
To: Queen's Capital Advisory Board
From: Kelvin Li
Date: July 28, 2015
Re: **George Weston Ltd. (TSX:WN) [Weston Foods Stub]**

COMPANY PROFILE

Industry: Food Retail
Main Asset(s): Loblaws and Weston Foods

Market Capitalization: \$491mm

Net Debt: \$488mm

Enterprise Value: \$978mm

NTM(E) Revenue: \$1,981mm

NTM(E) EBITDA: \$349mm

INVESTMENT PROFILE

Current Stub Value: \$3.84

Base Case Valuation: \$17

Downside Case Valuation: \$12

Upside Case Valuation: \$23

COMPANY DESCRIPTION

George Weston Limited, through its subsidiaries, engages in the food processing and distribution business in Canada and internationally. It operates through two segments, Weston Foods and Loblaws.

The Weston Foods segment produces fresh, frozen, and specialty bakery products, including breads, rolls, bagels, tortillas, donuts, cakes, pies, cookies, crackers, and other baked goods. This segment also provides control brand products to retailers and consumer food companies; supplies ice cream cones and sandwich wafers to the dairy industry, as well as Girl Scout cookies; and distributes cookies and control brand products. It sells its branded and control branded products through national and regional supermarkets, wholesale and club stores, convenience stores, food service distributors, and outlets, as well as other food retailing customers in North America under Wonder, Country Harvest, D'Italiano, Gadoua, Weston, ACE Bakery, Première Fournée de Weston, Deli World, All But Gluten, Casa Mendosa, and Flat Oven Bakery names. George Weston Limited was founded in 1882 and is headquartered in Toronto, Canada.

INVESTMENT THESIS

George Weston Ltd.'s stock price has been closely related to Loblaws' stock price due to 95.6% of WN sales originating from Loblaws operations. In late 2013, Loblaws' acquisition of Shoppers Drug Mart increased the gap between the stock price of Loblaws and George Weston, mainly due to increased synergies. The heavy growth in the Loblaws portion of WN's operating segment has overshadowed the Weston Foods portion that sells baked goods. This creates an opportunity for value as investors flock towards Loblaws stock. Sales within the Weston Food segments are beginning to turn around after a few quarters of consecutively decreasing volume. Just last year WN had an increase of 6% in their Weston Food segment compared to the same store sales growth of 2% within the Loblaws segment. The annual growth rate of the baked foods market is 2.2%. This recent growth in the Weston Foods segment and increasing distribution in Shoppers Drug Mart, Dollarama, and Costco stores will bolster growth moving forward. Also, plans of spending \$470mm dollars in the next 2 years to expand capacity in cake, donuts, cookies, crackers and artisan bread is a strong signal of increased demand for this growing segment. WN also trades on the lower end in terms of EV/EBITDA when compared to its peers. With an EV/EBITDA multiple of roughly 3x, it has room to grow to reach the industry average of 13x. Weston Foods has historically operated at a 7.5x EV/EBITDA multiple, this would imply a \$8 price based on the current \$311mm in EBITDA. Factoring in multiple valuation methods a downside case of \$12 still highlights significant value in the Weston Food stub.

KEY INVESTMENT RISKS

RISK I Description of Risk I: **Rising costs in input prices** – George Weston's operations in the food industry cause it to be sensitive to the cost of its inputs. The Weston Food segment is especially sensitive to wheat prices as flour is used to make its baked goods.

Mitigating Factor to Risk I: The world price of wheat is expected to stagnate until 2020. This allows prices to be predictable and margins to be adjusted accordingly. WN is expected to increase the cost of their products slightly due to increasing wheat prices in the coming year.

RISK II Description of Risk II: **Transition towards healthy eating** – The food industry is in a period where consumers are seeking healthy alternatives to their meals. An opportunity exists for manufacturers to increase the health quotient of their products by adding healthy or functional ingredients.

Mitigating Factor to Risk II: George Weston is working to develop new products such as grain bread, gluten-free bread and flat bread as sales have declined in white and whole-wheat products. In 2013, it introduced a line of baked goods called All But Gluten, tapping into the demand for gluten-free bakery products in Canada. WN is continuing to change their products based on consumer preferences.

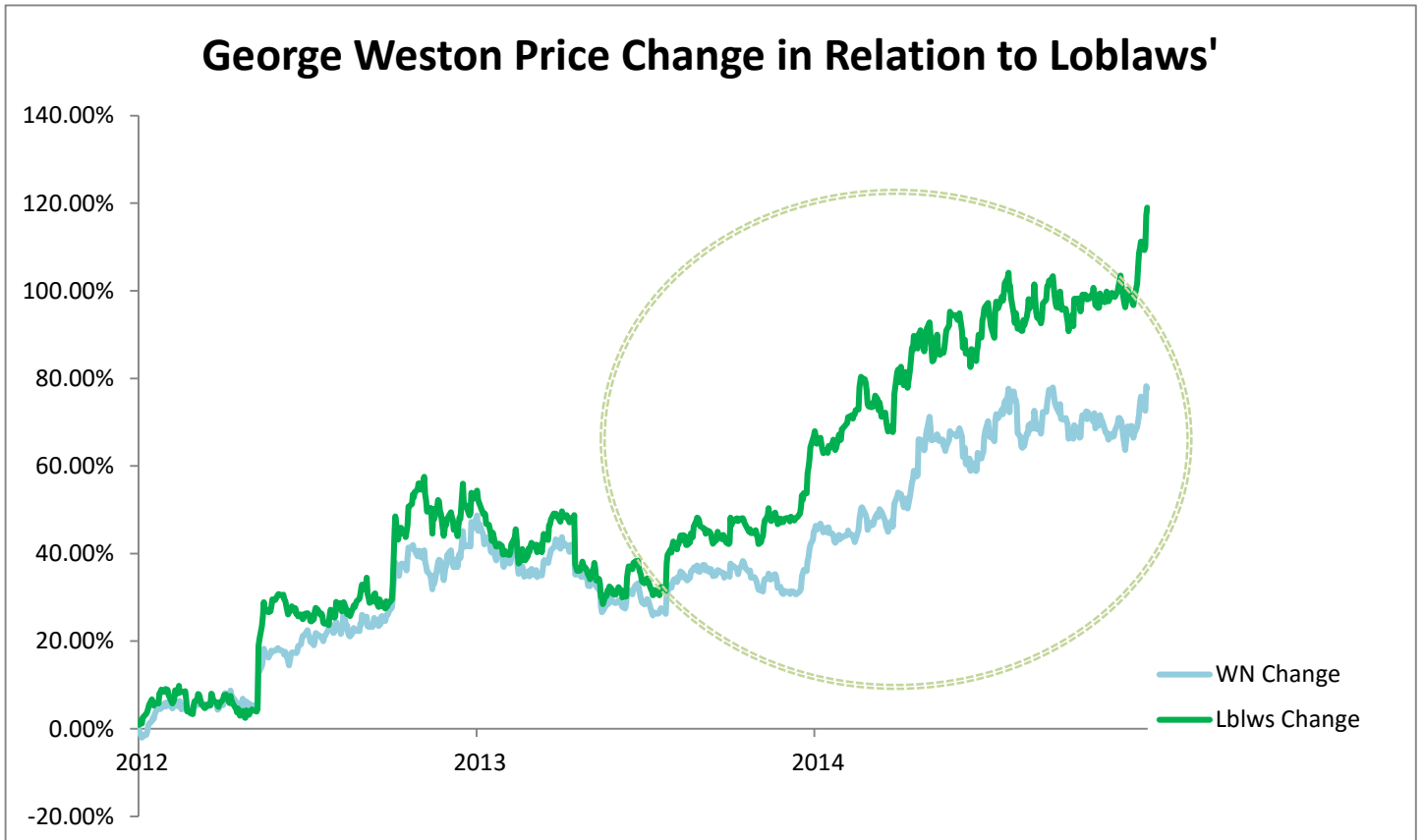
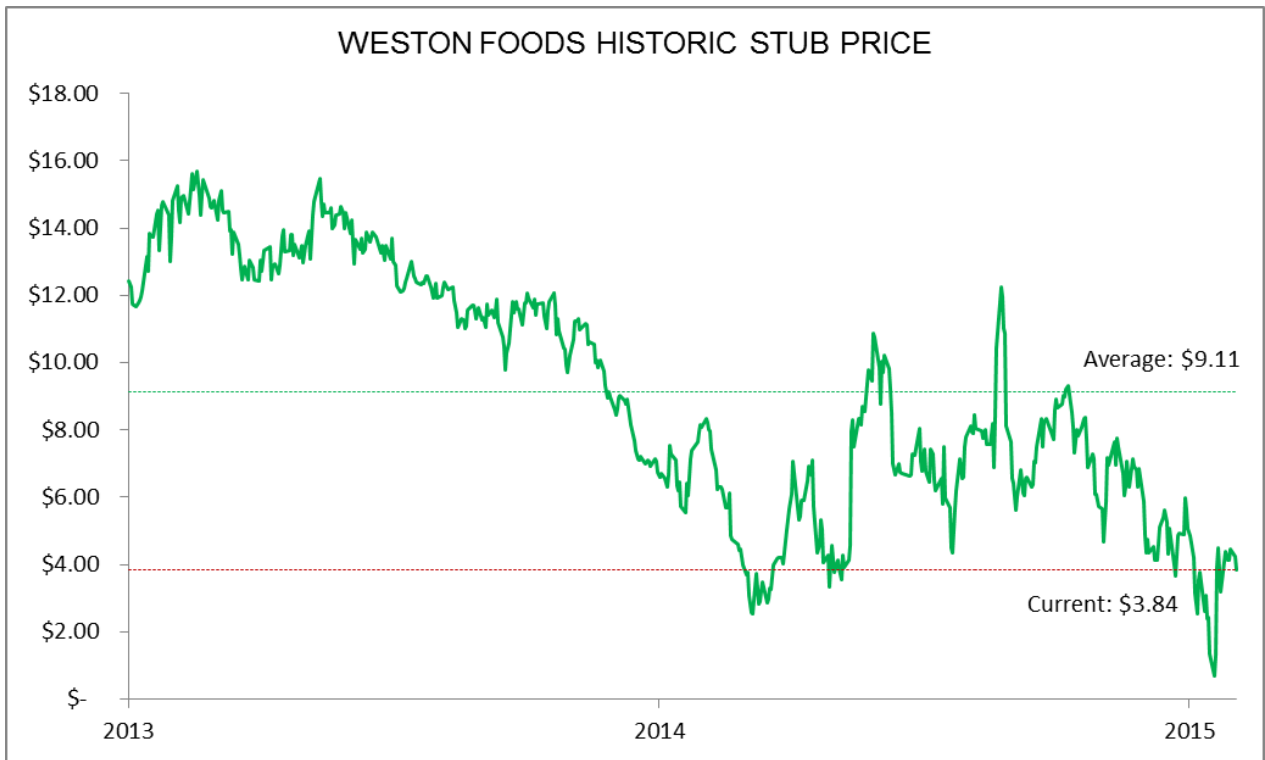
RISK III Description of Risk II: **External competition** – There is rising competition from imported goods and competing foods. Imports are growing at a rapid pace, and import penetration is increasing. New products introduced by producers in the United States, which account for more than 80% of total imports, has driven the demand for US products. In particular, the growing variety of organic, gluten-free and all-natural bread, rolls, bagels and packaged desserts produced by US companies has helped boost imports. Furthermore, the expanding immigrant population in Canada and growing popularity of ethnic cuisines has helped lift the demand for industry goods produced in China and Mexico.

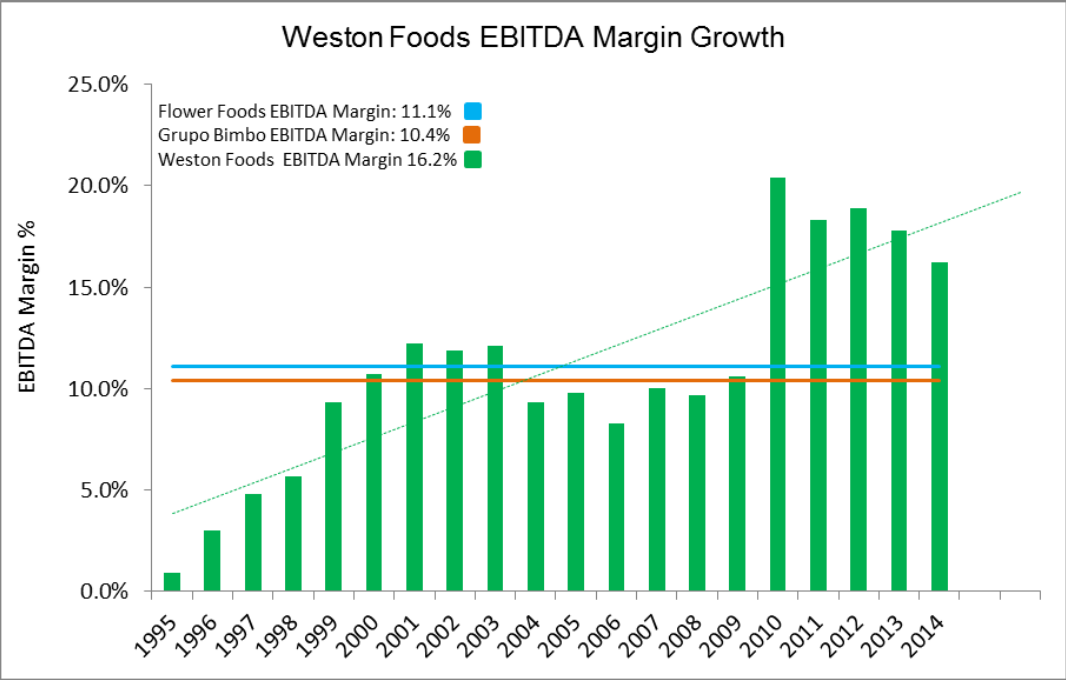
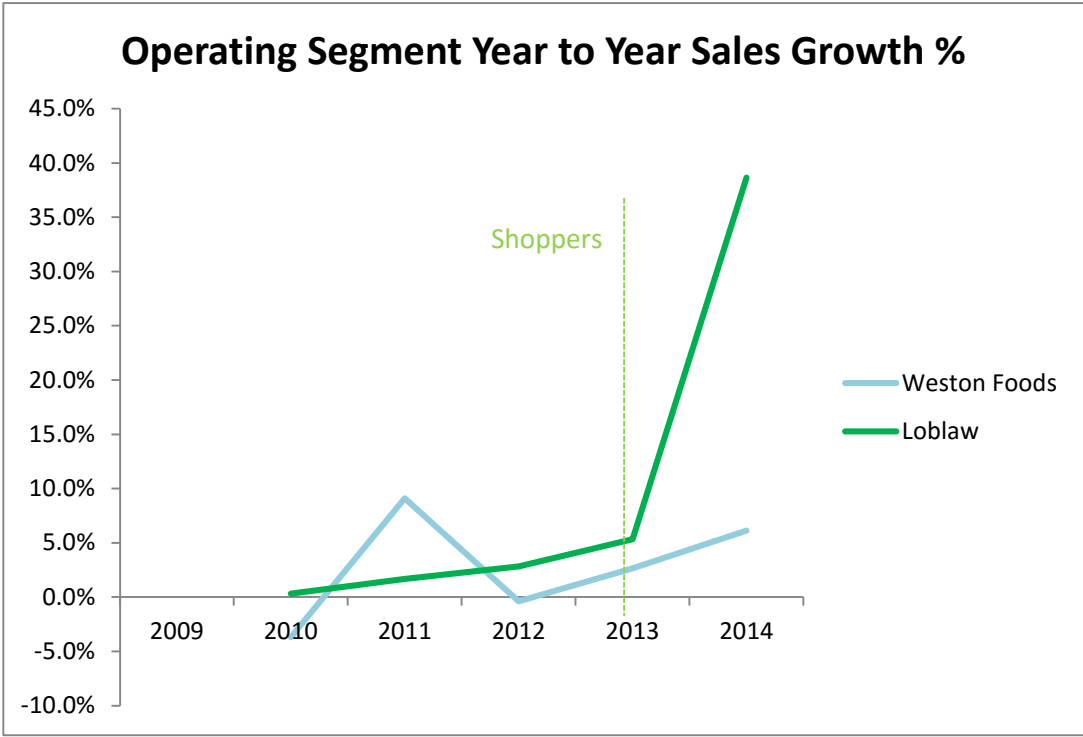
KEY INVESTMENT STRENGTHS

STRENGTH I Description of Strength I: **Brand recognition**- Weston Foods boasts 29 different brands under their belt. Some noticeable names include Mrs. Fields, Wonder Bread, Country Harvest, and D’italiano. With 14% market share of the baked goods market in Canada, Weston Foods continues to be a national leader within the industry. George Weston is also able to generate customer loyalty from certain customers who grew up with the brands.

STRENGTH II Description of Strength II: **Increasing capex on the Weston Foods segment** – 2015 Capex will reach \$300mm (note \$311 mm of EBITDA comes from the Weston Food segment in 2014). As well, Weston also highlighted a goal of having capital expenditures of \$170mm in the fiscal year of 2016. The historical capex run-rate is between \$50–60mm annually. Examples given in their capital expenditure investment program are focused on the Weston Foods segment such as expansions at the Indianapolis cake facility, a U.S.-based donut facility, and the Ace biscuit bakery in Brampton. The company confirmed that incremental capacity will begin to ramp-up during the second half of fiscal 2015, and will continue into fiscal 2016.

STRENGTH III Description of Strength III: **EBITDA Margin Growth**: Weston Foods continues to drive a strong EBITDA margin %. From 1995 to 2014, the stub’s EBITDA margin has grown at a compounded annual growth rate of 16%. It has one of the most dominate EBITDA margins amongst other bakery peers with Grupo Bimbo at 10.4% and Flower Foods at 11.1%. Greater EBITDA margins demonstrate increased efficiency and ability to generate free cash flow.





Current Stub Value			
Company	Shares Owned (mm)	Share Price	Market Cap (mm)
Loblaws	188	71.82	13,488
Choice Properties	21.7	11.51	250
Value of Loblaws and Choice REIT			13,738
George Weston Value	127.9	111.25	14,229
Weston Foods Mkt. Cap			491
Current Weston Stub Value			3.84

Weston Foods Segment Valuation	
EV/EBITDA Based on Peers	13.1x
Weston Foods EBITDA	311
Implied Weston Foods EV	4074.1
Less: Weston Foods Net Debt (Cash)	487.8
Less: Preferred Equity	817
Shares Outstanding	127.9
Weston Foods Target Share Price	21.65
High Target Share Price	24.57
Low Target Share Price	17.76

Public Comps EV/ EBITDA Range	
High	14.3x
Average	13.1x
Low	11.5x

Weston Foods Segment Valuation	
EV/Revenue Based on Peers	1.8x
Weston Foods Revenue	1923
Implied Weston Foods EV	3461.4x
Less: Weston Foods Net Debt (Cash)	487.8
Less: Preferred Equity	817
Shares Outstanding	127.9
Weston Foods Target Share Price	16.86
High Target Share Price	22.88
Low Target Share Price	9.34

Public Comps EV/Rev Range	
High	2.2x
Average	1.8x
Low	1.3x

	Price	Mkt. Cap (mm)	EV/EBITDA	EV/Revenue
J&J Snack Foods Corp. (NasdaqGS:JJSF)	117.5	2,197.1	13.9	2.1
Lancaster Colony Corporation (NasdaqGS:LANC)	94.28	2,579.2	14.3	2.2
Flowers Foods, Inc. (NYSE:FLO)	22.03	4,628.0	12.5	1.4
Grupo Bimbo, S.A.B. de C.V. (BMV:BIMBO A)	2.61	12,287.0	11.5	1.3
High	117.5	12287	14.3	2.2
Low	2.61	2197.1	11.5	1.3
Mean	59.11	5,422.8	13.1	1.8
Median	58.16	3,603.6	13.2	1.8

	2011	2012	2013	2014	2015	2016	2017	2018	2019	
Revenues	1,624	1,765	1,812	1,923	1,981	2,024	2,065	2,102	2,136	2012-2014 Avg
		9%	3%	6%	3%	2.20%	2.00%	1.80%	1.60%	6%
SG&A and COGS	n/a	(1,431)	(1,490)	(1,612)	(1,632)	(1,668)	(1,701)	(1,732)	(1,759)	
EBITDA	n/a	334	322	311	349	357	364	370	376	
EBIT	265.0	275	259	241	280	286	292	297	302	
Less: Weston Foods Portion of Taxes	n/a	(74)	(70)	(65)	(76)	(77)	(79)	(80)	(82)	TV (multiples)
Add: Depreciation & Amortization	60.0	59.0	63.0	70.0	69	71	72	73	74	2048
Less: Capital Expenditure	(39)	(93)	(111)	(128)	(119)	(122)	(124)	(126)	(128)	TV (GGM)
Add: Increase in NWC (Assuming 3% of WN Balance Sheet)	(29)	16	(22)	(21)	(9)	(9)	(10)	(10)	(10)	
Free Cash Flow	257.1	182.7	118.8	97.3	145.0	148.2	151.2	153.9	156.4	4235
NPV (GGM)	3993									
NPV (Multiples)	2269									
SG&A and COGS % of Sales	n/a	81.1%	82.2%	83.8%	82.4%	82.4%	82.4%	82.4%	82.4%	2012-2014 Avg
Depreciation % of Sales	3.7%	3.3%	3.5%	3.6%	3.5%	3.5%	3.5%	3.5%	3.5%	3.5%
CAPEX % of Sales	2.4%	5.3%	6.1%	6.7%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%
NWC % of Sales	1.8%	-0.9%	1.2%	1.1%	0.5%	0.5%	0.5%	0.5%	0.5%	0.5%

Assumptions	
Tax Rate	27%
Weston Foods Net Debt (Cash)	(488)
George Weston Preferred Shares	817
Terminal Value	
Growth Rate	1%
Exit Multiple	13.1x
WACC	4.87%
Terminal Value (GGM)	4235
Terminal Value (Multiple)	2048

WACC Calculation	
Weight of Equity	30.9%
Weight of Debt	64.1%
Weight of Preferred	5.0%
Cost of Equity	4.2%
Cost of Debt	7.2%
Risk Free Rate	2.1%
Return on Market Portfolio	10.0%
Beta	26.0%
WACC	4.9%

EV-> Equity (GGM)	
Implied Weston Foods EV	3992.7
Less: Weston Foods Net Debt (Cash)	487.8
Less: Preferred Equity	817
Shares Outstanding	127.9
Weston Foods Target Share Price	21.02
EV-> Equity (Multiples Method)	
Implied Weston Foods EV	2269.4
Less: Weston Foods Net Debt (Cash)	488
Less: Preferred Equity	817
Shares Outstanding	127.9
Weston Foods Target Share Price	7.54

Sensitivity Table EV (GGM)						
		WACC				
		4%	4.50%	4.87%	5%	5.50%
Terminal Growth Rate	0.50%	4,490	3,940	3,613	3,511	3,168
	0.75%	4,490	4,158	3,793	3,679	3,301
	1%	4,784	4,408	3,995	3,868	3,448
	1.25%	5,126	4,696	4,226	4,083	3,613
	1.50%	5,531	5,032	4,491	4,328	3,799

Sensitivity Table Implied Price (GGM)						
		WACC				
		4%	4.50%	4.87%	5%	5.50%
Terminal Growth Rate	0.50%	25	21	18	17	15
	0.75%	25	22	19	19	16
	1%	27	24	21	20	17
	1.25%	30	27	23	22	18
	1.50%	33	29	25	24	19

Sensitivity Table EV (Multiple Method)						
		WACC				
		4%	4.50%	4.87%	5%	5.50%
Exit Multiple	11.00x	2,085	2,042	2,011	2,000	1,959
	12.00x	2,213	2,167	2,134	2,123	2,079
	13.00x	2,342	2,293	2,257	2,245	2,199
	14.00x	2,470	2,418	2,381	2,368	2,318
	15.00x	2,599	2,544	2,504	2,490	2,438

Sensitivity Table EV (Multiple Method)						
		WACC				
		4%	4.50%	4.87%	5%	5.50%
Exit Multiple	0.50%	6.1	5.8	5.5	5.4	5.1
	0.75%	7.1	6.7	6.5	6.4	6.1
	1%	8.1	7.7	7.4	7.4	7.0
	1.25%	9.1	8.7	8.4	8.3	7.9
	1.50%	10.1	9.7	9.4	9.3	8.9

Football Field Valuation Target Price: \$17

