

Grocery Outlet Holding (GO)

\$40.74 (As of 08/26/20)

Price Target (6-12 Months): **\$47.00**

Long Term: 6-12 Months

Zacks Recommendation: **Outperform**

(Since: 08/12/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

1-Strong Buy

Zacks Style Scores:

VGM:D

Value: F

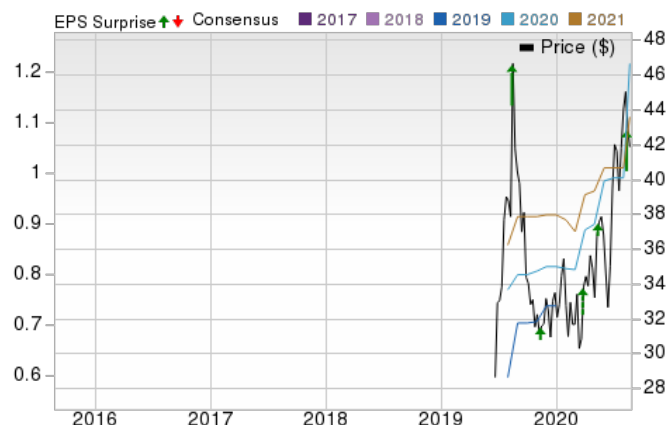
Growth: C

Momentum: B

Summary

Shares of Grocery Outlet have risen and outpaced the industry in the past three months. The company sustained its upbeat performance in second-quarter 2020, wherein both the top and the bottom lines not only surpassed the Zacks Consensus Estimate but also grew year over year. This was the fifth straight quarter of earnings beat. Notably, the company gained from coronavirus-led demand. The company managed its inventory well to meet customers' burgeoning demand amid the crisis. Also, we note that increase in average transaction size aided comparable-store sales growth. Evidently, Grocery Outlet looks well poised from a long-term perspective given its flexible sourcing and distribution model that differentiates it from traditional retailers. The company provides customers quality, name-brand consumables and fresh products at exceptional values.

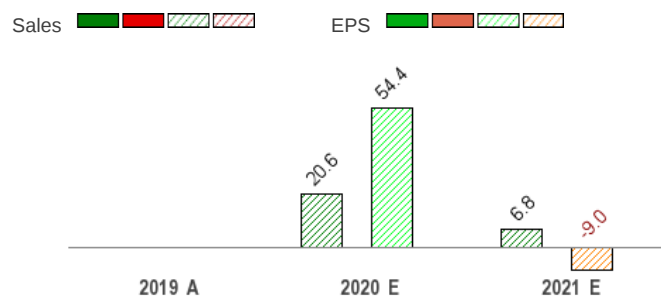
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$46.74 - \$28.11
20 Day Average Volume (sh)	964,998
Market Cap	\$3.7 B
YTD Price Change	25.6%
Beta	-0.12
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Consumer Products - Staples
Zacks Industry Rank	Top 37% (93 out of 252)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	82.6%
Last Sales Surprise	4.5%
EPS F1 Est- 4 week change	16.2%
Expected Report Date	11/09/2020
Earnings ESP	2.6%
P/E TTM	33.7
P/E F1	33.4
PEG F1	2.5
P/S TTM	1.3

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	791 E	851 E	836 E	819 E	3,299 E
2020	760 A	803 A	748 E	784 E	3,088 E
2019		645 A	653 A	656 A	2,560 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$0.28 E	\$0.32 E	\$0.27 E	\$0.24 E	\$1.11 E
2020	\$0.36 A	\$0.42 A	\$0.22 E	\$0.21 E	\$1.22 E
2019		\$0.20 A	\$0.22 A	\$0.21 A	\$0.79 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 08/26/2020. The reports text is as of 08/27/2020.

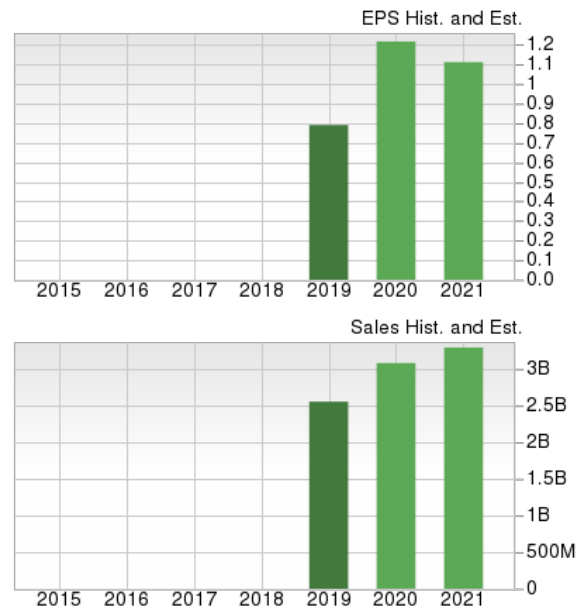
Overview

Founded in 1946 and headquartered in Emeryville, CA, Grocery Outlet Holding Corp. is a high-growth, extreme value retailer of quality, name-brand consumables and fresh products that are sold through a network of independently owned and operated stores. Notably, the company's stores offer a fun, treasure hunt shopping experience in an easy-to-navigate, "small-box" format of size 15,000-20,000 square feet. The company offers discounted, overstocked and closeout products from name brand and private label suppliers. Stores are operated by Entrepreneurial Independent Operators ("IOs").

The company's flexible buying model allows it to offer products significantly below those of conventional retailers and discounters. It acquires merchandise at considerable discounts arising from order cancellations, manufacturer overruns, packaging changes and approaching "sell-by" dates. Notably, an ever-changing assortment of "WOW!" deals, supplemented by competitively priced everyday staples attracts bargain-hunters.

As of Jun 27, 2020, the company had 362 stores in California, Washington, Oregon, Pennsylvania, Idaho and Nevada. The stores offer a curated and ever-changing assortment of approximately 5,000 SKUs. The company's perishable departments, which comprises dairy and deli, produce and floral and fresh meat and seafood, represented about 34% of 2019 sales. Non-perishable departments including grocery, general merchandise, health and beauty care, frozen foods and beer and wine, represented roughly 66% of sales. The company also provides a wide range of Natural, Organic, Specialty and Healthy or "NOSH" products. Consumables represented approximately 90% of product sales in 2019.

In June 2019, the company completed the initial public offering.



Reasons To Buy:

▲ **Impressive Q2 Results Boost Stock:** Grocery Outlet impressed investors with its second-quarter 2020 performance, wherein both the top and the bottom lines not only beat the Zacks Consensus Estimate but also grew year over year. The company gained from coronavirus-led demand. As people started dining at home and maintaining social distancing, they have been stocking essential items. The company reported adjusted earnings of 42 cents a share that comfortably beat the Zacks Consensus Estimate of 23 cents and improved significantly from 20 cents in the prior-year period. Higher net sales and lower interest expense contributed to the bottom line. This was the fifth straight quarter of positive earnings surprise. Net sales came in at \$803.4 million, up 24.5% from year-ago quarter courtesy of comparable-store sales growth and contribution from 32 new store openings since the end of the second quarter last year. The company made sure to maintain both opportunistic and everyday products in high volumes. The company managed its inventory well to meet customers' burgeoning demand amid the crisis. Notably, the company's shares have rose 12.7% in the past three months against the industry's decline of 4%.

We believe that Grocery Outlet's compelling value proposition will continue to attract bargain-hunters, encourage customers to revisit stores, and increase basket sizes.

▲ **Differentiated Business Model:** Grocery Outlet looks well poised from a long-term perspective given its flexible sourcing and distribution model that differentiates it from traditional retailers. The company provides customers quality, name-brand consumables and fresh products at exceptional values. The company purchases merchandise at considerable discounts that arise from order cancellations, manufacturer overruns, packaging changes and nearing "sell-by" dates. We note that a typical "Grocery Outlet basket" is priced roughly 40% below than conventional grocers and approximately 20% below than leading discounters. The company's product offering is ever-changing with a constant rotation of opportunistic products, complemented by everyday staple products. Opportunistically sourced products accounts for approximately half of purchasing mix, and are referred to as "WOW!" deals. Moreover, in order to drive customers and keep them well informed about price, quality and service, the company refreshed its brand image — updated website, modernized logo and adopted new marketing campaign "Welcome to Bargain Bliss."

Notably, the company's stores are operated by Entrepreneurial Independent Operators ("IOs"). The company enters into an "Operator Agreement" with each IO, which grants it a license to operate a particular Grocery Outlet Bargain Market retail store. The agreement provides the IO with greater decision-making power, which includes merchandising, selecting about 75% of products, managing inventory, marketing locally, directly hiring, training and employing store workers and supervising operations. The company shares 50% of store-level gross profits with IOs.

▲ **Decent Comps Performance:** We believe that Grocery Outlet's compelling value proposition will continue to attract bargain-hunters, encourage customers to revisit stores, and increase basket sizes. Cumulatively, these will drive comparable-store sales growth. Notably, expanded product offerings, more "WOW!" Deals and increased customer awareness will help fuel sales. In terms of offerings, the company source on-trend products based on consumer preferences. With consumers now looking for fresh and healthy options, the company shifted its focus to Natural, Organic, Specialty and Healthy or "NOSH" products, and fresh seafood and grass-fed meat. The company's opportunistic purchasing strategy, inventory optimization, marketing initiatives and new product offerings have helped it to register comparable-store sales growth for 16 straight years. In fiscal 2019, comparable store sales had risen 5.2%.

The company registered comparable-store sales growth of 16.7% during second-quarter 2020, following an increase of 17.4% in the preceding period, courtesy of increase in average transaction size. We note that the company's comparable-store sales rose a meager 5.8% in the prior-year period. Management notified that for the third quarter through Aug 10 comparable store sales growth is tracking at approximately 10%. The increase in comparable-store sales reflects rise in average basket size. Management expects comparable store sales growth to moderate as the economy reopens.

▲ **Store Growth Opportunity:** Grocery Outlet had earlier indicated that based on experience and in addition to research conducted by eSite Analytics, it believes that there is a room for more than 1,500 additional locations in the states in which it currently operates and neighboring ones. In the long term, the company believes that there is potential to establish 4,800 locations nationally. In fiscal 2019, the company had opened 34 new stores. During second-quarter 2020, the company opened seven new stores taking the total count to 362 stores in six states — California, Washington, Oregon, Pennsylvania, Idaho and Nevada. The company plans to open 30-32 outlets this year with no additional store closure planned. The company remains optimistic about 10% annual unit growth. Notably, the company has been making strategic investments to improve its functionality and scalability. These include enhanced point of sale, warehouse management, vendor tracking, store communications, real estate lease management, and financial planning and analysis.

▲ **Financial Flexibility:** Grocery Outlet ended second-quarter 2020 with cash and cash equivalents of \$79.8 million compared with \$18.7 million at the end of the same period in fiscal 2019. Total debt was \$460.1 million at the end of the quarter under review down from \$550.2 million at the end of the preceding quarter and \$475.5 million at the end of the prior-year period. During the quarter, the company repaid in full the \$90 million drawn on the revolving credit facility of its First Lien Credit Agreement. Also, the company's "times interest earned" ratio of 3.6 has improved from 1.6 at the end of the first quarter of 2020. The times-interest-earned ratio is very important for some companies, as it measures a company's ability to meet its debt obligations based on its current income.

Risks

- **Near Term Headwinds:** Industry experts believe that continued volatility given the uncertainty regarding consumer demand, changes in shelter-in-place orders, the impact of economic stimulus and potential for large scale liquidation sales may have a bearing on sales results. The company highlighted that it is starting to feel inflationary cost pressure across a number of categories, including meat, and deli and produce. This is going to be a bit of a gross margin headwind in the back half of the year. Undeniably, higher distribution and supply chain costs, short-term product mix shifts and potential increases in commodity prices are the factors that might hurt gross margin. Management expects gross margin rate in the back half to be roughly in line with prior year quarterly results.

- **Higher Operating Expenses a Concern:** We note that overall operating expenses jumped 14.7% to \$221.4 million during the second quarter of 2020, thanks to higher SG&A expenses that rose 25.6%. The increase in SG&A expenses was primarily driven by higher selling expenses related to higher sales volume. These increased expenses consisted primarily of variable commission payments to IOs, store occupancy and maintenance costs, as well as investments in general and administrative infrastructure to support the growth of business. SG&A expenses also increased on account of incremental costs associated with COVID-19.

Management continues to expect incremental expenses in the back half of the year related to the coronavirus outbreak. These include cleaning and safety costs, corporate and distribution center personnel expenditures, costs for protective equipment, and supply chain expenses. The company envisions adjusted EBITDA margin for the second half of 2020 to be modestly below prior-year levels.

- **Stock Looks Stretched:** Considering price-to-earnings (P/E) ratio, Grocery Outlet looks pretty overvalued when compared with the industry as well as the S&P 500. The stock has a forward 12-month P/E ratio of 35.50, which is below the median level of 41.03 and the high level of 68.32 scaled in the past one year. On the contrary, the forward 12-month P/E ratio for the industry and the S&P 500 is 22.01 and 23.11, respectively.
 - **Stiff Competition:** Grocery Outlet competes with both conventional grocery stores and discounters. The company faces stiff competition from a diverse group of retailers, including discount, conventional grocery, department, drug, convenience, hardware, variety, online and other specialty stores. The company views discount retailers of consumable products, such as Walmart, WinCo, Aldi and Lidl, as major competitors, as these provide wide range of products at relatively low prices, when compared with conventional grocery stores. While the company has embraced online and digital marketing, it has thus far not pursued e-commerce. The company also competes against a fragmented landscape of opportunistic purchasers, such as Big Lots and 99 Cents Only.
 - **Dip in Consumer Sentiment May Impact Sales:** Any dip in consumer confidence — a key determinant of the economy's health — may have serious bearing on spending. The company's customers remain sensitive to macroeconomic factors including interest rate hikes, increase in fuel and energy costs, credit availability, unemployment levels, and high household debt levels, which may negatively impact their sentiment. This may adversely impact its growth and profitability.
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Last Earnings Report

Grocery Outlet Q2 Earnings Beat, Revenues Increase Y/Y

Grocery Outlet Holding Corp. sustained its upbeat performance in second-quarter 2020 with both the top and the bottom lines not only surpassing the Zacks Consensus Estimate but also improving year over year. The company gained from coronavirus-induced spike in demand. As people started dining at home and maintaining social distancing, they have been stocking essential items.

Let's Take an Insight

The owner and operator of grocery store chains reported adjusted earnings of 42 cents a share that comfortably beat the Zacks Consensus Estimate of 23 cents and improved significantly from 20 cents in the prior-year period. Higher net sales and lower interest expense contributed to the bottom line. This was the fifth straight quarter of positive earnings surprise.

Net sales were \$803.4 million, up 24.5% from year-ago quarter courtesy of comparable-store sales growth and contribution from 32 new store openings since the end of the second quarter last year.

Notably, this Emeryville, CA-based company registered comparable-store sales growth of 16.7% during the quarter under review on account of increase in average transaction size, partially offset by decline in traffic. We note that the company's comparable-store sales rose a meager 5.8% in the prior-year period.

Management notified that for the third quarter to-date comparable store sales growth is tracking at approximately 10%. The increase in comparable-store sales reflects rise in average basket size, partly offset by lower store traffic as customers continue to consolidate trips. Management expects comparable store sales growth to moderate as the economy reopens.

Margins & Costs

We note that gross profit improved 27.7% year over year to \$253.8 million, while gross margin expanded 80 basis points to 31.6% courtesy of reduced markdowns. Management anticipates gross margin rate in the back half to be roughly in line with prior-year quarter.

During the quarter, adjusted EBITDA surged 34.7% to \$60.6 million owing to gross margin expansion, partially offset by modest SG&A deleverage. Adjusted EBITDA margin increased 50 basis points to 7.5%. Management envisions adjusted EBITDA margin for the second half of 2020 to be modestly below prior-year levels.

SG&A expenses rose 25.6% to \$198 million. Again, as a percentage of net sales, the same increased 20 basis points to 24.6%. The increase in SG&A expenses led to a jump of 14.7% in overall operating expenses of \$221.4 million. However, as a percentage of net sales, operating expenses contracted 230 basis points to 27.6%.

Management continues to expect incremental expenses in the back half of the year related to the coronavirus outbreak. These include cleaning and safety costs, corporate and distribution center personnel expenditures, costs for protective equipment, and supply chain expenses.

Store Update

During the quarter under review, Grocery Outlet opened seven new stores taking the total count to 362 stores in six states. The company plans to open 30-32 outlets this year with no additional store closure planned. The company remains optimistic about 10% annual unit growth.

Other Financial Aspects

Grocery Outlet ended second-quarter 2020 with cash and cash equivalents of \$79.8 million compared with \$18.7 million at the end of the same period in fiscal 2019.

Total debt was \$460.1 million at the end of the quarter under review compared with \$475.5 million at the end of the prior-year period. During the quarter, the company repaid in full the \$90 million drawn on the revolving credit facility of its First Lien Credit Agreement.

Net cash provided by operations during the quarter was \$22.2 million. The company incurred capital expenditures (excluding the impact of landlord allowances) of \$21.8 million during the quarter under review. Management envisions capital expenditures between \$95 million and \$105 million for the full year.

Quarter Ending 06/2020

Report Date	Aug 10, 2020
Sales Surprise	4.47%
EPS Surprise	82.61%
Quarterly EPS	0.42
Annual EPS (TTM)	1.21

Valuation

Grocery Outlet shares are up 25.5% in the year-to-date period but down nearly 4.3% in the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Consumer Staples sector are down 0.1% and 6.1%, respectively, in the year-to-date period. Over the past year, the sub-industry and the sector are down 0.1% and 4.2%, respectively.

The S&P 500 index is up 7% in the year-to-date period and 19.6% in the past year.

The stock is currently trading at 35.5X forward 12-month earnings, which compares to 22.01X for the Zacks sub-industry, 20.26X for the Zacks sector and 23.12X for the S&P 500 index.

Our Outperform recommendation indicates that the stock will perform better than the market. Our \$47 price target reflects 40.83X forward 12-month earnings.

Industry Analysis Zacks Industry Rank: Top 37% (93 out of 252)



Top Peers

Company (Ticker)	Rec	Rank
Big Lots, Inc. (BIG)	Outperform	1
Dollar General Corporation (DG)	Outperform	2
Ollies Bargain Outlet Holdings, Inc. (OLLI)	Outperform	2
Sprouts Farmers Market, Inc. (SFM)	Outperform	2
Target Corporation (TGT)	Outperform	1
Caseys General Stores, Inc. (CASY)	Neutral	2
Dollar Tree, Inc. (DLTR)	Neutral	3
Walmart Inc. (WMT)	Neutral	3

Industry Comparison Industry: Consumer Products - Staples				Industry Peers		
	GO	X Industry	S&P 500	BIG	OLLI	WMT
Zacks Recommendation (Long Term)	Outperform	-	-	Outperform	Outperform	Neutral
Zacks Rank (Short Term)	1	-	-	1	2	3
VGM Score	D	-	-	B	D	A
Market Cap	3.73 B	3.28 B	23.69 B	2.19 B	7.06 B	370.36 B
# of Analysts	6	4	14	6	7	15
Dividend Yield	0.00%	0.00%	1.65%	2.15%	0.00%	1.65%
Value Score	F	-	-	A	D	B
Cash/Price	0.02	0.10	0.07	0.15	0.02	0.05
EV/EBITDA	42.67	10.09	13.37	7.14	38.18	12.31
PEG Ratio	2.48	2.95	3.04	1.19	1.83	4.41
Price/Book (P/B)	4.44	3.37	3.17	2.47	6.46	4.56
Price/Cash Flow (P/CF)	30.78	16.22	12.78	7.76	47.96	14.76
P/E (F1)	33.39	20.94	21.63	8.39	39.28	24.85
Price/Sales (P/S)	1.30	1.30	2.50	0.40	4.93	0.68
Earnings Yield	2.99%	3.75%	4.44%	11.92%	2.55%	4.02%
Debt/Equity	1.53	0.70	0.75	1.68	0.27	0.75
Cash Flow (\$/share)	1.32	1.32	6.94	7.18	2.31	8.85
Growth Score	C	-	-	B	B	A
Hist. EPS Growth (3-5 yrs)	NA%	2.16%	10.41%	7.48%	31.17%	2.80%
Proj. EPS Growth (F1/F0)	54.01%	7.28%	-4.92%	80.93%	43.81%	6.69%
Curr. Cash Flow Growth	75.51%	15.07%	5.22%	0.18%	8.58%	-0.12%
Hist. Cash Flow Growth (3-5 yrs)	NA%	5.06%	8.50%	2.93%	30.96%	-0.31%
Current Ratio	1.61	1.56	1.34	1.48	2.48	0.79
Debt/Capital	60.41%	47.49%	44.18%	62.66%	21.48%	43.02%
Net Margin	2.24%	1.59%	10.25%	5.05%	9.48%	3.30%
Return on Equity	15.05%	13.89%	14.66%	19.99%	12.56%	19.13%
Sales/Assets	1.28	1.10	0.50	1.67	0.91	2.29
Proj. Sales Growth (F1/F0)	20.65%	3.23%	-1.45%	12.54%	21.94%	4.96%
Momentum Score	B	-	-	D	D	A
Daily Price Chg	-1.37%	0.44%	-0.18%	2.56%	1.38%	0.05%
1 Week Price Chg	-3.19%	0.00%	-1.45%	2.86%	5.16%	-0.73%
4 Week Price Chg	-5.89%	-2.53%	2.10%	37.49%	3.63%	0.01%
12 Week Price Chg	11.89%	14.49%	3.61%	44.40%	20.18%	5.86%
52 Week Price Chg	-4.30%	11.98%	3.61%	160.21%	42.36%	15.95%
20 Day Average Volume	964,998	766,932	1,883,291	1,162,246	1,036,223	8,286,171
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.48%
(F1) EPS Est 4 week change	16.17%	0.00%	0.93%	7.15%	2.87%	6.69%
(F1) EPS Est 12 week change	16.17%	0.00%	3.41%	124.45%	41.74%	6.74%
(Q1) EPS Est Mthly Chg	4.32%	0.00%	0.00%	62.16%	0.38%	2.97%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	F
Growth Score	C
Momentum Score	B
VGM Score	D

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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