



Kroger Corporation (NYSE: KR)
Wake Forest Investment Club

Target: \$57.18
Current: \$44.29
Upside: 29.10%

Executive Summary

1

Data and Digital Sales

- Albertsons will provide Kroger with more data and an improved digital sales platform

2

Economies of Scale

- The Kroger and Albertsons merger will lead to increased economies of scale and positive synergies

3

Trading at a Discount

- Competitors are trading at higher multiples despite Kroger being the second largest retailer in the U.S.



Company Overview



Company Overview

Company Description

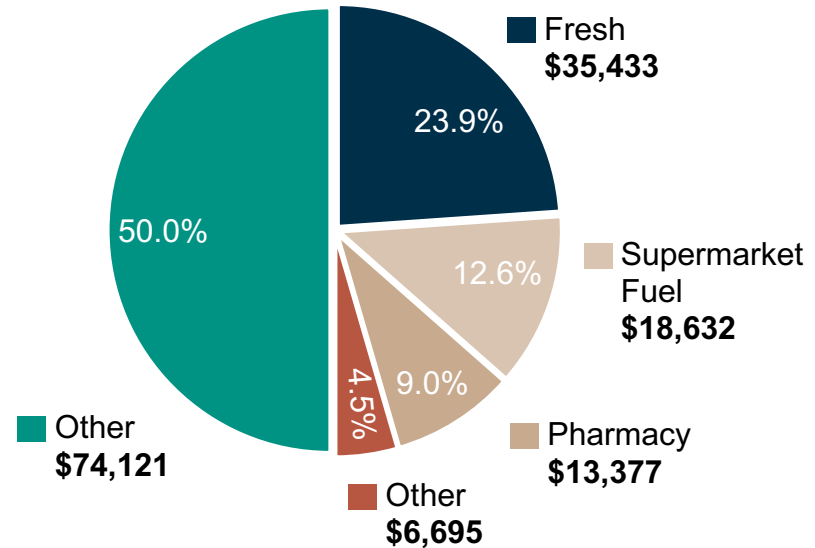
- The Kroger Co. operates as a food and drug retailer in the United States
- The company's marketplace stores offer full-service grocery, pharmacy, health and beauty care, perishable goods, as well as general merchandise

Commentary

- Founded in 1883
- Headquarters in Cincinnati, OH
- Roughly 420,000 employees



Revenue By Segment



Company

Management



Gary Millerchip
CFO (2019)

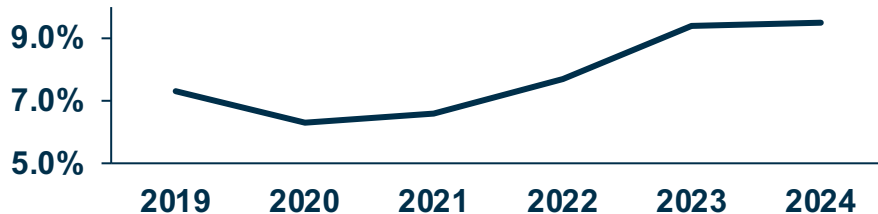


W. Rodney McMullen
CEO (2014)

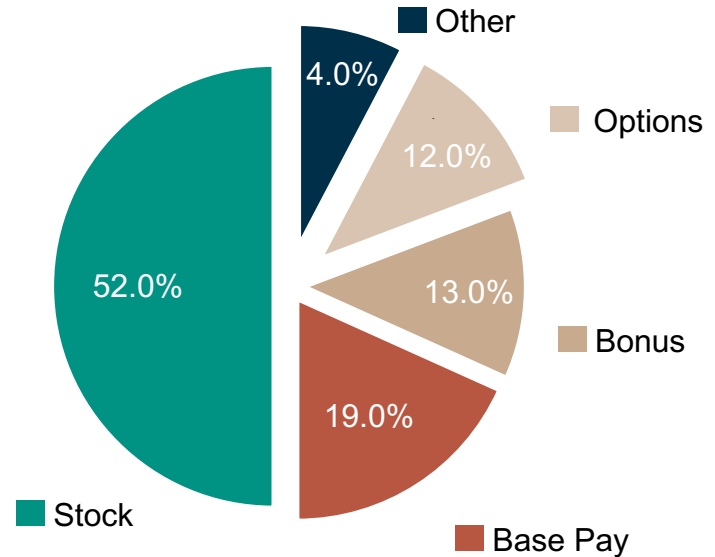


Yael Cosset
CIO (2019)

ROIC



Compensation Breakdown



Digital Sales



Industry Overview

Supermarkets



Hypermarkets



Headwinds





- Health consciousness is reducing demand for high margin CPG and increasing demand for lower margin premium fresh foods
- With reduction of inflation, shoppers are more likely to return to more expensive stores
- The legacy technology debt

Tailwinds

- A stabilizing economy will encourage more predictable demand
- Subsiding supply chain woes will drop costs and enable greater purchase volumes
- Rise of delivery options empowers grocers to implement subscription services to compete with meal prep providers



Key Performance Factors

PF vs SA	Private Brand Strategy	Delivery
	<ul style="list-style-type: none"> 3 brand tiers: Private Selection, The Kroger Brand and Value brands Target different customer segments Together create over \$30B 	<ul style="list-style-type: none"> +2,700 stores First Party Data on 60M Households Significant Digital Business, >\$10B
  	<ul style="list-style-type: none"> Private brands include Signature, Open Nature, and Value Corner lines (7x sales compared to Kroger's private brands) Kroger & Albertsons will reach 2 in 3 shoppers in the US New strategy: Ethnicity, Urbanicity, and Sustainability—especially among the West 	<ul style="list-style-type: none"> National footprint of 4,996 stores ~\$59B Fresh Sales First Party Data on ~85M Households Significant Digital Business, >\$12B

Data Growth and Online Sales

Investment Initiatives

- Optimizing process efficiency
- Improving customer experience
- Enhancing digital capabilities

Data Usage

- Targeted advertising
- Customer retention
- High frequency of visits
- Optimize store assortments
- Increasing in-stock levels
- Reduces shrinkage

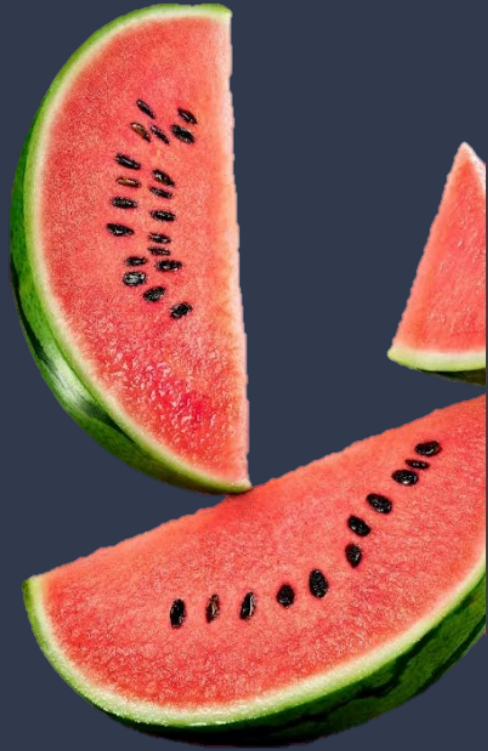
Online Sales Growth

 + 15%

 + 19%



Economies of Scale



Catalyst

Counterparties



Deal Terms

- **Purchase Price: \$34.10/share**
- **Current Share Price: \$22.75**
- **Total Value: \$24.6 Billion**
- Includes \$4.7 Billion of Albertsons' Debt



Risks

FTC

- FTC could say merger violates antitrust laws
- Kroger and Albertsons proactively sold 400+ stores to mitigate this risk
- Even if the merger fell through, Kroger's business model remains strong

Delivery

- Kroger is currently outpaced by its larger competitors
- Albertsons' strong online business has developed a strong delivery presence
- Increased scale of business will take this delivery process to hypermarket level

Debt

- Kroger takes on \$4.7B of Albertsons debt, lowering their interest coverage ratio in the short term
- We predict that the coverage ratio will stabilize back to normal levels in 5-7 years

Low Synergies

- Risk of low cohesion between Kroger and Albertsons
- Unlikely as Kroger brings strong brick and mortar while Albertsons brings strong online
- Both companies bring strong management teams to capitalize on strengths



Valuation



Comparables

TEV / EBITDA
Median: 6.95

5.7x

5.4x

8.2x


22.6x

11.9x

10.1x

4.0x

5.3x

Company								
Market Cap	32,254	13,022	48,473	246,870	420,988	22,753	1,500	1,750
TEV / EBITDA (LTM)	5.7x	5.4x	8.2x	22.6x	11.9x	10.1x	4.0x	5.3x
TEV / FCF	14.0x	17.7x	NM	43.2x	24.0x	NM	38.7x	29.4x
P / E	19.4x	10.5x	14.4x	39.4x	30.1x	10.6x	7.00x	14.8x
Revenue	148,038	78,390	108,008	242,290	630,794	38,807	5,760	4,780
Beta (6M)	0.48	0.45	0.76	0.78	0.57	0.56	0.45	0.48
EBITDA Margin	5.1%	5.2%	7.0%	4.2%	5.9%	10.0%	7.9%	6.1%
TTM FCF	2,830	538	1,630	6,750	19,220	94	71	93
Number of Locations	2,715	2,271	1,972	874	10,550	19,866	198	197
Same Store Sale Growth (YoY)	5.6%	6.9%	2.2%	5.2%	7.1%	4.3%	7.7%	10.9%
Inventory Days	18.6	22.5	14.2	25.1	33.8	65.2	29.4	22.8



Merger Model - Assumptions

Offer Value	
Target Share Price	\$22.69
% Offer Premium	50.3%
Offer Price Per Share	\$34.10
Diluted Shares Outstanding	628.5
Offer Value	21,430.2
(+) Target Debt	8,910.1
(-) Target Cash	(455.8)
Enterprise Value	29,884.5
Implied EV / EBITDA	6.9x

Sources of Funds			
	%	\$	Mult.
Excess Cash	0.0%	15.0	0.0x
Rollover of Existing Debt	0.0%	0.0	0.0x
New Revolver	0.0%	0.0	0.0x
New Term Loan A	19.8%	6,110.0	0.5x
New Term Loan B	75.5%	23,299.4	1.9x
Equity Issuance	4.7%	1,449.4	0.1x
Total Sources of Funds	100.0%	30,873.7	2.5x

Uses of Funds			
	%	\$	Mult.
Purchase of Target Equity	69.4%	21,430.2	1.8x
Target Debt Refinanced	28.9%	8,910.1	0.7x
Transaction Expenses	0.7%	214.3	0.0x
Financing Fees	1.0%	319.1	0.0x
Total Uses of Funds	100.0%	30,873.7	2.5x

Assumptions	
Assumed Annual PT Synergies	1.0%
Acquirer 2024E EBITDA	7,889.4
Target 2024E EBITDA	4,335.5
NTM PF EBITDA	12,225.0
Acquirer Cash Balance	1,015.0
PF Minimum Cash Balance	1,000.0
Excess Cash	15.0
Transaction Expenses (% Offer Value)	1.0%

Transaction Financing	
Existing Target Debt	8,910.1
Refinancing Existing Target Debt	Yes
Leverage Multiple (NTM EBITDA)	3.50x
Maximum Leverage	42,787.4
(-) Existing Acquirer Debt	(13,378.0)
Incremental Leverage Capacity	29,409.4
Multiple (NTM EBITDA)	2.4x
Total Equity Issuance	1,449.4
Acquirer Share Price	\$44.14
Acquirer Shares Issued	32.8
Pro Forma Diluted Shares Outstanding	760.5
Nominal Exchange Ratio	0.8x



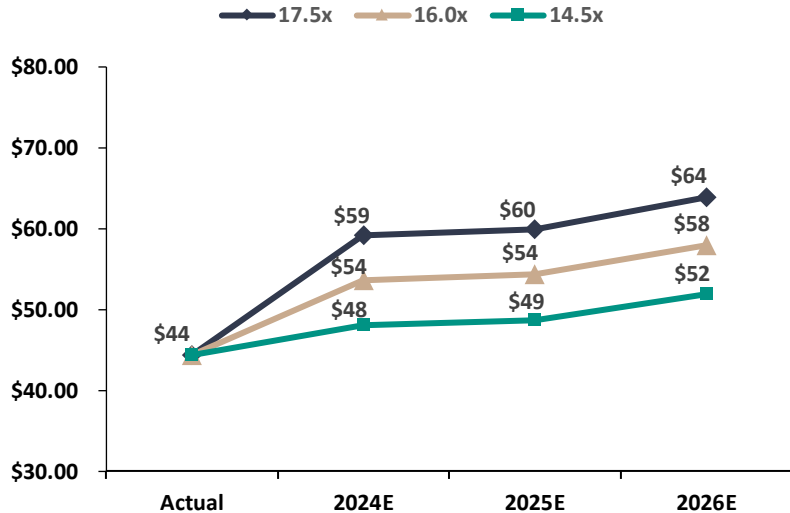
Merger Model - Synergy Sensitivity

Synergies:	1.00%	2.00%	3.00%	4.00%
Income Statement				
Yr. 2 Operating Income	7,041.0	7,163.9	7,286.9	7,409.8
Yr. 5 Operating Income	7,688.6	7,816.9	7,945.2	8,073.5
Yr. 2 Earnings-Per-Share	\$3.94	\$4.07	\$4.20	\$4.34
Yr. 5 Earnings-Per-Share	\$5.60	\$5.76	\$5.92	\$6.08
Yr. 2 Accretion / Dilution \$	\$0.19	\$0.32	\$0.46	\$0.59
<i>Yr. 2 Accretion / Dilution %</i>	<i>5.1%</i>	<i>8.6%</i>	<i>11.5%</i>	<i>14.0%</i>
Yr. 5 Accretion / Dilution \$	\$1.10	\$1.26	\$1.42	\$1.58
<i>Yr. 5 Accretion / Dilution %</i>	<i>29.8%</i>	<i>33.7%</i>	<i>35.6%</i>	<i>37.4%</i>
Cash Flows Statement				
Yr. 2 FCF	4,017.2	4,118.9	4,220.6	4,322.2
Yr. 5 FCF	5,068.4	5,191.0	5,313.6	5,436.2
Balance Sheet				
Yr. 2 Interest Coverage	2.8x	2.8x	2.9x	2.9x
Yr. 5 Interest Coverage	4.9x	5.0x	5.2x	5.4x
Yr. 2 Debt-to-Equity	2.3x	2.3x	2.3x	2.3x
Yr. 5 Debt-to-Equity	1.6x	1.6x	1.6x	1.5x



Merger Model - Future Share Price

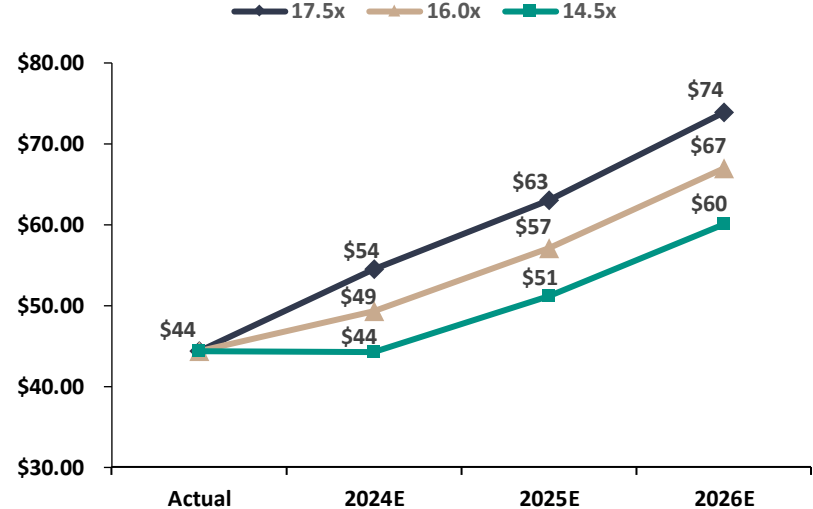
Kroger Future Share Price



Standalone

Actual	2024E	2025E	2026E
\$44.29	\$59.15	\$59.94	\$63.86
\$44.29	\$53.61	\$54.32	\$57.87
\$44.29	\$48.06	\$48.70	\$51.89

Kroger-Albertsons Future Share Price



Pro Forma

Actual	2024E	2025E	2026E
\$44.29	\$54.52	\$63.09	\$74.07
\$44.29	\$49.41	\$57.18	\$67.12
\$44.29	\$44.30	\$51.26	\$60.18



Discounted Cash Flows - Standalone

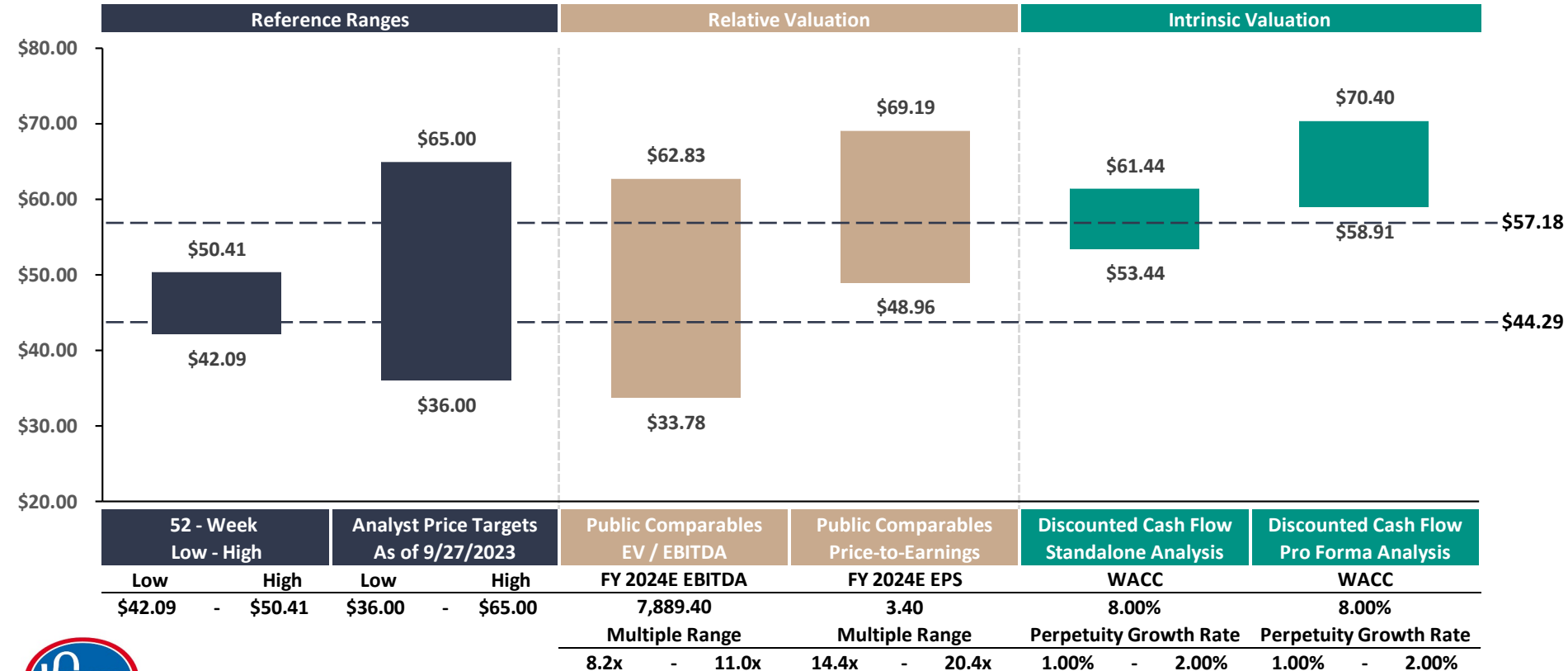
	Historicals	Wall Street Forecast				Illustrative Extrapolation				Terminal Value
	2023A	2024E	2025E	2026E	2027E	2028E	2029E	2030E		
Revenue	148,258.0	150,078.5	149,895.1	151,927.5	153,174.1	154,430.9	155,698.1	156,975.6	156,975.6	
Gross Profit	31,778.0	32,942.2	32,857.0	33,287.3	33,560.4	33,835.8	34,113.5	34,393.4	34,393.4	
EBIT	4,126.1	4,758.8	4,671.3	4,787.4	4,930.4	5,072.1	5,212.4	5,351.4	5,351.4	
Less: Tax Expense	(775.7)	(1,070.7)	(1,004.3)	(1,029.3)	(1,060.0)	(1,090.5)	(1,120.7)	(1,150.5)	(1,150.5)	
NOPAT	3,350.4	3,688.1	3,667.0	3,758.1	3,870.4	3,981.6	4,091.7	4,200.8	4,200.8	
Plus: Depreciation & Amortization		3,130.7	3,177.5	3,146.1	3,068.1	2,992.1	2,918.0	2,845.7	3,063.9	
Plus: Asset Impairment Charges		67.0	67.0	67.0	67.0	67.0	67.0	67.0	67.0	
Less: Change in Net Working Capital		(273.1)	27.5	(304.9)	(187.0)	(188.5)	(190.1)	(191.6)	(191.6)	
Less: Capital Expenditures		(3,602.9)	(3,656.9)	(3,763.7)	(3,670.5)	(3,579.5)	(3,490.9)	(3,404.4)	(3,404.4)	
Unlevered Free Cash Flow		3,009.8	3,282.0	2,902.6	3,148.1	3,272.6	3,395.8	3,517.5	3,735.7	

WACC	Culmulative FCF			Terminal Value			Enterprise Value		
	1.00%	2.00%	3.00%	1.00%	2.00%	3.00%	1.00%	2.00%	3.00%
9.00%	16,778.9	16,778.9	16,778.9	26,936.2	31,089.1	36,626.2	43,715.1	47,867.9	53,405.0
8.00%	17,291.2	17,291.2	17,291.2	32,684.9	38,509.9	46,664.9	49,976.0	55,801.1	63,956.1
7.00%	17,830.3	17,830.3	17,830.3	40,509.2	49,092.3	61,967.0	58,339.5	66,922.6	79,797.3

Net Debt	Equity Value			Diluted Shares Outstanding			Implied Per Share Price		
	1.00%	2.00%	3.00%	1.00%	2.00%	3.00%	1.00%	2.00%	3.00%
11,090.0	32,625.1	36,777.9	42,315.0	727.7	727.7	727.7	\$44.83	\$50.54	\$58.15
11,090.0	38,886.0	44,711.1	52,866.1	727.7	727.7	727.7	\$53.44	\$61.44	\$72.65
11,090.0	47,249.5	55,832.6	68,707.3	727.7	727.7	727.7	\$64.93	\$76.73	\$94.42



Football Field



Allocation

- **Duration recommended**
 - 5 to 7 years to capture all the upside of the merger
- **Catalysts**
 - Merger should be finalized in early 2024
- **Consensus**
 - Data and Digital Sales
 - Economies of Scales
 - Trading at a Discount
- **Milestone**
 - Clears the FTC
- **Pre-Mortem**
 - FTC blocks the merger
 - Lower Interest Coverage ratio



Conclusion

We strongly recommend a long position in KR due to the implied price target of **\$57.18** which is **29.10%** upside from the current price of **\$44.29**.

Our analysis reveals that the Kroger-Albertsons Merger will result in **positive synergies** and an **accretion of EPS** that will result in Kroger being an **undervalued** stock.



Appendix



Merger Model – Income Statement

			Historicals	Wall Street Forecast				Illustrative Extrapolation				CAGR 23' - 30'
			2023A	2024E	2025E	2026E	2027E	2028E	2029E	2030E		
Acquirer Revenue			148,258.0	150,078.5	149,895.1	151,927.5	153,174.1	154,430.9	155,698.1	156,975.6		
Target Revenue			77,649.7	79,363.8	80,736.5	83,074.6	84,966.7	86,902.0	88,881.4	90,905.8		
Consolidated Revenue			225,907.7	229,442.3	230,631.5	235,002.1	238,140.8	241,332.9	244,579.4	247,881.4		1.3%
% Change			7.7%	1.6%	0.5%	1.9%	1.3%	1.3%	1.3%	1.4%		
Consolidated Gross Profit			53,533.6	55,178.1	57,124.8	58,339.2	59,343.2	60,205.8	61,084.1	61,978.3		2.1%
Pro Forma EBITDA			11,205.2	12,225.0	12,296.0	12,657.0	12,775.2	12,828.9	12,880.0	12,927.7		2.1%
Plus: Pretax Synergies	2024	2025 +	-	61.1	123.0	126.6	127.8	128.3	128.8	129.3		
	0.5%	1.0%										
Less: D&A from Asset Write Ups			-	(340.1)	(340.1)	(340.1)	(340.1)	(340.1)	(340.1)	(340.1)		
Less: Amortization of Financing Fees			-	(39.6)	(39.6)	(39.6)	(39.6)	(39.6)	(27.4)	(27.4)		
Less: Depreciation & Amortization			(4,772.1)	(4,901.3)	(4,998.3)	(5,146.1)	(4,964.8)	(4,888.8)	(4,814.7)	(4,742.4)		
Pro Forma Operating Income			6,433.2	7,005.2	7,041.0	7,257.9	7,558.5	7,688.6	7,826.7	7,947.1		2.1%
Plus: Other Income (Expense)			(656.0)	(689.00)	(689.00)	(689.00)	(689.00)	(689.00)	(689.00)	(689.00)		
Less: Interest Expense (net)			(939.6)	(2,998.9)	(2,512.5)	(2,061.3)	(1,909.0)	(1,537.8)	(1,360.4)	(1,096.4)		
Pretax Income			4,837.6	3,317.3	3,839.5	4,507.6	4,960.5	5,461.8	5,777.3	6,161.8		3.1%
Less: Taxes			(1,075.0)	(730.7)	(846.2)	(993.7)	(1,093.9)	(1,203.9)	(1,272.8)	(1,356.8)		
Net Income			3,762.6	2,586.7	2,993.2	3,513.9	3,866.5	4,258.0	4,504.5	4,805.0		3.5%
% Change			14.5%	(31.3%)	15.7%	17.4%	10.0%	10.1%	5.8%	6.7%		
Accretion / Dilution												
Acquirer Standalone EPS			\$3.09	\$3.70	\$3.75	\$3.99	\$4.23	\$4.50	\$4.78	\$5.14		
Target Standalone EPS			\$2.41	\$2.61	\$2.76	\$2.93	\$3.17	\$3.25	\$3.33	\$3.41		
Pro Forma EPS				\$3.40	\$3.94	\$4.62	\$5.08	\$5.60	\$5.92	\$6.32		
Accretion-dilution \$				(\$0.30)	\$0.19	\$0.63	\$0.85	\$1.10	\$1.14	\$1.18		
Accretion-dilution %				(8.0%)	5.1%	15.8%	20.2%	24.5%	23.8%	22.9%		



Merger Model – Leverage Analysis

Pro Forma Leverage / Coverage Analysis							
	2024E	2025E	2026E	2027E	2028E	2029E	2030E
<i>Coverage</i>							
EBIT	7,005.2	7,041.0	7,257.9	7,558.5	7,688.6	7,826.7	7,947.1
Interest Expense	3,048.0	2,552.5	2,101.3	1,949.0	1,577.8	1,400.4	1,189.0
Interest Coverage	2.3x	2.8x	3.5x	3.9x	4.9x	5.6x	6.7x
<i>Leverage</i>							
Total Debt	39,999.9	36,919.7	33,769.2	30,033.9	25,902.5	21,532.5	19,488.0
Shareholders' Equity	16,025.6	16,025.6	16,025.6	16,025.6	16,025.6	16,025.6	16,025.6
Debt-to-Equity Ratio	2.5x	2.3x	2.1x	1.9x	1.6x	1.3x	1.2x
Standalone Leverage / Coverage Analysis							
<i>Coverage</i>							
EBITDA	7,889.4	7,848.8	7,933.5	7,998.5	8,064.2	8,130.3	8,197.1
Interest Expense	727.9	691.1	676.6	694.3	695.1	686.8	622.3
Interest Coverage	6.5x	6.8x	7.1x	7.1x	7.3x	7.6x	8.6x
<i>Leverage</i>							
Total Debt	13,378.0	13,378.0	13,378.0	13,378.0	13,378.0	13,378.0	13,378.0
Shareholders' Equity	12,212.4	14,446.2	16,858.6	19,445.4	22,227.0	25,216.3	28,464.0
Debt-to-Equity Ratio	1.1x	0.9x	0.8x	0.7x	0.6x	0.5x	0.5x



Discounted Cash Flows – Pro Forma

	Historicals	Wall Street Forecast				Illustrative Extrapolation				Terminal Value
	2023A	2024E	2025E	2026E	2027E	2028E	2029E	2030E		
Revenue	225,907.7	229,442.3	230,631.5	235,002.1	238,140.8	241,332.9	244,579.4	247,881.4	247,881.4	
Gross Profit	53,533.6	55,178.1	57,124.8	58,339.2	59,343.2	60,205.8	61,084.1	61,978.3	61,978.3	
EBIT	6,433.2	7,005.2	7,041.0	7,257.9	7,558.5	7,688.6	7,826.7	7,947.1	7,947.1	
Less: Tax Expense	(1,410.6)	(1,543.0)	(1,551.8)	(1,599.9)	(1,666.9)	(1,694.7)	(1,724.3)	(1,749.9)	(1,749.9)	
NOPAT	5,022.6	5,462.2	5,489.1	5,657.9	5,891.6	5,993.9	6,102.4	6,197.2	6,197.2	
Plus: Depreciation & Amortization		4,901.3	4,998.3	5,146.1	4,964.8	4,888.8	4,814.7	4,742.4	3,063.9	
Plus: Depreciation from Asset Write Ups		93.6	93.6	93.6	93.6	93.6	93.6	93.6		
Plus: Amortization from Intangible Write Ups		246.5	246.5	246.5	246.5	246.5	246.5	246.5		
Less: Changes in Net Working Capital		(615.9)	(247.0)	(772.5)	(565.4)	(575.6)	(585.9)	(596.5)	(495.3)	
Less: Capital Expenditures		(3,602.9)	(3,656.9)	(3,763.7)	(3,670.5)	(3,579.5)	(3,490.9)	(3,404.4)	(3,404.4)	
Unlevered Free Cash Flow		6,484.9	6,923.6	6,607.9	6,960.6	7,067.7	7,180.4	7,278.9	5,361.5	

WACC	Cumulative FCF			Terminal Value			Enterprise Value		
	1.00%	2.00%	3.00%	1.00%	2.00%	3.00%	1.00%	2.00%	3.00%
9.00%	36,193.7	36,193.7	36,193.7	38,658.6	44,618.6	52,565.4	74,852.3	80,812.4	88,759.2
8.00%	37,292.2	37,292.2	37,292.2	46,908.9	55,268.9	66,972.9	84,201.2	92,561.2	104,265.2
7.00%	38,447.9	38,447.9	38,447.9	58,138.3	70,456.7	88,934.3	96,586.2	108,904.6	127,382.2

Net Debt	Equity Value			Diluted Shares Outstanding			Implied Per Share Price		
	1.00%	2.00%	3.00%	1.00%	2.00%	3.00%	1.00%	2.00%	3.00%
41,331.6	33,520.7	39,480.8	47,427.6	760.5	760.5	760.5	\$46.06	\$54.26	\$65.18
41,331.6	42,869.6	51,229.6	62,933.6	760.5	760.5	760.5	\$58.91	\$70.40	\$86.48
41,331.6	55,254.6	67,573.0	86,050.6	760.5	760.5	760.5	\$75.93	\$92.86	\$118.25



Weighted Average Cost of Capital

Bottom Up Equity Beta	Target D/E	Tax Rate	Bottom-Up Asset Beta
0.73	0.91	24.5%	0.43
Weighted Average Cost of Capital			
Market Risk Premium			4.9%
Multiplied by: Bottom Up Beta			3.6%
Adjusted Market Risk Premium			7.0%
Add: Risk-Free Rate of Return (RF)			5.0%
Add: Size Premium			0.0%
Cost of Equity			10.1%
Multiplied by: Weight in Equity			5.29%
Cost of Debt			6.90%
Tax Rate			25.7%
After-Tax Cost of Debt			5.13%
Multiplied by: Weight in Debt			2.44%
WACC			7.73%



Weighted Average Cost of Capital

Comps	Levered Beta	D/E	Tax Rate	Asset Beta
NYSE:WMK	0.38	0.14	22.4%	0.34
NYSE:TGT	1.18	1.61	20.2%	0.52
NasdaqGS:COST	1.00	0.42	25.9%	0.76
NYSE:WMT	0.63	0.78	33.0%	0.41
NYSE:DG	0.60	2.86	22.7%	0.19
NasdaqGS:IMKT.A	0.63	0.42	24.7%	0.47
NYSE:WMK	0.38	0.14	22.4%	0.34
Company Ticker				
NYSE:KR	0.55	1.10	25.7%	0.30

