metro

MSU: Metro Inc. Pitch

February 24, 2016

QUEEN'S CAPITAL

Disclaimer

The analyses and conclusions of Queen's Capital contained herein are based on publicly available information. The analyses provided may include certain statements, estimates and projections prepared with respect to, among other things, the historical and anticipated operating performance of the companies, access to capital markets and the values of assets and liabilities. Such statements, estimates, and projections reflect various assumptions by Queen's Capital concerning anticipated results that are inherently subject to significant economic, competitive, and other uncertainties and contingencies and have been included solely for illustrative purposes. Actual results may vary materially from the estimates and projected results contained herein.

Queen's Capital assumes no responsibility or liability for any error, inaccuracy, or omission contained that may be made of such information by the viewer. No information herein may be replicated without prior consent by the Executive Board of Queen's Capital.

Executive Summary

metro

Content	Slide
Company Overview	4
Industry Outlook	5
Investment Thesis	6
Catalysts	7
Risks	8
Valuation	10-13
Target Price	13

Company Overview

metro

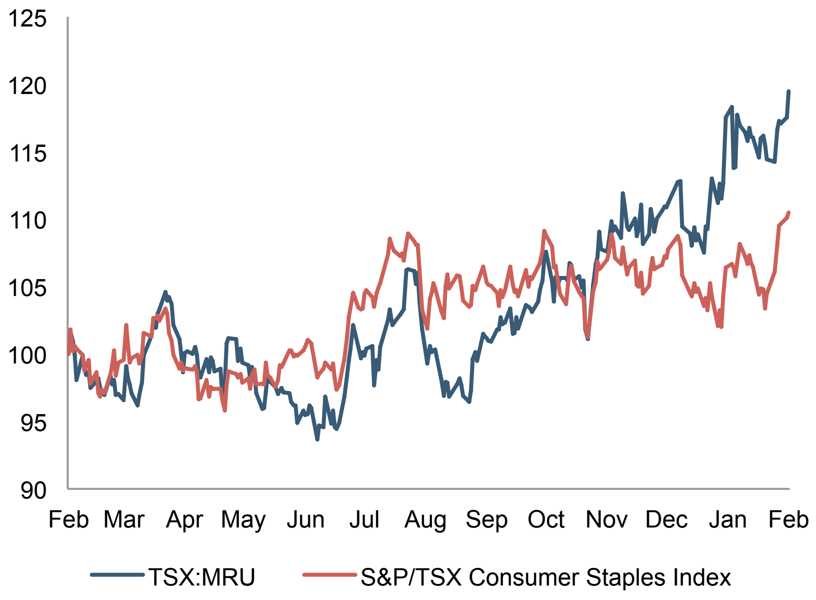
Operational Overview

- Metro is a food retailer and distributor in Quebec and Ontario, operating a network of supermarkets, discount stores and drug stores
- Operates 590 food stores under Metro, Metro Plus, Super C, Food Basics, Adonis, and Premiere Moisson; and 254 drugstores under the Brunet, Clini Plus, and Drug Basics banners
- Holds a 5.7% stake in Alimentation Couche-Tard Inc. (~$1.95bn)

Market Data

Mkt. Cap (mm)	9,845.9	**P/E**	19.4x
EV (mm)	11,504.6	**EV/EBITDA**	12.1x
Last Price	41.61	**Div. Yield %**	1.4%
52 Week High	42.43	**Float %**	99.6%
52 Week Low	32.87	**2015 EBITDA**	876.0
Float %	99.6%	**2015 Revenue**	12,344.9
Beta 5Y	0.16	**2015 Earnings**	532.9

LTM Price Performance vs. Index



Overview | Industry Outlook | Investment Thesis | Catalysts & Risks | Valuation

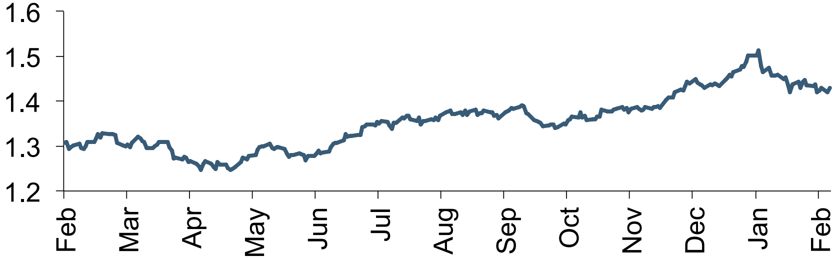
Industry Outlook

metro

Overview

- Over 2015 the consumer staples index beat the S&P 500 by around +5%
- Low oil prices is increasing consumer spending power, but it is also leading to investor's fear that the weakened economy will decrease demand for energy and materials
- Additionally, low commodity prices will help improve staple's profit margins as input prices will decrease
- Canadian grocery market is highly consolidated with only 5 companies controlling over 80% market share
- Limited competition has lead to higher profits and margins (operating margins from 5-7%)
- Unique characteristics of Canadian market provide a barrier to entry for American Companies like Safeway and SUPERVALU
- Small express stores that struggle in the US are in high demand in Canada, with Metro's network at 40% (Food Basics and Super C)

Weak CAD Tough on Domestic Retailers



- Input prices for food retailers are increasing due to the weak CAD and higher import costs; profit margins are being squeezed
- On a general note, US companies are looking into Canadian acquisitions (e.g. Lowe's $3.2bn acquisition of Rona's in Jan 2016)

Shift into E-Commerce

- "Click and Collect" being tested in parts of Western Canada by Loblaws and Wal-Mart
- Experts believe it will take 3-5 years before grocery e-commerce will be a significant channel (currently represents 0.2% of the grocery market)

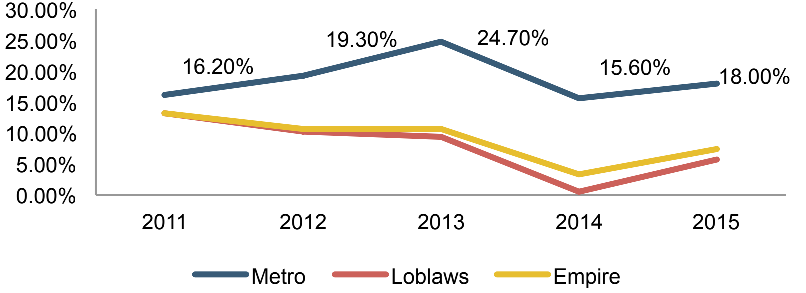
Investment Thesis I: Strong Fundamentals to Provide LT Growth

metro

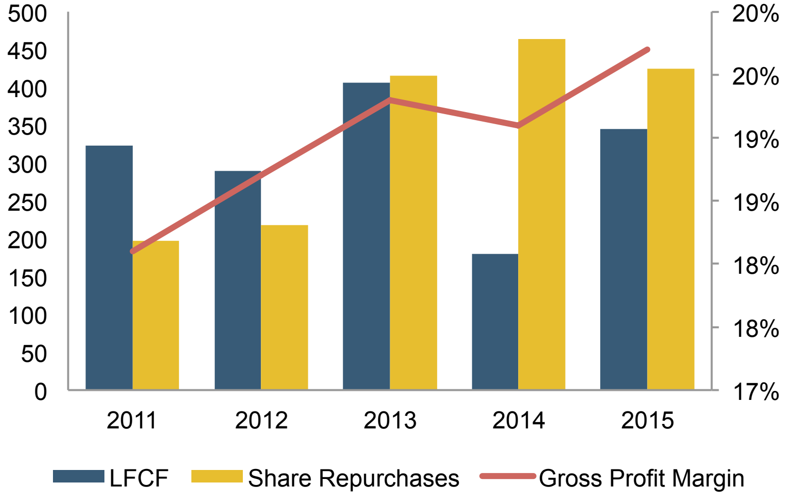
Overview

- Strong financial performance that has consistently outperformed estimates over the past two fiscal years
- Holds a solid portfolio of well-recognized food retailers and drugstores that allows it to appeal to multiple consumer base

Industry-Leading ROE



Strong Cash Flows and Gross Profit Margins



- Metro's consistent cash flow generation allows it to engage in opportunistic acquisitions, dividend hikes, and share repurchases, all of which are accretive to equity holders

Overview | Industry Outlook | Investment Thesis | Catalysts & Risks | Valuation

Investment Thesis 2: Well-positioned in Economic Downturn

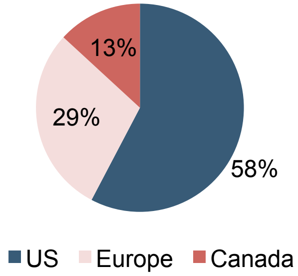
Lack of Direct Exposure to Alberta

- Metro operates solely in Ontario and Quebec
- Based on February 2016 data, Alberta's unemployment rate is at 7.4%, surpassing the national rate of 7.2%
- The bulk of job losses were from Alberta and New Brunswick, areas where Metro has no operations
- Ontario saw job expansion of 20,000 jobs in January; Albertans are looking to move to Ontario and British Columbia to find employment; a positive economic indicator of Ontario

Downside Protection due to Diversification

- Metro operates Food Basics and Super C, discount food retailers in Ontario and Quebec, respectively
- More customers will begin to shop at Metro's discount retailers during the recession, allowing for customer retention
- Drugstore revenues will likely hold steady, as spending on drug products are marginally affected during recessionary periods
- Metro's impressive and growing private label mix sold earn higher margins over branded product; 350 products added in 2015

Stake in Alimentation Couche-Tard Provides Further Diversification



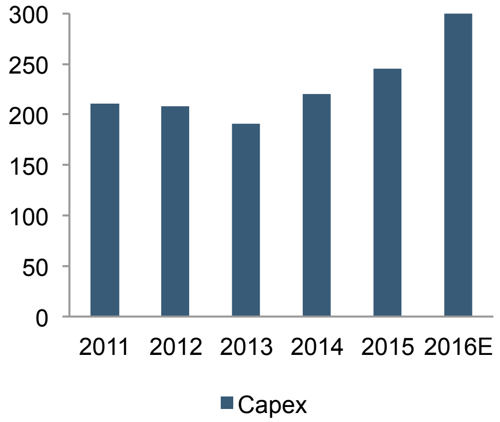
- Owns a $1.95bn stake in Couche-Tard, an operator of convenience stores through and US, Europe, and Canada
- Offers diversified end market exposure and is well-positioned in US and European markets
- Engages in selective value-oriented acquisitions, including Topaz, a convenience store company in Ireland in December 2015

Catalysts

metro

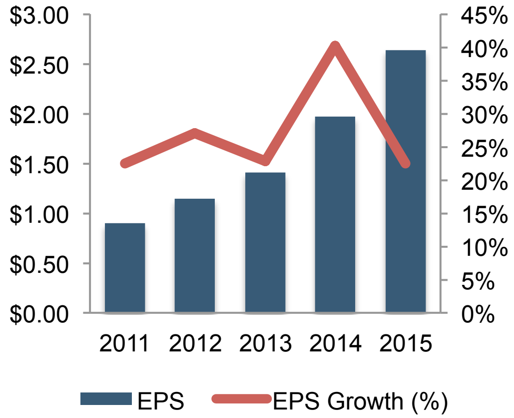
Continued Investments in 2016

- $300 million in planned investments into 10 new store openings and 30 major renovations this year
- Management's past investments have improved performance and resulted in price appreciation



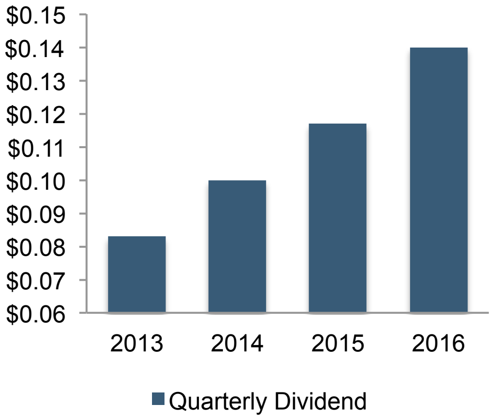
Stake in Alimentation Couche-Tard

- Metro's stake in Couche-Tard can serve as a catalyst for growth in the future
- Couche-Tard's recent acquisition in Topaz may result in price appreciation



Dividend Hike

- Metro has consistently raised its dividend for over 20 years
- Dividend raises going forward may make the stock more attractive for investors looking for blue-chip stocks with growing dividends



Risks

metro

Food Price Inflation

- Food-cost inflation is driving up prices for grocery retailers, with fruit and vegetables up 9%, and meat up 5%
- This is mainly due to the weakened loonie which currently sits at 0.73 compared to the US dollar
- Despite rising prices Metro’s same store sales are increasing, and they are able to sell more despite the record high inflation
- While persistent inflation may impact profits, currently they are not impacting Canadian grocery retailers significantly

Trend Towards Healthy Eating

- Global sales of healthy products estimated to hit $1 trillion 2017, with 88% of consumers willing to pay a premium
- Fresh food market is estimated to hit $60 billion in sales by 2025, which is an area that Metro needs to improve on
- Google is launching a fresh grocery delivery service in LA and San Francisco (could pose a problem for Metro in the future)
- Metro is taking steps to improve their fresh food, investing $300 million for 10 new stores and 30 major renovations

Investment in Alimentation Couche-Tard

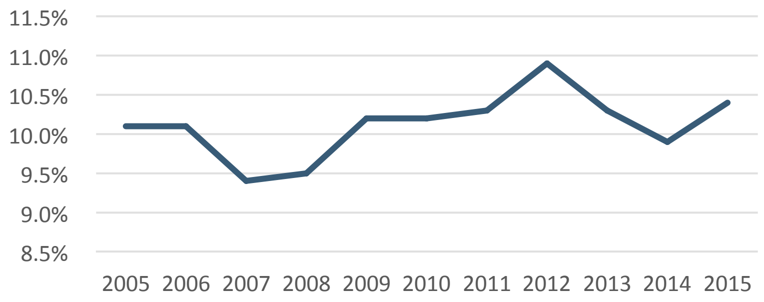
- Metro holds 5.7% interest in Alimentation Couche-Tard with share of earnings at $64.3 for the 2015 fiscal year
- This poses new potential risks for Metro Inc. if Couche-Tard begins to do poorly (risks such as M&A execution, and management changes due to new CFO)
- Upside of the investment in Alimentation Couche-Tard is that their strong growth and profitability has allowed Metro to sell around half of their investment in 2013 for $266.4 million which they invested in

Valuation – Public Company Comparables

metro

Company Comp Set	Market Cap ($MM)	Enterprise Value ($MM)	EV/Sales LTM	EV/Sales 2016E	EV/Sales 2017E	EV/EBITDA LTM	EV/EBITDA 2016E	EV/EBITDA 2017E	P/E LTM	P/E 2016E	P/E 2017E	ROIC LTM	ROE LTM	ROA LTM
Loblaw Companies Ltd. (TSX:L)	$27,551.01	$38,184.01	0.8x	0.8x	0.8x	10.6x	10.8x	10.1x	31.0x	19.4x	17.0x	5.37%	5.70%	3.50%
Empire Company Limited (TSX:EMP.A)	$7,048.89	$9,268.39	0.4x	0.4x	0.4x	7.5x	7.5x	6.9x	16.0x	15.4x	13.4x	12.49%	6.20%	4.20%
North West Company Inc. (TSX:NWC)	$1,513.16	$1,698.30	0.9x	0.9x	0.9x	11.6x	10.9x	10.0x	21.8x	19.9x	18.9x	13.85%	20.60%	8.90%
High	$27,551.01	$38,184.01	0.9x	0.9x	0.9x	11.6x	10.9x	10.1x	31.0x	19.9x	18.9x	13.85%	20.60%	8.90%
Low	$1,513.16	$1,698.30	0.4x	0.4x	0.4x	7.5x	7.5x	6.9x	16.0x	15.4x	13.4x	5.37%	5.70%	3.50%
Mean	$12,037.69	$16,383.57	0.7x	0.7x	0.7x	9.9x	9.7x	9.0x	22.9x	18.2x	16.4x	10.57%	10.83%	5.53%
Median	$7,048.89	$9,268.39	0.8x	0.8x	0.8x	10.6x	10.8x	10.0x	21.8x	19.4x	17.0x	12.49%	6.20%	4.20%
Metro Inc. (TSX:MRU)	$9,921.34	$11,356.04	0.9x	0.9x	0.9x	12.9x	12.2x	11.8x	19.3x	17.8x	16.4x	12.67%	19.10%	7.80%

Metro Historical ROIC



Commentary

- Metro is undervalued compared to its peer group on a P/E basis, but is overvalued in terms of a EV/Sales and EV/EBITDA basis
- We believe that the company is moving towards stronger revenue and EBITDA growth through continual expansion of store footprint, ongoing renovations, and shifting focus towards more urban locations servicing fresh produce and home meal replacements
- The company has strong profitability metrics in comparison, Metro’s ROIC, ROE, and ROA are all higher than the mean and median of its peers
- ROIC for the company has been relatively stable over the past 10 years, averaging around 10-10.5% consistently

Valuation – DCF Assumptions and Output

metro

Comparable Companies - Unlevered Beta Calculation					
Name	Levered Beta	Debt	Equity Value	Tax Rate	Unlevered Beta
Loblaw Companies Ltd.	0.63	2,117	27,551	29.6%	0.60
North West Company Inc.	0.54	219	1,513	31.9%	0.49
Empire Company Limited	0.80	1,526	7,049	36.9%	0.70
Median	**0.63**				**0.60**

Metro - Levered Beta Calculation					
Name	Unlevered Beta	Debt	Equity Value	Tax Rate	Levered Beta
Metro Inc. - Levered Beta Calculation	**0.60**	1,356	9,921	24.92%	**0.66**

WACC Calculation			
Risk-Free Rate	1.12%	Market Cap	$9,912,334,200
Levered Beta	0.66	Debt	$1,356,000,000
Expected Market Return	12.09%	Total Cap	$11,268,334,200
Cost of Equity (Re)	8.37%	% Equity	87.97%
Tax Rate	24.92%	% Debt	12.03%
Cost of Debt (Rd)	3.95%	**WACC**	**7.72%**
Share Price	$41.61	**Perpetuity Growth Rate**	**2.00%**
Shares Outstanding	238,220,000		

Share Price Calculation	
PV of UFCF	5,023.85
Terminal Growth Rate	2.00%
Discount Rate	7.72%
PV of Terminal Value	8,419.87
Enterprise Value	**13,443.72**
Enterprise Value	13,443.72
Less: Net Debt	1,356.00
Less: Noncontrolling Interests	235.10
Plus: Cash and Cash Equivalents	21.50
Implied Equity Value	**11,874.12**
Shares Outstanding	238.22
Implied Share Price	**49.85**

		Terminal Growth Rate				
		1.80%	1.90%	2.00%	2.10%	2.20%
WACC	6.92%	57.60	58.48	59.41	60.37	61.37
	7.32%	52.76	53.50	54.26	55.06	55.88
	7.72%	48.58	49.20	49.85	50.51	51.20
	8.12%	44.94	45.47	46.01	46.57	47.15
	8.52%	41.73	42.19	42.65	43.13	43.62

Valuation – DCF Model

metro

Metro DCF Summary

	Historical Period			Projection Period									
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Revenue	**11,400**	**11,590**	**12,224**	**12,957**	**13,864**	**14,904**	**16,096**	**17,304**	**18,515**	**19,718**	**20,901**	**22,051**	**23,154**
Revenue Growth	*(2.4%)*	*1.7%*	*5.5%*	*6.0%*	*7.0%*	*7.5%*	*8.0%*	*7.5%*	*7.0%*	*6.5%*	*6.0%*	*5.5%*	*5.0%*
Cost of Goods Sold	(10,589)	(10,794)	(11,360)	(12,048)	(12,891)	(13,858)	(14,967)	(16,089)	(17,216)	(18,335)	(19,435)	(20,504)	(21,529)
Selling, General & Administrative	(8)	(4)	(4)	(6)	(7)	(7)	(8)	(8)	(9)	(9)	(10)	(10)	(11)
Depreciation & Amortization	(180)	(176)	(177)	(196)	(210)	(226)	(244)	(262)	(280)	(298)	(316)	(334)	(350)
Operating Expenses	(10,777)	(10,974)	(11,541)	(12,250)	(13,108)	(14,091)	(15,218)	(16,360)	(17,505)	(18,642)	(19,761)	(20,848)	(21,890)
Operating Income	**623**	**617**	**683**	**707**	**756**	**813**	**878**	**944**	**1,010**	**1,076**	**1,140**	**1,203**	**1,263**
Add: Depreciation & Amortization	180	176	177	196	210	226	244	262	280	298	316	334	350
EBITDA	**802**	**793**	**860**	**903**	**966**	**1,039**	**1,122**	**1,206**	**1,290**	**1,374**	**1,457**	**1,537**	**1,614**
EBITDA Margin	*7.0%*	*6.8%*	*7.0%*	*7.0%*	*7.0%*	*7.0%*	*7.0%*	*7.0%*	*7.0%*	*7.0%*	*7.0%*	*7.0%*	*7.0%*
Less: Depreciation & Amortization	(180)	(176)	(177)	(196)	(210)	(226)	(244)	(262)	(280)	(298)	(316)	(334)	(350)
EBIT	**623**	**617**	**683**	**707**	**756**	**813**	**878**	**944**	**1,010**	**1,076**	**1,140**	**1,203**	**1,263**
EBIT Margin	*5.5%*	*5.3%*	*5.6%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*	*5.5%*
Cash Taxes	(197)	(150)	(161)	(188)	(201)	(216)	(233)	(251)	(268)	(286)	(303)	(319)	(335)
NOPAT	**425**	**467**	**521**	**519**	**556**	**597**	**645**	**693**	**742**	**790**	**838**	**884**	**928**
Add: Depreciation & Amortization	180	176	177	196	210	226	244	262	280	298	316	334	350
Less: CapEx	(208)	(191)	(220)	(228)	(244)	(262)	(283)	(304)	(325)	(347)	(367)	(388)	(407)
Less: Change in Net Working Capital	(59)	181	8	48	51	55	59	64	68	72	77	81	85
Unlevered Free Cash Flows	**337**	**633**	**486**	**535**	**573**	**616**	**665**	**715**	**765**	**814**	**863**	**911**	**956**
Discount Period				0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5
Discount Factor				96.3%	89.4%	83.0%	77.1%	71.6%	66.4%	61.7%	57.3%	53.2%	49.3%
Present Value of Unlevered Free Cash Flows				516	512	511	513	511	508	502	494	484	472

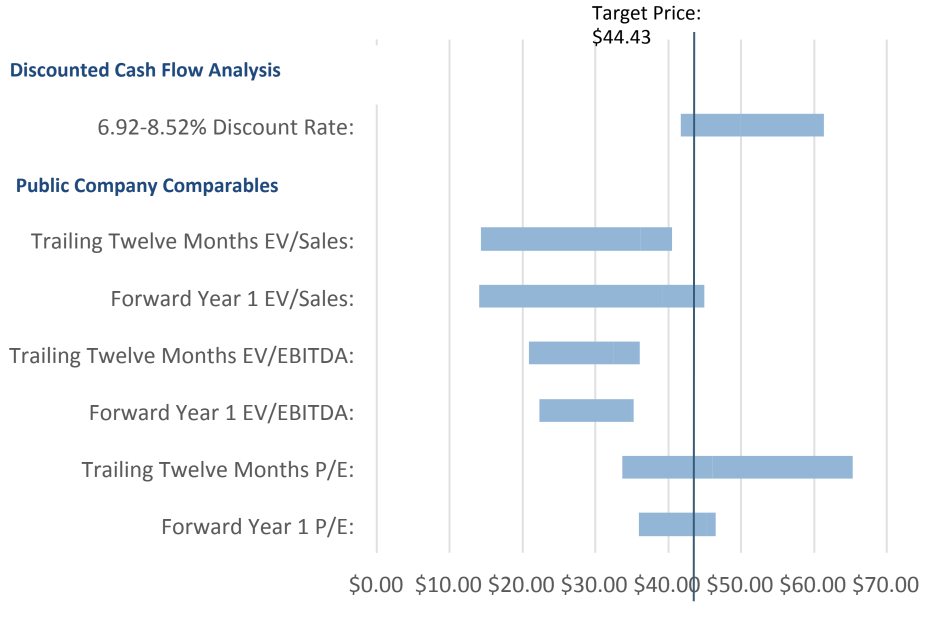
Operating Assumptions

	Historical Period			Projection Period									
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
Expenses as % of Revenue													
Cost of Goods Sold	(92.9%)	(93.1%)	(92.9%)	(93.0%)	(93.0%)	(93.0%)	(93.0%)	(93.0%)	(93.0%)	(93.0%)	(93.0%)	(93.0%)	(93.0%)
Selling, General & Administrative	(0.1%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)	(0.0%)
Depreciation & Amortization	(1.6%)	(1.5%)	(1.4%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)	(1.5%)
Capital Expenditures	(1.8%)	(1.6%)	(1.8%)	(1.8%)	(1.8%)	(1.8%)	(1.8%)	(1.8%)	(1.8%)	(1.8%)	(1.8%)	(1.8%)	(1.8%)
Cash Taxes													
Tax Rate	(31.7%)	(24.3%)	(23.6%)	(26.5%)	(26.5%)	(26.5%)	(26.5%)	(26.5%)	(26.5%)	(26.5%)	(26.5%)	(26.5%)	(26.5%)
Change in NWC as % of Revenue	(0.5%)	1.6%	0.1%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%	0.4%

Valuation – Conclusion

metro

Indicative Valuation Range



Conclusion

- In the Canadian bear market, we believe Metro is a an attractive investment opportunity with significant downside protection due to its strong underlying fundamentals, consistent cash flows, and dividend growth
- We recommend buying the stock at market price and holding until either: A) the stock reaches $44.43 or B) new information becomes available to determine the appropriate course of action

Investment Summary

Valuation Method	Weighting	Target Price
DCF Analysis	50%	$49.85
Public Company Comparables	50%	$39.02
Target Price		**$44.43**
Current Price		$41.16
Dividend Yield		1.32%
All-in Return		9.27%
Stop Loss		Price
Soft Stop Loss		$34.00
Hard Stop Loss		$30.00