

NEWALB 7.45 08/01/29

S SHORT

Albertsons Companies Inc

Credit, Consumer, Event Driven/Special Sit

06/13/2018

Publicly traded companies mentioned herein: Albertsons Companies Inc (Private Company w/ Public Debt), Amazon.com Inc (AMZN), The Kroger Co (KR), Rite Aid Corporation (RAD), SUPERVALU Inc (SVU), Walmart Inc (WMT)

Highlights

Albertsons has been struggling to maintain its relevance in an increasingly competitive grocery market for some time. Walmart and Amazon have grown at the expense of numerous players, including many of Albertsons' banners (e.g., Shaw's, ACME, and Safeway). An inability, or unwillingness to invest in its stores has led to underperformance, and now the company is looking to reverse merge with Rite Aid in a bid to come public again. The deal has been met with resistance from Rite Aid shareholders, and overall, the presenter is bearish on the outlook for Albertsons. He is short the NEWALB 7.45s because NEWALB's own OpCos (substantially all of NEWALB's assets) directly guarantee the ALBLLC notes, not the NEWALB notes.

- Cerberus acquired 877 Albertsons stores from Supervalu in 2013, which added to its base of stores originally acquired in 2006. The private equity firm then bought Safeway in a \$9.2B deal that was completed in early 2015 and merged the grocers. Looking at the financials over the past six years reveals over \$500MM of burned cash, when adding back adjustments, said the presenter.
 - While Albertsons management says they are investing in digital, the presenter noted that compared to Kroger, Albertsons invests about half as much per square foot in its stores (just \$10 per sq ft); and it can no longer afford to compete on price.
 - Albertsons executed a sale-leaseback of 71 stores in 4Q '17 at a cap rate of ~6.7%, said the presenter. This is evidence of the problem, as "good" grocery stores will change hands at 5.5% cap. As such, the presenter believes, "Investors are getting smarter on Albertsons; they know it's struggling".
- Before trying to buy/reverse merge with Rite Aid, a \$24B deal (including debt), the presenter said Albertsons made some adjustments to the capital structure. The NEWALB box is now smaller, with 515 stores located mostly in the Northeast (old SVU assets). This box had a set of opcos that were guaranteed by another box within the structure that includes ~\$4B of real estate. That guarantee has been released, leaving NEWALB structurally subordinated, and making the 7.45s an attractive short.
 - Given the cash flow issues the presenter sees at Albertsons, he has concluded that it is, "just another dying retailer, and it is only a matter of time before it has to be restructured". The boxes that are more subordinated are the most levered, and the real estate does not likely cover all the debt, as bulls suggest, so the bonds should decline.
 - On a pure EBITDA basis, the presenter said reported EBITDA is misleading. Looking at the most recent quarter/year-end results, "core" EBITDA, excluding Safeway synergies, was down to \$500MM (compared to \$543MM YoY). If he further adjusts the number to remove acquired stores, EBITDA was \$370MM, versus \$410MM YoY.
 - ▶ Over the past two years, the presenter has observed a double-digit decline in the core business. The claim of \$823MM in synergies with Safeway has been largely offset by an \$800MM decline in the core business.
- Regarding Rite Aid and Albertsons' financial health, the presenter noted that the original deal to acquire Rite Aid included the potential for Albertsons to infuse ~\$1B of cash into the newco for store upgrades. By the time the deal was finished/announced, this offer was off the table (he does not believe there is sufficient cash flow available to make such a large investment). Additionally, if the deal does go through, the NEWALB box will be further subordinated.
- It appears RAD shareholders - retail and institutional - do not like the deal, as it has been reported that many are against it (and

- intend to vote that way). Cerberus has been trying to exit this position, including via IPO twice, and if the deal falls through, the presenter's opinion is that Albertsons' decline will accelerate.
- Overall, Albertsons' banners are performing poorly and no longer have the ability to price competitively against a peer group that includes Walmart, Amazon (Whole Foods), and Kroger, among others.
- The presenter is short the NEWALB 7.45s and noted that investors can also buy the NEWALB 5-year CDS, which references that issue as well. The position can be paired with Long ALBLLC 6.625 06/15/24, as that box has the security of the opcos underneath the NEWALB box (it has the claims on the real estate). The ALBLLC paper trades at ~95, and NEWALB is in the low 80s.
 - If the vote is not in favor of the Rite Aid deal, the presenter reasons that the CDS will rise, and the spread between NEWALB and ALBLLC should widen (with the NEWALB box being the poorer performer). Also, NEWALB is not exposed to Safeway, which is the better asset.
 - If the deal goes through, the presenter thinks bears will have to wait longer to get paid, as the newco will have \$200MM more FCF to work with. While the retail side of Rite Aid looks "a little better" lately, and it still owns Envision (a small PBM), RAD stock has been an underperformer and is down from over \$2 to ~\$1.70 since late February when the deal was announced.

For questions regarding DeMatteo Research Events and Services, please contact:

Hans Noering, Co-Director of Research, 212-833-9932, hnoering@dmlc.com

Important Disclosures

This summary has been prepared by DeMatteo Research LLC (“DeMatteo” or the “Firm”). The Firm sponsors events featuring institutional investors (“Presenters”). The opinions, estimates, projections, and views contained in this summary are those of, and exclusively sourced from, the Presenters and may differ from those of the Firm. While the Firm attempts to summarize accurately the comments of the Presenters, the summary is not endorsed by the Presenters.

This summary is provided for information purposes only and does not constitute an invitation or offer to subscribe to or purchase or sell any of the products or services mentioned. It is intended for institutional investors only and should not be forwarded to third parties. Securities, financial instruments or strategies discussed herein may not be suitable for all investors. The opinions and views expressed in this summary do not take into account individual client circumstances, objectives, or needs and are not intended as recommendations of particular securities, financial instruments, or strategies to particular clients. DeMatteo is not, by making this summary available, providing investment, legal, tax, financial, or accounting advice to the recipient of this summary or any other party. DeMatteo is not acting as an advisor or fiduciary to any client in connection with providing this summary. Past performance is not indicative of future results. This summary has been prepared based on information, including market prices, data and other information, obtained from sources believed to be reliable; but DeMatteo does not warrant its completeness or accuracy. The Firm makes no representation or warranty, express or implied, in respect thereof, and accepts no liability whatsoever for any loss arising from any use of or reliance on this summary or its contents. Information, estimates, assumptions, and/or opinions expressed herein are made as of the date of the Guest Speaker’s presentation and are subject to change without notice. DeMatteo assumes no obligation to maintain or update this summary based on subsequent information and events. Further information on any of the securities mentioned in this report may be obtained upon request.

Analysts are compensated through a base salary and an annual bonus. The amount of an analyst’s annual bonus is related, among other factors, to the Firm’s overall revenues and profitability, and is not tied to any level of investment banking or other similar business in which the Firm engages. Neither the Firm nor any affiliate, in the aggregate, beneficially own 1% or more of any class of common equity securities issued by any company discussed in the report.

- Analysts are compensated through a base salary and an annual bonus. The amount of an analyst’s annual bonus is related, among other factors, to the Firm’s overall revenues and profitability, and is not tied to any level of investment banking or other similar business in which the Firm engages. Neither the Firm nor any affiliate, in the aggregate, beneficially own 1% or more of any class of common equity securities issued by any company discussed in the report.
- The Firm, the analyst involved in the preparation of this report, and members of the analyst’s household do not have a financial interest in securities of any company discussed in the report.
- As of the end of the month immediately preceding the issuance of this Research Report (or the end of the second most recent month if publication date is less than 30 calendar days after the end of the most recent month), no analyst involved in the preparation of this report has received compensation from any company discussed in this report or knows of any other actual, report conflict of interest regarding this report.
- Neither the Firm nor any affiliate has received compensation for investment banking services from any company discussed in the report in the last twelve (12) months.
- Neither the Firm nor its affiliates expect to receive or intend to seek compensation for investment banking services from any company discussed in the report in the next three (3) months.
- No company discussed in the report is, or during the 12-month period preceding the date of distribution of the report, was, a client of the Firm.
- No director, officer or employee of the Firm is a director of any company in which the Firm provides research coverage.
- No analyst involved in the preparation of this report or any member of the analyst’s household serves as an officer, director or advisory board member of any company discussed in the report.

- The Firm does not act as a market maker in the securities of any company discussed in the report.
- Neither the firm nor any of its affiliates managed or co-managed a public offering of the securities for the subject company in the past 12 months.
- No analyst received any compensation from the subject company in the previous 12 months.

REG. AC Certification

The opinions, views and / or analyses of the companies and / or industries contained in this document generally consist of a summary of a presentation made by one or more securities professionals at an event sponsored by DeMatteo Research LLC ("DeMatteo") and are not typically the views or opinions of the individual at DeMatteo responsible for the preparation of this document. Where any views or opinions expressed in this document are attributed to the individual responsible for the preparation of this document, then such views or opinions accurately reflect the personal views of the author of this document regarding the subject securities and / or issuers.

No part of the compensation of the individual responsible for the preparation of this report was, is or will be directly or indirectly related to the specific recommendations or views contained in this document.

Copyright ©2018 DeMatteo Research LLC and/or its affiliates. All rights reserved.