GLOBAL EQUITY | MARCH 2022

Consumer Retail

Subsector Primer

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Global Equity | March 2022

Consumer & Retail

I. Sporting Goods & Hobby

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Sporting Goods & Hobby - Primer

January 9, 2022

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The Sporting Goods & Hobby industry is broken up into distinct segments. Sporting goods covers sports equipment, footwear, apparel, and firearms, while hobby covers games, toys, hobby goods, and crafts.

Industry View

Since early 2020, the COVID-19 pandemic created an unexpected increase in demand for many goods and services within the Sporting Goods & Hobby industry. As consumers spent more time at home, whether it be in lockdowns or transitioning to working from home, their enthusiasm towards outdoor sports, personal fitness, DIY projects, and new hobbies increased, leading to large revenue increases for many firms within the industry. As consumers slowly return to pre-pandemic habits, and with many returning to in-person office work through 2021, it remains to be seen whether the sharp growth within the Sporting Goods & Hobby industry will last into a post-pandemic world.

Industry Drivers – Rising Disposable Income

Per capita disposable income has been slowly rising in North America over the past 5 years and that trend is expected to continue through and beyond the COVID-19 economic recovery. As disposable income rises, consumers tend to spend more on discretionary goods and services, such as sporting goods and hobby activities. Furthermore, rising disposable income tends to push consumers towards higher-end products, enabling higher margins for firms within the industry. The threat of inflation, pegged around 5-7% currently, can counteract this driver, as it reduces consumer's buying power and may push consumers away from making expensive purchases in the Sporting Goods & Hobby industry.

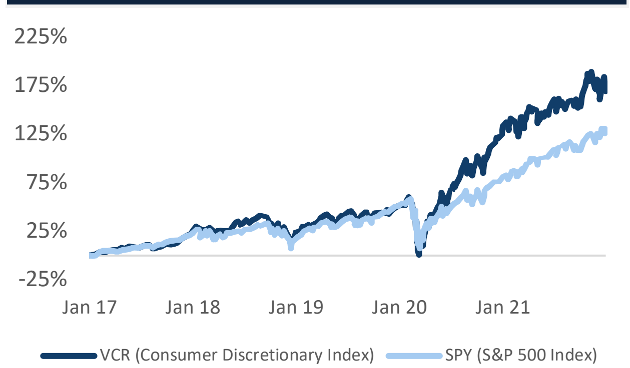
Industry Valuation – Traditional Metrics

The Sporting Goods and Hobby industry is affected by similar drivers as the general consumer discretionary industry. The left graph illustrates cumulative returns of the Vanguard Consumer Discretionary Index relative to the S&P 500.

Industry Research	
Sporting Goods	
North American Revenue	$70.9 bn
Annual Growth (Past 5 Years)	4.4%
Annual Growth (Next 5 Years)	1.6%
Hobby	
North American Revenue	$22.5 bn
Annual Growth (Past 5 Years)	-1.2%
Annual Growth (Next 5 Years)	0.7%

Key Companies	
Dick's Sporting Goods	DKS
Revenue LTM	$12.1 bn
EBITDA	$2.2 bn
Enterprise Value	$11.5 bn
Canadian Tire Ltd.	Ticker
Revenue LTM	$15.0 bn
EBITDA	$2.3 bn
Enterprise Value	$16.5 bn
Academy Sports and Outdoors	ASO
Revenue LTM	$6.6 bn
EBITDA	$964.3 mm
Enterprise Value	$4.92 bn
GameStop	GME
Revenue LTM	$5.8 bn
EBITDA	-$95.6 mm
Enterprise Value	$11.4 bn

Cumulative Returns of Consumer Discretionary



Sporting Goods

Subsector Segmentation and Growth

The Sporting Goods industry in North America comprises of establishments retailing new products that can be segmented into sporting equipment, firearms and hunting equipment, athletic apparel, athletic footwear, and other.

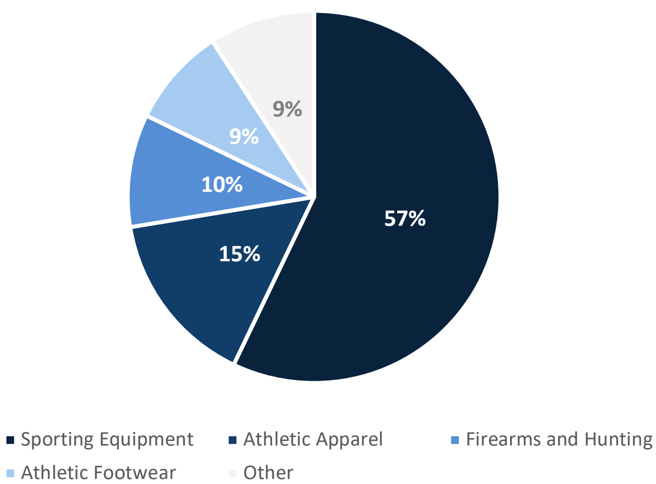


Figure 1. Sporting Goods Segmentation in Canada
Source: IBISWorld

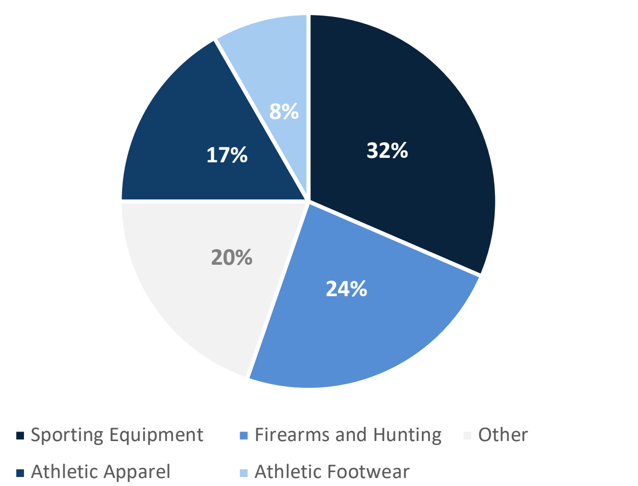


Figure 2. Sporting Goods Segmentation in the U.S.
Source: IBISWorld

The sporting equipment segment is the largest within the Sporting Goods industry in North America, comprising of 57% and 32% of stores in Canada and the U.S. respectively. Within this segment, the market can be further categorized into gym and exercise, golf, water and winter sports, fishing, team sports, playground, and other. The fastest growing sub-category here is forecasted to be water and winter sports equipment, with demand increasing at a five-year CAGR of 4.3%. Playground equipment demand is the only segment projected to decline, mainly due to minimal growth projected in the population cohort aged 5-14 years, which does not favor spending increases on children's playgrounds.

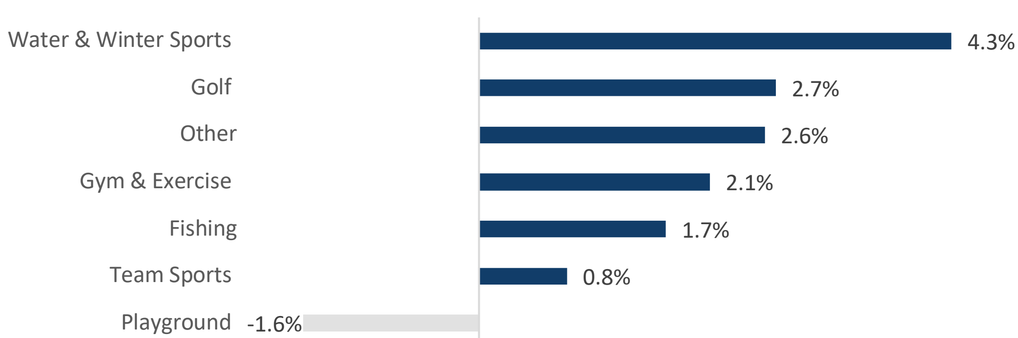


Figure 3. Sports Equipment Demand CAGR (%), 2019-2024
Source: Freedonia

Industry Drivers

Consumer Disposable Incomes

Demand for the Sporting Goods industry is heavily influenced by consumer disposable income. Growth in income enables consumers to demand more high-quality brand-name merchandise, which are typically higher margin and will fuel industry growth. The opposite would encourage consumers to purchase low-quality and low-cost items, or choose a secondhand alternative rather than new sporting goods. According to IBISWorld, per capita disposable income is expected to grow at a CAGR of 1.5% and 1.8% in Canada and the US respectively. This rise is expected to increase consumer spending and boost demand for sporting goods products, especially for higher margin water and winter sports equipment.

The projected increase in disposable income will also increase the number of industry operators. With an increase in household spending capacity, more families are expected to participate in higher-cost activities, such as paddleboarding, hockey, horseback riding, camping, or other equipment-heavy activities. Outdoor sporting equipment is expected to benefit from this driver, especially small sports retailers that service niche markets. As a result, the number of industry operators is estimated to rise at an annualized rate of 1.6% over the next five years to 2027.

To counteract this optimism, inflation is risk that could negatively impact the increase in disposable income for consumers. Inflation in both Canada and the U.S. has been pegged around 5-7%, meaning the increase in disposable income, currently, is not on pace with inflation. Inflationary risks imply that consumers will spend less on the discretionary items within the Sporting Goods sector and more on basic expenses such as food and housing.

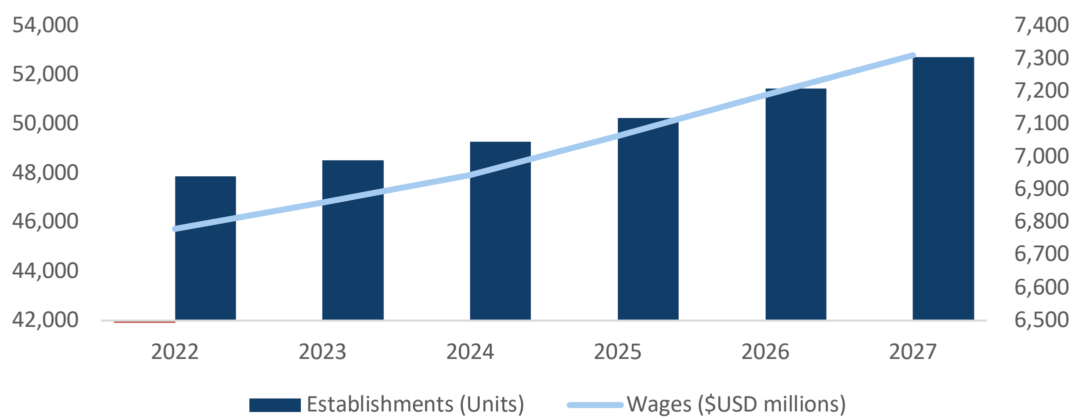


Figure 4. Relationship Between Increases in Disposable Income and Number of Sporting Goods Establishments
Source: IBISWorld

Sports Participation Rate

The sports participation rate is another driver of demand for sporting equipment, apparel, and footwear in the Sporting Goods industry. According to the Bureau of Labor Statistics, 19.5% of the U.S. population was engaged in sports and exercise regularly in 2021. Over the next five years, participation in regular sports and exercise is projected to grow steadily to 21% of the U.S. population in 2027. This growth is correlated to the expected growing disposable income driver that will enable consumers to afford higher sports participation. Furthermore, participation in team sports is expected to recover after the COVID-19 pandemic, as it becomes safer to gather in larger groups.

Key Trends

Increase in Popularity of At-Home Exercise and Individual Sports

The COVID-19 pandemic has drastically impacted the sports equipment market in the last two years. Specific sports, such as team sports and indoor sports, have struggled due to pandemic restrictions and cancellations of major sporting events. However, opportunities in other segments emerged as the focus shifted towards home workouts, running, yoga, and Pilates, increasing purchases in the sporting equipment segment. This trend will continue to see short-term gains as consumers seek ways to exercise during widespread gym closures as a result of government restrictions in response to the pandemic. Independent sports, such as golf and fishing, were also considered relatively safe outdoor activities that allowed consumers to participate in leisure activities outside of the home. Equipment sales for these groups also posted gains during the pandemic and are expected to be relatively sticky as consumers maintain their newfound hobbies.

Rise in Health-Conscious Consumers

According to industry research from McKinsey & Company, interest in consumer wellness is growing around the globe, especially with the North American global wellness market currently growing at a CAGR of 5-10%. From 2015-2020, the amount of gym memberships increased at a CAGR of 4% in the U.S., alongside increasing popularity of premium-priced gyms and personal trainers. Despite the number of gym memberships declining from 2020-2021 due to the COVID-19 pandemic, it will be expected to grow at a CAGR of 2.7% over the next five years to 2027.

The impact of health-conscious consumers on Sporting Goods sales is evident as data for consumer spending on sports services is highly correlated with their spending on sports equipment. For example, consumer spending in adult/youth recreational sports leagues will lead to related equipment purchases. Moreover, consumer spending on gym memberships will reflect in an increase in commercial spending on fitness equipment. As the number of gym memberships is forecasted to increase, industry trajectory for Sporting Goods is expected to follow suit.

Increasing Low-Cost Competitors

Consumers of the Sporting Goods industry tend to be price conscious and demand a competitive price as well as a large product portfolio of merchandise from retailers. There has been increasing prevalence in low-cost sporting goods from mass merchandisers and discount manufacturers that have impacted the industry. For example, large chains such as Walmart Inc., can use its market power to secure low-cost sporting goods from manufacturers in bulk, creating pricing pressure for other retailers to lower product markups. Overall, most sporting goods retail stores are seen to differentiate themselves through the quality and range of products offered, in comparison to low-cost competitors that typically carry lesser quality goods in a limited range. This has been a winning strategy, as majority of consumers value having a variety of options and testing out the quality of their equipment or apparel on-site prior to purchase.

Competitive Landscape

The Sporting Goods industry in North America is operating at a moderate level of market concentration, with consolidation expected to take place over the next five years. The industry's top three players, Dick's Sporting Goods Inc., Bass Pro Shops LLC, and Academy Sports & Outdoors are expected to have generated 36% of industry revenue with market shares of 14.3%, 11.6%, and 7.3% respectively. Currently, the industry is still considered fragmented, with a large number of small players holding over 60% of total market share. Such retail stores are typically family owned or operated independently, catering to local customers.

Overview of Key Players

Dick's Sporting Goods Inc.

Dick's Sporting Goods Inc. (Dick's) is a full-line sporting goods retailer specializing in team sports equipment, golf equipment, footwear, fitness and athletic apparel, and outdoor lodge equipment and accessories. The company has 728 stores across the US, with its subsidiaries, Golf Galaxy, Field & Stream, and True Runner operating an additional 126 stores across 34 states. Dick's creates a unique shopping experience for its customers by adding features to its retail stores such as treadmills to test athletic shoe, and seasonal sports display areas. The company also hires in-store experts, including certified fitness trainers, to help customers match products to their needs. Over the past five years, Dick's has executed an expansion strategy that includes opening over 200 stores, and acquiring Golf Galaxy Inc., ultimately growing company revenue to increase at a 6% CAGR. The company has also been cutting costs through leaner operations and selective advertising, allowing for operating income to stay relatively high.

Bass Pro Shops LLC

Bass Pro Shops (BPS) sells outdoor gear and apparel, including hunting, shooting, fishing, boating, and camping goods. The company is headquartered in Springfield, MO and has 153 stores in the US and 16 stores in Canada, with each store customized based on regional characteristics and preferred activities. BPS has grown inorganically the past few years through M&A activity, recently acquiring Cabela's Inc., allowing BPS to expand its hunting, camping, and fishing segments in the Rocky Mountain and Plains geographical regions. BPS is a privately held company but is expected to have experienced significant revenue increases throughout the past five years at an annualized rate of 15% due in large part to its acquisition of Cabela's.

Canadian Tire Corporation Ltd.

Canadian Tire Corporation Limited (Canadian Tire) owns FGL Sports Ltd., the largest retailer of sporting goods in Canada. FGL sports operates as a retailer in Canada through its SportChek, Sports Experts, Atmosphere, and Pro Hockey Life labels. Similar to other operators in the industry, FGL sports focuses on appealing to specific market niches in each geographical

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region, using each of its distinct brands. Retail stores are also differentiated with in-store digital features to help customers purchase the right equipment. FGL Sports benefits from Canadian Tire's corporate relationships, allowing the company to create strategic partnerships with many professional sports organizations, including the National Hockey League. Canadian Tire's real estate expertise and supply chain network also positively impacts FGL Sport's retail performance, by chosing high performing retail locations and enabling access to low-cost distribution services.

Dick's Sporting Goods (NYSE:DKS)

Consumer Retail – Sporting Goods

Healthy Growth

January 9, 2022

Dick's Sporting Goods Inc. (NYSE:DKS) is a full-line sporting goods retailer specializing in selling team sports equipment, golf equipment, footwear, fitness and athletic apparel, and outdoor lodge equipment and accessories. The company has 728 stores across the US, with its subsidiaries, Golf Galaxy, Field & Stream, and True Runner operating an additional 126 stores across 34 states.

Internal Analysis – Reimagining the Athlete Experience

Dick's Sporting Goods is a leader in the North American Sporting Goods Industry. It specializes in creating a superior retail experience for customers, through customization, interactive testing areas, and in-store experts. These qualities are exemplified as the company reports an increase of 12.2% in same store sales in Q3 2021. E-commerce sales penetration grew 15% in 2021, highlighting the company's growth in the new channel. Alongside strong consumer demand, a differentiated product mix is key to driving sales for DKS.

External Analysis – Healthy Drivers

Consumer demand is expected to increase in the next five years for the Sporting Goods industry due to increases in household disposable income, increase in sports participation rate, and the rising health-conscious trend that promotes regular physical activity. DKS has a good chance of capitalizing on this due to its strong retail and e-commerce presence and partnerships.

Valuation

Analyst: Cathie Ji, BCom. '23
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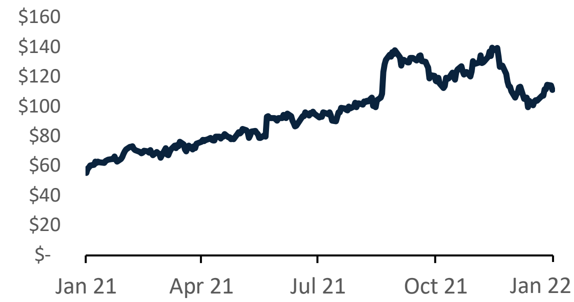
Equity Research	US
Price Target	**USD $155.54**
Rating	Buy
Share Price (Jan 4. Close)	CAD $109.31
Total Return	42.3%
Key Statistics	
52 Week H/L	$147.39/55.10
Market Capitalization	$9.67B
Average Daily Trading Volume	$2.71M
Net Debt	$3.06B
Enterprise Value	$11.54B
Current Ratio	1.52x
Diluted Shares Outstanding	$89M
Free Float	95%
Dividend Yield	1.57%

WestPeak's Forecast	2022E	2023E	2024E
Revenue	$3.28B	$2.58B	$3.18B
EBITDA	$2.26B	$1.79B	$1.89B
Net Income	$1.44B	$1.07B	$1.48B
EPS	$2.90	$2.28	$3.85
P/E	7.54x	10.4x	10.4x
EV/EBITDA	3.75x	4.96x	5.84x

1-Year Price Performance

At its current share price of USD$111.66, we believe the market undervalues the stock. After using a DCF and Comps analysis equally weighted, we have determined a target share price of USD$155.54. This implies an upside of 42.3% and we initiate a **buy** rating on Dick's Sporting Goods Inc.



Hobby

Subsector Segmentation and Growth

The Hobby industry is broad in scope and covers various segments. The largest product segment in both Canada and the U.S. is children's toys, which comprises of a variety of goods from magic kits to plush animals. This segment has been shrinking in terms of overall share, as kids move towards electronic entertainment options at increasingly younger ages. The hobby goods segment is very broad and ranges from collectible items to puzzles. Craft supplies include scrapbooking, model airplane sets, and traditional arts & craft goods. Finally, games comprise of traditional games, such as board games, educational games for kids, and video games.

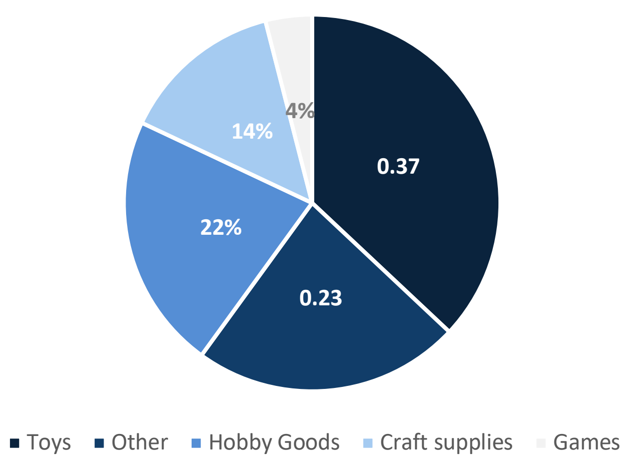


Figure 1. Hobby Segmentation in Canada
Source: IBISWorld

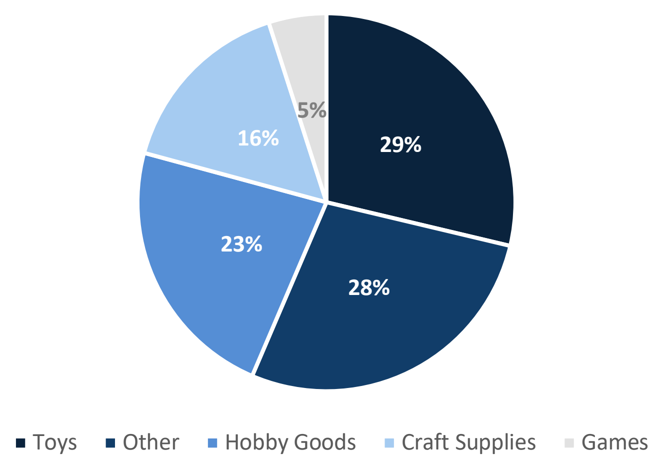


Figure 2. Hobby Segmentation in the U.S.
Source: IBISWorld

In 2021, U.S. and Canada industry revenues were USD $18.9 bn and USD $2.7 billion, respectively. After hitting a peak of $20.1 billion U.S. revenues in 2016, the industry was slowly declining prior to a sudden uptick at the start of the COVID-19 pandemic, as lockdowns and governmental restrictions forced people home and allowed them time to develop new hobbies. The industry is considered mature and is unlikely to see a big change to revenues in the upcoming years.

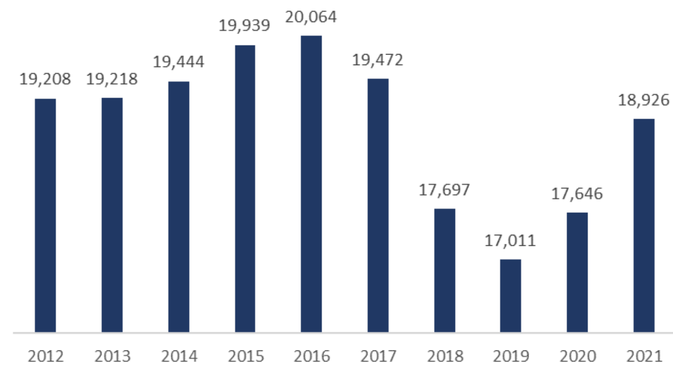


Figure 3. Hobby Revenue in the U.S. (US$ mm)
Source: IBISWorld

Key Trends

Rise in Disposable Income

Per capita disposable income is one of the most impactful drivers to the Hobby industry, as increases in disposable income are correlated with increased spending in discretionary categories like hobby activities. Thus, if this metric continues to rise, more consumer spending will be funnelled towards the Hobby industry.

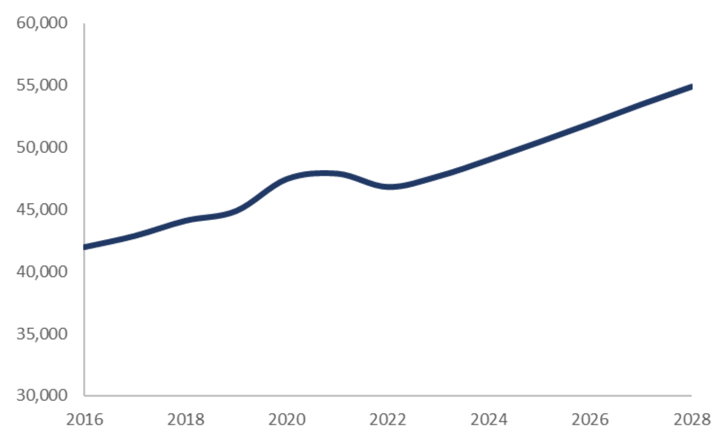


Figure 4. Per Capita Disposable Income in the US (US$)
Source: IBISWorld

Per capita disposable income has increased at a compounded annual growth rate of just under 3% in the past five years in the U.S. – and a more tempered rate in Canada. In the U.S., the 2017 Tax Cuts & Jobs Act has been a strong contributor to this notable increase, as the act reduced income tax at all income levels, leading to more disposable income. Likewise, rises in minimum wage across various states have also contributed to the increase. In 2022, a total of 26 US states and 56 cities will see increases to their minimum wage. This trend of increasing disposable income is expected to continue through the COVID-19 economic recovery.

Notably, inflation is a major concern which could counteract the increases in disposable income for consumers. Inflation in both Canada and the U.S. has been pegged around 5-7%, meaning the increase in disposable income, currently, is not on pace with inflation. If this trend continues into 2022, consumers may have to divert spending away from hobby activities and towards the increasingly expensive categories of food, gas, auto, and rent, among other items.

Threat From E-Commerce and Discount Retailers

As the e-commerce space continues to grow at a rapid pace, with a CAGR of over 15% in the past 5 years in the U.S., traditional hobby companies have been losing out to online retailers like Amazon. While the rise of online shopping does present an opportunity for hobby companies, these same companies typically have a weaker online presence and find it difficult to compete with Amazon. Consumers have come to value the expedited shipping times and everyday low prices that a traditional hobby store cannot offer. The net impact is that companies like Amazon are drawing consumer spending away from brick-and-mortar hobby and toy stores. In an attempt to reverse this trend, some hobby companies like Michael's have put significant attention and resources towards their digital presence. Since the COVID-19 pandemic, Michael's has been rewarded with very strong e-commerce growth with a 150% increase in FY2020 e-commerce sales.

Similarly to e-commerce retailers, discount retailers have also been slowly eating away at profits of traditional hobby stores. Walmart and Target have become the biggest toys and games retailers in the United States, taking a coveted spot once held by Toys 'R Us. It has become increasingly difficult for specialized toy stores to compete with the low prices offered by discount retailers and department stores. Additionally, game manufacturers like Mattel or Hasbro have increasingly been selling directly to department stores in large quantities, who then sell direct to consumer for cheaper than hobby and toy stores would be able to.

There are some exceptions in niche markets that have been able to avoid the threat from e-commerce and discount retailers. Vinyl records, for example, have been largely immune to these threats and are expected to grow at 7% CAGR through 2024. Still, there are few examples like this, and they are far too small in size to have an impact on the Hobby industry as a whole.

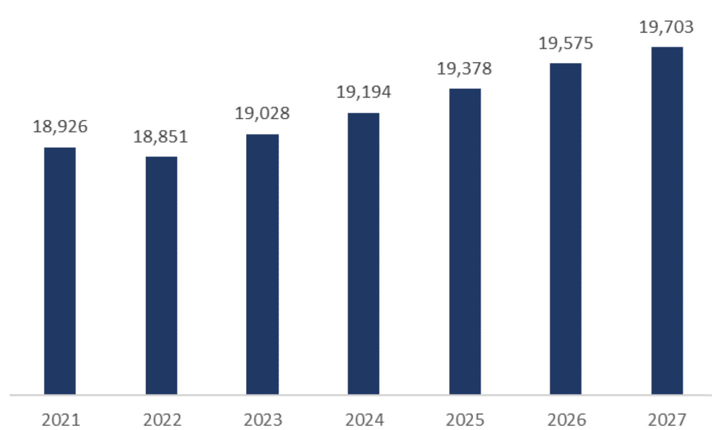


Figure 5. E-Commerce Sales in the US (US$ bn)
Source: IBISWorld

COVID-19 Pandemic

The COVID-19 pandemic has had a mixed impact on different product segments and firms within the expansive Hobby space. As consumers spent more time at home during lockdowns and/or working from home on a more permanent basis, new hobbies were developed and old hobbies revisited. Consumers invested time and resources into personal fitness, home décor & DIY, arts & crafts, and collectible items, among other categories. Notably, consumer spending did not increase across the Hobby industry equally. Firms in the arts & craft space like Michael's benefited from increased revenues, but many companies in the children's toys segment continued to trend downwards in revenues.

There is some doubt whether this spur in activity from the pandemic will continue to linger or return to pre-pandemic levels. Additionally, throughout the industry, the common trend of supply chain disruptions have persisted since 2020 and 2021.

Industry Growth

Revenue growth in the Hobby industry has been slowly trending downward over the past 5 years at an annualised rate of -1.2% in the United States, according to IBIS World. As the COVID-19 economic recovery continues to progress and consumers have more discretionary spending, the industry is projected to slowly rebound and grow at an annualized rate of ~1% through 2026.

The Hobby industry is still facing strong and persistent external threats that are unlikely to subside, including the growth in e-commerce and discount retailers. This will likely dampen any prospect of high growth within the Hobby industry.

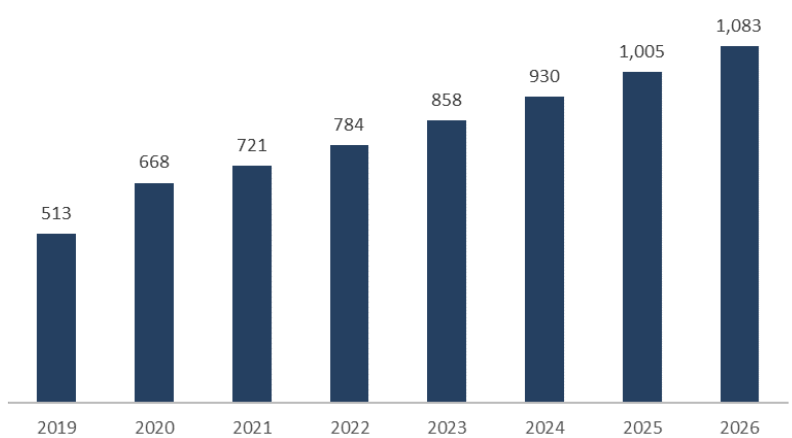


Figure 6. Forecasted Hobby Revenue in the US (US$ mm)
Source: IBISWorld

Overview of Key Players

With the retail Hobby industry being very broad, there are a few key B2C players with large market shares as well as countless smaller firms, from medium-sized players, such as Mastermind Toys, to small businesses across North America. With low start-up capital requirements and low barriers to entry, the industry is competitive.

Although the firms below are all classified in the Hobby industry, most are not in direct competition with each other, due to the broadness of the industry. For example, Michael's, which primarily operates in the craft supplies product segment within the industry, does not compete with Toys 'R Us, whose revenues largely come from the toys product segment.

Toys 'R Us

Known for their large selection of toys and games, Toys 'R Us has undergone major difficulties in the past few years. Toys 'R Us used to be a one-stop shop for children's toys, board games, and video games, among other items, and had USD $11.8 bn in revenues before they entered bankruptcy in 2016. Toys 'R Us' brick-and-mortar-centric model had been losing out to e-commerce retailers, like Amazon, as well as discount retailers, like Walmart. Target and Walmart became the largest toy retailers in the United States, overtaking a struggling Toys 'R Us.

Despite the bankruptcy proceedings occurring in the United States, Fairfax Financial Holdings acquired the Canadian stores in 2018 for $300 mm and have enabled 82 stores in Canada to remain operating through 2021. Toys 'R Us Canada earned CAD $810 mm in 2020 and has been seeing a slow decline in revenues at a -0.3% CAGR over the past 5 years, for many of the similar reasons that impacted the company in the United States. Additionally, unlike other retailers in the industry, COVID-19 did not bring the unexpected upturn in revenues to Toys 'R Us. The pandemic attracted new consumer spending to self-directed hobbies, whether that be arts & crafts or personal fitness, but this effect did not carry over to spending on kids

Hobby Lobby

With ~15% of the US market share in the Hobby industry, Hobby Lobby operates 900 stores across the country and offers over 65,000 products. The offerings include a wide variety of products in arts & crafts, jewelry, sewing, party décor, home décor, and scrapbooking. As the firm is privately owned, financials are not made available to the public; however, Forbes estimated that Hobby Lobby earned $5.3 bn in revenues in 2020 and $2.8 bn in revenues specific to the Hobby industry.

Like other arts & crafts stores like Michael's, the COVID-19 pandemic had a positive impact on Hobby Lobby, as consumers spent more time at home devoted towards their hobbies. Through 2020 and 2021, consumer spending on arts & crafts, DIY activities, and home décor increased. It remains to be seen whether this was only a temporary boost during the pandemic or whether consumers will remain loyal to brands like Hobby Lobby in a post-pandemic world.

GameStop

GameStop is the largest video game retailer in the world and primarily sells video games, gaming consoles, and collectibles & gaming merchandise. The company has seen, and continues to expect, increases in revenues due to the emergence of new gaming consoles, such as the PlayStation 5, Xbox Series X, and Nintendo Switch OLED. Additionally, GameStop has diversified their offerings away from just video games and into other pop culture items and collectibles. Now, apparel, action figures, and Funko Pops (vinyl character figurines) have become prominent features of GameStop stores.

U.S Hobby industry-specific revenues have increased at an annualized rate of 5% since 2017. Note that industry-specific revenue only includes video game hardware (not video games), collectibles, and accessories. In Canada, the trend has been reversed, with 10% annualized declines since 2015. As GameStop still heavily depends on its largely brick-and-mortar model, the business remains threatened by e-commerce retailers and other competitors. With the simplicity of online shopping, it is easy for consumers to shop around online for the cheapest prices – a move which does not always benefit GameStop.

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The Michaels Companies Inc – Target (MIK)
Apollo Global Management Inc – Financial Sponsor (APO)

Consumer Cyclical – Specialty Retail, Fabric Craft & Sewing

A Crafty Deal

December 7, 2021

LBO deal summary for the acquisition of the Michaels Companies Inc. by Apollo Global Management at $22 per share, a 47% premium to the closing share price prior to announcement on February 26, 2021

The Michaels Company (Target) Strategic Objectives

Michaels is the largest arts and crafts specia lty retailer in North America. The company announced positive FY2020 results, partially fueled by an unexpected increase in demand for crafts products in light of the COVID-19 pandemic. These results also validate the efforts of Michaels' new management team and the initial success of their turnaround strategy, after underperformance and share price lows in 2019. Moving forward, Michaels is investing heavily in e-commerce and omnichannel capabilities in order to continue performing strongly post-pandemic.

Apollo Global Management Strategic Objectives

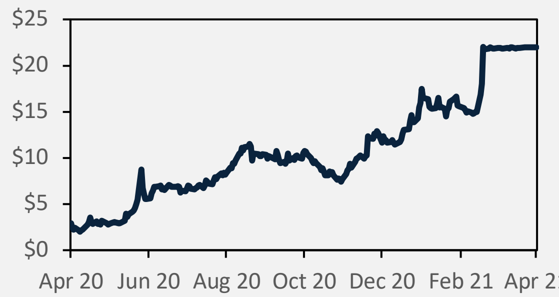
Apollo is purchasing Michaels before the company's turnaround strategy is fully realized, while the company is still being traded at a discount. Through this purchase, Apollo signals that it expects consumers will not lose interest in the arts and crafts segment post-pandemic, and that Michaels can carry their momentum from the past year.

Synergies

One notable synergy is Apollo's ownership of Shutterfly, a photography and image sharing company. Possible areas for collaboration between the two portfolio companies may strengthen Shutterfly's photography product offerings as well as Michaels' department for photography and framing.

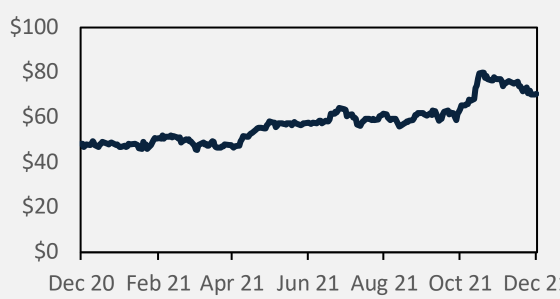
Key Statistics – MIK (Target)	
52 Week H/L	$22.0/$2.0
Market Capitalization	$3,110M
Average Daily Trading Volume	3.89M
Net Debt	$2,500.4M
Enterprise Value	$4,534.6M
Net Debt/EBITDA	8.3x
Diluted Shares Outstanding	147.8M

1-Year Price Performance



Key Statistics – APO (Financial Sponsor)	
52 Week H/L	$81.1/$45.0
Market Capitalization	$31.3B
Average Daily Trading Volume	2.7M
Net Debt	$17.7B
Enterprise Value	$29.2B
Net Debt/EBITDA	1.9x
Diluted Shares Outstanding	231M
Dividend Yield	2.8%

1-Year Price Performance



Business Overview – Michaels Companies Inc

Company Overview

Michaels operates more than 1,250 stores across Canada and the United States, selling over 45,000 different products. The company has three distinct revenue segments; general craft products, home décor and seasonal products, and framing and papercutting, making up 45%, 25%, and 30% of revenue, respectively.

Michaels also owns a portfolio of private in-house art supplies brands, including Artist's Loft, Art Minds, Craft Smart, and many other smaller brands. These brands are primarily sold at Michaels stores North America-wide and comprise 57% of Michaels' net sales.

Net sales decreased by 4% from 2018 to 2019. The bulk of this decrease, however, resulted from the closure of subsidiary stores of Pat Catan's and Aaron Brothers. Pat Catan operated 36 arts and craft retail stores in the Midwest United States. About a third of the closed Pat Catan stores reopened under the Michaels brand name. Aaron Brothers comprised of 94 framing and art supplies stores primarily on the West Coast of the United States. Many of these brick-and-mortar locations had been suffering financially and unable to compete with online alternatives.

COVID-19 Impacts

Michaels experienced a strong tailwind from COVID-19 as consumers turned to pass times such as crafts and redecorating during lockdowns, particularly once economic stimulus kicked in and consumer spending rebounded. The result for Michaels was a significant increase in revenue throughout FY2020. The company's equity fell along with the broader market upon the outset of 2020 but recovered by June as they continued to beat earnings estimates.

E-Commerce Strategy

Michaels' new CEO Ashley Buchanan launched a plan upon his instalment to close the gap between Michaels e-commerce capabilities with its competitors by the end of 2020. In 2020, the company had reached in store pickup availability at approximately 80% of its stores and same-day delivery in approximately 60% of stores and increased the speed and ease-of-use of its e-commerce platform. These developments were cost-effective for Michaels as they were able to implement these capabilities at or below their typical spend rate. The company plans to add two seasonal distribution centers in 2021 to support omnichannel sales growth.

Business Overview – Apollo Global Management Inc.

Overview

Apollo Global Management is an investment management firm based in New York. Its $455.5 billion in assets under management (AUM) are divided between their credit, private equity, and real estate assets, making up $439 billion, $81 billion, and $46 billion AUM respectively. Apollo Global Management focuses its investments across nine industry sectors, with those being chemicals, manufacturing and industrial, natural resources, consumer and retail, consumer services, business services, financial services, leisure, and technology, media, and telecommunications. The firm mainly seeks investments based in North America and Europe. Apollo employs a combination of contrarian, value, and distressed strategies to make its investments. The firm has many competitors in all of its business lines but its most notable competitors are other top tier private equity firms including The Blackstone Group, KKR & Co Inc., and the Carlyle Group.

Industry Analysis

Overview

Michaels is a market leader in the fabric, crafts, and sewing supplies (FC&S) industry in North America. Industry players primarily retail fabric, patterns, sewing supplies, yarns, needlecraft supplies, seasonal decorations, and craft machines. The combined market size for Canada and the United States is $4.4 an billion and there are 29,428 businesses in operation. Majority of these businesses are small, independently owned operators with a few major retailers commanding majority of the market share.

Key Trends & Drivers

Increasing Median Age of the Population

One of the key drivers of the FC&S industry is the increasing median age of the population of the United States. The United States Census Bureau projects the number of people over the age of 65 to grow at an annual rate of 1.7% from 15.0% of the population in 2020 to 23% of the population in 2026 as seen in Figure 1. This shift to an older demographic will positively impact industry revenue as typically older people are the primary customers of the FC&S industry.

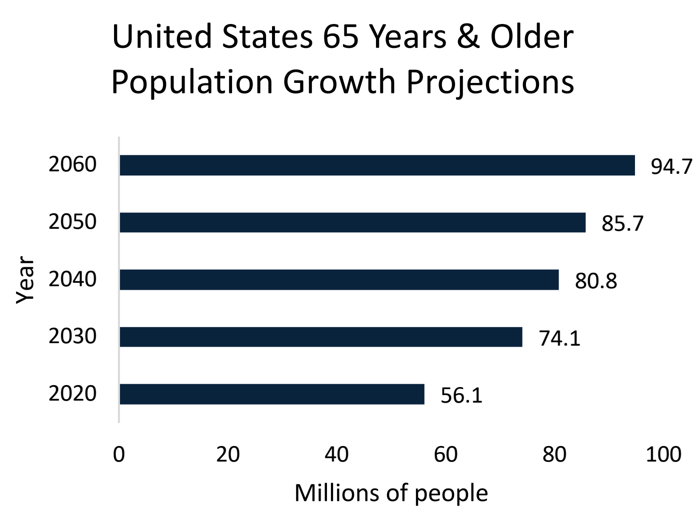


Figure 1: Increasing Median Age of the US Population
Source: United States Census Bureau

This leads into a trend that has been dramatically impacting the industry in recent history where female baby boomers have been taking over as the leading demographic of consumers. Currently, female baby boomers make up 10.0% of total industry sales, however, with the expected increase in the median age it is expected to grow. Furthermore, as baby boomers continue to retire, they will have more time available to spend on their hobbies. Combining this newfound leisure time and their retirement savings, baby boomers are expected to continue to be the key consumer of the industry.

Increased Competition from E-commerce

Key players in the FC&S industry will expect to see high competition from pure online retailers. E-commerce websites are able to provide a relatively higher selection of products at lower prices, incentivizing consumers to switch from shopping at traditional brick-and-mortar stores to online websites. Michaels has already identified this threat and has dramatically increased its omnichannel offerings in FY2020 in response to the COVID-19 pandemic. During this period, Michaels alongside other retailers experienced store closures due to lockdown measures. Michaels was able to experience a 150% increase in e-commerce sales during FY2020, increaseing e-commerce share of revenues from 5% in FY2019 to 13% in FY2020. However, physical retail stores seem to still hold an advantage, most likely because they allow customers to touch and feel products to assess quality and texture before purchasing. After lockdown measures eased, shoppers in the FC&S industry were seen to have returned to brick-and-mortar stores. For Michaels, this was was shown as e-commerce sales declined 49% in the beginning of FY2021. Strengthening this channel to engage customers will partially mitigate pressure from online retailers.

Increased Per Capita Disposable Income

Purchases in the FC&S industry are discretionary and hobby-related, hence, an increase in per capita disposable income will drive demand for industry products. In 2020, government stimulus funds to aid economic recovery spiked per capita disposable income. As the economy begins to recover from the coronavirus, per capita disposable income is projected to increase at an annualized rate of 0.8%.

Competitive Landscape

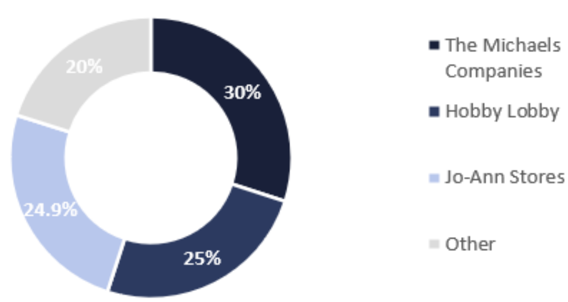


Figure 2: Market Share of US Fabric, Crafts, and Sewing Stores in 2021
Source: IBISWorld

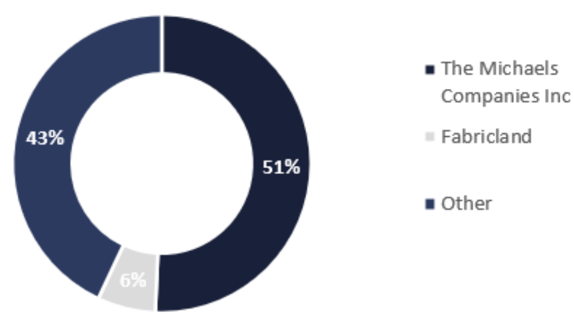


Figure 3: Market Share of Canadian Fabric, Crafts, and Sewing Stores in 2021
Source: IBISWorld

FC&S industry is oligopolistic in nature, with three major players accounting for 80% of market share in 2021. The remaining 20% is extremely fragmented, with revenue generated by small, independent operators that provide niche offerings. Market share concentration has been high for the past five years and has remained relatively stable due to acquisition activity. Michaels has been acquisitive historically, leveraging economies of scale to lower costs and capture more market share. The trend for consolidation is expected to continue in the future as large players continue to seek acquisition opportunities and smaller operators are forced to close down shop due to pricing pressures. To succeed in the space, small businesses need to focus on customer relationships, product selection and presentation, proximity to key markets, and inventory management. The. There are no significant foreign-owned operators in the industry, and many smaller operators serve local communities. Notably only Michaels, as a major operator, has international operations within North America due to its size and scale.

Overview of Key Players

Hobby Lobby Stores Inc

Hobby Lobby is the third-largest fabric and craft retailer in the United States with 25% market share and over 900 locations across the country. The company sells supplies for arts and crafts, jewelry making, needlework and scrapbooking, as well as sewing machines, home accents, fabric, and patterns. Hobby Lobby's main growth activities are through expansion of new brick-and-mortar establishments, despite other retailers in the industry closing down physical stores.

Jo-Ann Stores, LLC (NASDAQ: JOAN)

Jo-Ann Stores follows closely behind Hobby Lobby with a 25% market share in the United States. It is the second-larget craft retailer in the United State based on store count of 855 locations. The company sells a range of fabrics used in crafting, quilting, and apparel sewing, as well as products for home decoration projects, craft components, artificial and dried flowers and finished seasonal merchandise. The company sought to boost sales by improving operational efficiencies. This includes implementing a new point-of-sale system for better promotions and improved inventory management of all stores. Jo-Ann IPO'd NASDAQ in early 2021, after being taken private in 2011.

Fabricland

Fabricland is a Canadian retailer with 6.3% market share and over 100 stores across Canada. The company offers a wide selection of fabrics and sewing accessories, ensuring customers can acquire all their crafting needs. Fabricland is a subsidiary of House of Fabrics Inc, a company owned by Jo-Ann Stores Inc.

Other Small Operators

The remainder of the hobby and crafts industry is extremely fragmented and characterized by many small operators. In 2021, IBISWorld estimates there are around 28,041 specialty operators, many of which are small businesses. These smaller operators differentiate their offerings from larger players by focusing on superior customer service, niche offerings, and higher-quality goods.

Industry Outlook

Despite the positive impacts of the growing demographics, the spike in sales seen from COVID-19 is expected to fall off and return to pre-pandemic levels as seen in Figure 4. Longer term growth projections are positive given the upward shifting median age, however, it is unlikely that the growth will reach the levels seen during the pandemic due to the threat of e-commerce and larger online marketplaces.

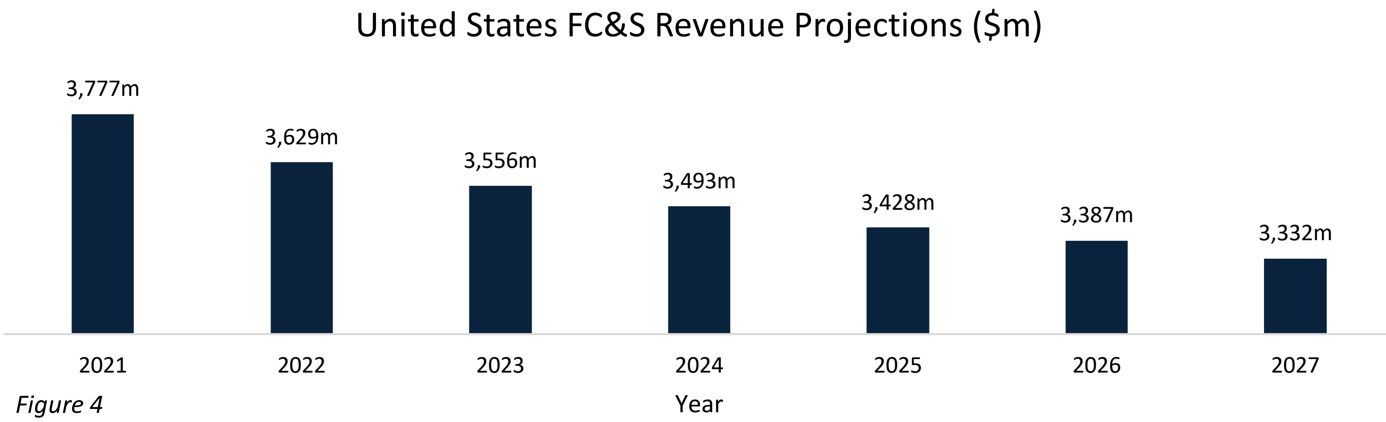


Figure 4
Source: IBISWorld

LBO Rationale

Strategic Objectives

Apollo is purchasing Michaels at the brink of Michaels' turnaround strategy while the company is still being traded at a discount, relative to their 2016 high of above $30 per share. Michaels' poor retail performance in 2019 was highlighted by an 86.1% plunge in their share price within one year, leading to share price lows of $1.56 in March 2020 when the COVID-19 pandemic first shocked the markets. The pandemic unexpectedly benefited Michaels, though, as consumers across the continent developed new hobbies while stuck at home, such as arts & crafts or home décor, which, in turn, improved Michaels' bottom line. Apollo expects that consumers will not lose interest in their crafty hobbies, as the pandemic slowly fades, and that Michaels can carry their momentum from the past year.

Michaels initiated its turnaround plan in 2020 by welcoming Ashley Buchanan as the new CEO, previously a Chief Merchandising Officer at Walmart U.S. e-commerce. Alongside a new executive team, Mr. Buchanan developed a plan to revitalize the business through an improved retail presence and strengthened e-commerce and omnichannel capabilities. Traditionally, Michaels had been very weak in e-commerce, with a minimal online presence, slow delivery times, and only 5% of sales coming from e-commerce. Even pre-pandemic, Michaels' e-commerce sales trended upwards, but the early 2020 lockdowns had them skyrocket, with temporary boost of over 300% to e-commerce sales. Apollo will hope to improve Michaels' omnichannel presence, supporting consumers that continue to shift towards online shopping as well as those that still rely on traditional brick-and-mortar stores.

The turnaround concept was partially validated in Michaels' Q4 2020 earnings – the last publicly released earnings before going private. Positive performance was recorded for FY2020, with an increase of 3.9% in net sales, 4.8% increase in comparable store sales, and 8.2% increase in net income compared to FY2019.

Apollo has an opportunity to use its network and resources to improve Michaels operations and complete its turnaround, bringing the company to future success and making it more valuable to potential future buyers. Apollo's management team most likely work towards expanding Michaels' e-commerce revenues and omnichannel capabilities in the short term rather than increase store count. These two initiatives have proven to be leading trends in the FC&S industry and will be the most effective in sustaining Michaels' competitive advantage. The company's upwards trajectory in combination with the management support of a large private equity fund makes Michaels a strong financial investment for Apollo.

Synergies

Given Apollo is a financial sponsor, it is unlikely the buyer will benefit from the same synergies that a strategic acquirer would. One notable exception is Apollo's ownership of Shutterfly, whom they acquired in late 2019. Shutterfly sells photography products, including photo books, prints, and novelty items such as personalized calendars. Michaels also operates a department for photography and framing, which could stand to benefit from collaboration with Shutterfly.

Additionally, the takeover of Michaels adds industry diversification to Apollo's portfolio that may act as risk diversification. Michaels' strong performance during the COVID-19 pandemic contrasts the struggle of business in other discretionary industries. This has shown that Michaels' product offerings can be able to withstand and even thrive in an unprecedented environment.

Valuation

Comps

For the comp analysis, four companies were chosen based on them operating in the retail industry, similar business models to Michaels, and being primarily based in North America. In addition to this, all have brick and mortar stores generating the majority of their revenue, similarily to Michaels further strengthening them as candidates.

Bed Bath & Beyond (NASDAQ: BBBY)

Bed Bath & Beyond and its subsidiaries operate with two segments, Noth American Retail and Institutional Sales. Here they sell bed linens, bath items, kitchen supplies, and furnishings through both in-store and online means. Bed Bath & Beyond operates in the United States and Canada with most of their revenue and store locations being in the United States.

Williams Sonoma (NYSE: WSM)

Williams Sonoma operates as a retail business for kitchen and kitchen related supplies ranging from cookeware, cutlery, tables, and cookbooks. Additionally, Williams Sonoma has a home furnishing brand called Williams Sonoma Home where they offer furniture, bedding, lights, and other home furnishings. Williams Sonoma generates the majority of their revenue from brick-and-mortar locations in the United States.

Jo-Ann Inc. (NASDAQ: JOAN)

Jo-Ann operates as a retailer of arts and crafts and sewing supplies in the United States. Specific products include fabrics, tools, buttons, yarns, and needlecraft supplies. Jo-ann has a total of 855 retail locations across 49 states in the United States.

Dick's Sporting Goods (NYSE: DKS)

Dick's Sporting Goods and its subsidiaries operates as a sporting goods retailer in the United States. Products they carry include fitness, hunting, and fishing equipment as well as apparel. Dick's also has a portfolio of specialty including Gold Galaxy and Field & Stream, each specializing in a specific niche. The majority of Dick's locations are located in the east of the United States.

Precedent Transactions

The nature of Michaels' business is cyclical and niche. Thus, we chose to include precedent transactions involving private placement or M&A of companies within subsections of the specialty retail industry including home improvement retail, specialty stores, and home furnishing retail. These businesses are driven by a similar set of factors as Michaels' stores including per capita disposable income and consumer sentiment.

Cabela's Incorporated

Cabela's is a specialty hunting and fishing retailer that operates in the Unites States and Canada. As of December 2021, the company operates 85 locations. Locations tend to be extremely large and offer an incredibly diverse range of products. The company was acquired by Bass Pro Group, LLC in September 2017 for $8,666.78M. Cabelas was acquired by Bass Pro to consolidate the industry and realize operational synergies.

At Home Group Inc.

At Home Group Inc. operates home décor specialty stores in the United States. The company carries items such as furniture, mirrors, rugs, and wall art. As of June 23, 2021, the company operated 228 stores. The company was acquired by Hellman & Freeman LLC in July 2021 for $4,364.66M. Hellman & Freeman acquired the company with the intention of generating top-line growth through increased new store openings.

Mattress Firm Holding Corp.

Mattress Firm Holding Corp. operates as a specialty retailer of mattresses and related bedding products in the United States. It has both owned and franchised retail locations as well as an e-commerce platform. The company was acquired by Steinhoff International Holdings N.V. in Septmebr 2016 for $2,981.71M.

Rona Inc.

Rona is involved in the distribution and retail of hardware, building materials, and home renovation products in Canada. In addition to retailing, the company also offers installation and delivery services. As of 2016, it operated approximately 500 corporate and independent affiliate dealer stores across Canada. The company was acquired by Lowe's Companies Canada, LLC in May 2016 for $2,295.42. The acquisition was completed with the intention of increasing the company's Canadian footprint and realzing operational synergies.

Risks

Unsuccessful Transition to E-commerce

Michaels Stores' reliance on e-commerce has been increasing throughout the last few years, most notably during the COVID-19 pandemic. The company notes that if their efforts to successfully deliver an efficient omnichannel shopping experience to their customers fails they could see a significant decrease in revenue. This risk is partially mitigated through Michaels' success during the pandemic in providing a seamless option for customers to order online and pick up merchandise in stores.

Uncertain Post-Pandemic Demand

It is uncertain whether the spur in demand fueled by the pandemic will endure into the future. Michaels was one example of a company that benefited due to the COVID-19 pandemic, experiencing an increase in sales and profitability due to an increase in demand for arts and crafts products. Despite its positive performance, it is unclear how sustainable this demand will be as pandemic restrictions continue to ease. Apollo is essentially taking the burden of Michaels' uncertain future through this acquisition. Michaels has already taken efforts to mitigate this risk by improving e-commerce efforts, deepening customer relationships through specialized classes, and strengthening its retail operations to improve customer experience.

Appendix 1: Comparable Company Analysis

(Figures in mm USD)

Company	Ticker	Share Price	Diluted Shares Outstanding	Equity Value	Enterprise Value	2020A EV/EBITDA	2021A EV/EBITDA	2022E EV/EBITDA	2020A P/E	2021A P/E	2022E P/E
						EV/EBITDA Multiple			P/E Multiple		
Bed Bath & Beyond	(NASDAQ: BBBY)	$ 18.58	122.9	2,283.2	3,935.2	25.9 x	16.8 x	7.6 x	n/a	n/a	15.2 x
Williams Sonoma	(NYSE: WSM)	$ 177.47	79.0	14,020.1	14,790.7	22.6 x	13.5 x	14.2 x	39.5 x	20.6 x	23.0 x
JOANN	(NASDAQ: JOAN)	$ 9.38	40.5	380.1	2,149.2	6.7 x	5.5 x	8.5 x	2.1 x	1.8 x	4.4 x
Dick's Sporting Goods	(NYSE: DKS)	$ 106.84	96.6	10,317.6	12,357.7	17.8 x	11.4 x	12.7 x	32.0 x	18.7 x	21.0 x
The Michaels Companies Inc	**(NASDAQ: MIK)**	**$ 21.97**	**147.8**	**3,248.0**	**4,534.6**	**7.1 x**	**7.1 x**	**7.2 x**	**12.3 x**	**11.1 x**	**9.1 x**
Median						**20.2 x**	**12.4 x**	**10.6 x**	**32.0 x**	**18.7 x**	**21.0 x**
Mean						**18.3 x**	**11.8 x**	**10.8 x**	**24.5 x**	**13.7 x**	**16.1 x**
High						**25.9 x**	**16.8 x**	**14.2 x**	**39.5 x**	**20.6 x**	**23.0 x**
Low						**6.7 x**	**5.5 x**	**7.6 x**	**2.1 x**	**1.8 x**	**4.4 x**

	EV/EBITDA Implied Price			P/E Implied Price		
Median	$ 78.04	$ 45.19	$ 36.25	$ 56.94	$ 36.98	$ 50.80
Mean	**$ 69.66**	**$ 42.43**	**$ 36.89**	**$ 43.68**	**$ 27.11**	**$ 39.04**
High	$ 102.70	$ 64.11	$ 51.52	$ 70.36	$ 40.81	$ 55.70
Low	$ 19.87	$ 15.26	$ 23.54	$ 3.74	$ 3.53	$ 10.61

Appendix 2: Precedent Transactions

(Figures in mm USD)

Acquirer Name	Target Name	Announcement Date	Transaction Enterprise Value	Valuation Multiples: EV / LTM Revenue	Valuation Multiples: EV / LTM EBITDA
Ontario Steel Investment Limited	Essar Steel Algoma Inc.	2016-07-10	$ 903.00	0.5 x	NM
BlueScope Steel Limited	North Star BlueScope Steel, LLC	2015-10-26	$ 1,481.00	1.3 x	8.0 x
Nucor Corporation	Gallatin Steel Company	2014-09-15	$ 770.00	N/A	N/A
Hitachi Metals, Ltd.	Waupaca Foundry, Inc.	2014-08-19	$ 1,337.80	0.8 x	8.3 x
Steel Dynamics Inc.	Severstal Columbus, LLC	2014-07-21	$ 1,625.00	0.8 x	11.2 x
AK Steel Corporation	Severstal Dearborn, Inc.	2014-07-21	$ 707.00	0.4 x	29.4 x
Trinity Industries Inc.	Meyer Steel Structures	2014-06-27	$ 600.00	3.0 x	19.1 x
ArcelorMittal and Nippon Steel & Sumitomo Metal Corporation	ThyssenKrupp Steel USA, LLC	2013-11-29	$ 1,550.00	0.9 x	19.3 x
Reliance Steel & Aluminum Co.	Metals USA Holdings Corp.	2013-02-06	$ 1,216.48	0.6 x	8.5 x
Nucor Corporation	Skyline Steel L.L.C.	2012-05-17	$ 684.00	0.8 x	N/A
Winsway Coking Coal Holdings Limited & Marubeni Corporation	Grande Cache Coal Corporation	2011-10-31	$ 1,028.42	3.6 x	13.9 x
Maximum			$ 1,625.00	3.6 x	29.4 x
75th Percentile			$ 1,409.40	1.2 x	19.2 x
Median			**$ 1,028.42**	**0.8 x**	**12.5 x**
25th Percentile			$ 738.50	0.7 x	8.4 x
Minimum			$ 600.00	0.4 x	8.0 x

Global Equity | March 2022

Consumer & Retail

II. Luxury Automotive Manufacturing

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WESTPEAK RESEARCH ASSOCIATION

Luxury Automotive Manufacturing - Primer

January 9, 2021

Analyst 1: Matias Canofari, BCom. '24
Analyst 2: Alex McKenzie, BCom. '23

Industry Summary: *Activities in the luxury automobile industry include manufacturing and finishing high-end vehicle chassis and components. The industry is characterized by deep and complex supply chains, high barriers to entry, and high regulation.*

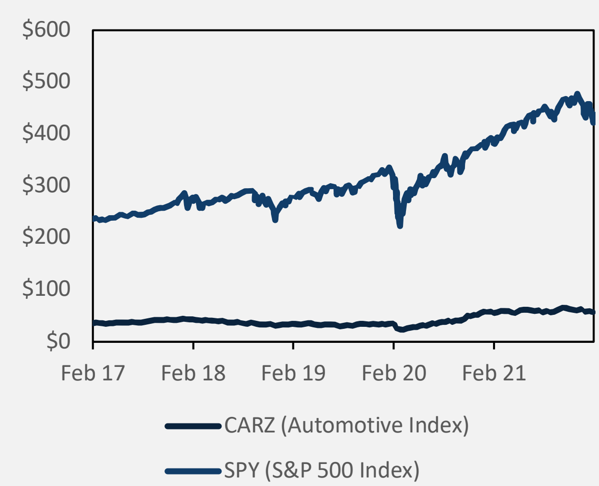
Industry View

The last 5 years of industry growth in the luxury automobile space was offset by the pandemic. Although consumer disposable income and global GDP are forecasted to grow in the next 5 years, industry profits are expected to decline as a result of increasing input costs including, commodities and labour. In addition, as environmental awareness continues to grow, so do compliance costs for auto manufacturers. Due to the technical complexity of manufacturing a vehicle and incredibly complex supply chains, auto manufacturers are required to begin engineering vehicles years before they will reach production. Forecasting and complying with future regulations while minimizing costs is an arduous process that manufacturers must undergo to ensure their vehicles are not locked out of certain markets, most notably Europe and California.

The most notable recent events in the sector include a 15% decline in revenue in the broader auto manufacturing industry in 2020 due to broader economic decline resulting from continued COVID-19 related pressures as well as supply bottlenecks resulting from an upstream semiconductor shortage. Semiconductor shortages have resulted in decreased production of new vehicles and inventory shortages. As a result, dealerships have been able to increase their markups resulting in higher industry profits for FY21. Inventory shortages are expected to continue into 2022.

Industry Research	
Luxury Automotive Manufacturing	
Global Revenue	USD $571B
Annual Growth (Past 5 Years)	-1.27%
Annual Growth (Next 5 Years)	2.8%
Key Companies	
Daimler AG	ETR: DAI
Enterprise Value	$206.82B
Implied Price	$83.46B
Bayerische Motoren Werke AG	ETR: BMW
Enterprise Value	$144.29B
Implied Price	$108.47
Jaguar Land Rover Automotive	NYSE: TATAMOTORS
Enterprise Value	$23.84B
Implied Price	$6.61
Volkswagen Group	ETR: VOW3
Enterprise Value	$267.22B
Implied Price	$307.68
Toyota Motor Corporation	NYSE: TM
Enterprise Value	$403.34B
Implied Price	$182.95

CARZ 5-Year Price Performance



Industry Analysis

Market Size & Growth

The luxury automobile manufacturing market had $571 billion USD in global revenue in 2021. The industry is still adversely affected by COVID-19 pandemically related pressures such as decreased economic performance and supply chain disruption. It is forecasted that mature and saturated markets such as the U.S. and Japan will be the slowest to recover from this recent contraction. The Asia-Pacific region is forecasted to lead growth in the luxury auto space, key markets in the region such as India and China are growing at much higher rates than saturated markets. Trends such as electrification are poised to continue positively affecting luxury auto manufacturing. Top electric brands such as BMW and Tesla both exclusively produce luxury cars. Semiautonomous technology will continue to stimulate the luxury auto subsector as it allows for price increases and stimulates consumer demand. Consumer disposable incomes are projected to continue to grow which will stimulate demand in the luxury auto market.

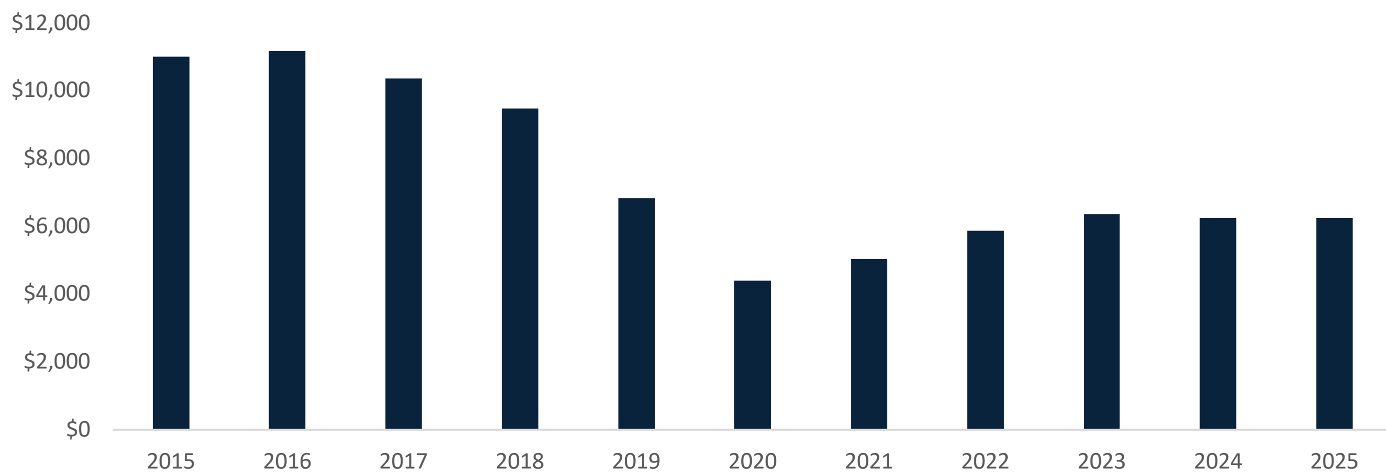


Figure 7. Luxury Car Sales in the U.S. from 2015 – 2025 (US$ m)
Source: Statista

Key Trends – Drivers

Consumer Disposable Income

Automobiles in general, let alone luxury automobiles, are incredibly expensive items. As such, their sales tend to be highly correlated with consumer disposable income. Despite the pandemic, consumer disposable income as a whole increased 5.7% in the U.S. in 2020 and continued to perform well in 2021, even surging 23.7% month over month in March. Loose monetary policy and historically low interest rates resulted in the availability of cheap financing options, making the option of purchasing a luxury automobile realistic to many consumers that otherwise may have been constrained.

GDP of BRIC Nations

BRIC nations (Brazil, Russia, India, China) are currently some of the fastest expanding economies in the world. This results in increased industrial capacity for producing vehicles and inputs for vehicle production, as well as increased consumer demand for vehicles. Given that these nations are minting new members of the upper and middle class at a much faster rate than other developed markets such as the U.S. or Europe, the continued GDP growth of these nations is a very important driver for the luxury automobile industry.

Price of Crude Oil and Steel

Automobile production involves a large number of natural resources as inputs, in particular steel, aluminium, and crude oil-derived products. Hence, industry profits vary with the global cost of these inputs. The industry is currently experiencing cost pressure in both of these inputs, adversely impacting profits as it is difficult to pass costs through to customers. Additionally, the price of crude oil has a large impact on the price of gasoline. As gasoline becomes more expensive automobiles become increasingly unaffordable to consumers, particularly luxury automobiles which often take premium-grade fuel.

Trends

Growing Demand for Luxury SUVs

One of the key trends seen in the luxury automobile segment is a shift in consumer demand from luxury sedans and coupes to luxury SUVs. The main reason behind this shift is the design perks of SUVs compared to other models available. SUVs come standard with more safety features as well as a more functional design. This leads safety-conscious consumers to prefer owning and driving an SUV over another model. In addition to this, the functionality of SUVs is higher. When compared to sedans, a staple design of luxury automobiles, SUVs offer more trunk space, legroom, and a higher seat position making the driver more comfortable. These key differences have led to a large shift in demand in the luxury automobile segment, from what used to be exclusively sedans to a variety of SUV models. Finally, the popularity of larger

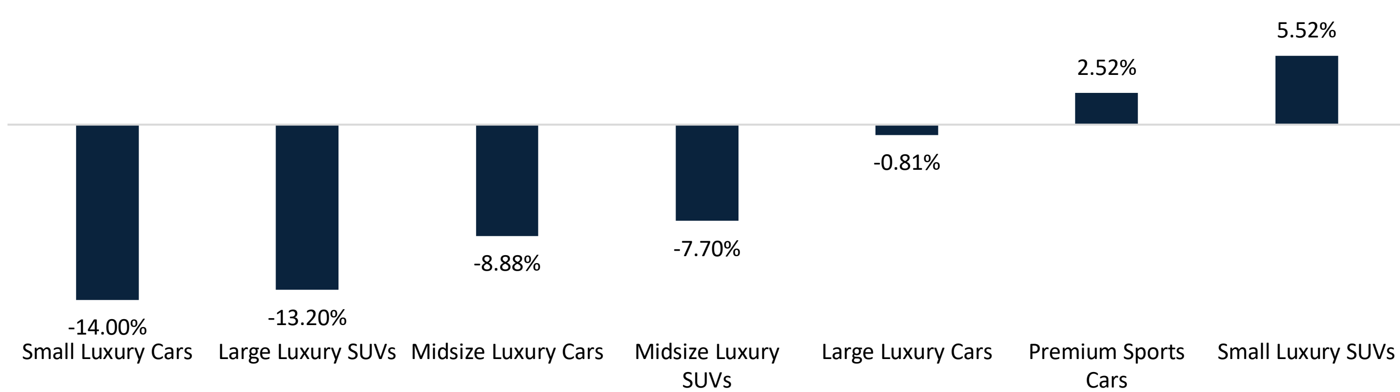


Figure 8. Luxury Car Sales Growth in US by Category, 2019 – 2020

Source: Statista

vehicles as SUVs has historically been negatively correlated with fuel prices. Following the 2015 decrease in fuel prices, the popularity of SUVs began to spike and this trend continues to unfold, particularly in the luxury subsector.

Shift Towards Electric Vehicles

Consumer preferences have been shifting towards electric vehicles ("EV") over gas cars because of the benefits EVs have over gas cars. Some key drivers behind this shift include government subsidies on purchasing an EV, not having to pay extremely high gas prices in some cities and having less of a carbon emissions impact on the planet. This was first seen in the consumer automotive segment but has now taken the luxury automobile segment by storm. Initially, EVs were primarily manufactured as performance cars within the luxury automobile segment, however, this is also quickly influencing other lines of cars such as Bentley with their Bentley Bentayga and with Porsche with their Porsche Panamera. In addition to shifting consumer taste, investment in electrification is also being necessitated by regulators. Most notably, in 2021 the European Union moved to ban the sale of new gas- or diesel-powered cars by 2035. California has been engaged in litigation with the U.S. federal governments of the jurisdiction of emissions regulation in the country. Due to the outcome of litigation being inherently uncertain major automakers such as Ford were compelled to reach deals the with California State Government to ensure they could prevent future models from being locked out of the market.

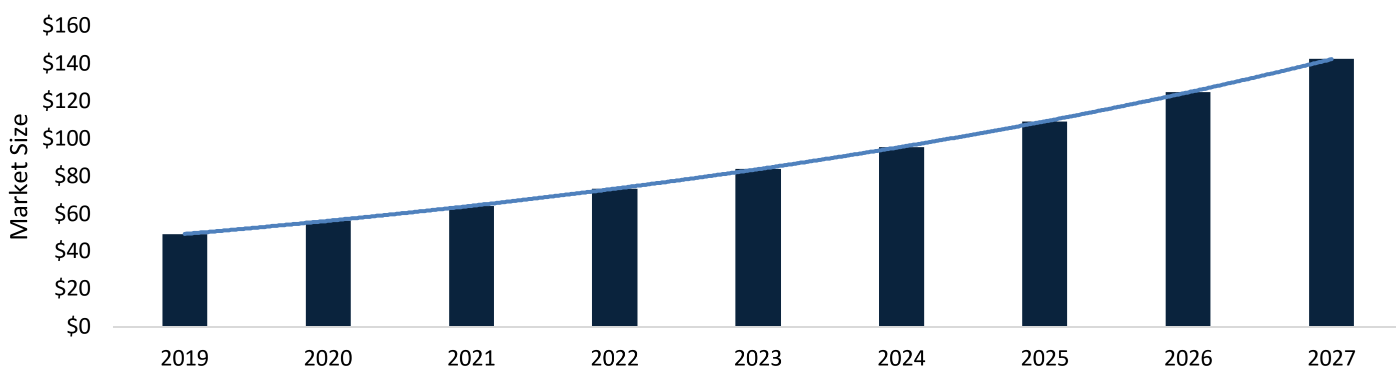


Figure 9. Projections for Global EV Market Size, 2019 - 2027 (US$ b)

Source: Statista

Large Investments in Supply Chain

A growing trend in the luxury automobile segment is companies investing heavily into their supply chains – ranging from direct investments into suppliers to the in-house production of necessary components. The most prominent example of this is with the shift towards EVs as companies have been working to secure their supply of batteries to avoid a shortage from the projected surge in demand and a repeat of the chip shortage. For instance, Daimler AG is working with Automotive Cells Company to develop their batteries for their luxury line and Bayerische Motoren Werke AG is investing in lithium production as well as their microchip supply lines. Additionally, as investor regard for ESG impact continues to rise automotive manufacturers are looking into their relationship with their suppliers. Automotive supply chains are incredibly complex; eight layers deep in some cases. As such, it is very difficult for companies in the space to ensure that their materials have been ethically sourced. Most major automotive companies are investing significant amounts of time and resources into monitoring and working with suppliers to ensure they are not sourcing parts that have passed through unethical labour or sourcing practices.

Competitive Landscape

The luxury automobile segment is highly competitive between a few major companies. This is due to the high costs of materials and manufacturing in combination with a smaller target market compared to other industries such as consumer automobiles. For reference, the luxury automobile segment makes up only 4.5% of total units sold within all consumer automobiles sold in the US. These industry characteristics encourage M&A activity as companies are pushed to acquire smaller brands to capture as much of the market as possible. Examples of this will be seen below, with the most prominent one being Volkswagen Group ("VWG") targeting all aspects of the consumer and luxury automobile markets with their diverse portfolio of brands.

Overview of Key Players

Daimler AG (ETR: DAI)

Daimler AG ("Daimler") is one of the leading players in the luxury automotive segment with a market capitalization of $82.2 billion USD. Within this segment, their key brands include Mercedes-Benz, Mercedes-AMG, Mercedes-Maybach, and Aston Martin Lagonda. In 2021 Q3, Daimler like many other automobile manufacturers suffered from a semiconductor and chip shortage resulting in 25% lower units sold compared to 2020 Q3. This did not impact their revenue though as Daimler has been shifting their product mix which resulted in revenue remaining the same from the previous year. As the automobile and luxury automobile segments move towards electric vehicles as brands introduce them into their lineups, Daimler has taken an aggressive strategy to this shift. In addition to shifting their products to electric-powered, they have also joined Automotive Cells Company to develop speciality batteries that will cater to the luxury and performance automobile segments.

Bayerische Motoren Werke AG (ETR: BMW)

Bayerische Motoren Werke AG ("BMW") has a market capitalization of $65.4 billion USD and is the next leader in the luxury automotive segment. In the luxury automotive segment, their key brands consist of Rolls-Royce, BMW, and some high-end models of their John Cooper Works Minis. Given the transition towards electric cars, BMW has taken a similar approach to Daimler in becoming involved in the battery manufacturing process. BMW announced that they are now investing in lithium extraction to make it more efficient and sustainable considering the growing demand, and sure to secure their own supply. Similarly, BMW has been strengthening their supply chain by securing contracts with microchip and semiconductor manufacturers including INOVA Semiconductors and GlobalFoundaries to ensure they will not face another shortage as seen in 2021.

Jaguar Land Rover Automotive PLC (NYSE: TATAMOTORS)

Jaguar Land Rover Automotive PLC ("JLR") is owned by Tata Group and is traded under their symbol with a market capitalization of $23.07 billion USD. Tata Motors owns a range of companies, but the ones relevant to the automotive segment are JLR, Tata Motors Limited, and Tata Steel Limited. Both JLR and Tata Motors Limited produce luxury automobiles and Tata Steel is one of the largest crude steel manufacturers in the world. Unlike other automobile companies who have more recently begun internalizing their supply chains, JLR and Tata Steel have been ahead of their competitors. This however did not help JLR face the chip shortage as they lost $413 million USD in Q2 2021.

Volkswagen Group (ETR: VOW3)

Volkswagen Group is one of the leading automobile manufacturers with their portfolio of brands with a market capitalization of $128.07 billion USD. Specifically, in the luxury automotive segment, their brands include Porsche, Bentley, Lamborghini, and Audi as well as Ducati for premium motorcycles. Like other automobile companies, VWG faced a loss of $208.83 million USD in Q3 2021 due to the chip shortage which was around the industry average of a 25% loss. With the shift towards electric vehicles, VWG has been transitioning most of their brands to exclusively electric lines and as such has been investing heavily into their battery supply and manufacturing. The company is an industry leader in the shift to electrification, with an extensive and developed fleet of fully electric and plug-in hybrid models. VWG partnered with Vulcan Energy Resources Ltd. for zero-carbon lithium, joined Umicore to produce components of battery cells, and invested $24.0 million USD to obtain battery manufacturing processes such as dry coating.

Marketshare of Key Competitors by Brand

Since competitors' market capitalizations will include their business conducted in other sectors and is not an accurate representation of their dominance in the luxury automotive segment, Figure 9 shows the units sold of each brand worldwide. Lexus is the only luxury car brand in the top three most reliable car brands according to consumers in a 2021 study, with an average score of 76, followed by Mazda with 75 and Toyota with 71. No major acquisitions or new entrants have occurred after 2016 so this chart is an accurate depiction of the market landscape.

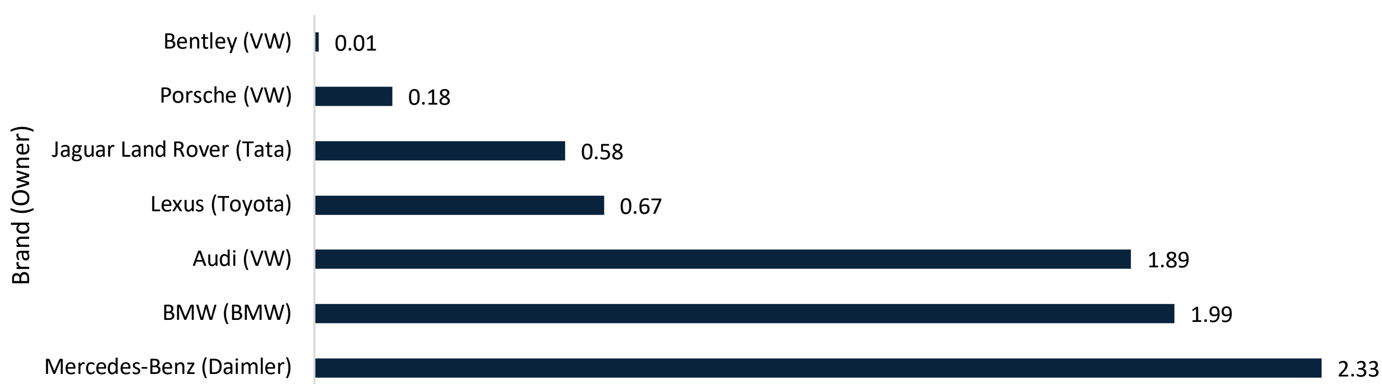


Figure 10. Luxury Car Sales Worldwide in 2016 (Millions of Units)

Source: Statista

Volkswagen Group (ETR: VOW3)

Consumer Retail - Automobiles

Racing Ahead of the Competition

January 6, 2022

Analyst: Matias Canofari, BCom. '24
contact@westpeakresearch.com

Equity Research	EU
Price Target	**EUR €235.22**
Rating	Buy
Share Price (Jan. 6 Close)	EUR €189.10
Total Return	24.4%

Key Statistics	
52 Week H/L	€252.2/€141.8
Market Capitalization	€122.97B
Average Daily Trading Volume	€1.14M
Net Debt	€205.86B
Enterprise Value	€235.54B
Net Debt/EBITDA	7.2x
Shares Outstanding	€5.01B
Free Float	46.9%
Dividend Yield	2.54%

WestPeak's Forecast	2021A	2022E	2023E
Revenue	€222.9B	€200.6B	€210.9B
EBITDA	€28.5B	€25.7B	€27.2B
Net Income	€18.4B	€15.6B	€16.6B
EPS	€16.60	€15.23	€16.14
P/E	5.3x	4.2x	5.1x
EV/EBITDA	4.4x	3.5x	3.9x

1-Year Price Performance

Volkswagen Group ("VWG") manufactures and sells automobiles in European, American, and Asian-Pacific markets. They operate with four segments – passenger cars and light commercial vehicles, commercial vehicles, power engineering, and financial services. In addition to cars and commercial vehicles, VWG offers heavy machinery, motorcycles, insurance, and fleet management solutions.

Internal Analysis – Expansion of Electric Vehicle Battery Production

Companies such as VWG have begun moving into battery manufacturing in anticipation of the rising demand for batteries due to shifting consumer preferences. VWG has already formed partnerships to develop sustainable lithium mines, battery cell components, and innovations such as dry coating to use on their batteries. This move into battery manufacturing represents a big opportunity for VWG to become a key player in the rising market.

External Analysis – Shift to Electric Vehicles

With consumer preferences shifting towards electric vehicles ("EV"), car manufacturers have begun shifting their models to operate with electricity over gas. VWG has already implemented EVs into nearly every one of their brands' products, well ahead of competitors such as Jaguar Land Rover Automotive PLC who have not reached the same level of integration. This shift will allow VWG to use their already established EVs to corner the market in most categories while other companies try to catch up. This shift will not be enough to outweigh the immediate losses incurred by the chip shortage, however, recovery is projected as the chip shortage ends and EVs see an uptick in demand.

Valuation

Based on our analysis, we have determined a target share price of €235.22. Using a DCF, comp analysis, and industry consensus, we have determined that VWG is undervalued with an implied upside of 24.4%. As such, we are placing a **buy** rating on Volkswagen Group.

Daimler AG (ETR: DAI)

Consumer Retail - Automobiles

Pushing for Electrifivation

January 9, 2022

Analyst: Alex McKenzie, BCom. '23
contact@westpeakresearch.com

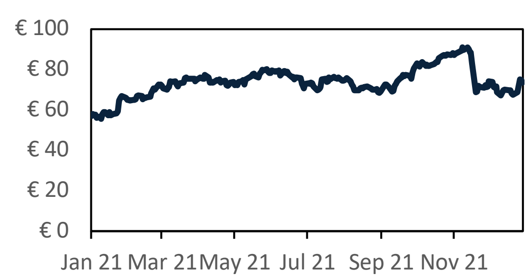
Equity Research	EU
Price Target	**€90**
Rating	Buy
Share Price (Jan. 9 Close)	EUR €73.56
Total Return	22.35%

Key Statistics	
52 Week H/L	€91.63/€55.44
Market Capitalization	€78.69B
Average Daily Trading Volume	€3.21M
Net Debt	€130.71B
Enterprise Value	€182.28B
Net Debt/EBITDA	6x
Shares Outstanding	1.07B
Free Float	70.29%
Dividend Yield	3.14%

WestPeak's Forecast

	2021A	2022E	2023E
Revenue	€167.87	€184.66	€193.88
EBITDA	€24.45B	€26.7	€28.24
Net Income	€13.8B	€15.06B	€15.93B
EPS	€3.39	€3.7	€3.91
P/E	5.3x	4.7x	5.1x
EV/EBITDA	7.45x	6.3x	7.5x

1-Year Price Performance



Daimler AG ("DAI") manufactures and sells automobiles in European, American, and Asian-Pacific markets. They manufacture and sell passenger cars, trucks, vans, and buses. The Mercedez-Benz brand, which includes Mercedes-AMG and Mercedes-Maybach offers premium luxury vehicles.

Internal Analysis – Vertical Integration into Battery Production

Mercedes has rolled out a battery strategy that largely mirrors Volkswagen's. The company is aiming to produce a standard battery unit that will be used in 90% of vehicles. The company is opening eight new battery factories. Major players in the luxury automotive space are pushing for vertical integration in the EV supply chain in order to capture margin.

External Analysis – Shift to Electric Vehicles

As ESG awareness has proliferated and consumers have been incentivized by subsidies to purchase electric vehicles, EV demand has surged. Daimler operates primarily in the European Union, which has some of the strictest emissions regulations in the world. As such, Diamler has set an ambitious goal of a 50% EV sales mix by 2025. Vehicles in the electric vehicle space currently have a lower margin than gas-powered vehicles due to the high price of inputs. Despite this, Daimler has maintained its margin target through 2025. This target is heavily reliant on falling battery costs through the coming years. Daimler is planning to spin off its Daimler Truck and rename the remaining entity Mercedes-Benz Group AG. The move is aimed at narrowing the company's valuation gap with Tesla by having it recognized as a premium tech company and leader in the space.

Valuation

Based on our analysis, we have determined a target share price of €90. By utilizing a DCF, comp analysis, and industry consensus, we have determined that DAI is undervalued with an implied upside of 22.35%. As such, we are placing a **buy** rating on Daimler AG.