Global Equity | February 2021

Consumer & Retail
Industry Primer

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I. Softlines

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Softlines - Primer

A New Look

February 27, 2021

The softlines retail industry is composed of subindustries such as apparel, linens, and other "soft" products. The industry has been hit hard by the COVID-19 pandemic due to store closures and decreased discretionary consumer spending. However, with the accelerated adoption of e-commerce and stores reopening, the industry should experience rapid recovery in 2021.

Industry View – Hard Hit, Recovery and Growth on the Way

As a mostly consumer discretionary industry, the softlines industry experienced a sharp decline in 2020 due to the economic downturn and layoffs, which hindered consumer purchasing power. Although the overall industry is mature, some subindustries are still experiencing higher growth due to expansion to different geographic locations, primarily emerging markets. Once the COVID-19 vaccines become readily available and in-store shopping returns to pre-pandemic levels, the industry will realize these emerging market opportunities.

Industry Drivers – Adapting to New Shopping Climate

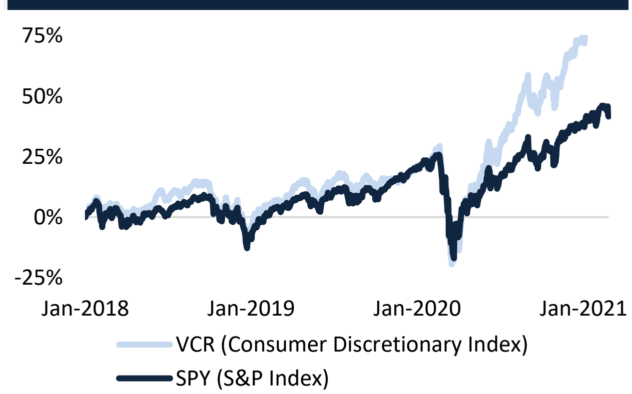
Although softlines has traditionally relied on physical stores, there is a current shift towards e-commerce integration. COVID-19 has acted as a catalyst to further accelerate this integration in many of the significant softlines retailers. The integration of cross-platform shopping allows brands to immerse their consumers in their products. With omnichannel retailing, companies no longer depend on in-store transactions and instead use their physical stores as a marketing tool to supplement their e-commerce channels.

Industry Valuation – Traditional Metrics with Margins

In the softlines retail industry, metrics are used such as P/E ratios and EV/EBITDAR (earnings before interest, taxes, depreciation, amortization, and rent), with retail-specific metrics like comparable-store sales growth and industry turnover. As the softlines industry is affected by similar drivers as the general consumer discretionary industry, the left graph illustrates cumulative returns relative to the S&P 500.

Industry Research	
Industry	**Softlines**
Global Revenue	US $1.67B
Annual Growth (Past 5 Years)	-1.42%
Annual Growth (Next 5 Years)	6.5%
Key Companies (US$)	
Capri Holdings	NYSE: CPRI
Enterprise Value	$10.6B
EV/EBITDA	18.3x
TJX Companies	NYSE: TJX
Enterprise Value	$87.2B
EV/ BITDA	45.4x
Ross Stores	NASDAQ: ROST
Enterprise Value	$45.1B
EV/EBITDA	61.1x
Nike	NYSE: NKE
Enterprise Value	$224.6B
EV/EBITDA	44.1x
VF Corporation	NYSE: VFC
Enterprise Value	$37.5B
EV/EBITDA	26.8x

Cumulative Returns of Consumer Discretionary



SPORTSWEAR

Industry Analysis

Subsector Segmentation and Growth

At just over $345B in global sales, the Sportswear subsector plays a growing role in the softlines industry. North America is the largest geographic market comprising 39% of sales, followed by Asia Pacific (27%), Western Europe (18%), Middle East & Africa (6%), and Latin America (6%). Consistent growth in the Asia Pacific market is attributed to the increasing norm of everyday fitness, with statistics showing 58% of Asia Pacific consumers exercise at least once a week. Sports Apparel and Sports Footwear, the two largest categories of Sportswear, saw an overall 2019 growth of 3.9% and 5.6% respectively. While a relatively small category (8.6%), Sports-inspired footwear is the fastest-growing category with 6.6% 2019 growth fuelled by the incorporation of fashion trends such as the casualization of dress codes and growing consumer focus on comfort and versatility.

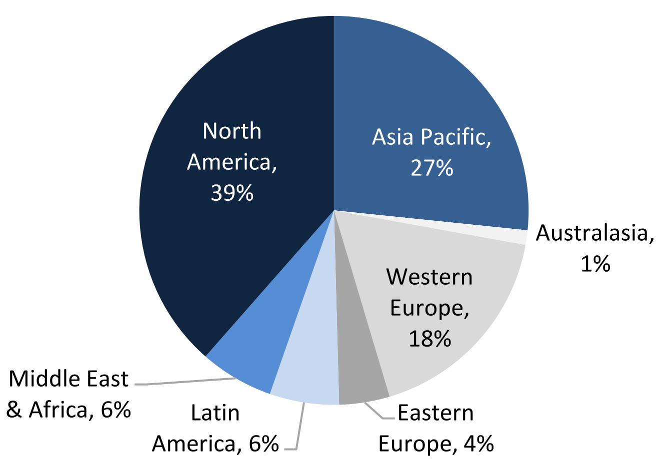


Figure 1. Sportswear shares by geography, 2019
Source: Euromonitor

Category	Category Value (%)	Current Year Growth
Sports Apparel	29.7%	3.9%
Sports Footwear	20.3%	5.6%
Performance Apparel	13.3%	4.2%
Sports-inspired Apparel	11.8%	4.5%
Performance Footwear	9.1%	5.6%
Sports-inspired Footwear	8.6%	6.6%
Outdoor Apparel	4.7%	1.6%
Outdoor Footwear	2.6%	2.1%

Figure 2. Sales of sportswear by company
Source: Euromonitor

Sportswear Sales Growth

Sportswear saw a sales CAGR of 2.16% from 2014-2017, and now accelerating to a sales CAGR of 4.33% from 2017-2019 heavily driven by an increasing global appetite for healthy living and sports-inspired products becoming norms of everyday wear. The entire subsector grew 4.6% y/y in retail value globally, with a forecasted decline of 7.4% in 2020 derived mainly by pandemic-driven sales store closings, but later followed by a 10.2% forecasted growth in 2021. Forecasted sales performance y/y growth for 2022-2024 remains positive but declining. Recovering from a -7.4% y/y growth in 2020, the forecast looks promising in successive years, fuelled mainly by a huge recovery in consumer discretionary spending.

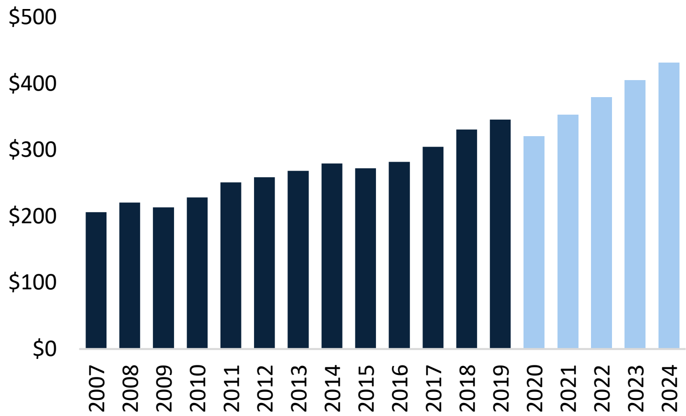


Figure 3. Historical and forecasted sales of Sportswear, 2007-2024 (in billions USD)
Source: Euromonitor

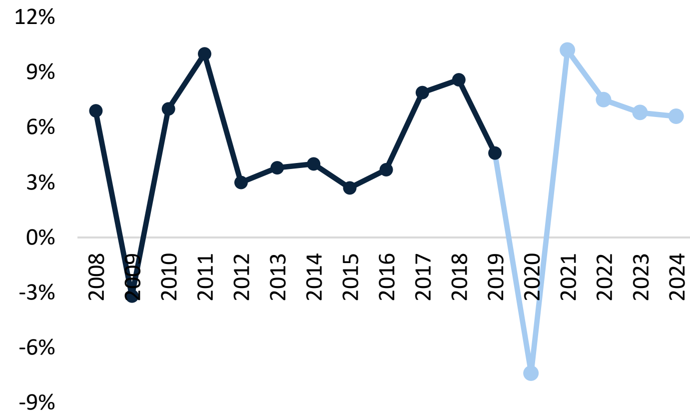


Figure 4. Historical and forecasted sales performance, 2008-2024 (in %YoY)
Source: Euromonitor

Sportswear Market Share by Company

Nike Inc (16.0% share), Adidas (11.6% share), and VF Corp (3.9%) are the top three branded companies in the subsector comprising 31.5% of the total Sportswear market. The Sportswear industry continues to consolidate globally as leading companies are well-placed to tap into emerging trends of athleisure and casualization, gaining the favour of more fashion-oriented consumers. Although declining in market share compared to strong increases by leading companies, competition from smaller brands and private labels continues to grow. Brands such as Lululemon, Kate Hudson's Fabletics, and private label sportswear brands extending from general apparel brands (e.g. Athleta by Gap Inc.) are slowly becoming staples in consumers' wardrobes. The high barriers to entry seen through large-scale production, high R&D costs, and large investments in product innovation have kept the industry relatively difficult for younger, emerging brands and more attractive for established market leaders.

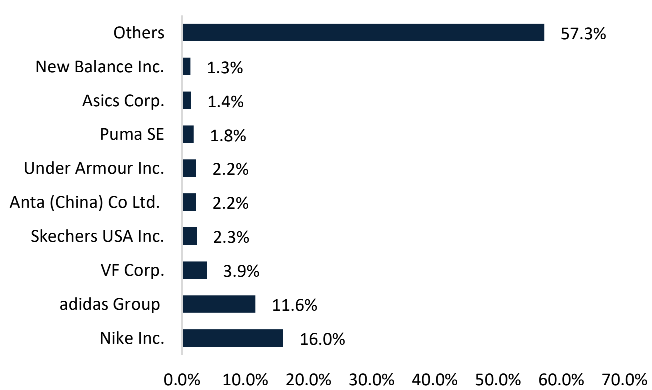


Figure 5. Company shares of Sportswear, 2019
Source: Euromonitor

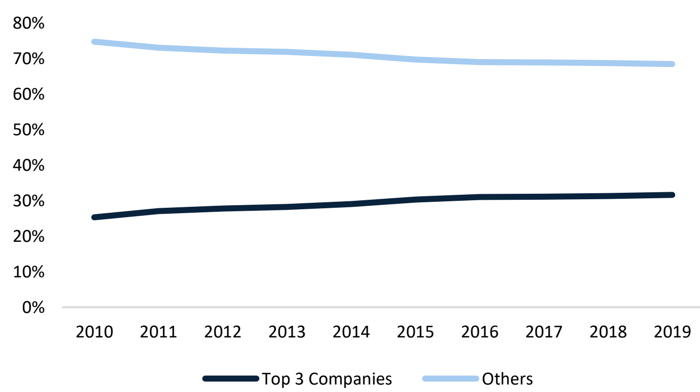


Figure 6. Market concentration of Sportswear by company
Source: Euromonitor

Key Trends & Drivers

Prioritization of Comfort and Versatility

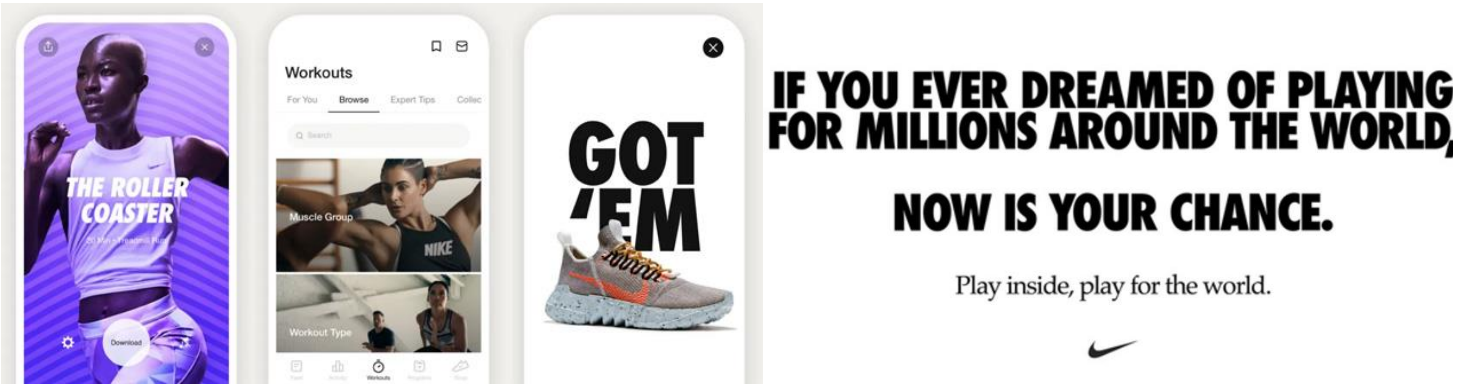
Driven by the pandemic, consumers prioritize comfort and versatility in their apparel choices, influencing their purchase decisions. Athleisure and sportswear have been increasingly popular for daily wear due to the cancellations of social gatherings and a work-from-home lifestyle. Despite the ease in lockdowns and the beginning of vaccine immunizations, this trend is expected to extend post-COVID, with major players Nike and Lululemon continuing to blur the lines between athleisure, sportswear, and casual wear. As more retailers are attracted by potential growth opportunities in the athleisure category, analysts predict a 6.5% annual growth through 2023, taking share from traditional apparel.

Figure 7. Athleisure trends
Source: Google

Figure 8. Traditional activewear
Source: Nike catalog

Increased Health Awareness and At Home Wellness

Accelerating the pre-existing trend of increased health awareness, wellness and health are becoming an even bigger priority amongst consumers in this new reality comfort. An increased interest in-home workouts and at-home wellness have lifted sales opportunities in Sportswear despite the slowdown in discretionary spending in light of difficult economic conditions. With the digitalization and e-commerce trend thriving, companies are continuously adopting digital retail strategies, with most embracing customer-centric thinking and moving towards an overall channel-agnostic structure. Sportswear companies like Lululemon and Nike publish workout training programs and live classes through their app and on Instagram, with Nike leading the market with their #HomeWorkout movement by expanding into customer engagement and e-commerce promotions on their Nike Training Club mobile app. Having powered up their e-commerce channels, ranging from creative campaigns to celebrity workouts, Nike's current digital sales now comprise over 30% of its overall sales.



Figures 9 & 10. Recent Nike campaigns
Source: Company website

Overview of Key Players

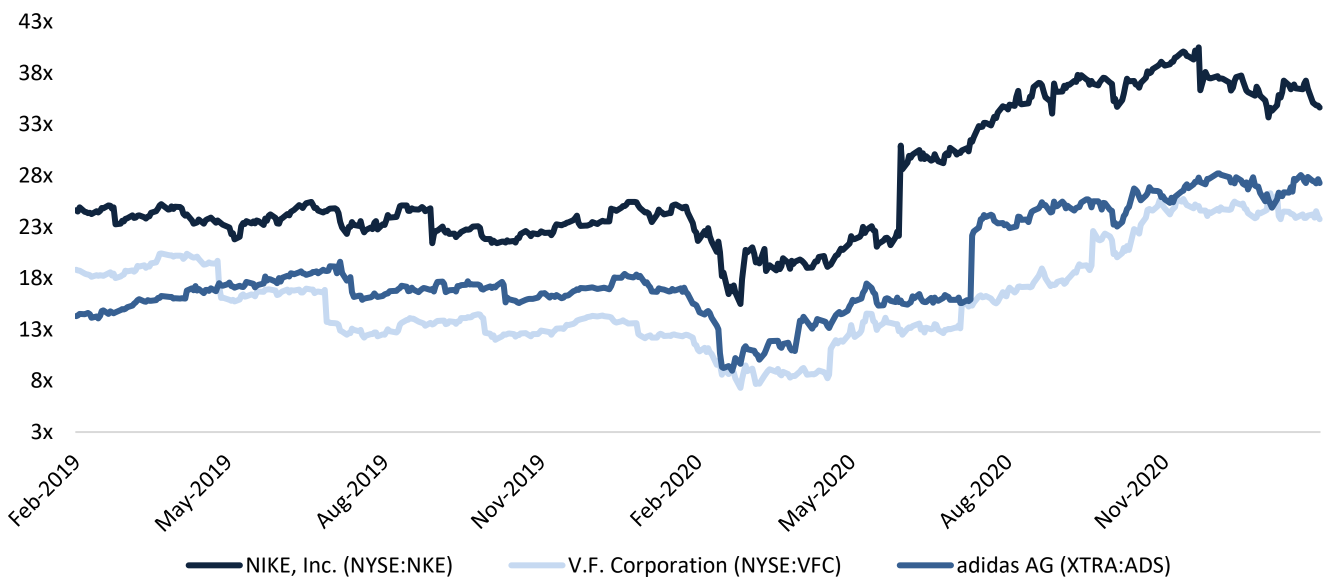


Figure 11. Two-year EV/EBITDA of key companies
Source: CapIQ

Nike Inc. (NYSE: NKE)

Nike Inc is an American multinational seller of athletic footwear, apparel, equipment, and accessory products under NIKE, Jordan, Hurley, and Converse brands. Operating under a market capitalization of $225.5B and $37.4B in FY20 revenue, Nike Inc remains the leading market player capturing 16.0% of market share. Its footwear segment is the company's leading product offering, bringing in more than 60.0% of total sales, endorsed mainly through diverse advertising and promotional campaigns, including endorsements of celebrity athletes. To recover from a 4.0% revenue decline from FY19, the company's goals of doubling the impacts of innovation through increased digital transitions and boosting its online direct sales model remain priorities amidst pandemic setbacks. While Nike has acquired many sportswear footwear and apparel brands in its history, it has divested many throughout the early 2000s intending to focus on its core product lines. Its main growth strategies rely on the sportswear market momentum and growth through its current market share dominance.

Adidas AG (ETR: ADS)

Following closely behind Nike with 11.6% of market share, adidas AG is a German sportswear company selling athletic footwear, apparel, and equipment sporting the iconic three-stripe logo in more than 160 countries. Its market capitalization of $58.2B leaves it at a limited scope for brand positioning compared to Nike, with only two brands, Adidas and Reebok. The company's Asia Pacific region accounts for one-third of its sales, followed by Europe, North America, Latin America, and Russia sequentially. Sponsoring the German national soccer team and soccer athletes like Messi, more than half of the company's budget is allocated towards sponsorship deals, with the majority of these ranging in the soccer category. After selling its loss-making golf business for $425M, Adidas' margins are looking more attractive in its Adidas and Reebok brands, with the persistent goal of reducing sponsorship expenses by 5% and concurrently increasing budget for digital advertising and non-sport partnerships. Gauging from the company's position relative to Nike, Adidas' current market position is believed to stay stable. Nike's influential presence seen through an almost quadrupled market capitalization, large following on all social media platforms, and constant product innovation within its four brands increase the difficulty for any company in surpassing them.

VF Corp. (NYSE: VFC)

VF Corp is a portfolio of global consumer brands focused on jeans wear, outerwear, packs, footwear, sportswear, and occupational apparel categories. It is composed of brands: North Face and Timberland (outdoor-oriented), Vans (skateboard-inspired footwear), Rock and Republic brands, and its newly acquired Supreme streetwear brand. Operating on three main segments, active (45% of total sales), outdoor (45%), work (10%), its active segment consists mainly of sportswear apparel and footwear from brands such as Vans, Kipling, Napapijri, Eastpak, Jansport, and Eagle Creek. Headquartered in Colorado, VF rings up 55% of its sales in the US, with the remaining from Europe. Recovering from its 2017 and 2018 revenue declines, the company reaches its $10.5B mark in 2020, a 2% increase from the previous year. With plans to unlock growth opportunities in the Asia Pacific region, the company aims to optimize its portfolio of brands even more. However, the sportswear industry in the APAC region is dominated again by Nike and Adidas, with VF Corp merely placing sixth with 2.5% of market share. Resembling the North American market, VF Corp's APAC growth strategy is not believed to yield as optimistic results as the company forecasts given that the emerging APAC market is already dominated by larger top players.

DISCOUNT RETAIL

Subsector Structure and Growth

The discount apparel sub-sector subscribes to an oligopolistic structure as the space is primarily dominated by the three key players of TJX Companies (TJX), Burlington (BURL), and Ross Stores (ROST). As shown in Figure 12, TJX currently occupies 48.2% of the total market share through taking advantage of its strongly reputable brands, TJ Maxx, Marshalls, and Winners.

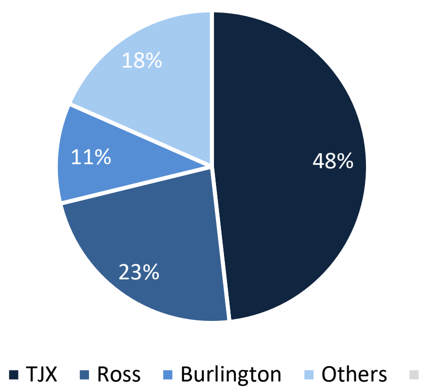


Figure 12. Subsector structure and key players
Source: Euromonitor

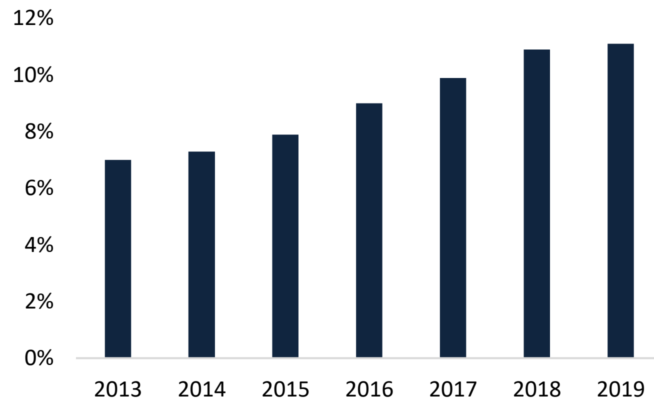


Figure 13. Market share of discount apparel retailers (%) in Softlines Industry
Source: Euromonitor

Over the past six years, the market share of discount apparel retailers in the consumer softlines industry has steadily increased from 7.0% in 2013 to 11.1% in 2019. Geographically, $59.9B of sales revenue in 2019 was generated in North America (USA and Canada), followed by $4.3B in Europe and $1.2B in Asia. In a turbulent retail environment plagued by bankruptcies and store closings, off-price chains, such as TJ Maxx and Marshalls, have consistently reported robust same-store sales and aggressively expanded their physical footprints. In 2019, same-store sales for TJX, ROST, and BURL increased by 4.0%, 3.0%, and 2.2% respectively, according to S&P Global. Additionally, all three companies have consistently beat analysts' earnings estimates for the past year and a half. In comparison, Kohl's (KSS) and Macy's (M), which operate in the struggling department store sector, witnessed a 1.9% and 0.8% drop in their respective same-store sales (Figure 14). Department stores are classified as retail establishments that sell a wide variety of goods ranging from ready-to-wear apparel and accessories for adults and children to yard goods and household textiles, small household wares, and furniture. Although discount retailers also possess a diverse assortment of goods, they can offer them at drastically lower prices. These low prices and unique "treasure hunt" shopping experiences have prompted increases in demand in recent years. On the supply side, discount retailers' flexible inventory management practices, based on the idea of opportunistic buying, have allowed them to gain a competitive advantage over department stores as they can reduce costs associated with inventory build-up and storage.

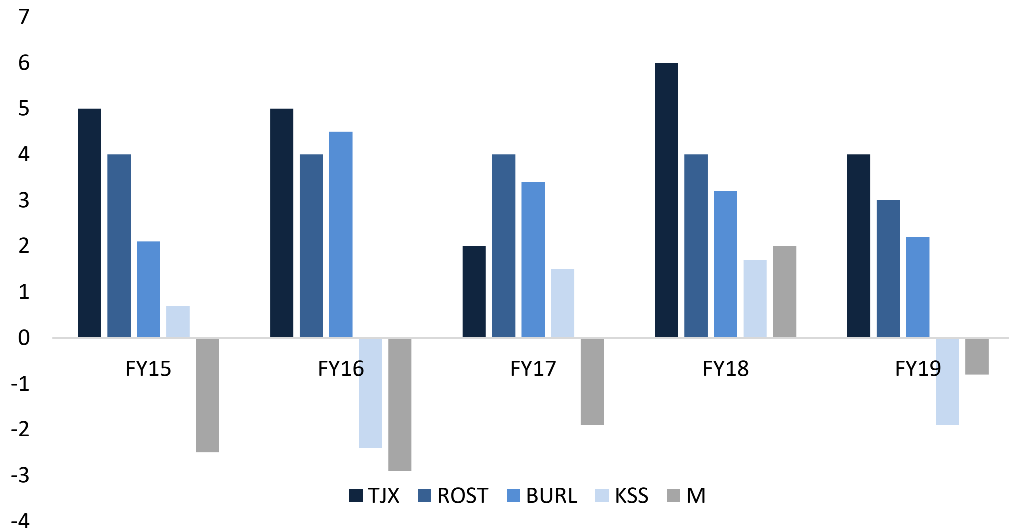


Figure 14. Same-store sales growth of major discount retailers vs. department stores over time (%)
Source: S&P Global Intelligence

Overview of Key Players

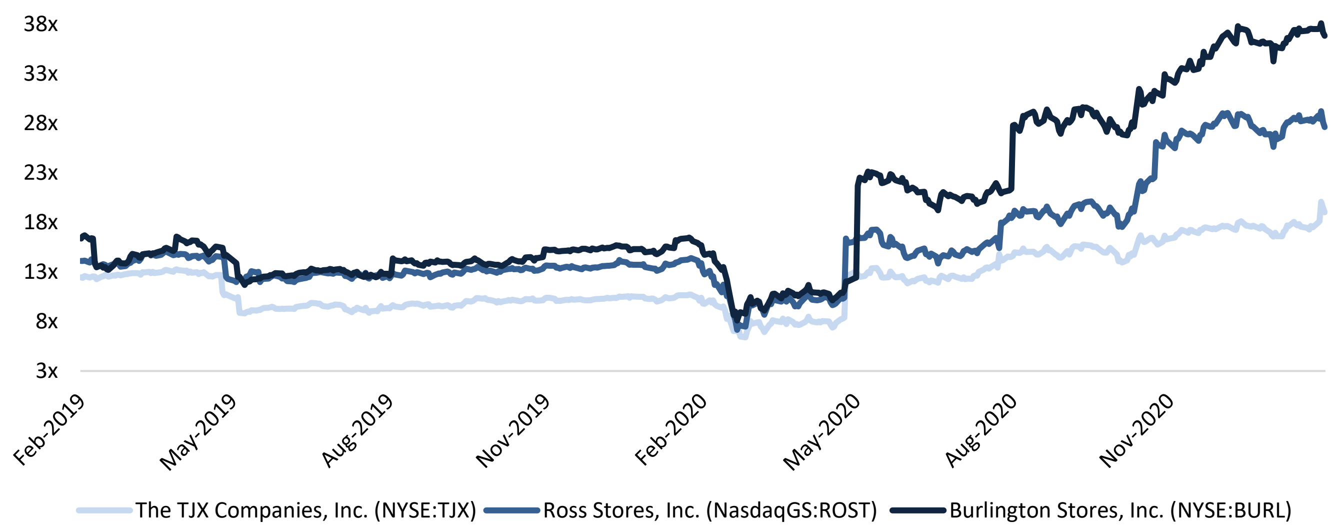


Figure 15. Two-year EV/EBITDA of key companies
Source: CapIQ

TJX Companies Inc. (NYSE: TJX)

With a market capitalization of $82.0B, TJX is one of the leading players in the discount apparel subsector. The company opened 107 stores in Q3 2020, taking the total number to 4,519. This is a strategic decision considering that rents for physical store spaces across the United States have reached historically low levels due to the pandemic. If the company can capitalize on these rental rates and secure long-term contracts, it will be able to keep operating costs low on the supply side. Furthermore, the retailer is continuing to expand its fleet with plans to stop at roughly 6,100 stores in the long term. TJX's value proposition revolves around a flexible business model and opportunistic buying strategies, which has allowed it to consistently improve upon its markdown rates and inventory availability. Moving forward, the company will be focussing on developing relationships with new vendors and launching an e-commerce site for the brand HomeGoods.

Burlington Stores Inc. (NYSE: BURL)

Although BURL is relatively small in terms of its $17.3B market capitalization, it still occupies a substantial share of the discount apparel market. In the long-term, the company is seeking to grow through rolling out new and more targeted marketing programs and increasing operating margins by improving inventory turnover and reducing occupancy costs.

Ross Stores Inc. (NASDAQ: ROST)

ROST, with a market capitalization of $43.7B, primarily appeals to the younger female demographic of bargain shoppers. 70%-75% of the company's consumers consist of young women shopping for themselves and family members. ROST is currently pursuing a growth strategy based on expanding its market share in existing markets and entering new geographic markets. In FY 2019, it added a total of 88 new locations, 5 of which allowed the company to enter into the new state of Ohio. Over the long term, management hopes to grow the total amount of locations from 1,546 to approximately 3,000 Ross and dd's DISCOUNTS stores.

Key Trends & Drivers

COVID-19 Pandemic and Economic Downturn

Due to the COVID-19 pandemic, strict legal regulations enforced the closure of many non-essential businesses including discount apparel retailers. As these retailers generate the majority of their sales through physical channels, they suffered a significant loss in sales revenue, with TJX, ROST, and BURL having missed EPS estimates for their quarters ending in April (Figure 16). However, as the restrictions gradually eased, many retailers have now reopened their doors to the public. In this time of economic downturn, more consumers are becoming value-oriented and turning to off-price retailers for cost-effective apparel. The hike in unemployment rates experienced by the U.S. and Canada at the height of the pandemic left lingering effects on regular consumers (Figure 17) and increased the attractiveness of discount retailers due to their superior affordability and variety.

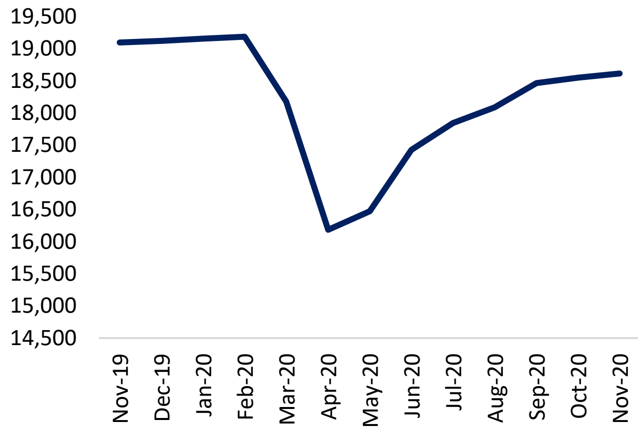


Figure 16. Employment rate in Canada (thousands)
Source: Statistics Canada – Labour Force Survey

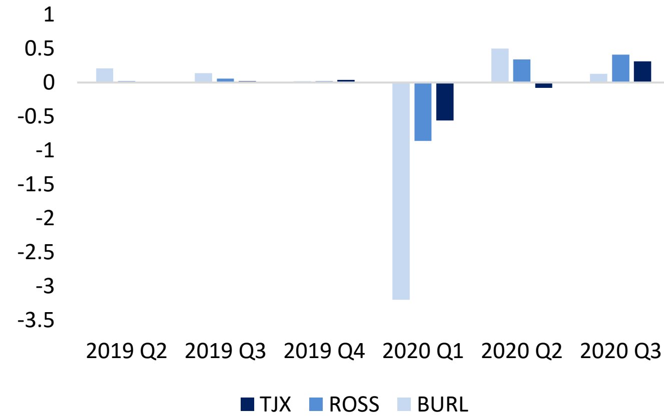


Figure 17. Difference in actual EPS and EPS consensus estimates ($USD). Aside from pandemic quarters, off-price retailers have consistently beat analysts' estimates.
Source: Bloomberg

On the supply side, the widespread cancellation of orders by full-line retailers during the pandemic created an excellent opportunity for off-price retailers to sweep enormous stale inventories for low prices. In the short run, this has increased their profit margins. However, this may not be sustainable in the long term as retailers have re-adjusted their inventory to match decreased demand. Finally, industry consolidation may accelerate as struggling department stores exit the market, increasing the overall market share of discount apparel giants.

Popularity of "Treasure Hunt" Shopping Experiences leads to Economic Moats

The unique shopping experiences provided by discount apparel retailers, often compared to "thrilling treasure hunts", drive consumer demand in the sub-sector. Shoppers of all ages and incomes are drawn to the constantly changing assortments of merchandise in the physical stores, with fresh brands and styles being introduced every week. Built upon the concept of scarcity, the ever-changing inventory encourages consumers to engage in impulsive buying habits and increases the frequency and volume of their purchases.

Competition from E-Commerce

The pressure imposed by competition from online retailers poses a significant challenge for discount apparel retailers in the long-term. Companies such as Amazon offer consumers an easy and convenient alternative to ordering reasonably priced apparel from physical discount retailers. Although ROST and TJX are beginning to implement online channels with both companies having opened new websites for brands within the past two fiscal years, neither is expecting to witness high levels of growth in the e-commerce space. This reliance on brick-and-mortar stores can mostly be attributed to the ever-changing nature of the merchandise sold by off-price retailers. Opportunistic purchasing strategies make it difficult for companies to plan and manage a steady inventory for online stores. However, as competition from online retailers continues to intensify, it is crucial for discount apparel retailers to differentiate themselves by providing unique shopping experiences that appeal to the needs of value-oriented consumers. Luckily, many giants have already caught on to this changing market trend. For example, TJX has announced that it will roll out e-commerce for HomeGoods later next year. Although its success remains to be seen, the omnichannel expansion is a promising step into capturing and attracting a younger consumer base.

LUXURY GOODS

Subsector Structure

Luxury goods are products with higher price points that are priced beyond daily essentials. The luxury goods industry is unique as the industry experiences higher profit margins, emphasizing brand image and brand loyalty. The industry is comprised of large conglomerates that own multiple brands, each referred to as "houses." Each house usually has a distinct style and iconic items widely recognized in the industry, with loyal consumer bases. Industry rivalry is medium in luxury goods. While each brand offers differentiated products with loyal customers, consumer tastes are constantly shifting with changing habits in spending.

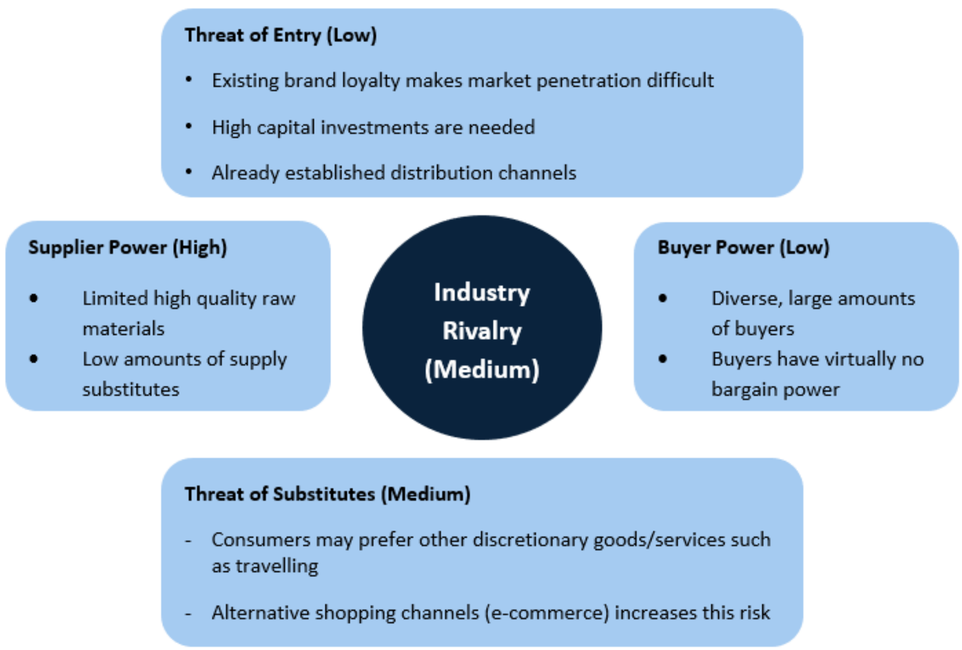


Figure 18. Porter's five forces of the luxury goods industry

Market Size & Growth

In 2020, the global luxury goods market reached a revenue of around US$285M. The luxury goods market was largely affected by COVID-19 in 2020 due to its lack of e-commerce integration. Luxury brands usually operate with a sense of exclusivity and rely heavily on in-store transactions, leading to the industry being affected by pandemic store closures; however, there are vital signs of recovery in 2021. Bain & Company's report estimates that the luxury goods industry will return to 2019 levels by 2023 and continue its strong growth throughout 2025 to reach new records. This accelerated growth is mostly driven by the rise in global disposable income, strong performance from emerging markets, and the adoption of e-commerce platforms. While the adoption of e-commerce platforms decreases brand exclusivity, we believe that it can add value to luxury brands in a meaningful way. By curating platforms that replicate the boutique experience, the companies can introduce accessibility to traditional luxury sales and boost their customer base.

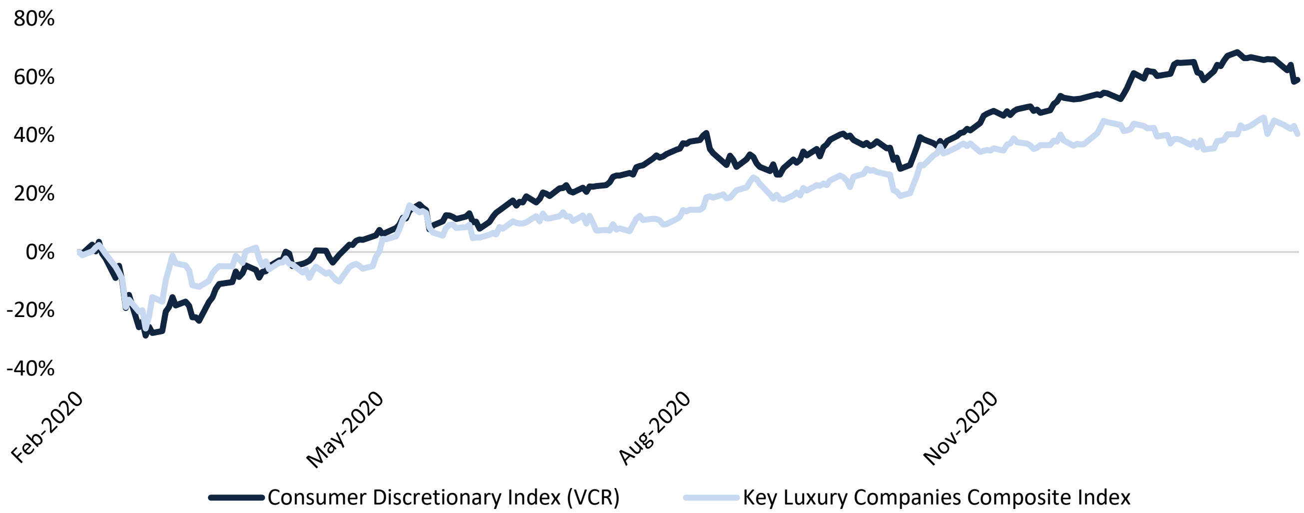


Figure 19. LTM price performance: key companies vs. consumer discretionary index
Source: CapIQ

Currently, the luxury goods industry is most robust in Western nations located in North America and Western Europe, as those consumers tend to have the highest disposable income. In addition, countries that are home to luxury brands, like France and Italy, experience high volumes of Asia-Pacific tourists who purchase luxury items during their travels. However, China is expected to become the largest luxury market by 2025, as Chinese consumers start to shop domestically due to the long-lasting impact from COVID-19 and stronger e-commerce integration. This trend will be explored later in the report.

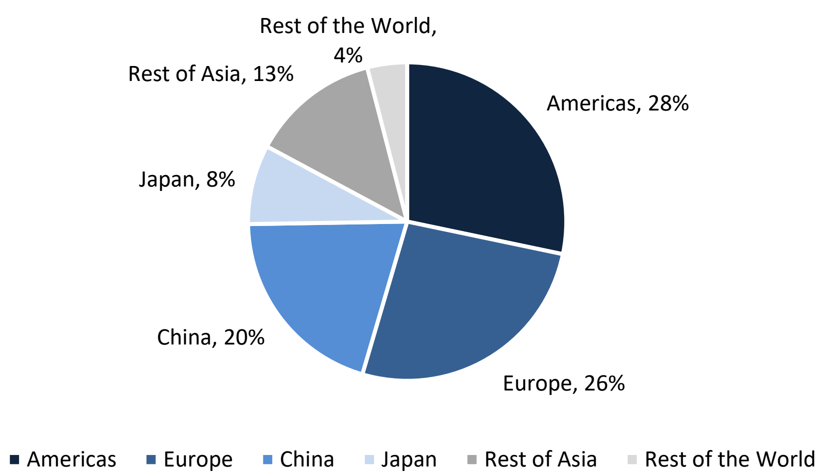


Figure 20. Luxury goods market share by geographic location, 2020
Source: Statista

Market Leadership Concentration / Key Players

The luxury apparel market remains to be reasonably fragmented with medium competition. Each luxury brand tends to have its differentiating style in which they design their products to reflect; therefore, with differing consumer preferences in the market, it is difficult for one brand to attract the most customers. The industry remains moderately competitive as consumer trends are dynamic, and firms must continue to innovate to keep up with the market demands.

Key Trends & Drivers

Adoption of E-commerce and Omnichannel Retail

While the majority of other fashion stores have since fully adopted e-commerce and omnichannel platforms, luxury brands have been reluctant to do so. In 2020, only around 11% of total revenue in luxury goods was generated through online channels. The primary reason for this delay is the unique in-store experience of a luxury shop that is difficult to replicate online. Since the products are not easily accessible, the exclusivity of the luxury products also builds brand image. However, the integration of e-commerce proves to be even more crucial in the post-COVID world, especially in the growing Chinese market. According to a Vogue survey of 700 Chinese consumers, a majority of individuals said that they would prefer e-commerce as the primary method of purchase after the pandemic.

As the millennial demographic matures and increases their disposable income, they become a critical consumer base for luxury brands to capture. Interestingly, according to a Euclid study, 48% of millennials said they shop in-store weekly; however, most of their purchases are made online. Brick-and-mortar stores play an increasing role in the overall marketing and presence of brands, yet purchase conversions often occur on e-commerce platforms. Therefore, as luxury brands integrate their in-store experience with reliable e-commerce platforms, effectively utilizing omnichannel retailing strategies, there will be faster recovery and growth.

Strong Chinese Market and Pent-up Demand

As mentioned before, there has been notable growth in the Chinese economy, leading to strong demand that continues to grow. Since opening up its economy in 1978, China has experienced average GDP growth of almost 10% a year. The Chinese economy has become the second-largest economy in the world. A booming middle and upper class means that individuals now have more disposable income to purchase luxury goods and travel to other countries. Many Chinese consumers travel to Europe for the experience of buying luxury apparel and handbags, usually from the fashion house’s origin country. With the travel ban under the pandemic, there will most likely be built-up demand for international travel post-COVID-19, which can further accelerate the luxury goods industry’s recovery and accelerate growth in the future.

The luxury goods sector targets wealthy consumers, and this segment of the population is less affected by job losses as many of them can work from home. Therefore, many of these consumers have maintained their income throughout the pandemic, and interestingly, these are the same individuals who tend to spend their discretionary income on travel and experiences. With the COVID-19 restrictions, they cannot travel, leading to a build-up of additional unspent income. They now have more income to spend on material objects such as luxury goods. This uptick in demand has also helped luxury brands to offset some of their revenue loss from the pandemic.

Focus on Vertical Integration

For most luxury brands, vertical integration has become a key component of their strategy in various areas, including raw materials and labour. Vertical integration gives luxury brands control over their products' supply chain, ensuring quality and upholding brand image, two distinct factors in the luxury goods industry.

Due to the premium quality of the luxury good sector, most companies utilize natural raw materials instead of synthetic materials. Natural raw materials refer to products such as leather, silk, and cotton. These materials cannot be produced on demand like synthetic fibers, as natural materials have to go through the natural growing process. Therefore, these raw materials must be carefully monitored to ensure that the companies have enough materials to create sufficient inventory. With a high demand for high-quality raw materials, companies are now buying out small farms to confirm their source of raw materials. This is also driven by consumer desires to trace the origin of their purchases to increase sustainability and transparency.

Regarding labour, some large companies have also been vertically integrating their labour sources. For example, since 2014, LVMH operates the LVMH Institut des Métiers d'Excellence, a work-study program that trains young students in preparation for work in the luxury goods sector, ranging from traditional crafts to sales roles. This vertical integration of labour allows luxury good companies to maintain the quality of its craftsmanship while securing young talent early, deterring them from competitors.

Margin & EPS / Earnings Growth

The luxury goods sector is characterized by extremely high-profit margins. In FY2019, the top 100 luxury goods companies achieved a composite net profit margin of 11.2%, comparing to the retail industry average of only 2.8%. The strong margins are mainly driven by the high markups of the luxury products, where trademarks and brand premiums push prices beyond standard margins.

Earnings in the industry are expected to grow as revenue grows, especially with the pandemic recovery. With increased disposable income and strong demand from emerging markets, the luxury goods sector is expected to be one of the fastest-growing industries. Additionally, with increasing vertical integration of raw materials sourcing, there should be additional positive impacts on earnings.

Valuation

When valuing companies within the luxury goods sector, it is important to note brand value. As previously mentioned, intangible assets such as brand recognition and licensing are extremely important in this segment and play a big role in determining a company's ability to price and capture market share.

One of the main metrics used in this sector is EV/EBITDAR (earnings before interest, taxes, depreciation, amortization, and rent), as luxury good companies operate extensive numbers of physical boutiques and faces significant leasing costs. Additionally, another metric is inventory turnover. In the luxury sector, inventory management remains a primary challenge. Retailers want to keep a steady amount of inventory, yet need to carefully avoid overstocking, as that leads to clearance sales that decrease brand value. Due to the nature of the products, inventory turnover is on the lower end, as luxury items do not sell as fast as other pieces. While the average retail industry turnover is around 24 days, the luxury goods sector turnover can be much lower than that.

Overview of Key Players

Although the industry is relatively fragmented, several key players drive the industry in terms of both brand image and product innovation. Below are five notable companies with significant portfolios of luxury brands with large international market presences.

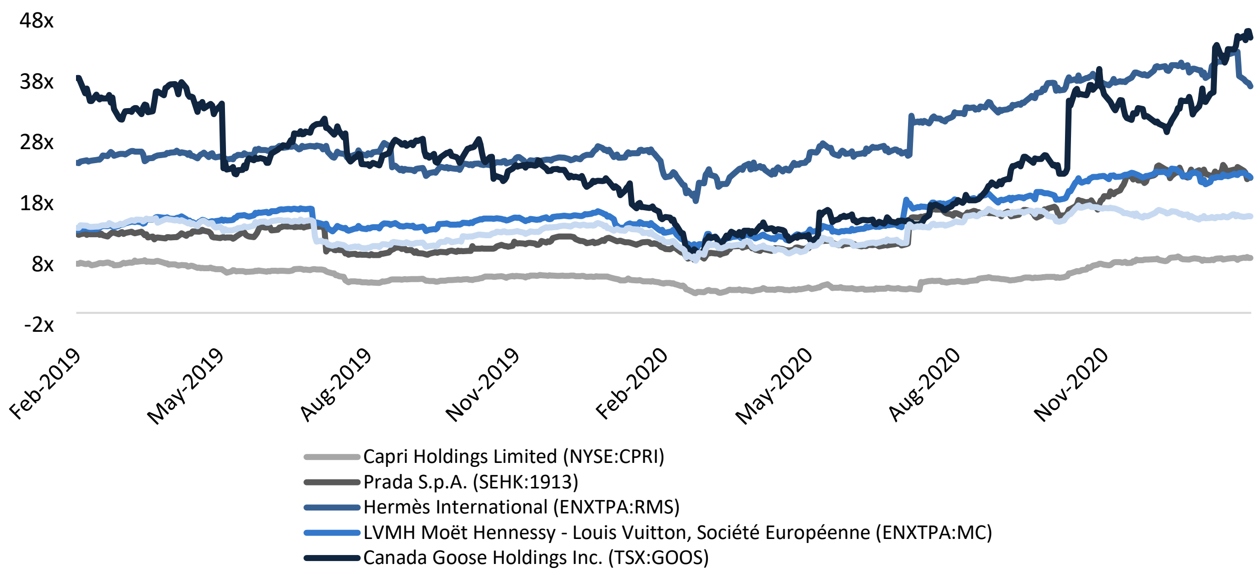


Figure 21. Two-year EV/EBITDA of key companies
Source: CapIQ

Hermes International S.A. (EPA: RMS)

Hermes International S.A. (Hermes) is a luxury goods manufacturer that originated in France in 1837. Hermes offers a wide range of products, such as leather goods, ready-to-wear items, jewelry, and perfume items. Hermes does not participate in any marketing or market research; the company is entirely driven by the consumers' knowledge of the company and intense brand loyalty for Hermes. The only marketing-related component of Hermes would be its physical store presence in popular tourist locations. In many ways, the company embraces the idea of "true luxury," where the brand image and marketing through word-of-mouth drive the company's success. The company does not own any other brands and only operates under Hermes, with a market capitalization of €88B.

Kering S.A. (EPA: KER)

Kering is a French luxury goods group that manages an extensive series of well-known luxury brands, including Gucci, Saint Laurent, Bottega Veneta, among other fashion houses. The three named brands are the main drivers for Kering, especially Gucci, as the fashion house gained more traction in recent years. Gucci brought in around 59% of Kering's total revenue in the first half of fiscal 2020. Saint Laurent brought in 13% of total revenue, while Bottega Veneta brought in 10%, with the other 18% distributed among the other houses. The luxury group was hit hard by the COVID-19 pandemic due to store closures and travel bans as two of their key fashion houses, Gucci and Saint Laurent, both operate extensive boutiques in central locations that cater to tourist shopping. As one of its main focuses, Kering continues to bring all of its e-commerce websites back in-house, instead of the existing joint-venture format. This allows Kering to better manage clientele information while streamlining its vertical integration. In-house management also provides Kering with the flexibility of investment decisions and fully capitalize on the e-commerce opportunity.

Figure 22. Kering's fashion houses

Capri Holdings Limited (NYSE: CPRI)

Capri Holdings Limited (Capri Holdings) is a luxury group that owns three luxury brands: Versace, Jimmy Choo, and Michael Kors. The three brands operate in the luxury fashion, handbag, shoes, and accessory segments. Capri Holdings' strongest brand is Michael Kors, as the brand generated almost 72% of total revenue in the first quarter of fiscal 2021 and operates 828 retail stores worldwide. Versace and Jimmy Choo only operate a combined store count of 433 stores globally. Unlike most other luxury goods companies, Capri Holdings operates a substantial wholesale business in addition to its retail channels. Recently, the company's own retail business has been delivering higher results than its wholesale segment, and it expects the trend to continue. In a recent earnings call, the company has stated that it expects the wholesale business to decrease from 30% of total revenue to 20% of total revenue, and this applies to all of its fashion houses. Direct retailing gives the company flexibility in decision-making while boosting the exclusivity of the brands. However, the reduction of wholesaling can also mean a decrease in consumer reach. The estimated EPS for last quarter was $0.04, and the company was able to beat estimates with an actual EPS of $0.9.

Prada S.p.A. (HKG: 1913)

Prada Group is a luxury group that owns several luxury brands, such as Prada, Miu Miu, Church's, Car Shoe, and Marchesi 1824. The group operates in segments across the luxury goods industry, including ready-to-wear apparel, handbags, shoes, and other accessories. Prada Group's performance is mainly driven by the Prada brand, with Prada generating close to 84% of total revenue in the first half of 2020. Miu Miu, the second-largest brand, only generated 14% of total revenue, and Church's accounted for 1.6% of revenue. Prada Group relies heavily on directly operated stores (DOS), with DOS accounting for 90% of net sales; therefore, the brand also took a significant hit from the COVID-19 pandemic. The DOS format allows Prada to project the best of its brand image with better inventory control, but Prada is also responsible for all investment decisions. This may be an issue when expanding to markets that Prada is not familiar with.

LVMH Moet Hennessy Louis Vuitton (EPA: MC)

LVMH Moet Hennessy Louis Vuitton (LVMH) is a French conglomerate in the luxury goods space, with 75 houses operating in six different industry segments. LVMH owns brands in Wines & Spirits, Fashion & Leather Goods, Perfumes & Cosmetics, Watches & Jewelry, Selective Retailing and other activities, making it the largest luxury good company on a global scale. Most notably in the softlines retail sector, LVMH operates Louis Vuitton, Christian Dior, Fendi, Celine, and many others. Louis Vuitton and Christian Dior remain some of LVMH's most influential and oldest brands. Still, the company has made a significant effort to introduce new up-and-coming houses into its portfolio mix, such as Fenty, in recent years. LVMH is highly diversified compared to its peers and is currently trading at a P/E ratio of 56.7x. While the multiple is significantly higher than the retail industry average of 23.2x, it is trading below Hermes's ratio of 79.8x, which is a luxury goods pure-play company. This indicates that investors are looking beyond diversification when creating their expectations.

Canada Goose Holdings (TSE: GOOS)

Canada Goose Holdings and its subsidiaries are manufacturers and retailers of extreme weather jackets and parkas. While the clothing is designed for functionality, the high price point and premium quality qualify it for being in the luxury goods sector. Founded in Canada in 1957, the company has an extended history of working with goose down and now differentiates itself in the market by offering a unique combination of functionality and luxury. Canada Goose operates its mono-brand stores (direct to consumer) and distributes its products through retailers like Nordstrom. While this provides Canada Goose with more sales channels, it also decreases the exclusivity of the brand. The company has been able to react quickly to the pandemic by scaling down costs and introducing new products such as masks. Meanwhile, it has also stated interest in continuing its physical store presence in China, one of its strongest growing markets. The company utilizes physical stores as marketing and experience venues, as demonstrated by its Toronto location, where shoppers can experience the jackets under extreme weather indoors.

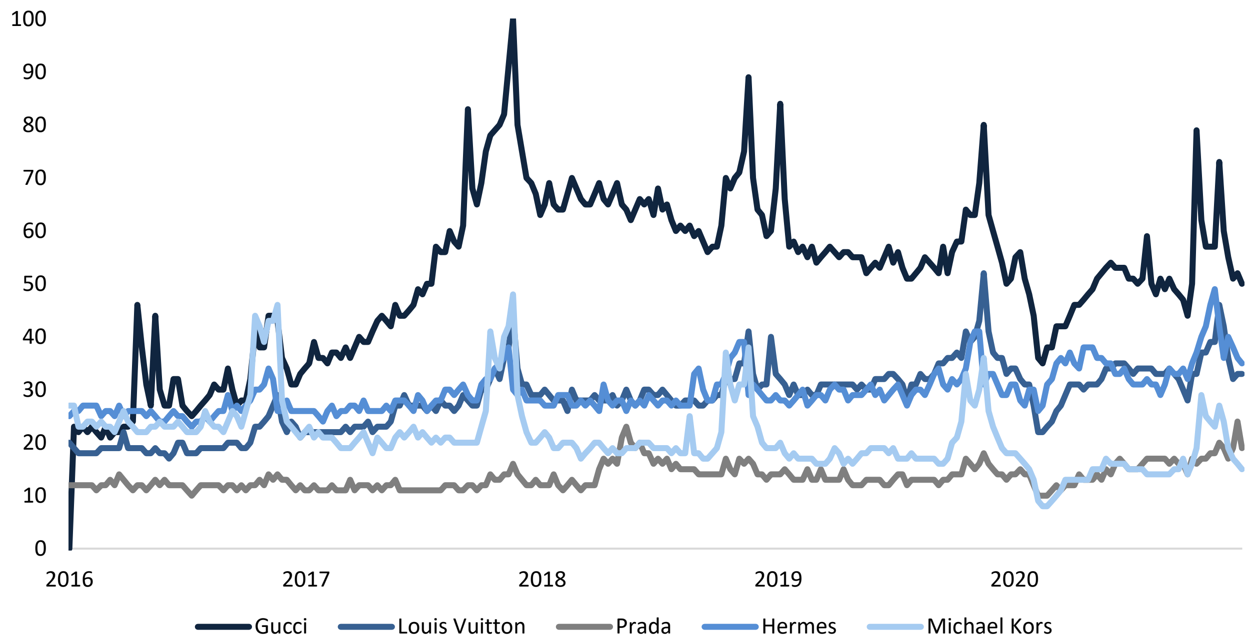


Figure 23. 5-year Google Trends graph of the bestselling brand from each key company. Note: the y-axis indicates search popularity (100 is peak popularity during the time interval, while 50 would be 50% of peak popularity

Source: Google

WESTPEAK RESEARCH ASSOCIATION

Canada Goose (TSX: GOOS)

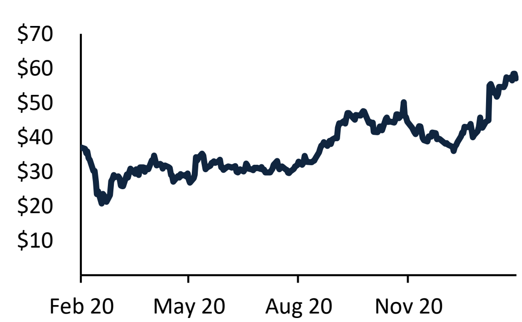
Consumer Retail - Softlines

Analyst: Jessica Zhang BCom. '22
contact@westpeakresearch.com

Equity Research	Canada
Price Target	**C$ 64.00**
Rating	Buy
Share Price (Feb. 26th Close)	C$ 57.04
Total Return	12.2%
Key Statistics (US$)	
52 Week H/L	$59.68/$18.27
Market Capitalization	$6.29B
Average Daily Trading Volume	263K
Net Debt	$175M
Enterprise Value	$6.47B
Net Debt/EBITDA	1.7x
Diluted Shares Outstanding	$111M
Free Float	99.9%
Dividend Yield	0%

WestPeak's Forecast (US$)	2019A	2020A	2021E
Revenue	$831M	$958M	$847M
EBITDA	$215M	$243M	$189M
Net Income	$144M	$152M	$75M
EPS	$1.28	$1.36	$0.67
P/E	42.6x	86.5x	87.9x
EV/EBITDA	29.3x	61.8x	32.7x

1-Year Price Performance



Canada Goose to Become International Goose

February 27, 2021

Canada Goose Holdings Inc ("Canada Goose" or "The Company") and its subsidiaries are manufacturers and retailers of winter clothing for women, men, and children. The company offers direct-to-consumer (DTC) sales through their physical stores and e-commerce website while also conducting sales through large retail distributors. The Company currently operates 29 DTC stores worldwide.

Internal Analysis – Goose Expertise and Positioning

Established in 1957, Canada Goose has been a long-time expert in goose down manufacturing. Canada Goose's parkas and jackets are made to withstand the climate and offer extreme protection. Over the years, the image of the Company has transitioned into a luxury brand, although still maintaining the original functionality. This provides a unique brand positioning for Canada Goose. While the products may be considered luxury items, they are still practical enough for many to justify a purchase, which cannot be said for many other luxury goods.

External Analysis – International Landings

With China being the world's second-largest economy and growing disposable income in the upper-middle class, the Chinese appetite for luxury goods is expected to continue its aggressive growth. Canada Goose products have already proven to be welcomed by Chinese consumers, as demonstrated by previous overseas shopping by travellers, but Canada Goose is now shifting to enter the domestic market. With eight stores located in mainland China, the Company still has a wide range of opportunities to capitalize in the foreign markets.

Valuation – Overseas Growth Migration

At its current share price of C$57.04, we believe the market undervalues the stock. After using a DCF and Comps analysis, weighted at 60% and 40%, respectively, we have determined a target share price of C$64. This implies an upside of 12.2%, and we initiative a **Buy** rating on Canada Goose Holding Inc.

Global Equity | February 2021

Consumer & Retail

II. Hardlines

ANALYSTS

Prabjot Sidhu
Senior Analyst

Josh Lax
Senior Analyst

WESTPEAK RESEARCH ASSOCIATION

Hardlines - Primer

Electric Innovation

February 27, 2021

The Hardlines industry is quite broad, but changes within the industry are closely connected. The majority of recent innovations can be associated with consumer behaviours changing; mainly in the increased adoption of electronic vehicles, and the growing popularity of e-commerce.

Industry View – Mixed Results from COVID-19

Since the hardlines industry is extremely diverse, mixed results are coming from the COVID-19 pandemic. For example, we saw the automotive industry face significant headwinds during the early stages of the pandemic such as workplace shutdowns that decreased the need for automobiles, which are slowly turning around. We also saw e-commerce segments of consumer electronics companies produce record numbers during this same time.

Industry Drivers – Electronic Vehicles and E-commerce

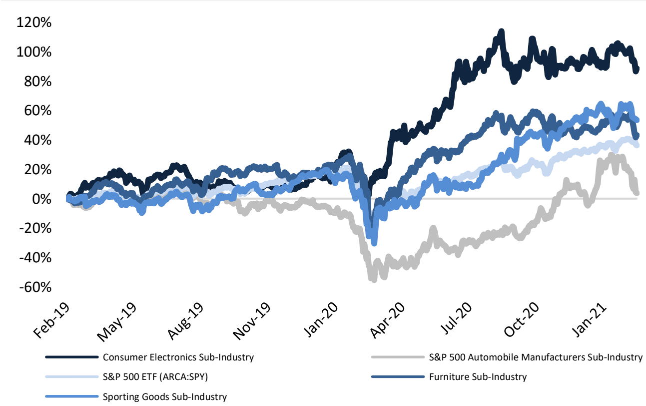
The electronic vehicle trend mainly affects the automotive industry, yet it is considered a major trend in retail hardlines due to its long-lasting effects on the North American and global economy. While electronic vehicles are still a minimal percentage of the total automotive market share, it is expected that this will change in the coming decades as companies like Tesla make vehicles more affordable and of greater quality. As well, e-commerce is affecting the consumer electronics, furniture, and sporting goods industries, and these effects are accelerated as a result of COVID-19.

Industry Valuation – Valuation Metrics and Current Valuations

The best valuation metrics to use in the retail hardlines space include EV/EBITDA and EV/EBITDAR for businesses with a brick-and-mortar business model. In terms of current valuations, all four industries in this report have performed well in 2020. The NASDAQ OMX Global Automobile index returned above 50% over the past year. Looking at individual stock performances for other sectors, it is evident that the companies also had strong price appreciation over the same period with Best Buy returning about 18%, Lowe's returning nearly 40%, and Nike returning over 40%.

Industry Research	
Hardlines	
North America Revenue	$2,074B
Annual Growth (Past 5 Years)	-0.84%
Annual Growth (Next 5 Years)	2.84%
Key Companies	
Toyota Motor Corp	NYSE: TM
Enterprise Value	$357.7B
EV/EBITDA	10.4x
Best Buy Co. Inc.	NYSE: BBY
Enterprise Value	$24.62B
EV/EBITDA	7.02x
Lowe's Companies Inc.	NYSE: LOW
Enterprise Value	$137.79B
EV/EBITDA	12.26x
The Home Depot Inc.	NYSE: HD
Enterprise Value	$312.98B
EV/EBITDA	15.05x
Nike Inc.	NYSE: NKE
Enterprise Value	$213.47B
EV/EBITDA	41.91x

Cumulative Returns of Hardlines Industry



PERSONAL AUTOMOBILES

Industry Analysis

North American Market Size & Growth

In 2019, over 4.7 million cars were sold in the United States. The same year, nearly 1.9 million cars were sold in Canada. To put these numbers in perspective, roughly 91% and 86% of US and Canadian households report that they have access to at least one vehicle, respectively. As seen in Figure 24, the percentage of households with access to cars has climbed steadily over the last several decades as cars have become more affordable, in addition to an increase in the average work commute time. Due to COVID-19, there was a sudden drop in the demand for personal vehicles as lockdowns were enforced and the whole world turned indoors. However, with consumers' recent aversion to ride-sharing services and public transport, as well as two stimulus checks in the U.S, there has been a boom in demand, particularly for used vehicles.

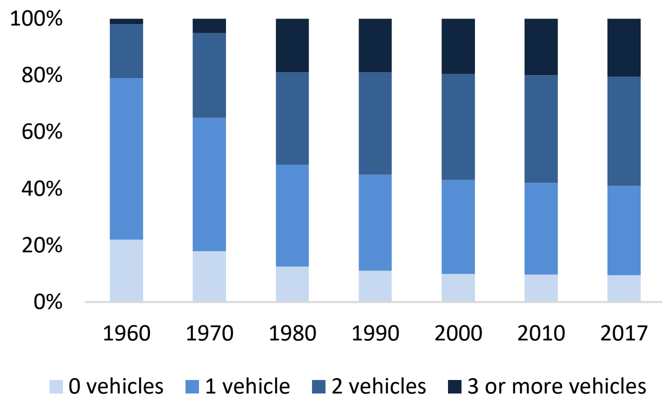


Figure 24. Percentage of Households with Access to Vehicles

Source: U. S. Department of Transportation

Key Players

Within the personal automobiles industry, there are a few different types of companies in the value chain to analyze: manufacturers, insurers, and used-vehicle sellers. Top manufacturers such as Toyota, Volkswagen, General Motors, Hyundai, Ford, and others combined to produce over 92 million vehicles in 2019. Last year proved to be a general slow-down for vehicle sales, as three of the major manufacturers, General Motors, Ford, and Toyota, all saw YoY decreases in sales ranging from two to five percent headwinds. On the insurance side, the average cost of car insurance in the US was nearly $200 per month in 2019. Though many insurers aren't publicly traded, a few giants such as All State, Progressive, and Travelers have performed extremely well over the last few decades. Lastly, some of the major players in the used-vehicle space such as CarMax, Copart, and Carvana have also done well in recent years as much of their cyclicality is tied to the decisions and performance of manufacturers and insurers.

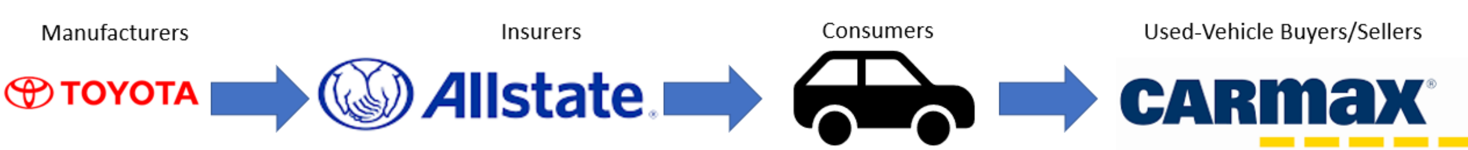


Figure 25. Personal Automobiles Value-Chain

Key Trends - Drivers

Increased Competition Amongst Manufacturers

With nearly $16 billion being spent on digital advertisements in 2019, the US automotive industry accounted for over 12% of total digital advertisement spent in the US. The highly competitive nature of the automobile industry leads brands to compete with innovative technology and aggressive discounts, which is ultimately a large win for consumers.

The Entrance of Electric Vehicles

The recent entry of electric vehicles (EV) has truly disrupted the automobile industry. Tesla is currently set to dominate the EV market and is revolutionizing the experience of driving with their autopilot technologies. A new entrant to this market is Nikola Corp, who plans to produce cars with hydrogen fuel cells rather than electric batteries like Tesla has. Though these hydrogen cells have the potential to expand driving ranges and reduce re-charging times, skeptics such as Elon Musk believe they are “staggeringly dumb” due to the inefficiency of using hydrogen to store energy. Other manufacturer giants such as Toyota and GM are beginning to penetrate the EV market as well, electrifying vehicles across many of their fleets.

Safer Vehicles are Expensive to Fix

On the insurance and used-vehicle front, one trend has connected the two industries in recent years. Between increased demands for safety ratings and innovation in terms of technology and performance, cars have become significantly more expensive to fix upon an accident. When looking at the business of a vehicle insurer, the crucial calculation they must make in the case of a major accident is in determining if it is cheaper to fix the car or to consider it totaled, and subsequently sell it to a used-vehicle partner. Since individual car parts have become much more expensive, this calculation has become skewed to the point where classifying the car as totaled and generating income from their used vehicle partners is extremely attractive. As a result, the average price of used vehicles has steadily risen since 2012, as tracked by the Manheim Used Vehicle Value Index.

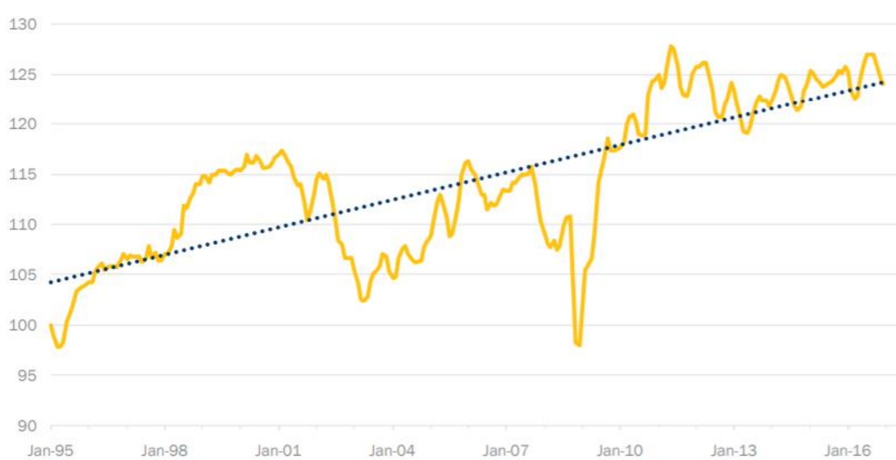


Figure 26. Manheim Used Vehicle Value Index
Source: Manheim Consulting

Margin & EPS / Earnings Growth

The average last twelve months (LTM) gross margin for the Automobile and Truck Manufacturers industry was 16.7% as of Q3 2020. Looking at net profit margins, the industry has oscillated between 1-5% in recent years. On an earnings front, major players have varied significantly in recent years, which we will explore more in the valuation section. Ford and Honda have struggled this past decade, with earnings occasionally dipping negative in particularly poor quarters. On the flip side, companies such as Toyota and Tesla, both of whom have capitalized on the wave on electric vehicles, have performed well.

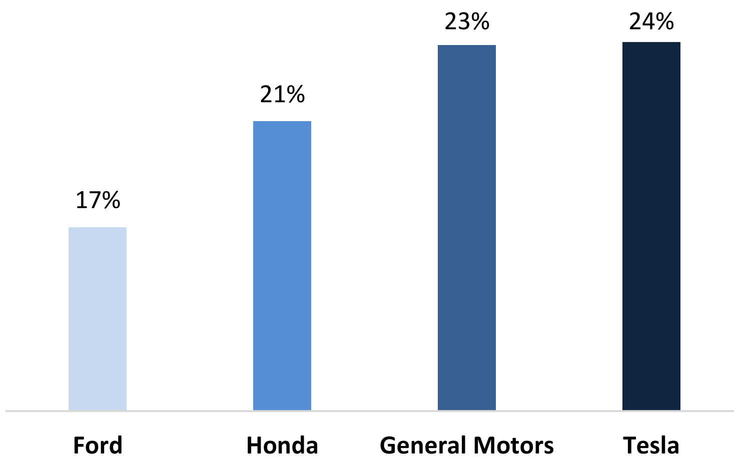


Figure 27. LTM Gross Margin of Top 4 Manufacturers
Source: IBIS World

Valuation

When the topic of valuation comes up for car manufacturers, many investors continue to look at Tesla and Nikola Motors in disbelief. Tesla's market capitalization of over US$800 billion is greater than the combined total of the seven largest automakers: Ford, Honda, BMW, GM, Daimler, Volkswagen, and Toyota. With Tesla's US$28 billion in LTM revenue, companies such as Ford and General Motors have brought in more than triple Tesla's LTM revenue while sitting at valuations at only 5% and 10% of Tesla's, respectively. In a similar outlandish fashion, Nikola Motors has exploded to a near $6 billion market capitalization despite selling zero vehicles to date.

Beyond the valuations of Tesla and Nikola, companies such as Ford, General Motors, and Toyota all lie in an EV/Revenue multiples range between 1.0x and 1.5x. For EV/EBITDA, there is a wide range between the biggest manufacturers, representing gaps in investor sentiment of the growth potential for each company.

Competitive Landscape

As we have discussed, the largest car manufacturers have competed with technology and innovation to distinguish themselves amongst a highly competitive industry. With the entry of electric vehicles and autonomous driving, most companies have hopped on board and are fighting to gain valuable market share. Due to economies of scale, new manufacturers aren't popping up very often, though EV entrants such as Nikola are challenging this status quo in the EV space. Long-term success within the EV market will be heavily tied to technological innovations in the energy sources used by different manufacturers, as this will determine crucial factors such as driving range and re-charging time.

Toyota Motor Corp. (NYSE: TM)

Toyota has continued its strong track record of success in both its standard and electric vehicle fleets. With the 1997 launch of the Prius, a gas and electric hybrid vehicle, Toyota helped get drivers on board with considering purchasing an electric or hybrid vehicle. Since then, the Prius has gone through numerous iterations to improve efficiency and range. Prius sales peaked at over 230,000 units in the US in 2012 and have since declined due to the entry of many other options in the electric and hybrid market. In 2020, Toyota's top three best-selling vehicles were the RAV4, the Camry, and the Corolla, with over 850,000 total units sold in the US. Looking forward, Toyota highlights a few future and concept vehicles which they plan to offer, specifically targeting niches within the EV market such as high-performance and ultra-compact.

Tesla Inc. (NASDAQGS: TSLA)

Between the impressive technology, their growing fleet of supercharging stations, and their ground-breaking autonomous driving technology, Tesla has become the gold standard for EV's. One major advantage Tesla provides is the ability to continually update and improve its cars' software. Tesla claims that its new vehicles contain hardware that will meet all needs for full self-driving capabilities in the future, meaning that a Tesla vehicle might even be an appreciating asset. After recently achieving positive profits for 12 consecutive months, Tesla was added to the S&P 500. Much of their ability to achieve profits were a result of the hefty tax credits Tesla received through the production of EV's, but these credits are rapidly decreasing as governmental policies expire. With Biden taking office, there is an expectation that these credits will continue, as he plans to invest heavily in renewable energy. Though Tesla's stock performance is driven largely by momentum, Elon Musk continues to push Tesla's mission to accelerate the world's transition to sustainable energy.

Nikola Corporation (NASDAQGS: NKLA)

Nikola Corporation has gained significant attention for its plans to create a fleet of electric and hydrogen-powered vehicles. Compared to using lithium-ion batteries as Tesla does, using Hydrogen allows for a higher potential driving range, as well as a significantly shorter recharging time. However, to reach these results, a network of Hydrogen refueling centers is required, which currently doesn't exist at the same scale as battery recharging stations. In November 2020, General Motors canceled a collaboration deal and investment with Nikola due to deception by Nikola's founder, Trevor Milton, who has since stepped down from his position as Executive Chairman. The stock has fallen more than 50% since November, and vehicle production is still set for some time in 2021.

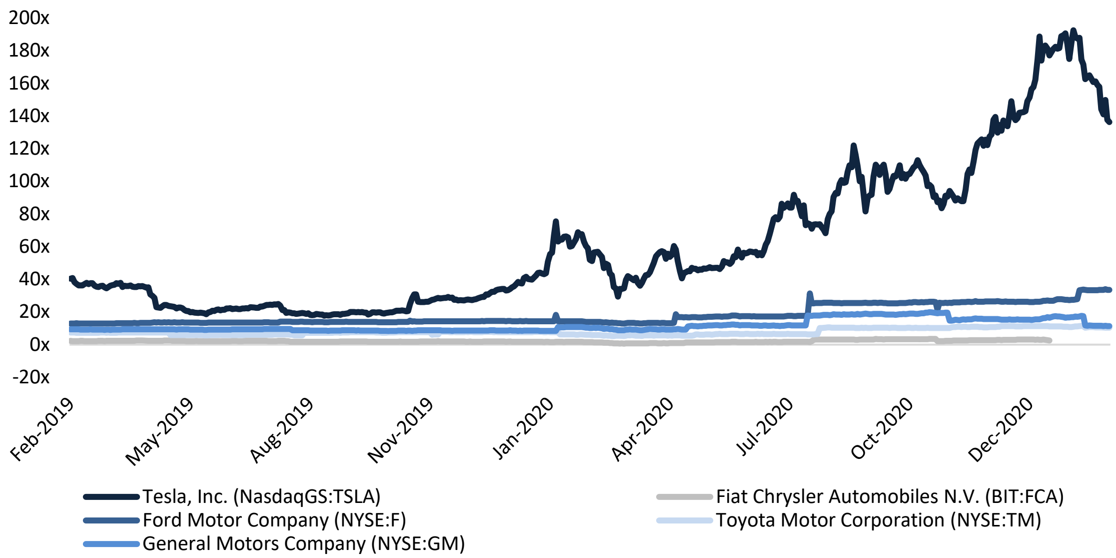


Figure 28. Two-year TEV/EBITDA for key players in Personal Automobiles industry
Source: CapIQ

CONSUMER ELECTRONICS

Industry Analysis

Market Size & Growth

The consumer electronics industry in the U.S. has a market size of US$301 billion, with a Canadian market size of C$9.7 billion. Two main segments in this space are brick-and-mortar stores and e-commerce. In the past, consumer electronics was largely dominated by brick-and-mortar retailers such as Best Buy and GameStop. The brick-and-mortar sales for the U.S. were reported as US$85.2 billion for 2019. However, over the past 5 reported years, sales growth for this channel has declined at 2.6% annually. Brick-and-mortar sales are forecasted to grow at 0.1% from 2020-2025. We also saw a significant decrease in the number of brick-and-mortar storefronts, which is a trend that is expected to continue as the popularity of e-commerce grows.

This secular shift to e-commerce, further exaggerated by the COVID-19 pandemic, has led e-commerce sales to overtake brick-and-mortar in the U.S., as seen with estimated 2020 e-commerce sales of US$179.35 billion.

Market Leadership Concentration / Key Players

There are a few main players in each of the two largest segments in the consumer electronics space. For brick-and-mortar, the largest players in the U.S. include Best Buy, with a 39.6% market share, GameStop, with a 4.6% market share, and P.C. Richard & Son, with a 0.5% market share. The remaining market share represents businesses that aren't pure plays on consumer electronics such as Walmart, Target, and Apple. In Canada, the largest player is Best Buy Canada, with a market share of 28.4%, while the rest is highly fragmented.

In the e-commerce segment for the U.S, the largest players in 2019 were Amazon, with US$40.2 billion in sales, Apple, with US$11.4 billion in sales, and Best Buy, with US$6.8 billion in sales.

Key Trends - Drivers

Growth in E-commerce

The extensive growth in e-commerce has significantly affected the consumer electronics industry as the brick-and-mortar segment has seen annual decreases in growth by -2.6% over the past five years. During the same time, e-commerce grew at an astonishing 18.4% annually. Since there is greater growth in e-commerce, the brick-and-mortar segment will likely continue to suffer. Thus, we believe the brick-and-mortar stores which are likely to be successful in the future are those that can efficiently transfer over to the e-commerce space such as Best Buy.

Consolidation of Businesses

With the trend towards e-commerce, there is no space for small shops to stay viable in the consumer electronics industry. Thus, we are likely to see greater consolidation where the medium-sized players become larger including companies like Best Buy, Amazon, and Walmart. The major reason for this consolidation is because smaller players are no longer able to compete with larger players that already have established e-commerce platforms. As the consolidation occurs and consumer electronics turns more towards e-commerce, cost savings will start being realized as the need for fixed assets decreases. Among these largest players, the winner would be the one that can achieve long-term success in e-commerce, where Amazon is currently the leader by a significant margin.

Greater Competition

The consolidation in the consumer electronics space drives a greater degree of competition among the largest players. This increased competition will result in lower prices for consumers which may also cause lower profit growth for the largest players. Thus, important factors to consider during the coming years are which business can successfully cut down on prices and still earn strong returns, and which business can maintain quality in its products.

Margin & EPS / Earnings Growth

Average profit margins in the consumer electronics industry sit around 5.7%. However, profit margins in brick-and-mortar segments have steadily decreased at an annual rate of -0.3% for the past 5 years, to a level of 4.2%. This serves as a great display of how the majority of margin expansion has been realized due to growth in e-commerce. An example of this phenomenon is Best Buy, which experienced growth in both its brick-and-mortar and e-commerce segments but has seen growth in its e-commerce segment at a significantly greater pace, which has led to increased profit margins. This is also evident with the higher profit margin growth seen by e-commerce businesses like Amazon when compared to traditional brick-and-mortar companies such as GameStop.

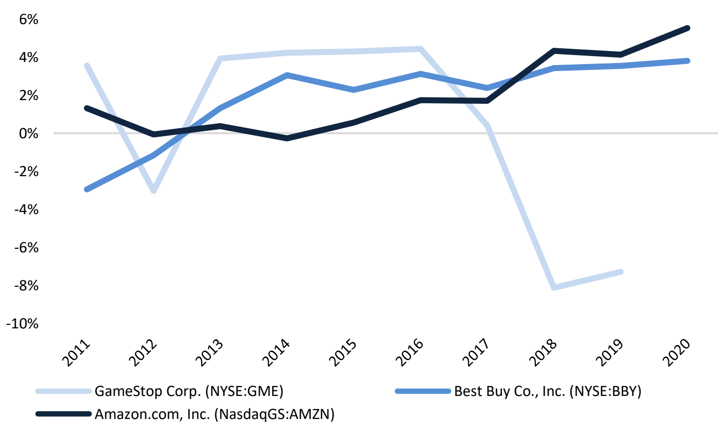


Figure 29. Profit margins for key players in Consumer Electronics industry over past 10 years
Source: CapIQ

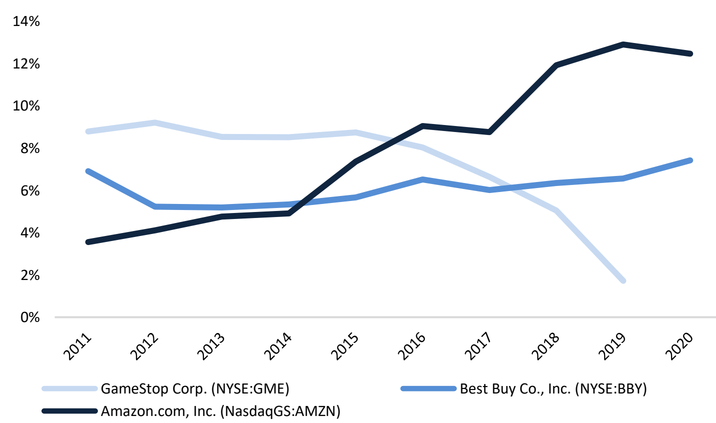


Figure 30. EBITDA margins for key players in Consumer Electronics industry over past 10 years
Source: CapIQ

Competitive Landscape

As previously mentioned, e-commerce is starting to represent a larger part of the consumer electronics industry in the U.S. and Canada, with the emergence of the COVID-19 pandemic accelerating that growth. This trend towards e-commerce is changing the competitive landscape of this entire industry. With brick-and-mortar stores shutting down, there is significant consolidation taking place in this industry with large firms growing market share as their e-commerce sales grow relative to brick-and-mortar.

Best Buy Co. Inc. (NYSE: BBY)

Best Buy is the largest player in the brick-and-mortar segment and the third-largest player in the e-commerce segment for the consumer electronics industry. In its most recent reported quarter (Q3-2020), Best Buy performed very well in light of the pandemic. Best Buy's comparable sales grew about 23% year-over-year (YoY) through leveraging its unique supply chain expertise and adjusting to the various difficulties brought about by the pandemic. It also saw earnings growth of about 33% YoY, a lot of which was due to the domestic online revenues which grew by 174% YoY. Due to this significant online sales growth in the domestic segment, Best Buy's online sales represent 35% of its total domestic revenues in Q3 of 2020. It also reported an increase in its reported non-GAAP ROI by about 15%. One downside during the most recent quarter is that Best Buy was forced to exit its operations in Mexico where it recorded US$102 mm of charges. Even though Best Buy's move towards e-commerce is resulting in the closing of a few stores, there are still many opportunities for Best Buy to utilize human interaction which is one of their key competitive advantages. For example, Best Buy's well-known Blue Shirt workers are still available to help customers make online purchases by using their expertise through a chat or telephone line. Overall, Best Buy had a great quarter in the middle of the pandemic showing its ability to adjust to difficult situations. With a healthy balance sheet and strong capital structure, Best Buy has the capital to continue to invest in the long-term e-commerce trend while still not eliminating one of its major competitive advantages of personal interaction.

GameStop Corp. (NYSE: GME)

GameStop is the largest video game retailer in the world and one of the largest brick-and-mortar consumer electronics retailers. GameStop differentiates itself through its unique buy-sell-trade program which allows its customers to buy games from GameStop and then sell or trade them once the game is not of use anymore. As of late, the company has underperformed. For example, GameStop reported LTM revenues of US$5,162 mm declining 7.1% YoY, with an LTM profit loss of US$275 million. The major reason behind this decline is the transition to online game purchases on the PlayStation and Xbox Store. Customers can conveniently buy their desired video games straight from their consoles, making GameStop's trading system less lucrative such that customers can no longer justify purchasing through them. Even from a game developer's point-of-view, they have fewer costs when selling direct-to-consumer (DTC) making GameStop useless. This transition has made many of GameStop's advantages obsolete, leading to a rapid decline in the company's performance. However, there is still some hope for GameStop. In its most recent quarterly filing, it reported a 275% e-commerce sales increase which contributes to the company's strategic objective of becoming a digital-first, omnichannel ecosystem for games and entertainment. The company also plans to file a shelf registration and prospectus with the SEC to allow them to issue Class A common stock at market offerings from time-to-time which would allow GameStop to have more financial flexibility and liquidity. Only time will tell if GameStop can turn its business around, but given the facts, we believe it is unlikely.

Amazon.com Inc. (NASDAQGS: AMZN)

Amazon is the largest online retailer in the world and is the business that has revolutionized the e-commerce space. One of Amazon's major selling segments is consumer electronics products, superseding Best Buy as the largest consumer electronics seller in the U.S. Sales generated by Amazon for its consumer electronics products are more than US$41 billion. With little information on its consumer electronics segment, it is tough to comment further. However, with financial flexibility and a world-renowned supply chain, we believe Amazon will continue being a champion of the consumer electronics e-commerce sub-industry.

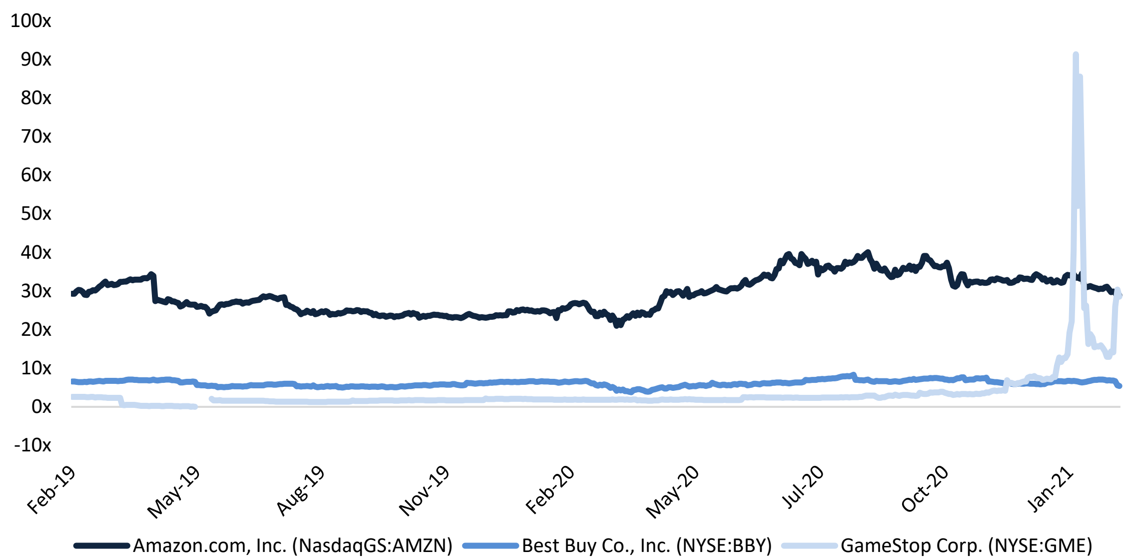


Figure 31. Two-year TEV/EBITDA for key players in Consumer Electronics industry
Source: CapIQ

FURNITURE

Industry Analysis

Market Size & Growth

The furniture industry is generally broken into three sub-industries: furniture stores, home furnishings stores, and home improvement stores. In 2020, revenues of the furniture stores sub-industry in the U.S. is expected to be US$58.9 billion. Between 2015-2020, growth in this sub-industry slowed to an annual rate of -1.2%. Consensus forecasted growth expects an uptick, with a 3.3% annual growth rate between 2020-2025. The revenues for the home furnishings stores sub-industry in 2020 is expected to be US$30.9 billion with an annual growth rate of -1.4% from 2015-2020. As well, the expected growth rate from 2020-2025 is about 2.1% annually. For 2020, home improvement stores sub-industry sales in the U.S. were US$163.1 billion. Growth in these sales from 2015-2020 was reported at 0.2% annually and is expected to rise significantly between 2020-2025 to 4.2% annually.

For Canada, in 2020 furniture store sales are expected to be C$10.6 billion, home furnishings store sales are expected to be C$3.9 billion, and home improvement store sales are expected to be C$24.9 billion.

The major reasons behind the expected future growth rates are due to the expected aftermath of the COVID-19 pandemic, where it is expected that the U.S. and Canada housing starts, per capita disposable income, and consumer confidence will all improve which acts as a tailwind for the furniture industry.

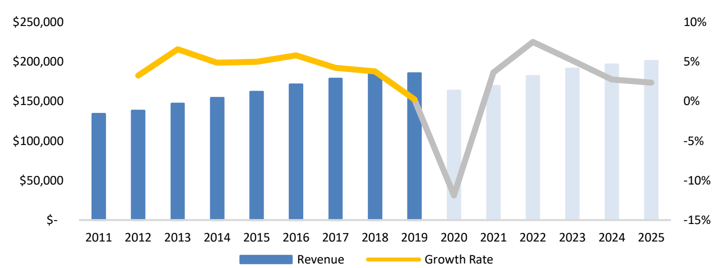


Figure 32. Revenue and revenue growth of home improvement stores sub-industry 2011-2025 (revenue figures in US$ mm)
Source: IBIS World

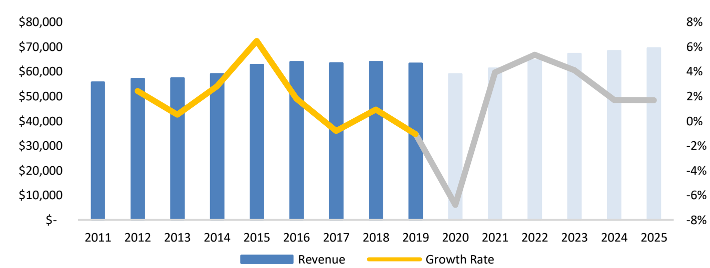


Figure 33. Revenue and revenue growth of furniture stores sub-industry 2011-2025 (revenue figures in US$ mm)
Source: IBIS World

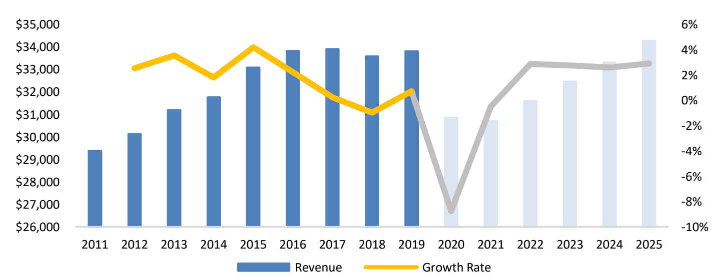


Figure 34. Revenue and revenue growth of home furnishings stores sub-industry 2011-2025 (revenue figures in US$ mm)
Source: IBIS World

Market Leadership Concentration / Key Players

Home Improvement Stores

As the largest sub-industry, home improvement stores service end consumers as well as contractors. The largest players in this space are Home Depot and Lowe's. There are many smaller players in this space, but it is effectively a duopoly in North America due to its cost leadership and strong brand images.

Furniture Stores

This segment also serves end consumers and businesses, but end consumers represent the majority of sales. The largest players in this space are IKEA and Ashley Furniture.

Home Furnishings Stores

This sub-industry is similar to furniture stores in terms of the consumers they both serve. But, for home furnishings stores the major players are Williams-Sonoma, Bed Bath & Beyond, and HomeGoods.

Key Trends - Drivers

Per Capita Disposable Income

This metric measures income per person after accounting for income taxes. Increases in this metric result in an increase in homeownership rates and in consumer expenditures, which leads to significant growth in this industry. Surprisingly, during the early stages of the pandemic, there was a significant increase in this metric, which may be a result of higher rates of saving and decreased spending due to lockdown restrictions. Since then, this figure has slowly decreased from that high and is expected to deviate back to pre-COVID-19 levels if the vaccine is effectively distributed. Thus, from this metric, we may see a stagnation in the growth rate for the furniture industry.

Increasing Concentration

As big-box stores continue to dominate the industry, we are likely to see smaller local retailers be pushed out of the market. This would result in stable profits or a slight profit decline as larger competitors continue to undercut smaller competitors' prices, similar to what has happened over the previous five years. As a result, this is expected to increase industry employment at an annualized rate of 1.3% over the coming five years. It is also likely that once smaller players are pushed out of the market, the larger players will participate in further price competition to gain market share which could push profits down and be beneficial for end consumers.

Growth in E-commerce

Though many consumers research products, before the COVID-19 pandemic only 14% of consumers purchased these products online. Since COVID-19 fast-tracked this development, we have seen a significant influx into online shopping which is assumed to stay. It is likely that competitors in this space can gain a large initial share of the online market and will have greater long-term success. Nonetheless, it is still important for retailers to have storefronts as the furniture market still is largely influenced by examining the furniture in-person which is something that e-commerce competitors like Amazon cannot offer.

Margin & EPS / Earnings Growth

In 2020, the furniture stores sub-industry has expected profits of US$2.4 billion in the U.S, which has decreased at an annualized rate of 4.8% between 2015-2020. Profit margins have also decreased at a rate of 0.8% to the current levels of 4.0% over the same time. The major reason behind this fall in profits and profit margin is due to the highly competitive nature of the furniture space which pushes down profits. In Canada, this sub-industry has profits of C$541.9 mm, with profit margins of 4.9%.

In the U.S. for 2020 the expected profits for the home furnishings stores sub-industry are US$1.4 billion which decreased at an annual rate of 3.4% from 2015-2020. Even the profit margins decreased at an annual rate of 0.5% during the same period where they are now about 4.5%. Also, in Canada, the same sub-industry has profits of C$173.4 mm with profit margins of 4.5%.

Profits in the home improvement stores sub-industry have suffered over the past several years due to intense competition and faltering demand. This may seem counterintuitive due to the various positive trends we have seen in this space, but the intense competition in home improvement is causing profits to decrease. Profits are currently standing at $10.4 billion, and have decreased at an annual rate of -8.7%, where profit margins of 6.4% have decreased by -3.8% annually between 2015-2020. Nonetheless, profit margins from both Lowe's and Home Depot have increased at a slow and steady rate over the same period, meaning that most of the margin declines came from smaller companies. In Canada, this segment saw has profits of $299 million and a profit margin of 1.2% in 2019.

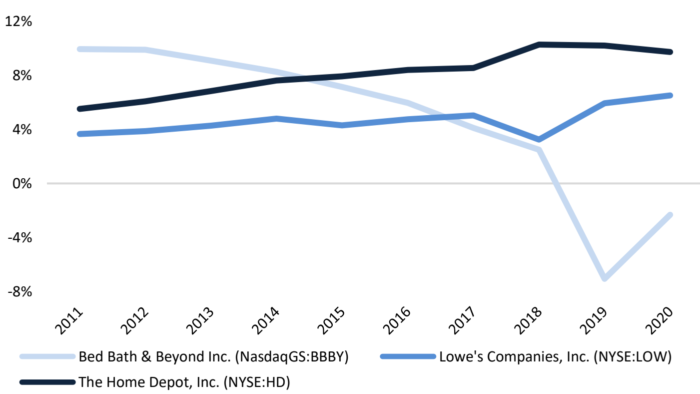


Figure 35. Profit margins for key players in Furniture industry over past 10 years

Source: CapIQ

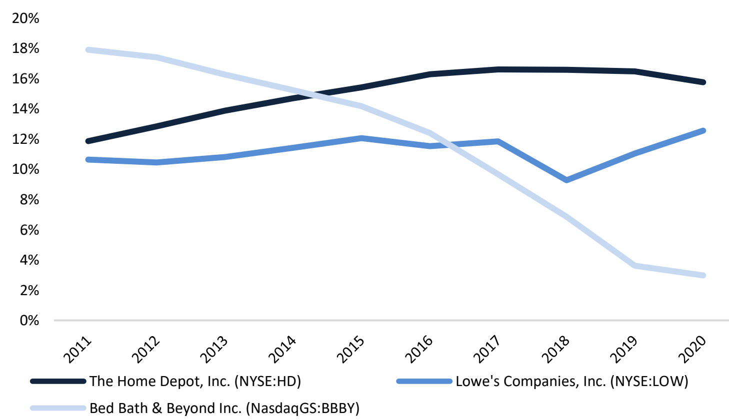


Figure 36. EBITDA margins for key players in Furniture industry over past 10 years

Source: CapIQ

Competitive Landscape

The level of competition is varied among the three sub-industries highlighted above. For furniture stores and home furnishings stores, the competition levels are high since there are a few large players, but a significant majority of the market is dominated by small independent businesses. The home improvement sub-industry is also competitive, but the competition is really between two major players that act as a duopoly: Home Depot and Lowe's.

The Home Depot Inc. (NYSE: HD)

Home Depot holds 52.5% of the market share of the home improvement segment in the U.S. It is the world's largest home improvement company and the sixth-largest retailer in the U.S. With the increasing age of baby boomers, a major target demographic of Home Depot's, it is likely to see an uptick in revenue from the do-it-for-me (DIFM) segment where customers hire contractors to complete projects for them. Due to the COVID-19 pandemic, Home Depot has experienced a gain in sales from the increase in do-it-yourself (DIY) projects as people spend more time at home and are more willing to spend money and time on improving their homes. Financially, Home Depot had a great third quarter where it reported comparable sales growth of 24.1% YoY and an EPS growth of 25.7% YoY. Much of its sales growth came from the YoY growth in its average ticket price by 10% and in its customer transactions of 13%. Home Depot has performed well during the COVID-19 pandemic largely due to the extra time spent at home which caused individuals to spend money to improve their living situations. We believe that if the pandemic persists for a while longer and work-from-home becomes a long-term trend, Home Depot is likely to reap the rewards.

Lowe's Companies Inc. (NYSE: LOW)

Lowe's holds a 36.8% market share of the home improvement segment in the U.S while being the world's second-largest home improvement chain and the eighth largest retailer in the U.S. Similar to Home Depot, Lowe's is experiencing the DIFM and DIY trends, and has performed well during the pandemic. For example, in its most recent quarterly filing Lowe's earned YoY sales growth of 28.3% and YoY comparable sales growth of 30.1%. This included growth rates above 15% in all 15 merchandising divisions and triple-digit growth online. Lowe's is also still focused on its investment into the supply chain to expand its omnichannel retailing capabilities which will drive sustainable growth. This will also help with Lowe's goal of focussing on online growth opportunities by removing points of friction from the online shopping experience. We believe Lowe's is on a path to success with its emphasis on online selling and the tailwinds coming from the pandemic which should contribute to strong growth in the future.

Bed Bath & Beyond Inc. (NASDAQGS: BBBY)

Bed Bath & Beyond holds a 23.3% market share of the home furnishings stores sub-industry in the U.S. It sells a wide array of merchandise including bed linens, bath products, and kitchen textiles. The company's LTM revenues are US$9,862 mm, with profits of -US$118 mm. The company's revenues have decreased over the past five years at an annual rate of -1.6%. These decreases are seen due to the shift towards e-commerce, which acts against its business model of requiring in-person contact with its customers. However, with the changing consumer habits coming about from the pandemic, Bed Bath & Beyond has growth opportunities. For example, during the past two reported quarters, the company has performed well with strong digital sales growth figures coming in the high double digits. And these digital sales are contributing to an overall increase in sales and profits for the second consecutive quarter. We believe that even though the company has performed well during the pandemic, there are uncertainties about the sustainability of the growth and whether the company can effectively transition into the e-commerce space.

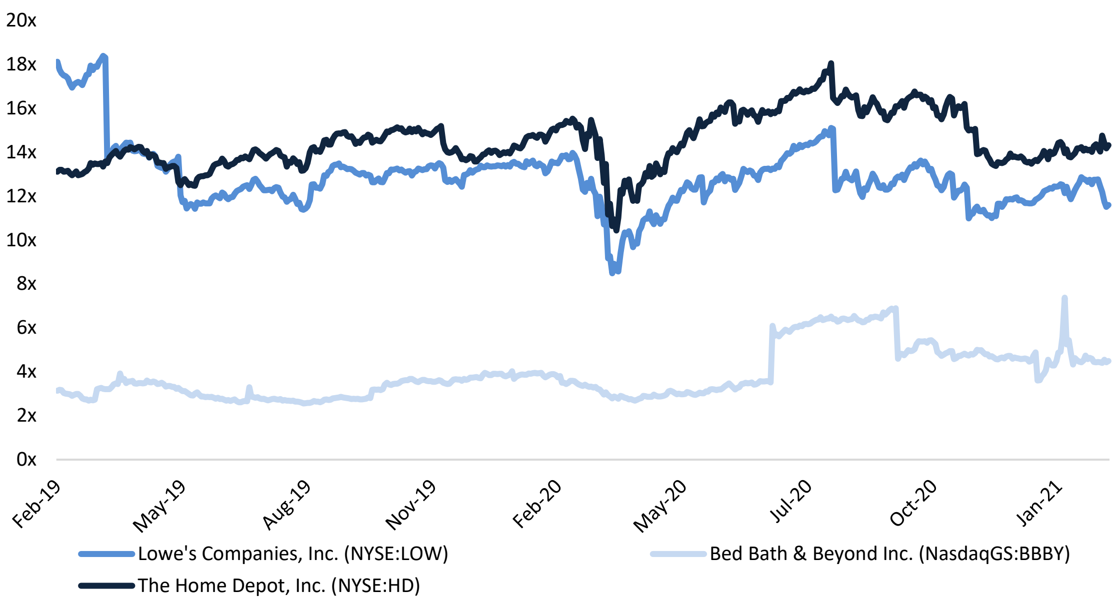


Figure 37. Two-year TEV/EBITDA for key players in Furniture industry
Source: CapIQ

SPORTING GOODS

Industry Analysis

Market Size & Growth

Sporting goods stores in the US and Canada brought in an estimated US$44.5 billion and US$5.4 billion in 2020, respectively. The past five years have been relatively weak in both markets, partially attributed to a 0.5% annual decrease in sports participation during that time. With current COVID-19 expectations, industry revenue is expected to grow at a 1.2% and 2.5% annualized rate until 2025 in the US and Canada, respectively, as a result of higher sports participation rates and disposable income.

Market Leadership Concentration / Key Players

The two segments of focus in the sporting goods industry are manufacturers and retailers. On the manufacturing side, major players include Nike, adidas AG, Under Armour, and Callaway Golf, who brought in US$39 billion, US$29 billion, US$5.3 billion, and US$1.7 billion in revenue in 2019, respectively. Since the sporting goods industry is highly fragmented and ultra-competitive, companies often compete over coveted brand deals with professional sports leagues and players, which we'll discuss later. On the retail side, there are a few major players such as Bass Pro Shops, Dick's Sporting Goods, and Academy Sports & Outdoors, who owned 16.9%, 13.8%, and 8.4% of the US market share in 2019, respectively.

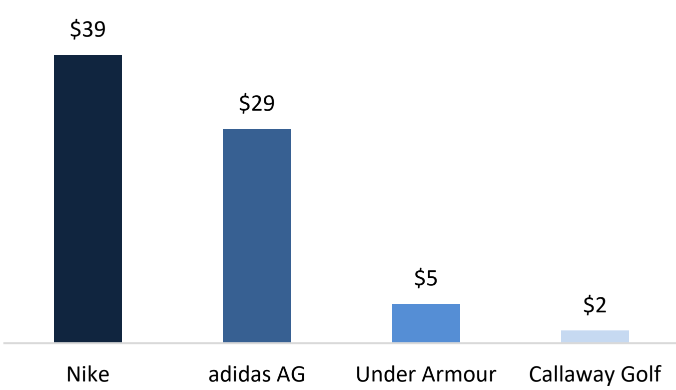


Figure 38. 2019 Revenue of 4 Major Manufacturers (US$ Billions)
Source: IBIS World

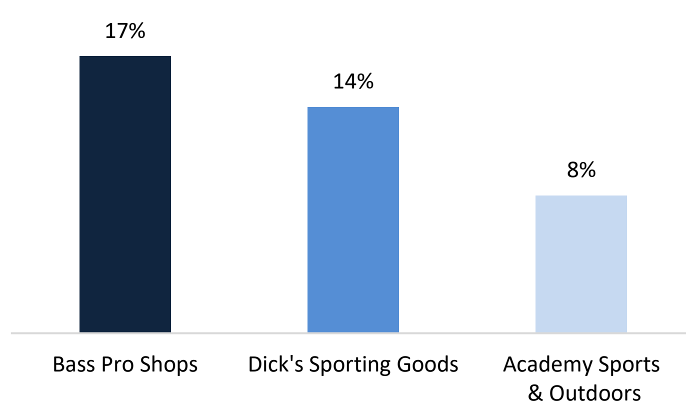


Figure 39. Market Share of 3 Major Retailers
Source: IBIS World

Key Trends - Drivers

A few headwinds have slowed down the sporting goods industry in recent years, but the future is bright. Post COVID-19, sports participation rates and disposable income are expected to climb again, which will provide a hefty tailwind towards spending on sporting goods. Even during COVID-19, certain companies such as Callaway saw YoY increases in revenue due to the increased demand for golfing equipment. Sports that can be played with social distance, such as golf, garnered significant demand in the latter half of 2020, in addition to record spending on at-home fitness equipment. We believe this trend will likely lose traction as more options re-open, and since many of these purchases are infrequent investments.

Another trend that has significantly impacted sporting goods retailers, is the dominance of e-commerce. With sporting goods, there is a bit of a lag in the adoption of online sales since interacting with the equipment in-person is often crucial in the customers' decision. Some retailers such as Walmart and Target have been utilizing their strong supplier contracts and economies of scale to undercut alternative retailers, which is likely to continue as they strengthen their online presence.

Margin & EPS / Earnings Growth

Due to the highly competitive nature of the industry, in addition to pressure from e-commerce and retail giants, profit margins have remained low in the 2-3% range over the last five years in the US. Potential room for margin expansion mostly relies on the additional value brick-and-mortar retailers can provide, as deep discounts through economies of scales dig away at what little profit remains.

Due to COVID-19, most sporting goods retailers and manufacturers faced significant losses in Q2 of 2020, and lackluster profits, if any, in Q3. Since there is some positive sentiment on revenue growth for the next five years, we can expect to see modest EPS growth once the effects of COVID-19 subside. However, many of the manufacturers such as Nike and Adidas have significant exposure to markets outside of North America, so the efficiency of vaccine distribution could certainly lengthen the time it takes for these firms to return to business as usual.

Valuation

When comparing valuations for sporting goods manufacturers and retailers, it is important to acknowledge the inherent differences in long-term upside and potential. On the surface, retailers such as Dick's Sporting Goods appear extremely under-valued with an EV/EBITDA multiple of 5x compared to manufacturers such as Nike, with an EV/EBITDA multiple closer to 50x. However, when considering the differences in portfolios, in addition to the long-term dissipation of brick-and-mortar stores and transition to e-commerce, it becomes clear that this isn't a fair comparison. Most retailers carry branded goods from manufacturers such as Nike, Adidas, Under Armour, and others, which also makes the logical progression for consumers to go directly to them rather than through a retailer. Of course, one of the biggest friction points here is the desire for consumers to interact in-person with the equipment, but as virtual and augmented reality technology evolves and becomes more adopted, this is likely to become less important.

As previously mentioned, one area of significant value generation for manufacturing giants has been through partnering with major professional sports leagues and players. For example, Nike spent $1 billion to become the National Basketball Association's (NBA) apparel supplier for eight years beginning in 2018. This investment helped drive not only Nike's apparel sales, but also demand for their signature sporting good lines. Competitors such as adidas AG and Under Armour have followed the same strategy, leading to continued brand awareness and penetration into massive developed and emerging markets.

Competitive Landscape

As we discussed, the sporting goods manufacturer and retailer industry is ultra-competitive. Despite this, the following companies have been able to garner significant market share and succeed through strategic positioning and branding. During COVID-19, each of these companies adapted to quickly close stores and transition sales almost fully online, each seeing unique challenges and opportunities due to headwinds and tailwinds stemming from the pandemic.

Nike Inc. (NYSE: NKE)

In 2020, Nike's brand alone was valued at nearly $35 billion. The sporting good giant has long excelled in the industry and continues to push boundaries with new technology across all their equipment and apparel. Between their numerous partnerships and marketing spend, Nike had over 7 billion brand impressions and 400 million social media engagements in Q2 of 2020 alone. With their already dominant e-commerce platform, Nike capitalized on their strong supply chain to make deliveries throughout the worst of COVID-19. As the entire sporting goods industry continues to shift to e-commerce, Nike is poised to benefit from the acceleration of online shopping due to the pandemic.

Under Armour Inc. (NYSE: UA)

With the huge athleisure trend in the past few years, Under Armour was a bit late to the party. They didn't capitalize on this trend nearly as much as competitors such as Nike and adidas AG did, and in an attempt to play catch-up, ended up poorly positioning themselves as a low-end brand. Under Armour tried to cash in on the athleisure wave by pushing out their products into discounted channels like Kohl's, which after some time diminished brand association. In recent earnings calls, management has made it clear that they are addressing this brand issue by cutting back on exposure to lower price channels, and instead targeting direct-to-consumer sales. Boasting key partnerships with professional athletes such as Stephen Curry, Michael Phelps, Bryce Harper, and Tom Brady, Under Armour has all the necessary tools to realign their brand as a more premium option and steal market share from Nike, Adidas, and others.

Dick's Sporting Goods Inc. (NYSE: DKS)

Though Dick's Sporting Goods has been a classic icon for sporting goods retail in the past few decades, they are in a difficult spot as the manufacturing industry has shifted to focus on direct-to-consumer sales. To make it worse, Dick's also must battle with the shift to e-commerce sales, where other retail giants like Target and Walmart can under-cut on pricing due to their scale. However, Dick's has made strategic decisions to stay relevant in the dying age of brick-and-mortar. Most recently, in December 2020, Dick's announced a partnership with Instacart, a delivery service typically used for picking up and delivering groceries. Instacart has been expanding its business beyond just grocery, and this partnership allows Dick's to stay relevant in the e-commerce age as the partnership targets a same-day delivery service for 20% of Dick's store base. The company is fighting to innovate in a difficult industry and is likely to continue to strengthen its e-commerce presence and find additional ways to generate value with the in-store experience.

Callaway Golf Co. (NYSE: ELY)

During COVID-19, the sport of golf saw a huge surge in demand due to its natural fit with being a socially distanced activity. In Canada, the number of golf games played in June and July 2020 was up 17% and 12% YoY, respectively. Callaway was able to capitalize on this huge tailwind, and in Q3 2020, saw a 12% increase in YoY sales and a 69% increase in YoY diluted earnings per share. With their numerous sets of golf clubs for players at all levels of experience, both newcomers to the sport and those looking to upgrade their sets can purchase Callaway equipment. In addition to their generally strong performance, Callaway made the strategic decision in October 2020 to buy-out the remaining equity in Topgolf Entertainment Group, a golf entertainment business with 60 locations worldwide. The CEO and many senior executives of Callaway previously worked at Topgolf, and Callaway had already had a 14% stake in the company, in addition to partnerships to feature equipment and apparel at their venues. This acquisition helps Callaway further expand their customer reach and serves as an extremely interesting case study for how sports equipment retailers can find strategic ways for customers to benefit from in-person interaction with equipment.

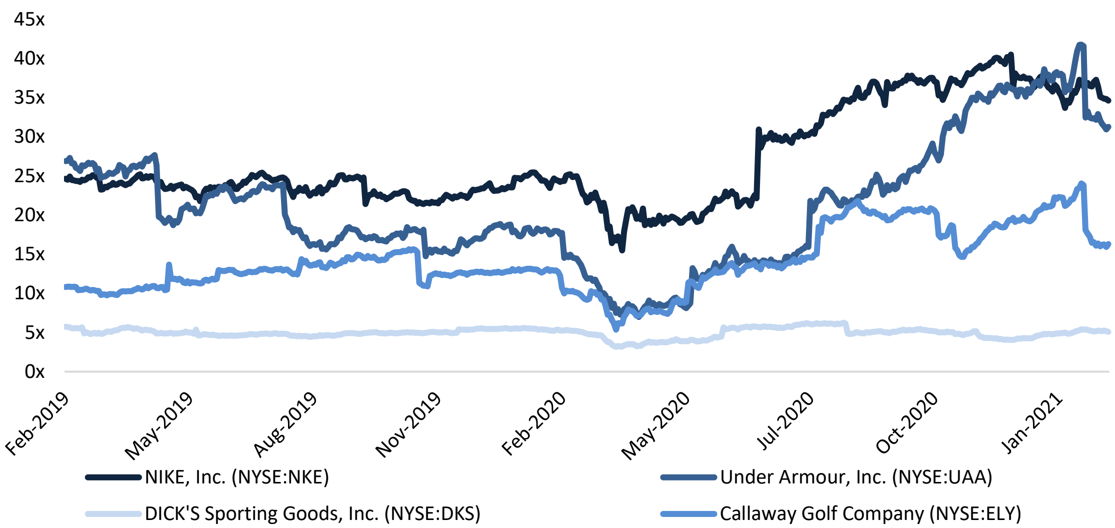


Figure 40. Two-year TEV/EBITDA for key players in Sporting Goods sub-industry
Source: CapIQ

WESTPEAK RESEARCH ASSOCIATION

Best Buy Co Inc. (NYSE: BBY)

Hardlines – Consumer Electronics

It's All Up to E-commerce

February 27, 2021

Analyst: Prabjot Sidhu, BCom. '22
contact@westpeakresearch.com

Best Buy Co Inc. ("Best Buy" or "The Company") is a multinational consumer electronics retailer headquartered in Richfield, Minnesota. Operating in 1,231 stores worldwide, Best Buy has brought forth a combination of great customer service and reliably low prices to be considered the largest specialty retailer in the U.S.

Internal Analysis – Breaking Away from Maturity

With slower sales growth and stagnation in margins, Best Buy is in the mature stage of its business life cycle. It closed over 500 stores over the past 7 years and has seen a 10-year average sales growth rate of -0.28%. However, it has grown at about 2% annually since 2015, largely due to the growth in e-commerce which could help them grow further in the future.

External Analysis – E-commerce

The industry trend that can improve Best Buy's performance is a greater push into e-commerce. Management has performed well in positioning Best Buy as a large player in the consumer electronics e-commerce space. With the lower costs and higher demand associated with e-commerce, Best Buy can likely realize margin expansion as e-commerce becomes a larger part of its business. These results may come sooner than expected, as the COVID-19 pandemic has resulted in Best Buy placing even greater importance on e-commerce.

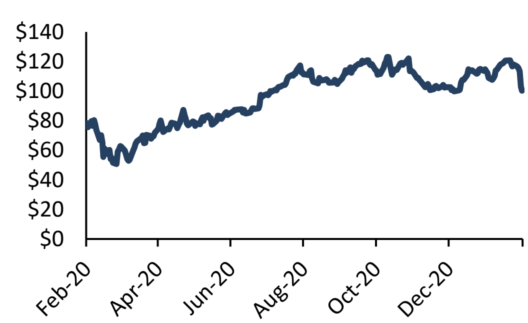
Valuation – Patience is Key

In 2020 Best Buy's stock price rose about 18%, just two percentage points above the S&P 500. Its current EV/EBITDA of 8.4x is higher than the companies' 13-year median of 5.8x. The combination of Best Buy's mature status and potential e-commerce growth has only led to conservative growth estimates, which earned Best Buy a **Hold** rating. Given the reliance on Best Buy's e-commerce performance and the associated uncertainties, we recommend investors be patient with Best Buy and wait to see these plans realized.

Equity Research	US
Price Target	**US$ 109.39**
Rating	Hold
Share Price (Feb. 26th Close)	US$ 100.35
Total Return	9.01%
Key Statistics	
52 Week H/L	$124.89/$48.11
Market Capitalization	$25.99B
Average Daily Trading Volume	3.5M
Net Debt	-$1522M
Enterprise Value	$24.62B
Net Debt/EBITDA	-0.4712x
Diluted Shares Outstanding	258.83M
Free Float	230.69M
Dividend Yield	2.18%

WestPeak's Forecast	2019	2020	2021E
Revenue	$43.64B	$44.95B	$46.30B
EBITDA	$2.86B	$2.96B	$3.04B
Net Income	$1.54B	$1.59B	$1.63B
EPS	$5.75	$6.03	$6.18
P/E	14.33x	17.63x	17.20x
EV/EBITDA	9.37x	9.08x	8.85x

1-Year Price Performance



Global Equity | February 2021

Consumer & Retail

III. Food & Beverage

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WESTPEAK
RESEARCH ASSOCIATION

Food & Beverages - Primer

Hungry Quarantiners

February 27, 2021

The Food & Beverages industry continues to evolve to meet the rapidl1y changing wants and needs of consumers. With preferences shifting for nearly every component of the value-chain, companies have been forced to adapt to succeed in an extremely fragmented industry.

Industry View – Alternative Everything

Between plant-based meats, lactose-free dairy, and fad diets, consumers have become increasingly picky with their eating habits. However, what ends up on their plate is not the only thing that has changed. With food delivery options growing tenfold, consumers have recognized the convenience of receiving groceries or a restaurant-prepared meal at their doorstep within the hour. That being said, COVID-19 has sent the industry into turmoil, and we expect a bumpy recovery to a new normal.

Industry Trends – Convenience Above All

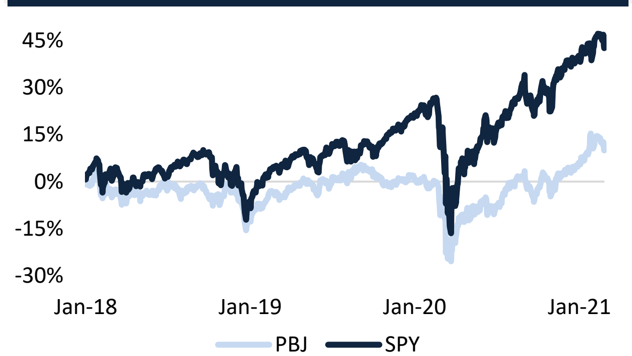
While each sub-sector within the Food & Beverage industry has unique drivers, one trend prevails across all: consumers value convenience. For packaged goods, demand for pre-made and frozen foods has remained strong through 2020. Many grocers have launched or revamped delivery this year, and with most restaurants being closed for dine-in services, consumers have grown accustomed to paying a premium for the convenience of delivery services.

Industry Valuation – COVID-19 and Beyond

When the effect of the pandemic on the market peaked in March 2020, many companies' stock prices dropped by 30-50%. By the end of 2020, most of these returned to pre-COVID prices, but this recovery path depended heavily on each companies' unique exposure to the pandemic. Typically, the best multiple to use in valuing Food & Beverage companies includes EV/EBITDAR and EV/Revenue. Looking forward, companies who can capitalize on high growth opportunities in secular trends and emerging markets are sure to be met with positive investor sentiment, which seems to be in a surplus in the current equity markets.

Industry Research	
Food & Beverages	
Global Revenue	$6,111B
Annual Growth (Past 5 Years)	-4.2%
Annual Growth (Next 5 Years)	7.1%
Key Companies (US$)	
PepsiCo	NASDAQ: PEP
Enterprise Value	$212B
EV/EBITDA	16.6x
Nestle	SWX: NESN
Enterprise Value	$330B
EV/EBITDA	17.8x
Kroger	NYSE: KR
Enterprise Value	$43B
EV/EBITDA	5.5x
McDonald's	NYSE: MCD
Enterprise Value	$187B
EV/EBITDA	20.6x
Starbucks	NASDAQ: SBUX
Enterprise Value	$138B
EV/EBITDA	44.6x

Cumulative Return of F&B Index



GROCERY

Industry Analysis

Market Size & Growth

The large grocery industry in the U.S. is broken into two sub-industries. First, is the supermarkets and grocery stores sub-industry, which in 2019 reported revenues of US$652,742 mm, and expects 2020 revenues of US$656,002 mm. Sales have grown at 0.6% annually for the past five years and are forecasted to grow at the same rate for the coming five years.

Second, is the online grocery sub-industry, which reported revenues of US$15,624 mm in 2019 and expects revenues of US$26,980 mm in 2020. This significant increase in online grocery sales is most obviously due to the COVID-19 pandemic, resulting in a 24.1% annual growth rate over the past 5 years. This growth, however, is expected to slow significantly to an annual rate of 5.6% between 2020-2025 as much of the new sales from the COVID-19 pandemic will not likely be sustainable.

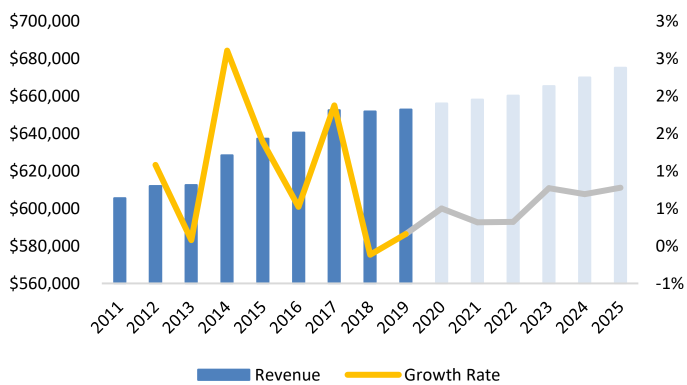


Figure 41. Revenue and revenue growth of supermarkets and grocery stores sub-industry 2011-2025 (revenue figures in US$ mm)
Source: IBIS World

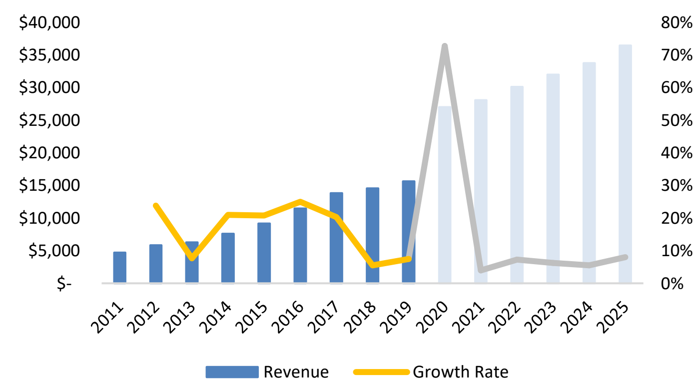


Figure 42. Revenue and revenue growth of online grocery sub-industry 2011-2025 (revenue figures in US$ mm)
Source: IBIS World

Market Leadership Concentration / Key Players

Supermarkets and Grocery Stores Sub-Industry

This sub-industry can generally be considered a low concentration space, as it has a few large grocery store chains but is still largely composed of minor players. The reason behind the low concentration is because we haven't included a few businesses such as Walmart and Costco. After all, they are considered mass merchandisers rather than just grocery stores or supermarkets. The largest pure-play grocery store chain is Kroger with a 19% market share, hosting supermarket brands like Kroger, Ralphs, Dillon's, and many more. Following that is Albertsons, which has a 9.4% market share, and accounts for supermarket brands like Albertsons, Safeway, Vons, and many more. The final large player is Publix Super Markets Inc, with a market share of 7.1%, and is the main supermarket brand of Publix.

Online Grocery Sub-Industry

This is a relatively new sub-industry that can be considered an oligopoly market with high concentration, though with room for further entry and competition. The largest player in this sub-industry is Amazon, which operates as AmazonFresh in the online grocery sub-industry with a market share of 32%. Next is Walmart, with a market share of 23.5%, which started distributing online groceries through Walmart Pickup – Grocery. The third is Kroger, which holds a 12% market share, operating through the brand ClickList. The last of the largest players is Peapod with a market share of 6.6%.

Key Trends - Drivers

Agricultural Price Index (API)

This measures the prices received by farmers for all agricultural products. As prices increase, grocery stores generally increase their prices because the effect on the agricultural products is generally minimal in absolute dollar terms. Conversely, if the agricultural price index falls, grocery stores may decide not to change their prices which leads to increased profits. In 2020 the API had a steep rise which positively affected grocery store revenues. This figure is also expected to rise for the coming years which may contribute to growth in grocery store revenues.

Competition in Online Grocery Sub-Industry

The online grocery retail industry is still quite small compared to brick-and-mortar grocery stores, but they are on the rise. Due to the pandemic, more people than ever are trying online grocery delivery services. Many new entrants in the industry are small tech companies that act as intermediaries between grocery stores and end customers. There are also established brick-and-mortar stores that are offering their delivery services. The emergence of these two groups is causing heightened price-based competition with companies like Amazon leading the way to price cuts as a measure to increase market share. This will bode well for consumers as the increasing competition will lead to lower prices, but it will result in decreased profit margins for players in the space.

External Competition in Supermarkets and Grocery Stores

The supermarkets and grocery stores sub-industry is facing greater external competition from mass merchandisers like Walmart and Costco which aren't specialized in grocery sales but retrieve a large portion of their sales from their grocery products. The reason for the increased competition is due to the convenience of a mass merchandiser compared to a specialized grocery store. Mass merchandisers allow the purchase of a wide variety of products while shopping for groceries, and they also have lower prices because they benefit from economies of scale. We believe this trend will continue going against the pure-play grocery store chains and result in price-cutting to stay competitive which will cut into already low margins.

Margin & EPS / Earnings Growth

The supermarkets and grocery sub-industry is among the lowest margin businesses that exist. With expected profits between US$10 - US$20 billion in 2020, the profit margins in this sub-industry are generally between 1-3%. The profits and margins have decreased over the past five years, but at a very minimal rate close to 1% total. For the online grocery sub-industry, the profit margins are a bit higher at around 3% but are still low. The reasoning behind these higher profit margins relative to the other sub-industry is due to the lower costs associated with selling products online rather than in-store which requires additional overhead costs.

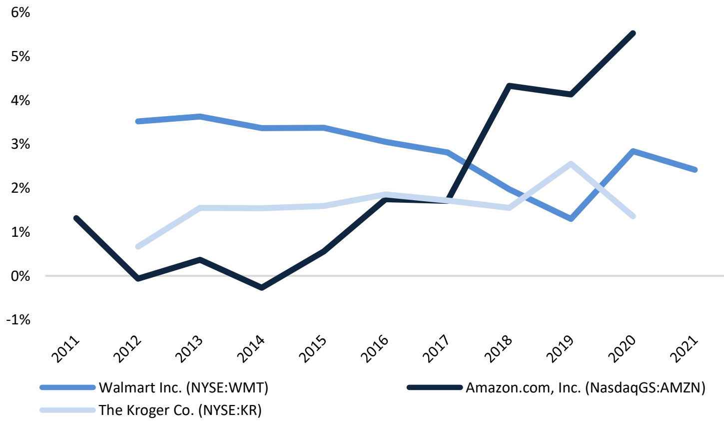


Figure 43. Profit margins for key players in Grocery industry over past 10 years
Source: CapIQ

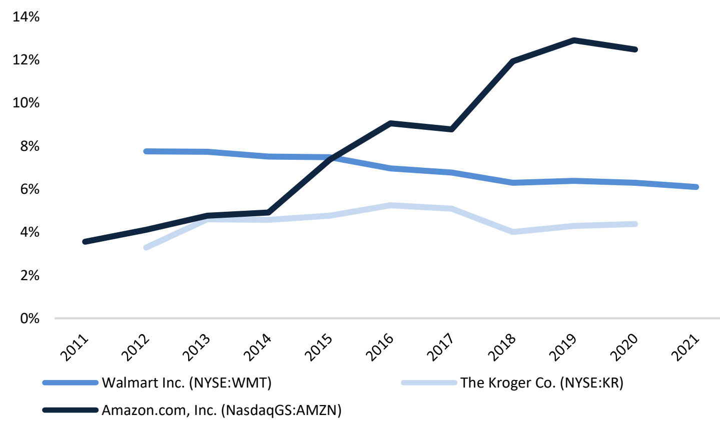


Figure 44. EBITDA margins for key players in Grocery industry over past 10 years
Source: CapIQ

Overview of Key Players

The competitive landscape in the supermarkets and grocery stores sub-industry can be characterized as one with a few large players, but yet is significantly composed of minor players. For the online grocery sub-industry, the competition is quite high, but the sub-industry is also highly concentrated.

The Kroger Co. (NYSE: KR)

Kroger has become one of the world's largest retailers by annual sales figures and the largest pure-play grocery store chain. Kroger currently has 2,750 supermarkets worldwide that serve millions of customers daily under brand names including Kroger, Ralphs, Dillon's, King Soopers, Fry's, and many more. It has performed well during the pandemic as seen in its most recent quarterly filing which showed a 10.9% YoY comparable sales growth excluding fuel and an impressive 108% growth in sales from its digital segment. Kroger also saw a decrease in its debt/EBITDA ratio during the most recent quarter as it fell to 1.74, however, they plan on bringing it back up to optimal levels around 2.5. Kroger also increased their distribution capacity reserves by 20% within its supply chain to minimize supply chain hold-ups which could help in the coming year since the pandemic is still looming over our heads. Kroger is in the mature stage of its life cycle, yet, due to the pandemic has achieved strong growth rates especially in its digital segment. And, we believe it will be interesting to see how Kroger can grow this digital segment in the future and if the growth in this segment can lead to growth in Kroger's margins.

Amazon.com Inc. (NASDAQGS: AMZN)

Amazon's initial foray into the grocery industry was through Amazon Fresh, which started in 2007. About 10 years later, in 2017, Amazon made its first splash into the supermarkets and grocery sub-industry with the acquisition of Whole Foods. Even though this acquisition is not considered a success, it still allows Amazon to find a method to expand its online grocery sales by using its grocery store chain. For example, through Whole Foods, Amazon can gather customer data and preferences to determine how it can further grow the online grocery segment and provide better value to its customers. Due to the COVID-19 pandemic, it was reported that Amazon's online grocery sales tripled in Q2, but its Whole Foods sales decreased by about 13%. On top of these two brands, Amazon also has Amazon Go, a new convenience store that allows customers to quickly grab food without having to manually check out. The results for this project are yet to be realized, but we see this project as possibly revolutionary for the supermarket and grocery sub-industry. Amazon is at the forefront of all e-commerce areas including that of grocery, and if COVID-19 makes online grocery shopping a habit even after the pandemic is gone, Amazon can reap great rewards.

Walmart Inc. (NYSE: WMT)

Walmart is the world's largest retailer with over US$500 billion in LTM sales and close to US$20 billion in LTM profits. Yet, we haven't considered it a part of the supermarkets and grocery store sub-industry due to its classification as a mass merchandiser even though it earns about US$200 billion of its revenue from the sales of grocery products. However, Walmart is a large player in the online grocery segment in the US. In 2015, it rolled out their Walmart Pickup – Grocery which is a service enabling customers to order online from a selection of thousands of grocery products with the chance to pick them up at a distribution center. Walmart also recently began selling and delivering online groceries where the company's distribution hubs will play a massive role in its success. Financially the online grocery segment has performed well during the pandemic as Walmart saw YoY growth rates around 50% during the first few months of the pandemic due to large numbers of shoppers' willingness to order groceries online.

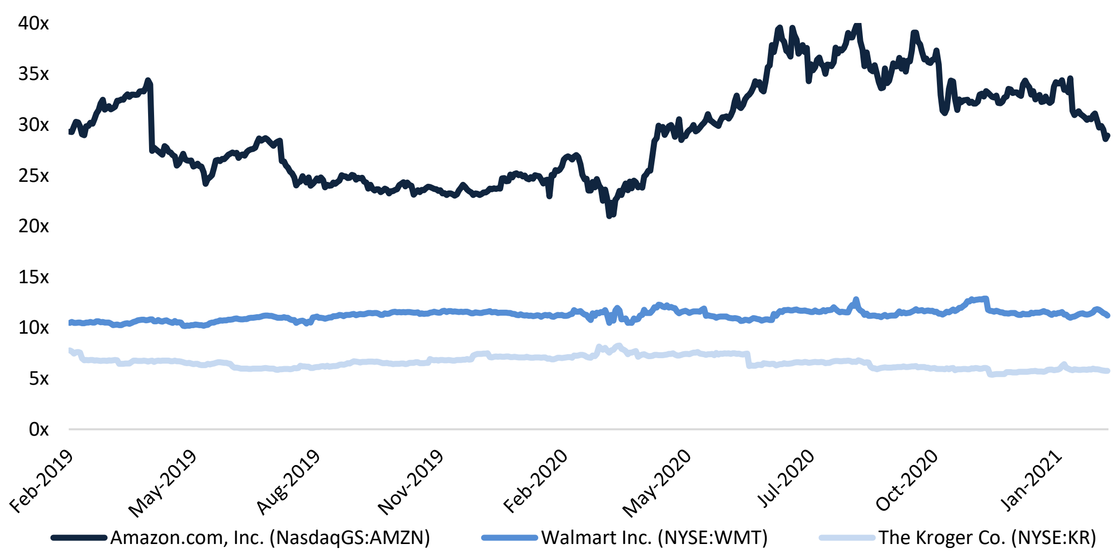


Figure 45. Two-year TEV/EBITDA for key players in Grocery
Source: CapIQ

PACKAGED FOODS

Industry Analysis

Under the Food and Beverage sector, packaged foods include various types of pre-packaged items widely available in grocery stores, convenience stores, and specialty shops. There are three main types of products within the packaged foods space; (1) Shelf-stable foods include packaged snacks, cereals, and various canned items. (2) Refrigerated foods include packaged meals, side dishes, dairy products, and processed seafood/meat. Lastly, (3) Frozen foods include frozen “ready” meals, frozen microwaveable snacks, and other frozen desserts.

Market Size & Growth

The global packaged food market is estimated to be valued at over US$2.8 trillion in 2018 and is expected to grow at a CAGR of 6.5% to reach US$4.9 trillion by 2027. The market for packaged foods is driven by the urban lifestyle, where many individuals prioritize convenience.

Market Leadership Concentration / Key Players

Packaged foods is a broad industry that encompasses numerous narrower subcategories. There is a significant presence of “Big Food” companies in the overall packaged food industry, but the degree of their market share concentration fluctuates depending on the subsector.

Big Food Companies

In this report, Big Food companies will refer to companies that own a portfolio of different brands under the packaged food industry; these companies can usually capture a large market share due to their size and economies of scale. Since packaged foods is an industry that requires large amounts of machinery, big companies possess a considerable advantage in economies of scale that creates high barriers to entry for smaller firms. However, Big Food companies have been losing market share in recent years due to shifting consumer preferences towards smaller, niche food companies.

Examples of Big Food companies include Nestle, PepsiCo, Kellogg’s, Coca-Cola, Unilever, Danone, General Mills, Mars, Associated British Foods, and Mondelez.

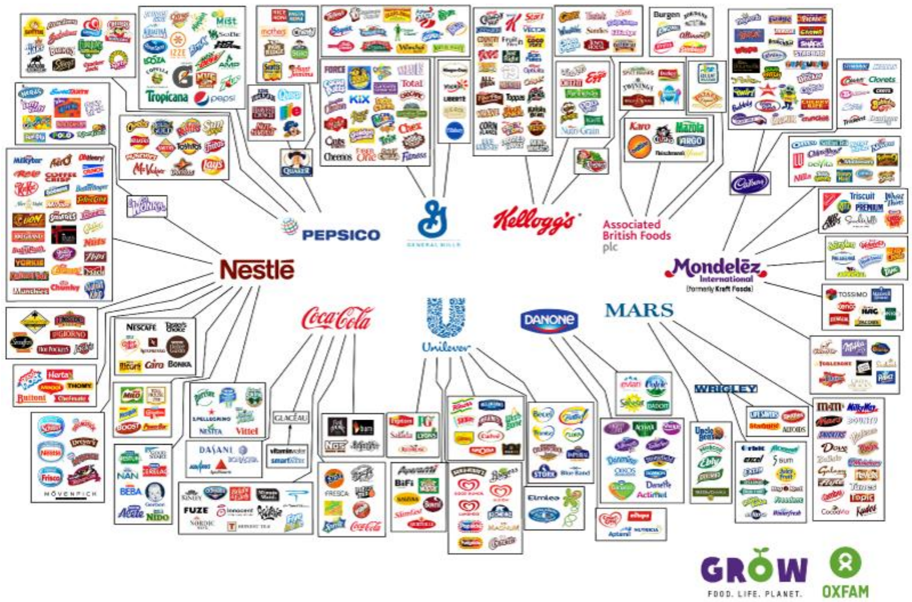


Figure 46. "Big Food" companies that control most of the packaged food industry.
Source: Business Insider

Key Trends - Drivers

COVID-19: Cooking at Home and Stockpiling

As the COVID-19 pandemic continues to affect lifestyles worldwide, there has been an increased demand for ingredients to cook at home. As more workers are working from home and eating their meals at home, an immense opportunity was presented to the packaged foods industry. It is estimated that 67% of Americans are cooking more at home when compared to pre-pandemic levels. With many companies considering the implementation of long-term work-from-home flexibility, the trend of eating and cooking at home will likely continue as the world recovers. However, due to increasing urbanization and busy lifestyles, customers still prioritize convenience even when eating from home. This will drive the demand for packaged foods, especially in the frozen and refrigerated ready-to-eat meals that act as quick lunches for workers during their workdays.

Although COVID-19 vaccines are starting to be available, the vaccines have yet to reach the mass population, meaning that some regions are still dealing with pandemic control. As seen from the situation in March, many individuals are choosing to stockpile non-perishables and packaged foods to avoid trips to public spaces, which also boosts short-term demand for packaged foods like premade pasta, snack foods, and "ready" meals." Although this trend may decline as the pandemic ends, the pandemic has deeply impacted many consumers' behaviour in the future. Therefore, the demand for packaged foods will still have tailwinds from permanent shifts in consumer behaviours.

Urbanization of Emerging Markets

Emerging markets continue to be a significant opportunity for packaged foods companies, especially in areas where the supermarket business model is becoming more developed due to urbanization. For example, according to a recent report by the Organization for Economic Co-operation and Development (OECD), it is estimated that Africa's population will double by 2050, with two-thirds of the new population located in urban locations. With higher populations in urban areas, these individuals will gain access to supermarket-like shops that carry packaged foods, driving the demand for packaged snacks and other foods.

Shifting Dietary Preferences

There has been a dietary shift for consumers to prefer healthier food products, and this trend is expected in the younger generation of consumers, who are rapidly rising in buying power. Therefore, it is becoming critical for companies to continue to innovate and adapt to widen their offerings to reflect consumers' demands. In a 2020 Food and Health Survey conducted by the International Food Information Council (IFIC), consumers value the healthiness of their food more, and more consumers are eating plant-based alternatives. Additionally, nearly 60% of consumers said it is important for them to shop for environmentally sustainable foods from responsible producers. With more health and environmentally conscious consumers, this challenges the traditional packaged foods players, especially for those in the snack foods segment. Consumers are no longer craving a bag of potato chips. Instead, they may prefer a bag of kale chips from a local manufacturer, which has contributed to the decreasing market share of Big Food companies. However, this also presents an opportunity as innovation is highly encouraged and needed.

Climate Change Impact on Agriculture

The packaged foods industry relies on key commodities such as wheat, corn, and dairy; thus, profitability fluctuates as commodity prices change over time. While overall agriculture prices have fallen since the 2008 financial crisis, certain commodity prices have increased again, such as wheat prices. Weather plays a vital role in determining agriculture yield, and with global warming, there have been devasting effects on crop growth. Factors such as changing precipitation patterns, temperature changes, and extreme weather can all limit crops' supply, leading to shortages and increasing prices. This remains a key risk in the industry as the consequences of climate change continue to develop. Meanwhile, these economic shocks are hard to predict from the companies' end. However, packaged food companies can offset some of these risks to the consumers, as the companies have the ability to raise shelf prices.

Margin & EPS / Earnings Growth

The majority of the packaged foods industry is considered consumer staples; therefore, the sector experiences relatively stable margins. However, in recent years, packaged food companies have been facing challenges in achieving higher margins, mainly due to competition and regulations regarding processed foods. The industry's net profit margin was around 3.7% in Q3 2020 and has stayed about 3-6% in the past five years with occasional fluctuation by the quarters. With changing consumer preferences, companies often have to invest in developing and marketing existing products to keep up with demand, which hinders profitability.

As the pandemic passes and people leave their homes, there will be less demand for packaged foods, which will affect earnings. Consumers will start shifting towards foodservice businesses with less stockpiling tendencies. Some companies have experienced earnings expansions during the pandemic due to cutbacks on advertising as the pandemic created incentives for consumers to purchase snack foods; however, advertising will still be needed post-pandemic. This factor will also decrease earnings in the next few years.

Overview of Key Players

The packaged foods industry is a highly competitive industry with countless differentiated product offerings. Consumer preferences remain dynamic and challenging for companies to predict, resulting in constant innovation from industry players. The industry's largest players remain to be Big Food companies, multinational companies that own several brands that allow them to gain significant market share. Below are five Big Food companies that own many grocery store favourites.

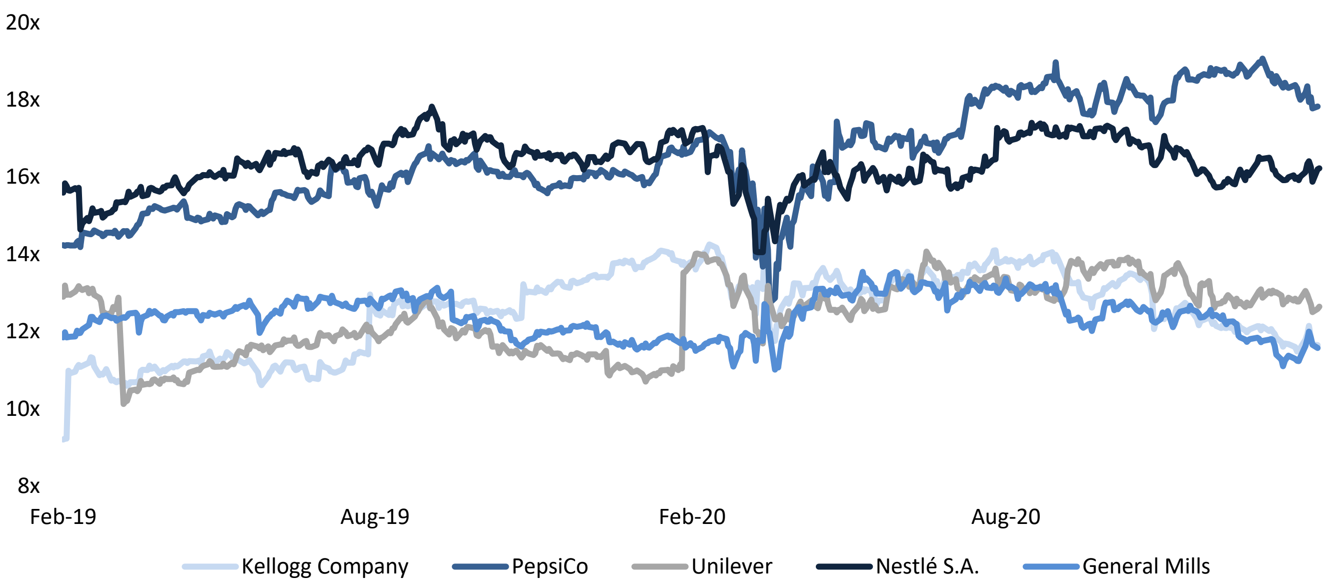


Figure 47. Two-year TEV/EBITDA for key players in Packaged Foods
Source: CapIQ

The Kellogg Company (NYSE: K)

The Kellogg Company ("Kellogg's") is a multinational food manufacturing company based in the United States. Kellogg's products can be found in over 180 countries. The company owns 36 brands across various food categories, including cereal & granola, breakfast foods, and packaged snack foods. Kellogg's is a key player in the cereal sector, as they own many grocery favourites, such as Raisin Bran, Frosted Flakes, Special K cereals, and many others. The company currently occupies 26.1% of the United States market share in the cereal sector. Kellogg's is one of many packaged food companies to benefit from the pandemic. They experienced heightened at-home demand; the company saw an organic net sales increase of 7% in the first three quarters of FY2020. The company has stated interest in increasing investments by double digits in the next quarter as they compensate for decreased investments from early pandemic days. Kellogg is looking to invest heavily in branding, targeted at international markets, and new products such as Incogmeato, their plant-based sausage brand.

PepsiCo Inc. (NASDAQ: PEP)

PepsiCo Inc. ("Pepsi") is a multinational food and beverage company based in the United States. PepsiCo is one of the largest packaged foods companies globally and is home to beloved snack brands such as Quaker, Lay's, Dorito's, and Cheetos. Pepsi currently has around a third of the snack foods market share in the United States. PepsiCo's products are sold globally and are available in over 200 countries, with products adapted to suit the local demographic regions. A key component of Pepsi's success comes from its ability to adapt to changing consumer preferences by introducing new products or adjusting the product mix according to geographic locations. For example, the North American assortment of Frito-Lay chips differs widely from the product mix sold in Asia. PepsiCo has experienced organic revenue growth of 4.2% in Q3 of 2020, with brands such as Frito-Lay, Cheetos, and Tostitos driving the growth as part of higher at-home snack consumption. The company has been investing in zero-sugar products, such as Gatorade Zero and Pepsi Zero Sugar. This follows the industry trend of more health-conscious consumers and companies adapting to this shift.

Nestle S.A. (SWX: NESN)

Nestle S.A. ("Nestle") is a multinational food and beverage conglomerate originating from Switzerland; it is currently the largest food and beverage company globally. Nestle has more than 2000 brands in its portfolio, and its products are sold in 187 countries. Some of its products are local products to specific geographic locations, but the company also owns popular international packaged food brands such as Hot Pockets, DiGiorno, and others. One of Nestle's expansion areas has been ready-to-drink products, such as Nescafe, their instant coffee line. This can be a crucial opportunity for Nestle, as coffee consumption is expected to rise globally, and younger consumers are always looking for convenience.

General Mills Inc. (NYSE: GIS)

General Mills Inc. ("General Mills") is a multinational packaged food manufacturer headquartered in the United States. General Mills owns an extensive portfolio of brands, including popular brands like Lucky Charms, Annie's, Bugles, and many others. Similar to other "Big Food" companies, General Mills also saw a growth in their top-line due to the pandemic. However, while their North American business grew, their European business line has experienced less growth. This is due to their European areas containing more foodservice operations, which has been negatively impacted in 2020. The company has also expressed that they do not expect e-commerce channels to grow significantly in the near future, as the retail distributors prefer the "order online and pick-up" model due to higher profitability.

Unilever PLC (NYSE: UL)

Unilever PLC's subsidiary, Unilever, is a multinational consumer-packaged-goods conglomerate headquartered in London, England. Unilever is considered one of the global leaders in consumer-packaged goods and operates in 190 countries with a portfolio of around 400 brands. Some of its notable packaged food brands include Continental, Klondike, and Breyers. Unilever's strong ice cream sales offset some of the declines in its food services sectors, but the company has been driven by more significant growth in other areas, such as home care and cleaning supplies.

RESTAURANTS

Industry Analysis

Market Size & Growth

In 2019, the Restaurants industry brought in roughly US$863 billion in the United States. Over 13.5 million individuals worked in the US Restaurants industry in 2019— an astonishing 10% of all US employees. This industry was not always as large as it currently is, but rather it has grown steadily over the last 50 years.

Growth in Discretionary Income

On a top-line basis, real median household income in the US has grown from US$ 53,000 in 1984 to US$ 68,000 in 2019. With a greater household income, a larger amount of money is allocated towards discretionary spending at restaurants.

Shifting Consumer Preferences

One of the key drivers of the growth in household income can be attributed to an increase in the participation of workers in the household— thus leaving less time for the average family to shop and prepare meals, causing a shift towards more meals eaten at restaurants.

Before COVID-19, The US National Restaurant Association's expectations for the Restaurants industry in 2020 were US$899 billion in sales, with a long-term outlook of US$1.2 trillion in sales in 2030, implying a ~3% CAGR. While many COVID-adaptions that the Restaurants industry implemented are likely to subside, we believe the pandemic has sped up the adoption of mobile-ordering and delivery.

Restaurants Terminology

Quick-Service Restaurants (QSR)

QSR's are generally the largest restaurant chains, serving a high volume of customers with a low average bill, commonly referred to as a ticket. These include brands such as McDonald's, Subway, Domino's, Starbucks, and many others.

Full-Service Restaurants

Unlike QSR's, Full-Service restaurants serve a lower volume of customers, with larger average tickets. Historically, families were the leading customer segment for Full-Service Restaurants, though there has been a recent shift in this group towards alternative options. This segment includes brands such as Red Lobster, The Cheesecake Factory, P.F Chang's, and others.

Casual Restaurants

Millennials have driven the strong performance of Casual Restaurants in recent years, which distinguish themselves through a focus on customer engagement and alcohol sales. Brands such as Applebee's, Olive Garden, Cactus Club Café, and others are grouped into this segment.

Fine Dining Restaurants

Lastly, we have Fine Dining Restaurants, which are characterized by their even lower customer throughput and higher average ticket when compared to Full-Service Restaurants. These restaurants are often not part of chains, but a common example would be an upscale steakhouse or sushi bar.

Market Leadership Concentration

Since these segments are broad, many restaurants fit between definitions or serve even more narrow niches. As a result, it is difficult to estimate the relative market concentration of each. However, we can draw some conclusions by comparing sales across brands within each segment. For example, as seen in Figure 48, QSR leader McDonald's system-wide US sales in 2019 were US$40 billion, while the next highest brand, Starbucks, brought in only US$21 billion system-wide. As seen in Figure 49, for Fast-Casual Restaurants in the US, a segment which is characterized as the intersection between QSR and Casual Dining, the market leader, Panera Bread, recorded around US$6 billion in US sales. The next highest, Chipotle Mexican Grill, brought in roughly $5.5 billion. From this comparison, we can observe that McDonald's has extreme dominance in QSR, while there is still significant competition in the Fast-Casual segment for the market leader. It is important to note that these System-Wide Sales figures vary drastically from what each company reports on their income

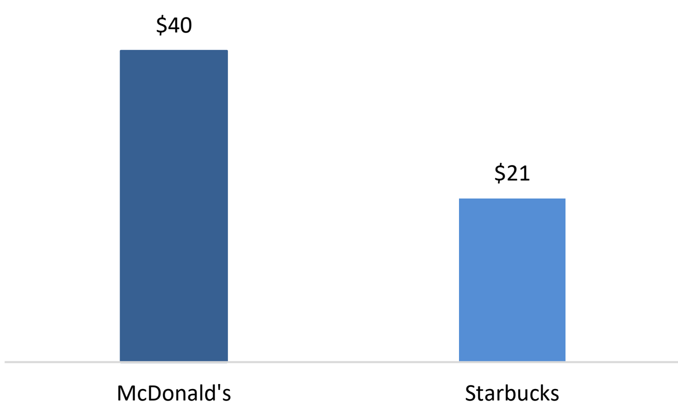


Figure 48. Top 2 QSR Restaurants by 2019 System-Wide Sales (US$ Billions)
Source: Company Filings

Figure 49. Top 2 Fast-Casual Restaurants by 2019 System-Wide Sales (US$ Billions)
Source: Company Filings

Key Metrics - Drivers

Same-Store Sales (SSS) Growth

SSS Growth compares sales from stores that have been open for at least 12 months. Ultimately, growing SSS has the greatest impact on a company's top-line, and is a major focus for corporate strategy.

New Store Productivity

Since new stores don't have prior years to compare performance to, New Store Productivity benchmarks the new store's performance relative to an existing store. This allows you to observe the efficiency and productivity of a new store, where

100% would indicate that the new store performed equally as well as an existing one. This figure lets management and investors determine how well the company can manage the logistics of opening a new store, how strategic opening this new location was, and possibly even the effects of cannibalization of sales.

System-Wide Sales

As mentioned previously, System-Wide Sales figures do not accurately represent the revenue a company reports on its income statement. System-Wide Sales refers to all sales generated across company-owned and franchised stores. With franchised stores, the reporting company generally only recognizes royalty revenues from their franchisees, which is determined by an agreed-upon Royalty Rate. The utilization of franchising varies drastically across companies in the Restaurants industry, and we will discuss some key examples in the Competitive Landscape section.

Margin & EPS / Earnings Growth

Once again, it is important to recall the presence of franchised stores when looking at margins and EPS figures for companies in the Restaurants industry. With the franchising model, the company itself incurs relatively minimal costs to allow an additional franchisee, usually only recognized in slightly higher SG&A expenses. In return, a portion of the franchisee's revenue flows effectively straight to pre-tax profit for the company. As a result, margins from franchised stores are significantly higher than company-owned stores. However, since the company only receives a small percentage of the franchisee's revenue, company-owned stores can still be extremely profitable since 100% of the profit flows to the company. In turn, major corporations have to decide upon an optimal percentage of company-owned and franchised stores. Similar to determining an optimal capital structure, there are often too many variables to decide on the true "optimal" strategy, and it can change significantly over time. Investors should pay close attention to how management discusses its companies' view on franchising, especially regarding how it changes to achieve certain strategic goals.

Simply put, margins vary drastically across companies depending on their utilization of franchised stores. Putting that aside, there are some margin ranges for each individual storefront which are useful to compare across segments. As of 2019, pre-tax profit margins for restaurants were generally between 2%-6%. In general, QSR and Casual restaurants sit on the higher end of this range, with Full-Service on the lower end, while Fine Dining restaurants vary depending on how exorbitant of a price they charge. These low margins might surprise you when you compare the price of eating out to cooking, but when you take the rule of thumb that 1/3 of revenue is lost due to COGS, another 1/3 to labor expenses, and nearly another 1/3 to rent and general overhead, it becomes obvious how important customer throughput and inventory management is to muster any profit at all. A recent area of focus for margin expansion is mitigating food waste, so smaller portion sizes and stricter inventory management are trends to follow.

When looking at EPS, unit economics and franchise scaling becomes extremely important to analyze. As previously mentioned, the major benefit of company-operated stores is the full retention of profits, which can only be achieved through reaching economically optimal production and customer throughput. Though margins on franchised stores are astronomically higher, it still takes significant scaling of system-wide sales to achieve profits, and the worry of over-saturation and cannibalization of sales limits long-term upside. One other point of note is the necessity for large capital expenditures for companies who predominantly have company-operated stores. Since this capex is not factored into EPS, it is important to also look at cash flow generation for these companies to truly analyze profitability and solvency.

Valuation

EV/EBITDAR

Beyond common EV multiples, EV/EBITDAR measures Enterprise Value to Earnings before Interest, Tax, Depreciation and Amortization, and Rent Expense. Since rent is a major expense to consumer retail companies, especially for companies in the Restaurants industry with coveted real estate, this multiple serves as another helpful screen to compare valuations.

EV/Revenue

The Enterprise Value to Revenue multiple is certainly not unique to companies in the Restaurants industry. However, EV/Revenue is especially useful to compare these valuations due to the high focus investors place on analyzing the ability of a restaurant to turn revenue into actual earnings.

While the EV/EBITDAR and EV/Revenue multiples are helpful alternatives to more standard options, the rate of franchised stores to company-operated stores can drastically impact these multiples. For example, approximately 93% of McDonald's stores are franchised, meaning they incur a significantly lower rent bill than company's whose stores are predominantly company-operated. Similarly, comparing companies with different franchise utilization by EV/Revenue might be inappropriate due to the varying growth nature of where revenue flows from.

Overview of Key Players

Due to the highly fragmented nature of the Restaurants industry, successful companies have found ways to distinguish themselves from the competition. We will now discuss five key companies in the industry and what they have done to separate themselves from competitors.

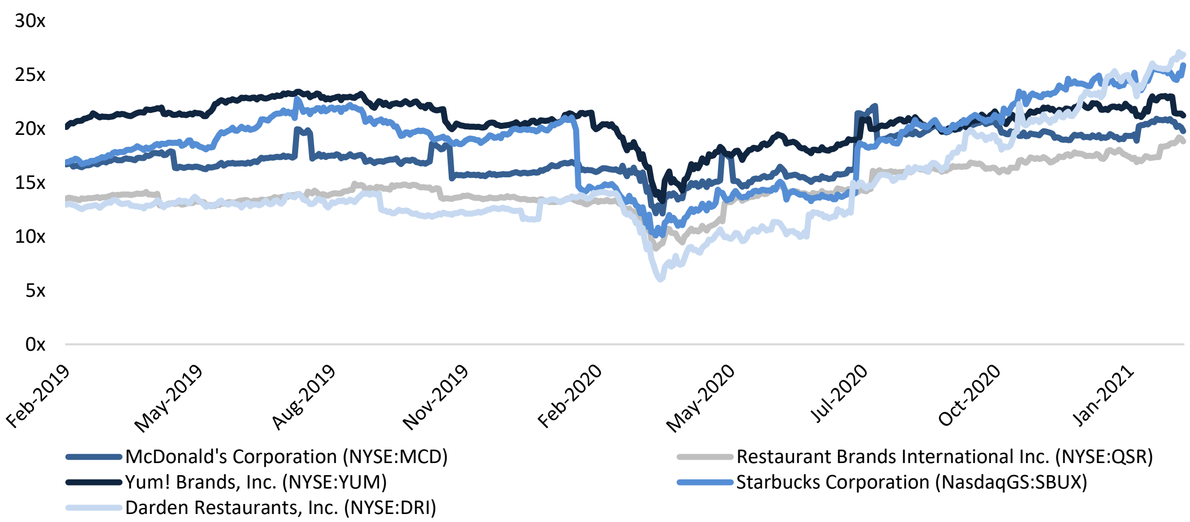


Figure 50. Two-year TEV/EBITDA for key players in Restaurants
Source: CapIQ

McDonald's Corporation (NYSE: MCD)

McDonald's has dominated QSR for decades. After pioneering the assembly-line system of food production, the golden arches have used their strong brand image and unbeatable scale to expand globally. As previously mentioned, McDonald's relies significantly on the franchising system— in 2019, 93% of stores were franchise owned. In 2019, McDonald's recorded $9.4 billion in sales from company-operated restaurants and $11.7 billion in revenue from franchised stores.

With shifts in consumer preferences towards more healthy food options, McDonald's has responded with periodic additions to their menu to meet these evolving customer needs. One item of high demand which is set to launch in the U.S in 2021, is the "McPlant", the company's take on a plant-based meat. Rather than partnering with plant-based meat companies like A&W did with Beyond Meat, or Burger King and Impossible Foods, McDonald's created the McPlant in-house. This will serve as a unique case study to observe if McDonald's changes their McPlant recipe to adapt to consumer demand, as is seen for many alternative meat companies.

Yum! Brands Incorporated (NYSE: YUM)

Yum! Brands runs three major QSR staples: KFC, Pizza Hut, and Taco Bell. With a major stake in the Chicken, Pizza, and Mexican food markets, Yum! Brands also heavily utilizes franchising, with 98% of their 50,000 stores franchised as of 2019. KFC and Pizza Hut have significant global exposure, with 83% and 61% of stores located internationally as of 2019, respectively, while Taco Bell only had 8% of stores located internationally in 2019. KFC brought in nearly 50% of system-wide sales for Yum! Brands in 2019, while Pizza Hut and Taco Bell were relatively equal at ~25% each. On March 18th, 2020 Yum! Brands acquired Habit Burger Grill, a fast-casual restaurant specializing in burgers and sandwiches. This will be an especially interesting addition to watch as we return to the new "normal" after COVID-19.

Starbucks Corporation (NASDAQ: SBUX)

Starbucks is the leading roaster, marketer, and retailer of specialty coffee around the world. The company places a high focus on maintaining its premier brand image and locates its stores in high-traffic areas to foster extremely high customer throughput. Starbucks sourced only 10% of its revenues through royalties from franchised stores in 2020, and is primarily concentrated in the Americas, which made up 70% of its revenue in 2020. Starbucks has a loyal fan-base with which the company has fostered a strong relationship through its industry-leading customer rewards platform. Their loyalty program has served as an invaluable source of data collection. As of 2019, app users were 5.6 times more likely to visit a Starbucks compared to non-app customers. Starbucks revolutionized the pre-order and pre-pay system, which is now common to many restaurants, and in 2019, more than 35% of app-users used the pre-order and pre-pay feature each visit.

Darden Restaurants (NYSE: DRI)

Darden Restaurants owns several full-service and fine dining restaurants in North America, most notably Olive Garden and LongHorn Steakhouse. As of 2019, Darden Restaurants had 1,804 company-operated locations and 62 franchised stores. Olive Garden is the company's major breadwinner, bringing in over 50% of total revenue in 2020, and is the largest full-service Italian restaurant in the US. LongHorn Steakhouse, a full-service steakhouse primarily located on the east coast of the US, brought in about 20% of Darden's total revenue in 2020. Due to COVID-19, Darden Restaurants were hit significantly harder than the previously listed companies, mostly due to the difficulty of converting full-service dining off-premise.

Restaurant Brands International Incorporated (NYSE: QSR)

As its stock ticker suggests, Restaurant Brands International holds three major QSR chains: Tim Hortons, Burger King, and Popeyes. In Q3 2020, effectively 100% of Restaurant Brands system-wide stores were franchised, with roughly 50% of revenues within Canada and 37% in the US. Between their three major chains, Restaurant Brands' portfolio spreads exposure across breakfast, chicken, and beef markets. With Popeyes and Burger King typically ranking lower than other brands in their niches, the company has their work cut out for them in terms of scaling revenue and profitability.

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Chipotle Mexican Grill Inc. (NYSE: CMG)

Consumer Retail - Restaurants

Bearish on Burritos

February 27, 2021

Chipotle Mexican Grill is the fast-casual leader for burritos and burrito bowls in the United States. With over 2,700 locations, the company has grown its business alongside a loyal fan base. Despite their success and performance in recent years, I believe Chipotle's current valuation is overvalued at $1,442 per share.

Internal Analysis – Why Franchise?

Coming in at a premium price point compared to competitors such as Taco Bell, Del Taco, and smaller regional restaurants, Chipotle continues to grow its average check size and customer throughput year over year. An interesting observation of Chipotle is its decision to avoid the franchising model. In 2014, the CEO commented on this, suggesting that Chipotle "doesn't need to franchise to grow", and that they don't want to risk their strong brand image for meager royalty revenues.

External Analysis – Squashing Competitors

Chipotle has positioned itself as a more health-conscious option in a market flooded with QSR alternatives. As a result, their loyal customer base does not mind paying a premium price. Chipotle has consistently prioritized engaging with its customers through advertising, brand partnerships, and giveaways. In a May 2019 survey, Chipotle's hard work was confirmed when they received the highest customer loyalty score amongst competitors. With their partnership with Doordash, Chipotle has capitalized on the flock to food-delivery services.

Valuation – Too Beefed Up

Despite Chipotle's strong performance over the last several years and its ability to bounce back from health concerns, its current valuation leaves little appetite for further growth. After a 61% jump in their stock price in 2020, Chipotle's EV/EBITDA multiple currently sits close to 70x, significantly higher than any other competitor. While management guidance offers extremely aggressive growth with plans to double store count, we believe the current valuation comes with too little upside to stomach the risk of reversion to the mean.

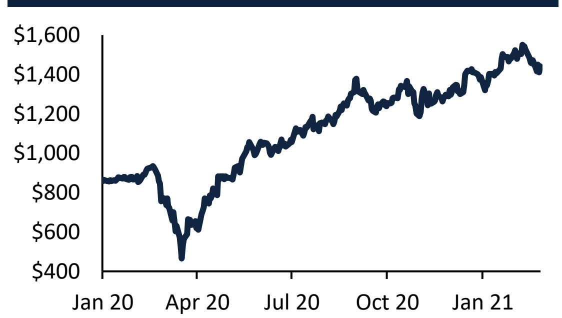
Analyst: Joshua Lax, BCom. '22
contact@westpeakresearch.com

Equity Research	US
Price Target	**US$ 1,200**
Rating	Sell
Share Price (Feb. 26th Close)	US$ 1,442
Implied Return	-17%

Key Statistics (US$)	
52 Week H/L	$1,564/$415
Market Capitalization	$40.6B
Average Daily Trading Volume	327K
Net Debt	-$1.1B
Enterprise Value	$43.0B
Net Debt/EBITDA	NMF
Diluted Shares Outstanding	29M
Free Float	88%
Dividend Yield	0%

WestPeak's Forecast (US$)	2020	2021E	2022E
Revenue	$6.0B	$6.5B	$7.0B
EBITDA	$529M	$600M	$650M
Net Income	$356M	$400M	$430M
EPS	$12.50	$13.50	$14.50
P/E	110x	90x	80x
EV/EBITDA	72x	60x	45x

1-Year Price Performance



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Global Equity | February 2021

Consumer & Retail
IV. Household & Personal Care

ANALYSTS

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Senior Analyst

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WESTPEAK RESEARCH ASSOCIATION

Household & Personal Care - Primer

The Year of Self-Care

February 27, 2020

The Household & Personal Care (hereinafter HPC) industry is comprised of four key sectors, beauty and personal care, consumer health, home care, and retail tissue/hygiene. The first two sectors are given a primary focus in this report due to their market share concentration.

Industry View

The HPC market reported over US$1 trillion in sales in 2019, averaging a compounded annual growth rate of 0.8%. Compared to other more volatile industries, the HPC market has proved itself stable with Consumer Health showing the fastest CAGR of 1.91% and its slowest subsector, Home Care, showing minimal downside with a CAGR of -0.2%. As pandemic lockdowns ease, analysts predict a steady CAGR of 4.2% in 2020-2024.

Industry Drivers

With the growing trends of digitalization and technology-enabled retail strategies, e-commerce is expected to grow at a CAGR of 9.4%, with the growing importance of convenience retailing. However, the recent surge in demand for home care products instigated for the COVID-19 pandemic is expected to be replaced by comebacks in the Beauty & Personal Care subsector. Product innovation and fierce competition continue in the industry as consumers seek sustainably sourced HPC products and as emerging markets like Asia produce attractive returns.

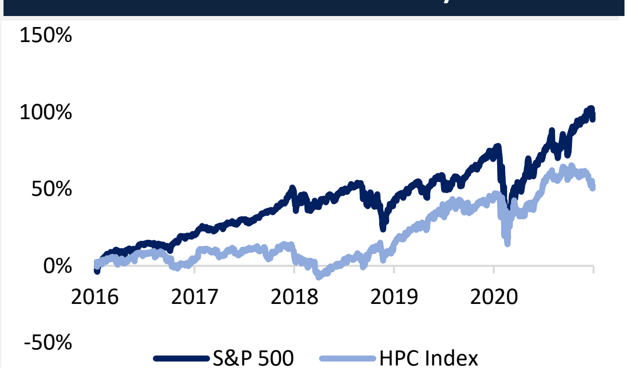
Industry Valuation

The HPC industry is expected to experience an average CAGR of 2% over the next five years. According to a baseline forecast by Euromonitor, tissue & hygiene and home care should recover the fastest from the impact of the pandemic, growing retail sales by 4% and 5.2% respectively by 2021. Consumer health should also expect to observe positive growth due to elevated consumption trends of OTC medications. However, more discretionary products like beauty and personal care may see slower recovery rates in comparison over the next few years.

Industry Research	
Industry	**Household & Personal Care**
Global Revenue	US$1.12T
Annual Growth (Past 5 Years)	0.83%
Annual Growth (Next 5 Years)	3.1%

Key Companies	
Procter & Gamble	NYSE: PG
Enterprise Value	$359.8B
EV/EBITDA	18.0x
Johnson & Johnson	NYSE: JNJ
Enterprise Value	$421.5B
EV/EBITDA	15.5x
Estee Lauder	NYSE: EL
Enterprise Value	$96.7B
EV/EBITDA	36.7x
Unilever	NYSE: UL
Enterprise Value	$153.2B
EV/EBITDA	13.7x
Colgate-Palmolive	NYSE: CL
Enterprise Value	$77.3B
EV/EBITDA	17.8x

Cumulative Returns of HPC Industry



Industry Analysis

Market Size & Growth

The HPC market is comprised of four key sectors: (1) Beauty & Personal Care, (2) Consumer Health, (3) Tissue & Hygiene, (4) and Home Care.

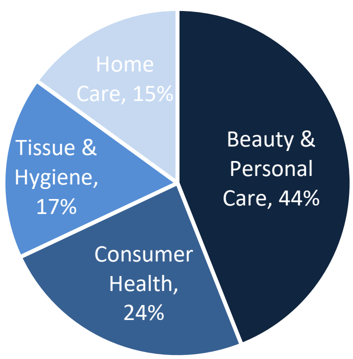


Figure 51. Four sectors of the HPC sector
Source: Euromonitor

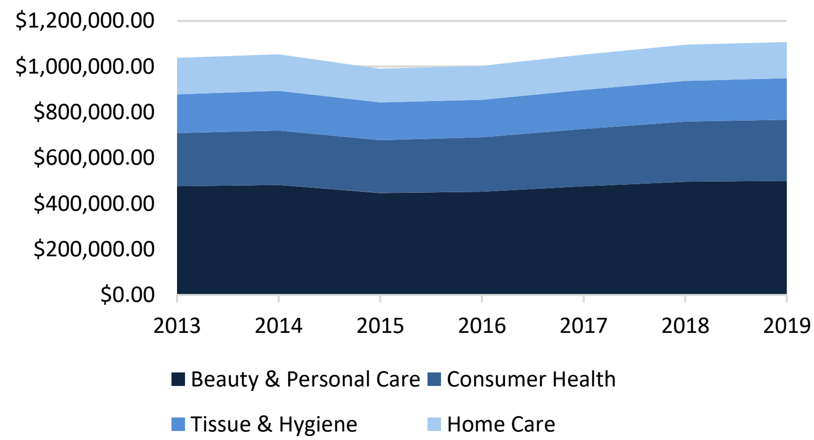


Figure 52. HPC market size, 2013-2019 (mm USD)
Source: Euromonitor

Growth in the HPC sector is relatively stable compared to more volatile industries. With sales over USD$1 trillion, the HPC market grew at a compounded annual growth rate (CAGR) of 0.83%, with Consumer Health showing the fastest CAGR of 1.91% and Home Care showing negative growth of 0.14%. Figure 52 above details the growth rates by HPC sub-sector.

Market Leadership Concentration / Key Players

Although the HPC industry overall operates in an oligopolistic structure, its four subsectors vary drastically in terms of market leadership concentration. The top 10 companies in Home Care and Tissue & Hygiene hold 59.7% and 48.2% of their respective sub-sector shares, making these subsectors heavily concentrated. Procter & Gamble has established itself as a key player in both subsectors.

Within Beauty & Personal Care, the top 10 companies have captured 46.8% of market share with L'Oreal maintaining a leading global position in 2020, followed by Procter & Gamble and Unilever Group. Consumer Health remains to be the least concentrated segment, as the top 10 branded players comprise only 21.9% of the market, with private label companies accounting for the largest share of the total market at 5.8%.

Home Care		Tissue & Hygiene		Beauty & Personal Care		Consumer Health	
Company	Share	Company	Share	Company	Share	Company	Share
Procter & Gamble	18.7	Procter & Gamble	15.0	L'Oreal Groupe	9.7	Private Label	5.8
Unilever Group	10.6	Kimberly-Clark	13.6	Procter & Gamble	7.7	GSK	5.2
Reckitt Benckiser	7.0	Essity AB	5.6	Unilever Group	7.3	Johnson & Johnson	3.4
Henkel AG & Co	6.9	Unicharm Corp	4.4	Estée Lauder	3.9	Bayer AG	3.0
Colgate-Palmolive	6.4	Hengan Intl	2.2	Colgate-Palmolive	3.2	Sanofi	2.5
Kao Corp	2.7	Georgia-Pacific	1.7	Coty Inc	2.9	Herbalife	1.9
Clorox	2.3	Kao Corp	1.6	Beiersdorf AG	2.6	Reckitt Benckiser	1.7
Guangzhou Liby	2.2	Johnson & Johnson	1.5	Private Label	2.6	Amway	1.6
Nice Group	1.5	Empresas CMPC SA	1.3	Johnson & Johnson	2.5	Procter & Gamble	1.5
Church & Dwight	1.4	Daio Paper	1.3	Shisedo Co Ltd	2.5	Nature's Bounty	1.1
Top 10 Brands	59.7%	Top 10 Brands	48.2%	Top 10 Brands	46.8%	Top 10 Brands	21.9%

Figure 53. Global market shares (%) by segment, 2020
Source: Euromonitor

As shown in the figure, large-cap companies such as Proctor & Gamble, Unilever, and Johnson & Johnson are currently dominating HPC through having leading market shares across their diversified portfolios.

Key Trends and Drivers

Growth of e-commerce

E-Commerce as a retail channel has grown exponentially over the past few years due to increased convenience, advancement in technology, and most recently, the COVID-19 pandemic. From 2020 to 2027, e-commerce is expected to continue to grow at a CAGR of 9.4%. This growth is predominantly driven by the technology-enabled online trials of health and personal care products, as well as the convenience of purchasing daily essentials from the comfort of consumers' homes. Within the Beauty & Personal Care sub-sector, online retailing is growing particularly rapidly with leading contributors being skincare and cosmetics. Beauty e-commerce is expected to grow robustly across all regions to 2023 as brand-adjacent online communities strengthen consumer engagement and personalization technology continues to improve.

COVID-19

In response to the COVID-19 pandemic, the demand for beauty and personal care products was quickly replaced with surging demand for cleaning and disinfectant products. However, as pandemic lockdowns ease and vaccine immunizations begin towards 2021, analysts expect prospects for the beauty and personal care subsector to brighten. They are expected to take over demand in the tissue and hygiene subsector. After a decline of 2.7% on annual sales globally for the beauty & personal care subsector, based on Euromonitor forecasts, analysts expect a steady CAGR of 4.2% in 2020-2024. While the tissue & hygiene subsector grew 4.7% in sales globally from 2019 to 2020, growth is expected to be sustained but averaged to a steady 4.0% CAGR in years 2020-2024. Figure 54 below details the historical and forecasted sales growth of both HPC subsectors most affected by the pandemic.

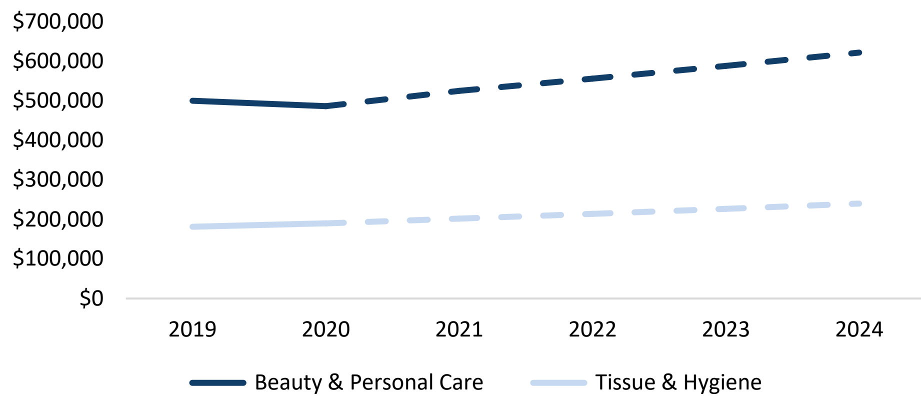


Figure 54. Historical & forecasted sales of HPC subsectors, 2019-2024 (mm USD)
Source: Euromonitor

Sustainability and Climate Consciousness

As shoppers become more environmentally conscious, a shift to sustainably sourced HPC products demands companies to drive product innovation to increase consumer attractiveness. Since 2015, large-cap HPC market players have all improved carbon footprint intensity, with L'Oreal leading the game, having cut emissions by 78% despite increasing volume by 37% since 2005. Figure 55 below shows a comparison of carbon emission intensities between HPC brands over 2015-2019. This move towards sustainable cosmetics will likely increase costs and reduce gross margins.

	Per Employee		Per Sales		Per Adj. Operating Profit	
	2019	% Change vs 2015	2019	%Change vs 2015	2019	%Change vs 2015
L'Oreal	0.9	-35.2%	2.4	-42.3%	12.9	-36.2%
Unilever	6.8	-35.4%	17.8	-40.5%	93.1	-31.2%
Procter & Gamble	41.8	-15.4%	59.9	-24.6%	287.7	-22.1%
Estee Lauder	2.0	-4.4%	6.5	-24.4%	42.4	-23.5%
Essity	64.5	-16.6%	217.2	-18.3%	1859.9	-15.7%
Colgate	13.8	-14.4%	30.2	-17.1%	129.0	-16.7%
Kimberly-Clark	98.6	-13.5%	213.8	-16.3%	1202.1	-14.8%
Clorox	30.9	-17.3%	43.8	-15.7%	243.3	-13.3%
Church & Dwight	38.9	-2.0%	42.8	-12.0%	222.0	-7.3%

Figure 55. Carbon intensity of HPC brands, 2015-2019
Source: Bloomberg

Emerging Global Markets

The majority of product categories within North America are in the maturity stage of their product life cycles. As a result, many companies are now looking to expand into emerging international markets. This trend is especially prevalent towards the beauty & personal care and home care subsectors, as demand in Asia now drives over 20% of the net sales growth for large-cap HPC companies such as Procter & Gamble and Estee Lauder. This is expected to grow as the spending power of the middle class in Asian countries continues to rise. P&G houses popular beauty & personal care brands such as Olay, Head and Shoulders, and SK-II, all of which compete alongside local Chinese skincare & cosmetics brands. Additionally, L'Oréal, another large-cap HPC player, continues to bring profitable returns from operations in emerging markets such as the Philippines. With increasing product innovation and powerful market positions, we believe HPC brands are successfully tapping into emerging markets globally.

Margin & EPS / Earnings Growth

Within the HPC industry, margins vary based on market share dominance, exposure to commodities, business mix, and international markets. Companies that primarily operate in the beauty & personal care industry, such as L'Oréal, Coty, and Estee Lauder, experience particularly high gross margins due to their high retail markups. The average gross profit margin of select U.S. HPC Large-cap companies has gradually risen over the past ten years from 51.7% to 54.3%. The charts below detail COGS margins and gross profit margins by company for 2019, as well as the 10-year growth in gross profit margins of the industry. This margin expansion over the past decade can largely be attributed to both retail markups caused by an exponential increase in demand and to economies of scale and long-term productivity gains.

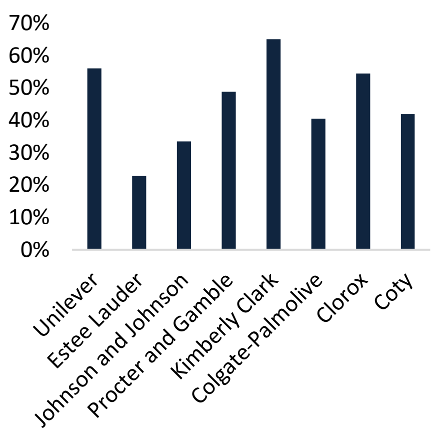


Figure 56. COGS as a % of sales, 2019
Source: Company filings

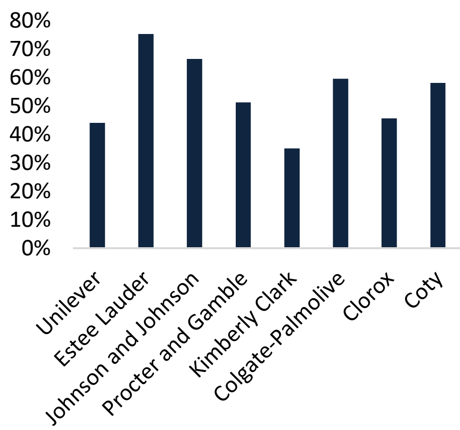


Figure 57. Gross margin by company, 2019
Source: Company filings

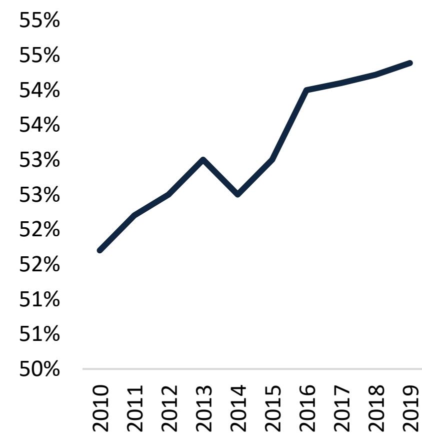


Figure 58. 10Y growth in profit margins
Source: Company filings

The table below summarizes EPS growth across the HPC space from 2013 to 2019. Over the past 10 years, large-cap HPC companies have experienced an average annual EPS growth of 5%.

Valuation

Typically trading at a premium to the market, HPC stocks commonly exhibit stable earnings growth and high returns. As seen in Figure 59, the sector's three-year average P/E multiple of 27.5x represented an 18.6% premium to the market, maintaining an above-market P/E multiple for the last 10 years. However, assumed to be due to the evident losses from the pandemic, only a 1.1% premium to the market is shown in 2020 YTD. Having seen tremendous adjustment to a new normal and expecting lockdowns to ease and immunizations to begin in 2021, the outlook for HPC stocks is looking increasingly attractive. Figure 60 below details P/E multiples by company based on their current and 5-year average P/E multiples.

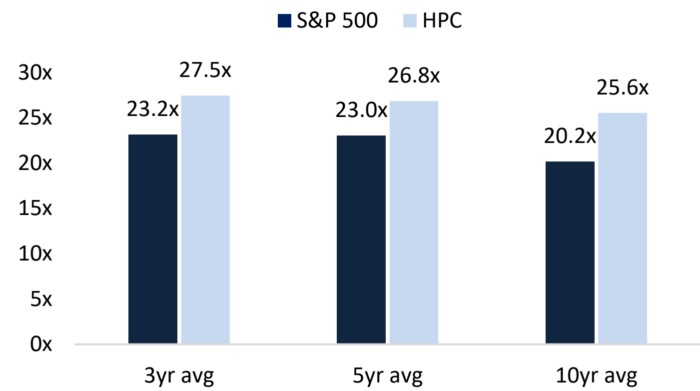


Figure 59. Average P/E multiple for HPC and S&P 500
Source: Bloomberg

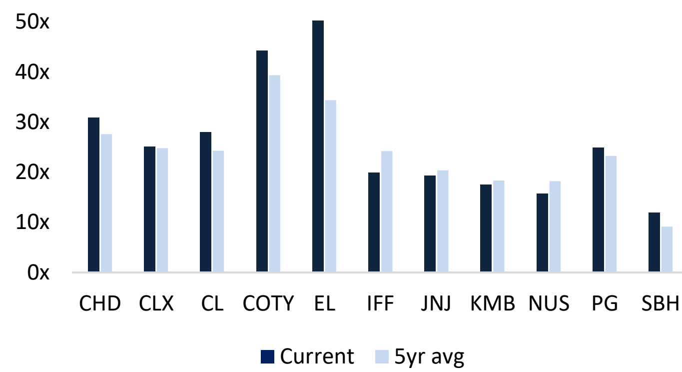


Figure 60. P/E multiple by company
Source: Bloomberg

Competitive Landscape

Holistically, HPC experiences an oligopolistic industry structure. However, high variance can be observed in the concentration ratio across different sub-sectors, with the consumer health segment being closer to monopolistic competition (Figure 61). Large HPC companies, such as Procter & Gamble, can dominate the market by establishing and maintaining leadership positions in two or more subsectors, allowing their diversified portfolios to minimize risks and maximize competitive advantages through size advantages like economies of scale. Primarily headquartered in North America and Asia-Pacific regions, many companies in HPC sell their products through third-party retailers, such as mass merchandisers, grocery stores, drugstores, and e-commerce retailers. A smaller number of companies, especially within the Consumer Health sub-sector, also sell their products directly to consumers (e.g. Herbalife and Amway).

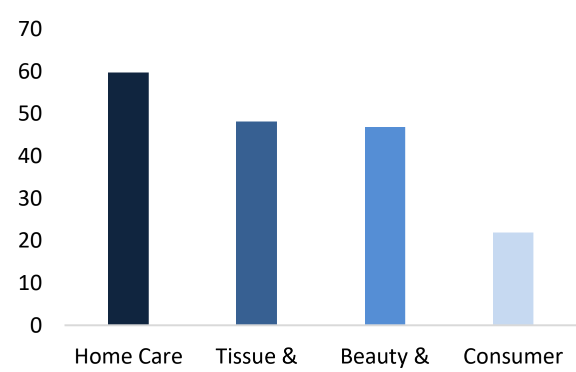


Figure 61. Market share of top 10 companies in each sub-sector
Source: EuroMonitor

The industry faces high barriers to entry due to capital investments as well as consumer demands for product differentiation and established brand names. For example, L'Oréal, which dominates the beauty and personal care sector, has a brand value that amounted to US$29.47B in 2020 despite having only generated US$30B in annual revenue. Consolidation has heavily impacted the industry in recent years as many large-cap companies have engaged in M&A activity to expand product offerings, exploit new markets abroad, and capitalize on cost synergies. For example, Q4 2020 witnessed 29 deals in beauty care alone, up by over 50% from Q3 2020. These included interesting strategic combinations such as Hut Group's acquisition of Dermstore.com and the merger of subscription box leaders IPSY and BoxyCharm. Finally, L'Oréal capped off the busy year in M&A with the acquisition of Takami, a Japanese skincare company particularly famous in China and other Asian countries. This is in line with L'Oréal's objective to become the leader in emerging markets.

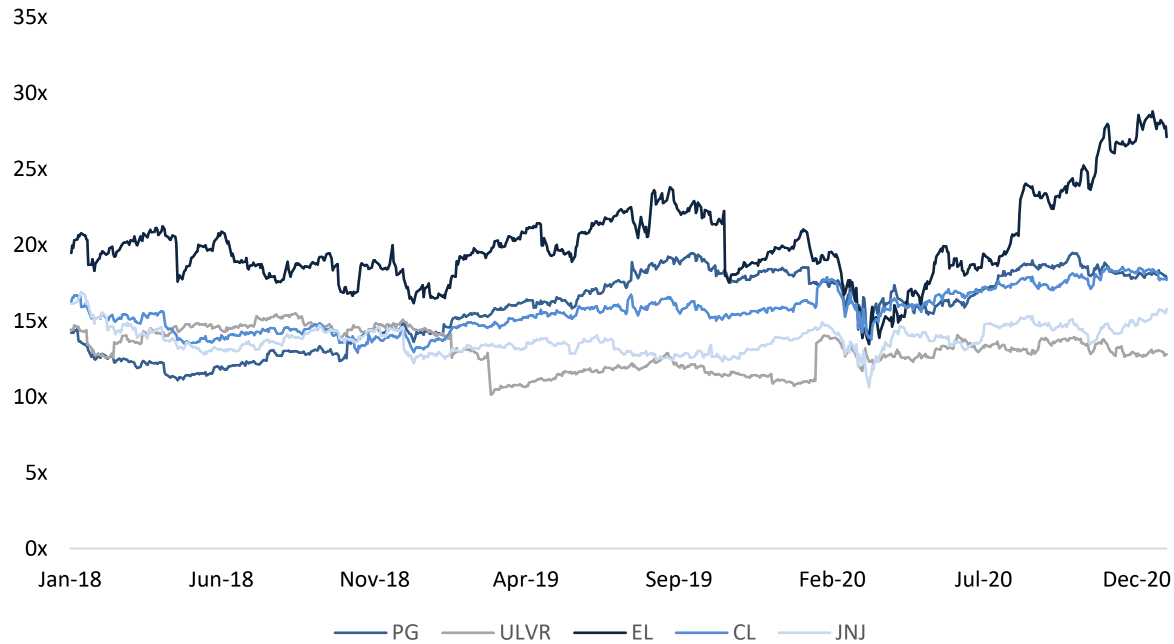


Figure 62. Two-year TEV/EBITDA for key players in HPC.
Source: CapIQ

Procter & Gamble (NYSE: PG)

Procter & Gamble is the largest player in the HPC industry with a market capitalization of US$343.2B and US$67.7B in FY 19 sales. It holds dominant leadership positions in-home care, tissue & hygiene, and beauty & personal care. In recent years, the company's organic sales growth has slowed as many of its product categories have reached maturity and there is a rise in the share captured by smaller, private label brands. Product innovation and development in emerging markets remain to be the key to maintaining growth as demand for P&G products in beauty & personal care as well as family care is currently being driven by success in China.

Estee Lauder (NYSE: EL)

With US$14.8B in FY 19 sales, Estee Lauder is a leader in the beauty & personal care subsector. Its US$95B market capitalization is contributed to by 25+ prestige brands operating across the four product categories of skincare, makeup, fragrance, and hair care. The company has maintained an average growth in net sales of around 9%, with double-digit growth in skincare. In 2019, emerging market sales climbed by more than 30% due to the company's leadership in China, India, and Southeast Asia. Moving forward, management plans to encourage long-term sustainable growth through focusing on ingredient transparency, responsible sourcing, innovation in the global prestige beauty industry, and an annual operating margin improvement of approx. 50 basis points.

Colgate-Palmolive (NYSE: CL)

Operating under a market capitalization of US$72.9B in the home care and beauty & personal care subsectors, Colgate-Palmolive has achieved US$15.9B in FY 19 sales, with the majority of its revenue being generated in North America and Latin America. It holds the leadership position in the market share for toothpaste worldwide. The company's growth strategy centers around three initiatives: driving premium innovation in our core businesses, pursuing adjacent categories, and expanding in faster-growing channels and markets. Its recent success in launching the first-of-its-kind recyclable toothpaste tube allowed the company to be ranked first in HPC by Dow Jones Sustainability indices. In 2019, Colgate Total delivered its strongest organic sales growth in three years, led by key markets including the United States, Brazil, and Mexico. Beyond organic growth, Colgate-Palmolive has also pursued advantageous acquisitions (e.g. PCA Skin, Elta MD, and Filorga) to expand into skin health and travel retail.

Johnson & Johnson (NYSE: JNJ)

With US$405.8B in market capitalization, Johnson & Johnson predominantly operates within the consumer health subsector. Recently, growth in over-the-counter medications such as Tylenol has accelerated due to COVID-19 demand. Performance in the oral care category has risen due to new product launches within the LISTERINE mouthwash brand, while sales in baby care have declined due to the divestiture of the Baby Center in 2019. The company is prioritizing its investments in R&D in the coming year and expects to capitalize on elevated consumption trends for health and hygiene-focused brands. Additionally, it hopes to enhance its strength in e-commerce channels.

Unilever PLC (NYSE: UL)

Unilever, a major competitor in the home care and beauty & personal care spaces, currently operates with a market capitalization of US$118.2B. The company focuses on driving volume-led competitive growth through diversified portfolios, with 84% of its brands in the top 1 or 2 market positions. In the most recent quarter, it experienced a total sales growth of 4.4%, with 5.3% from emerging markets. The company differentiates itself through ambitious sustainability goals focused on delivering a significant impact on renewable energy. This was witnessed in FY 19 when its Home Care Division grew by more than 6% due to innovations centered around the concept of 'green cleaning'. The performance of Unilever's recently acquired prestige beauty brands, which grew in sales y double-digits last year, is also expected to drive sales in the future.

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Procter & Gamble (NYSE: PG)

Household & Personal Care – Beauty & Personal Care

A Gamble Worth Taking?

February 27, 2020

Procter & Gamble Company ("PG", "P&G") is a branded consumer packaged goods provider to consumers globally. It operates in five distinct segments: Beauty; Grooming; Health Care; Fabric & Home Care, and Baby, Feminine & Family Care.

Internal Analysis – Laundry Leaders

At US$71.0B in FY 2020 sales and US$304.2B in market capitalization, PG is the largest HPC company in the consumer sector. Despite slowdowns in its Grooming and Beauty segments due to work-from-home periods, PG's Home Care and Family Care segments saw pandemic-driven demand, capturing 60% of sales altogether. A 9% growth in FY 2020 was seen in their Home Care segment attributed mainly to a 25% market share gain in laundry and fabric enhancers. Due to consistent product innovation, PG's lead in this segment is expected to extend into FY 2021.

External Analysis – Easy E-Commerce

Once again driven by the COVID-19 pandemic, the decrease in penetration of brick-and-mortar stores resulted in the broadening of online websites to welcome HPC products. Ending FY 2021 Q1, PG's e-commerce sales rose approximately 50%, representing 12% of its total sales. With shifting consumer behaviour, innovation-led growth through digital transformation persists as one of the company's main objectives to effectively serve customers wherever they decide to shop.

Valuation

Our weighted average cost of capital (WACC) is calculated to be 6.0% using a US Treasury Bill risk-free rate of 0.9%, a beta of 0.73 listed on Bloomberg, an expected market return of 8.2%, an effective tax rate of 21.0% detailed in company filings, and a pre-tax cost of debt of 4.5%. An EV/EBITDA exit multiple of 16.0x was used based on the mean trading multiple of industry comparables. Assuming that much of PG's revenue growth in their personal care subsector was not fairly priced into their financials, revenue assumptions show brightened sales in this subsector as pandemic lockdowns ease and demand shifts away from home care products. Weighing fully on the Discounted Cash Flow (DCF), we arrived at a target share price of US$155.96 We initiate a **Buy** rating on Procter & Gamble.

Analyst: Szarrii Lim, BCom. '23
contact@westpeakresearch.com

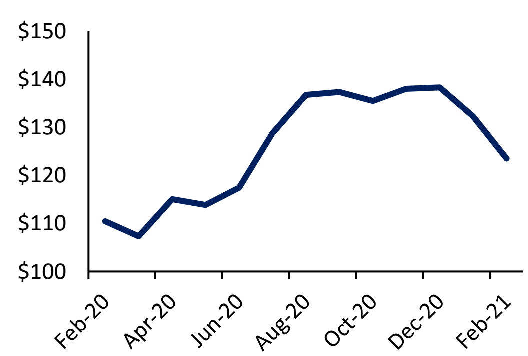
Equity Research	US
Price Target	**US$155.96**
Rating	Buy
Share Price (Feb. 26th Close)	US$123.53
Total Return	26.3%

Key Statistics (US$)	
52 Week H/L	$146.9/$94.3
Market Capitalization	$304.2B
Average Daily Trading Volume	7.5M
Net Debt	$19.4B
Enterprise Value	$324.6B
Net Debt/EBITDA	0.92x
Diluted Shares Outstanding	2.46B
Free Float	99.9%
Dividend Yield	2.6%

WestPeak's Forecast (US$)

	2020	2021E	2022E
Revenue	$71.0B	$74.2B	$76.3B
EBITDA	$19.1B	$21.7B	$24.2B
Net Income	$13.0B	$14.8B	$16.5B
EPS	$5.13	$5.98	$6.64
P/E	23.4x	23.1x	20.7x
EV/EBITDA	16.3x	16.0x	13.8x

1-Year Price Performance



Johnson & Johnson (NYSE: JNJ)

Household & Personal Care - Consumer Health

A "Healthy" Buy

February 27, 2021

Analyst: Sally Jiao, BCom. '23
contact@westpeakresearch.com

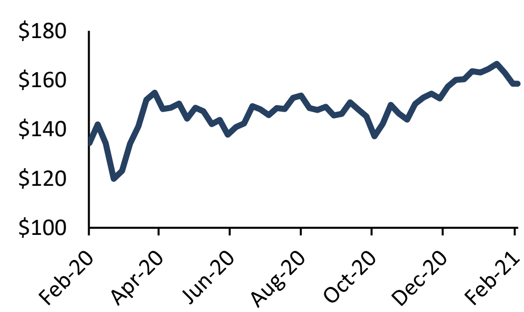
Equity Research	US
Price Target	**US$185.26**
Rating	Buy
Share Price (Feb. 26th Close)	US$ 158.46
Total Return	19.5%

Key Statistics (US$)	
52 Week H/L	$173.7/$109.2
Market Capitalization	$416.5B
Average Daily Trading Volume	8.2M
Net Debt	$20.5B
Enterprise Value	$412.8B
Net Debt/EBITDA	1.36x
Diluted Shares Outstanding	2.6B
Free Float	99.8%
Dividend Yield	2.6%

WestPeak's Forecast (US$)

	2020	2021E	2022E
Revenue	$82.9B	$88.9B	$93.7B
EBITDA	$28.6B	$31.8B	$33.6B
Net Income	$17.9B	$19.5B	$21.4B
EPS	$6.69	$7.11	$7.46
P/E	23.4x	22.0x	21.0x
EV/EBITDA	15.0x	13.4x	12.5x

1-Year Price Performance



Johnson & Johnson ("JNJ") is a healthcare company headquartered in New Jersey, United States. The company operates across three business segments: medical devices, pharmaceuticals, and consumer health.

Internal Analysis – Robust Company Fundamentals

From 2015 to 2019, JnJ achieved a CAGR of 4.1%, higher than that of its direct peer set. JnJ's ability to instantly recognize and capture emerging markets is evident in (1) its pioneer position in interventional solutions, whose sales have grown at a CAGR of 18% over the past three years, and (2) its recent acquisitions of Abbott Medical Devices and DR.CI:LABO, which have boosted growth in medical devices and consumer health. Under effective management, the company's gross margin of 24% has continuously improved and is currently ahead of its peers' 21%. The gradual implementation of a SKU rationalization system should continue to drive margin improvement. Additionally, the company has increased its dividend annually for the past 57 years with a current yield of 2.6%.

External Analysis – Elevated Consumption Trends Health Fuel Growth

Due to the pandemic, increased awareness for personal health and demand for over-the-counter medications has driven double-digit sales growth in the consumer health segment. Concurrently, it is expected that JnJ will experience a return to normal, if not higher, demand for medical devices as the economy recovers from the trend of consumers delaying routine and non-emergency health care for fear of catching or spreading COVID-19. Recent positive news regarding JnJ's single-shot vaccine further paints the company in an optimistic light

Valuation – Discounted Cash Flow Analysis

Through performing a DCF analysis, we arrived at an implicit share price of US$185.26. We believe that JnJ's strong fundamentals and ability to capitalize on growing demand in the consumer health sector are currently being undervalued by the market. We forecast revenue to (1) recover in the medical devices segment as procedures previously delayed due to the pandemic are performed, and (2) increase in the consumer health segment with elevated consumption trends of OTC medications. Based on the valuation, we recommend a **Buy** rating for JNJ.

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