labour disputes or transportation issues. Any disruptions could impact the company's operations and financial performance

Mitigant: Inflation and Economy



Push discount banners to emphasize lower-cost, higher-margin items



Keep a stock of frozen and canned items as demand for these increase



Consider adjusting the ordering strategy to eliminate less popular SKUs through a data-intensive approach

Mitigant: Healthcare Regulations



Enhanced hiring methods to include a pharmacists assessment abilities, not just prescribing abilities

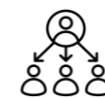


Keep a close eye on the political landscape to anticipate how lobbying and drug reform pressures the business



Anticipate how national pharmacare would impact consumer shopping behaviour

Mitigant: Distribution and Supply Chain



Getting backup suppliers in place if the original supplier has inventory issues



Using local expertise to understand and deal with any potential legal or political issues



Creating a contingency plan in the event of a natural disaster or economic issues

Healthcare regulations and economic factors threaten the earnings, while e-commerce presence and acquisitions are likely to increase profitability

RECOMMENDATION: BUY

- ✓ Defensive Positioning Through Discount Store Flexibility
- ✓ Dominant Presence in Growing Healthcare Market
- ✓ Geographic & Industry Diversification
- ✓ Proven Ability to Pass on Inflation
- ✓ Consistently High Margins, ROIC & Growth Relative to Peers
- ✓ Largest Loyalty Program of The Big 3
- ✓ Strong Private Label Presence Through Presidents Choice & No Name
- ✓ 23% Margin of Safety Based on Multiple Valuation Methods

We recommend a BUY at a target price of \$151.41 based on 50% DCF, 45% comparable companies, and 5% analyst targets, implying 23% upside

Appendix

MANAGEMENT OVERVIEW

Galen G. Weston

Chairman & President

Son of former Chair Emeritus of Loblaws' parent company George Weston Limited and great grandson of Loblaws founder George Weston. Weston has held various leadership positions within the company since 2006 and first became the Chairman and President of Loblaws in 2014 and held the position until 2017. Returned as Executive Chairman and President in 2021 following the retirement of Sarah Davis. Weston is also the Chairman and President of George Weston Limited.

Richard Dufresne

Chief Financial Officer

Joined Loblaws in 2021 following the return of Galen G. Weston as Chairman and President. Dufresne previously served as the CFO of both Loblaws and George Weston Limited from 2014 to 2017 during Weston's previous tenure as Chairman and President. Prior to his tenure at Loblaws and George Weston Limited, Dufresne was the CFO at Metro, where he spearheaded Metro's strong financial operations during and after the 2008 Financial Crisis.

Robert Sawyer

Chief Operating Officer

Joined Loblaws in 2021 following the return of Galen G. Weston as Chairman and President. Spent over 40 years as a Canadian retail executive, primarily at Metro, where he was COO and oversaw consistent financial performance in lieu of tough conditions; and Rona, where he was President and CEO, and oversaw successful operations over his tenure.

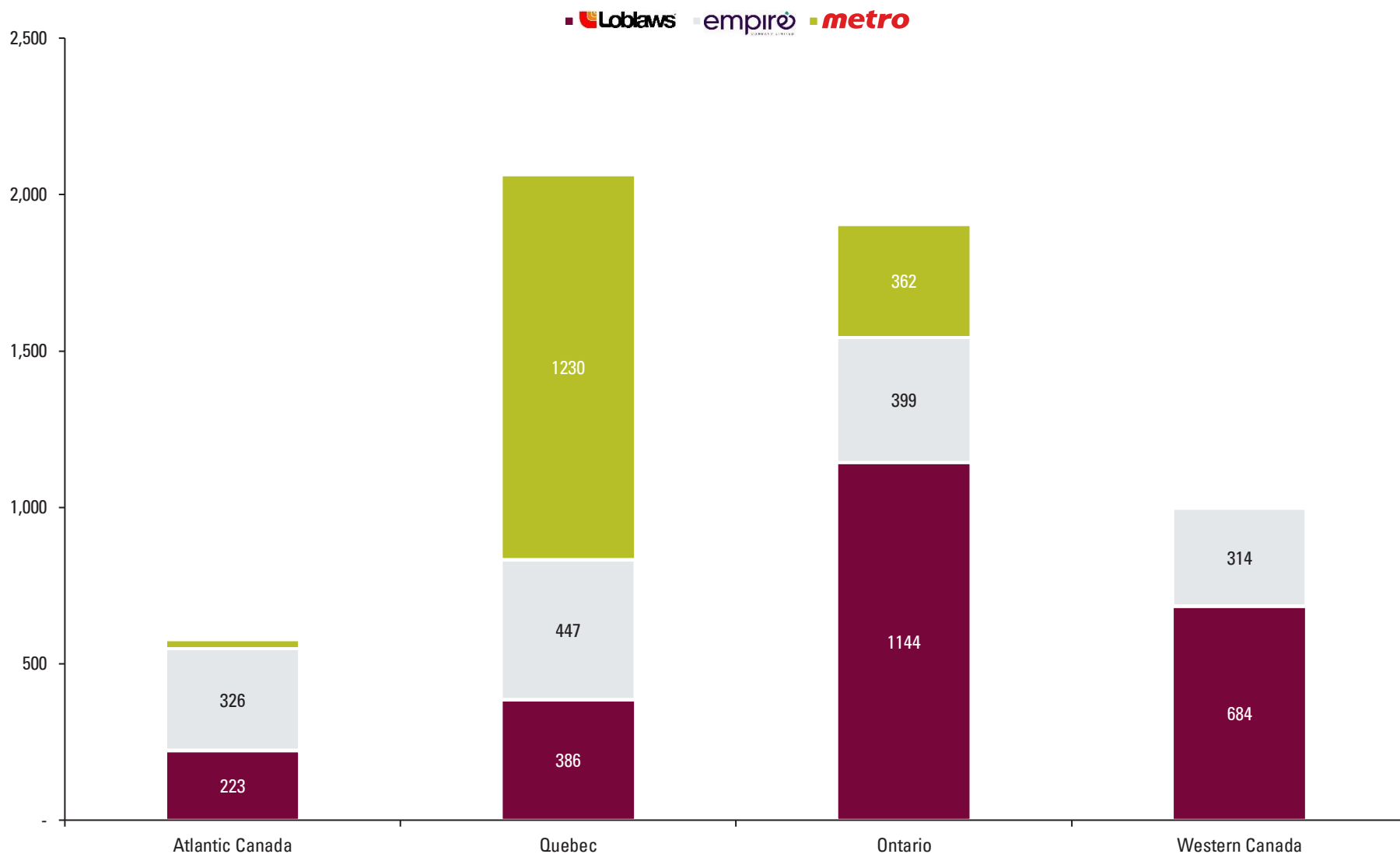
David Markwell

Executive Vice President and Chief Technology and Analytics Officer

Joined Loblaws in 2007 and has lead IT transformation initiatives at Loblaws since 2018, including the rollout of the PC Optimum loyalty program to all Loblaws subsidiaries and associated retail outlets. Markwell has been an adjunct professor in the field of business management at Queen's University's Smith School of Business since 2015 and at York University's Schulich School of Business since 2020.

Loblaws' upper management is overwhelmingly qualified and have a track record of succeeding despite tough economic conditions

REGIONAL PRESCENCE OF CANADIAN GROCERS



Despite Loblaws' moderate presence in Atlantic Canada and Quebec, their yearly revenue significantly outweighs that of their competition, evidencing the strength of their operations and their brand's resonance with customers

Source: Company Filings.

Notes: The Atlantic Canada region is comprised of NL, NS, NB, and PEI; the Western Canada region is comprised of MB, SK, AB, BC, and YK.

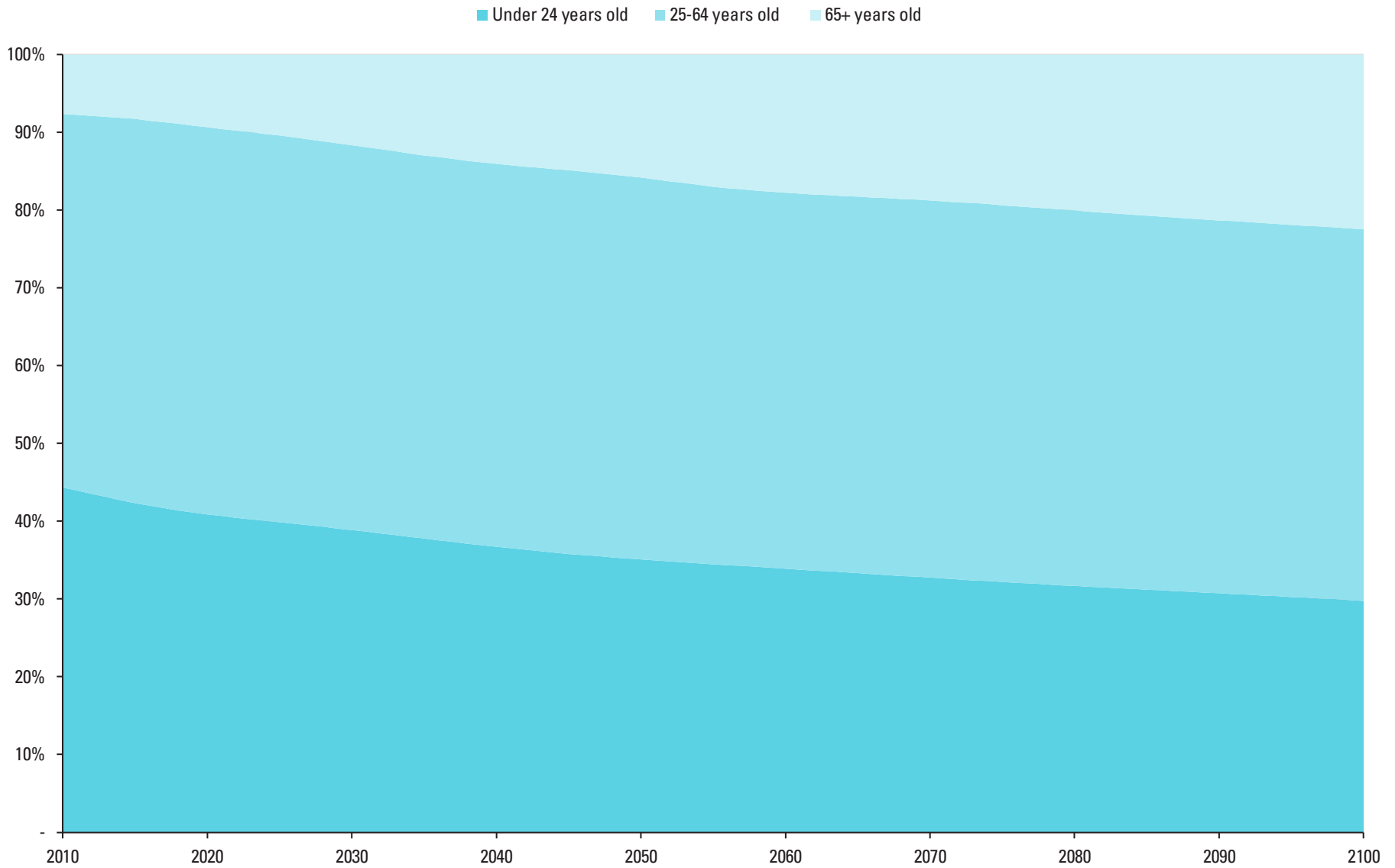
10Y CAPEX, REVENUE PER SQUARE FOOT (\$M)



Loblaws' CapEx per square foot has remained fairly steady over the last 10 years, while Metro's has increased greatly year-over-year, and Empire's has fluctuated wildly. Metro's major capital investments over the past four years have not distanced them greatly from Loblaws

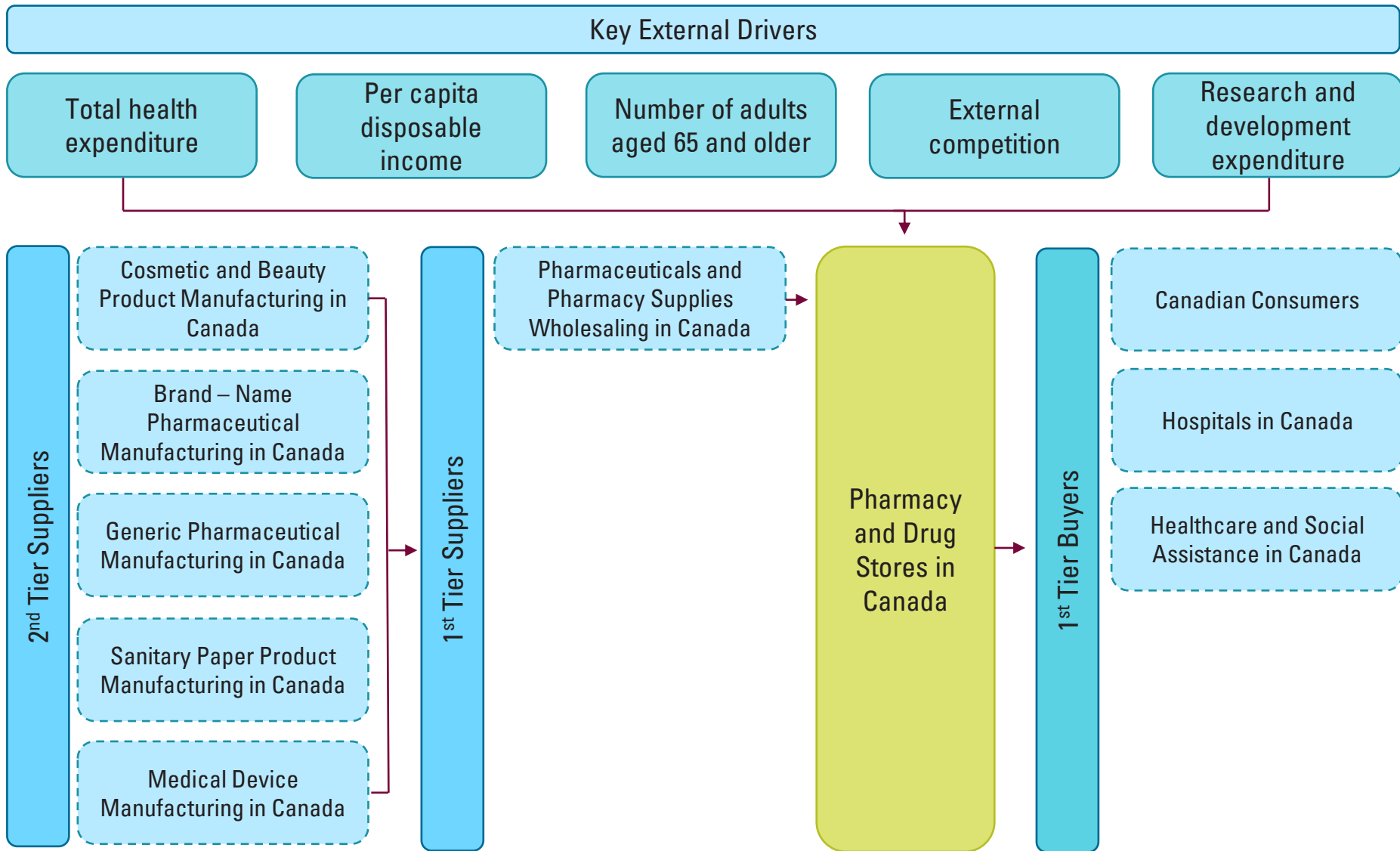
Source: NBF, Company Filings, Bloomberg.
Notes: All figures in CAD, unless otherwise noted.

AGING WORLD POPULATION



Shoppers Drug Mart seeks to benefit in the long-term from the aging population who will become reliant on pharmaceuticals to sustain their health

CANADIAN PHARMACY SUPPLY CHAIN



The Canadian pharmacy supply chain relies on a complex network of participating manufacturers to meet the diverse offerings of pharmacy stores