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Feb 14, 2020

Rite Aid Corporation (RAD)

$14.22 (As of 02/13/20)

Price Target (6-12 Months): **$16.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 12/24/19) Prior Recommendation: Neutral	**Outperform**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**1-Strong Buy**
	Zacks Style Scores:	VGM:A
	Value: A | Growth: A | Momentum: A	

Summary

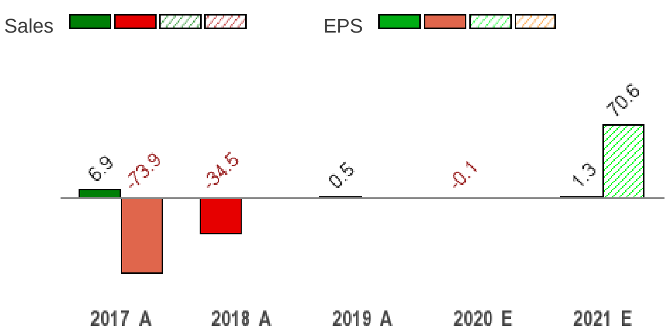
Shares of Rite Aid outperformed the industry in the past three months. The stock is witnessing momentum since reporting solid third-quarter fiscal 2020 results, wherein earnings and sales beat the Zacks Consensus Estimate and increased year over year. Earnings benefited from higher adjusted EBITDA, courtesy of tight expense control and higher prescription count at retail pharmacies. Improved pharmacy network at EnvisionRxOptions also drove results. Notably, it delivered sixth straight quarter of prescription count growth. Further, the company has been investing in the expansion of EnvisionRxOptions, which is adding growth. However, weak front-end sales have been hurting the company's top line. This coupled with projections of lower prescription reimbursement rates might hurt performance. Bleak EBITDA view for fiscal 2020 is also a concern.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$23.88 - $5.04
20 Day Average Volume (sh)	3,874,162
Market Cap	$779.5 M
YTD Price Change	-8.1%
Beta	1.99
Dividend / Div Yld	$0.00 / 0.0%
Industry	Retail - Pharmacies and Drug Stores
Zacks Industry Rank	Top 22% (57 out of 255)
Last EPS Surprise	1,700.0%
Last Sales Surprise	0.6%
EPS F1 Est- 4 week change	13.2%
Expected Report Date	04/09/2020
Earnings ESP	33.3%
P/E TTM	27.9
P/E F1	41.8
PEG F1	41.8
P/S TTM	0.0

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	5,452 E	5,452 E	5,550 E	5,486 E	21,919 E
2020	5,373 A	5,366 A	5,462 A	5,428 E	21,629 E
2019	5,388 A	5,421 A	5,450 A	5,380 A	21,640 A

EPS Estimates

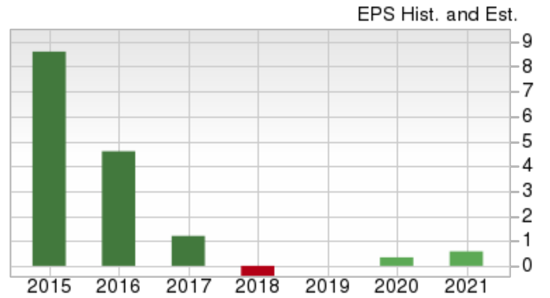
	Q1	Q2	Q3	Q4	Annual*
2021	-$0.17 E	$0.17 E	$0.50 E	-$0.01 E	$0.58 E
2020	-$0.14 A	$0.12 A	$0.54 A	-$0.14 E	$0.34 E
2019	-$0.20 A	-$0.20 A	$0.20 A	-$0.20 A	$0.00 A

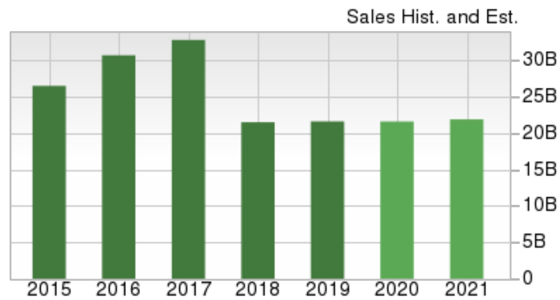
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/13/2020. The reports text is as of 02/14/2020.

Overview

Rite Aid Corporation, headquartered in Camp Hill, PA, is the third largest retail drugstore in the United States, based on revenues and number of stores. As of Nov 30, 2019, the company operated 2,400 retail pharmacy stores across 18 states. Through EnvisionRxOptions, the company also provides pharmacy benefit management to nearly 1,900 clients and 3.4 million members.





The company operates its business in two distinct segments – Retail Pharmacy Segment and Pharmacy Services Segment.

Retail Pharmacy Segment consists of Rite Aid stores, RediClinic and Health Dialog. *Rite Aid stores* offer prescription drugs and a wide assortment of other merchandise called "front-end" products. Front-end products include over-the-counter (OTC) medications, health and beauty aids, personal care items, cosmetics, household items, food and beverages, greeting cards, seasonal merchandise and other convenience products.

RediClinic is an operator of retail clinics. RediClinics are staffed by board-certified nurse practitioners and physician assistants, who are trained and licensed to treat common conditions and provide preventative services, in collaboration with local physicians affiliated with a leading health care system in each market. The company operated a total of 65 RediClinics at the end of fiscal 2019.

Health Dialog provides healthcare coaching and disease management services to health plans and employers. Health Dialog provides these services using a call in line staffed by nurse practitioners and through an on-line platform.

Pharmacy Services Segment comprises the EnvisionRx – its PBM operations that have been rebranded as EnvisionRxOptions. This segment provides a broad range of pharmacy benefits and services, including both transparent and traditional PBM options through its EnvisionRx and MedTrakRx PBMs, EnvisionPharmacies, EnvisionInsurance, EnvisionSavings and Laker Software.

In January 2019, Rite Aid proposed a 1-for-20 reverse stock split to regain compliance with NYSE minimum average share price listing requirements. The company's shares started trading on a split-adjusted basis from Apr 22.

Reasons To Buy:

Rite Aid delivered sixth straight quarter of prescription count growth in third-quarter fiscal 2020. This improvement was backed by increased immunizations and strong clinical pharmacy services.

▲ **Robust Q3 Earnings:** Shares of Rite Aid have surged 43.7% in the past three months against the industry's 2.2% decline. The company delivered solid earnings and sales in third-quarter fiscal 2020. Quarterly adjusted earnings per share of 54 cents significantly outshined the Zacks Consensus Estimate of 3 cents and the year-ago quarter's adjusted figure of 28 cents. Notably, the bottom line mainly benefited from higher adjusted EBITDA, stemming from tight expense control and higher prescription count at retail pharmacies. Improved pharmacy network management at EnvisionRxOptions also drove performance. Moreover, higher Medicare Part D revenues and prescription count sales growth aided performance. Rite Aid's view for fiscal 2020 includes the assumption of higher prescription count coupled with improvements in drug costs and SG&A expenses. Moreover, EnvisionRxOptions are likely to witness consistent improvements in pharmacy network as well as initial results of SG&A decline and gains from integration and restructuring efforts. Adjusted earnings for the current fiscal year are now envisioned in the band of 13-55 cents per share compared with the earlier guidance of flat to 56 cents.

▲ **Growth Strategy on Track:** Rite Aid remains on track with its growth strategy, which focuses on leveraging unique opportunities such as EnvisionRxOptions, enhancing the front-end channels and transforming processes to deliver operational efficiency. It continues to invest in the expansion of EnvisionRxOptions, especially its services, technologies and clinical offerings. Revenues in the EnvisionRxOptions increased nearly 6% in third-quarter fiscal 2020, driven by increase in Medicare Part D membership and improved pharmacy network management. Going forward, management is optimistic about the company on the back of EnvisionRxOptions as well as health and wellness offerings. In fiscal third quarter, prescription sales contributed 67.7% to total drugstore sales. Notably, the company delivered sixth straight quarter of prescription count improvement backed by increased immunizations and strength in the company's clinical pharmacy services. Prescription count at same-store sales, adjusted to 30-day equivalents, rose 2.8% in fiscal third quarter. Excluding cigarettes and tobacco products, front-end same-store sales inched up 1%.

In addition, the company is keen on capturing opportunities through diverse brand offerings. Apparently, the company has partnered with UNFI for introducing the Wild Harvest brand in Rite Aid stores. The Wild Harvest brand line up, acclaimed for natural and organic properties, has been boosting the company's wellness offerings. Furthermore, with a view to boost demand for CBD products, the company started selling CBD creams, lotions and lip balms at certain stores. Management expects all such moves to yield results in the forthcoming periods.

▲ **Drug Purchasing Deal to Support Retail Pharmacy Business:** With a view to retain strength in its Retail Pharmacy business, the company renewed the drug purchasing agreement with McKesson, which will extend for another 10 years. As part of the agreement, McKesson will continue providing Rite Aid with sourcing and direct-to-store delivery for branded and generic pharmaceutical products through March 2029. The partnership will provide Rite Aid with a combination of competitive drug pricing and operational flexibility, which will enhance shareholder value. This extension also represents a key step in strengthening the pharmacy business, with continued focus on improving access to preferred and limited networks and executing key script growth initiatives like further expanding its clinical pharmacy offerings.

▲ **Enhancing Customer Experience to Gain Market Share:** In order to increase its market share in an extremely competitive industry, the company has focused on remodeling its wellness stores. In another move to enhance customer experience, Rite Aid has shifted e-commerce fulfillment from a third-party provider to its own distribution network. This has reduced fulfillment lead time, lowered cost and helped increase online offering by 25%. Additionally, it is enhancing home delivery through partnership with Instacart. This technology-driven, on-demand delivery service should strengthen the company's omni-channel capabilities, and provide increased convenience and value to customers.

Moreover, its partnership with Amazon to add Locker and counter services to Rite Aid stores remains a key opportunity to improve traffic. The company is likely to soon offer an Amazon pickup solution at every Rite Aid store. In fact, it has been receiving favorable consumer response for self checkout facility, so far introduced in 100 stores across New York City and Los Angeles. In the first half of the next year, management intends to introduce self checkout across 200 additional stores. Additionally, the company formed a partnership with Adobe to enhance digital solutions and marketing capabilities. All these moves are expected to improve customer experience, positioning Rite Aid to deliver long-term growth.

Risks

- **Weak Front-End Sales:** Rite Aid has been witnessing weak front-end same-store sales since the past few quarters. In third-quarter fiscal 2020, the metric fell 0.5%. The downside followed declines of 1.8% and 0.3% in the preceding quarters. During fourth-quarter fiscal 2019, sales in this category fell 1.9%. Softness in tobacco, owing to regulation changes, which restricted selling tobacco in some New York stores, and in over-the-counter cough-cold and flu products are affecting front-end performance.

- **Soft EBITDA Outlook:** Rite Aid has been reporting weak adjusted EBITDA for a while, mainly due to lower front-end same-store sales. Although adjusted EBITDA increased third-quarter fiscal 2020, management's revised EBITDA guidance for the fiscal year remains bleak. Rite Aid now anticipates adjusted EBITDA to be between $515 million and $545 million, lower than $563.4 million reported in last fiscal. Earlier, management guided the metric in the range of $510-$550 million for fiscal 2020. Lower EBITDA might remain a threat to the company's bottom-line results. Further, management projects lower prescription reimbursement rates in fiscal 2020.

- **Consolidating Healthcare Industry – A Major Threat:** Over the last few years, many healthcare companies have merged to form a larger enterprise. As an enterprise, these companies enjoy greater power as well as cost and pricing benefits. The merger of Walgreen and Alliance Boots is an important example of such an alliance, which will together generate annual revenues of over $76 billion. Continuation of such a trend will reduce Rite Aid's bargaining power, thereby weighing on the prices of the company's products and services. To compete with such large enterprises, Rite Aid will have to either increase its revenue streams or reduce costs.

- **Competitive Risks:** Rite Aid's generic drug sales have been adversely affected by Wal-Mart's strategy of entering the retail generic drug market. Due to Wal-Mart's wide array of manufacturers in India, Israel, and the U.S., the mass merchant offers generic drugs at a discounted price compared with its rival companies.

Last Earnings Report

Rite Aid Beats Q3 Earnings Estimates, Updates View

Quarter Ending	11/2019
Report Date	Dec 19, 2019
Sales Surprise	0.64%
EPS Surprise	1,700.00%
Quarterly EPS	0.54
Annual EPS (TTM)	0.32

Rite Aid reported better-than-expected earnings and sales in third-quarter fiscal 2020 results. The company delivered adjusted earnings from continuing operations of 54 cents per share, which significantly beat the Zacks Consensus Estimate of 3 cents. Also, the bottom line increased from the year-ago quarter's adjusted figure of 28 cents. Further, it revised view for the current fiscal.

Notably, the bottom line benefited from higher adjusted EBITDA, courtesy of tight expense control and higher prescription count at retail pharmacies. Improved pharmacy network management at EnvisionRxOptions also aided performance. Further, the company has been investing in the expansion of EnvisionRxOptions, especially its services, technologies and clinical offerings.

Management stated that it will announce a comprehensive strategy for revitalizing the retail pharmacies as well as training pharmacists to cater to health and wellness needs.

Q3 in Detail

Revenues inched up 0.2% to $5,462.3 million and surpassed the Zacks Consensus Estimate of $5,428 million. During the fiscal third quarter, the Retail Pharmacy segment revenues slipped 1.7% due to lower store count. In the Pharmacy Services segment, revenues rose 5.7% owing to rise in Medicare Part D membership.

Retail Pharmacy same-store sales slipped 0.1%, thanks to 0.5% decline in front-end sales. The downside was partly offset by 0.1% rise in pharmacy sales. Excluding cigarettes and tobacco products, front-end same-store sales inched up 1%. Pharmacy sales included an adverse impact of nearly 331 basis points (bps) from the introduction of new generic drugs. Further, prescription count at same-store sales, adjusted to 30-day equivalents, rose 2.8%. Prescription sales contributed 67.7% to total drugstore sales.

Rite Aid's adjusted EBITDA increased 10.7% year over year to $158.1 million and adjusted EBITDA margin expanded 30 bps to 2.9%. The upside can be attributed to higher adjusted EBITDA in the Retail Pharmacy and Pharmacy Services segments.

Moreover, the Retail Pharmacy's adjusted EBITDA benefited from robust labor and expense control, somewhat offset by lower gross profit and decline in the Transition Service Agreement fee income from Walgreens Boots Alliance. The Pharmacy Services segment gained from improved pharmacy network performance.

Financial Status

Rite Aid ended the quarter with cash and cash equivalents of approximately $289.5 million, long-term debt (net of current maturities) of $3,566.3 million and total shareholders' equity of $1,015.9 million.

Further, the company used cash from operating activities of $423.7 million in the fiscal third quarter.

Outlook

Rite Aid updated its outlook for fiscal 2020. The view includes the assumption of higher prescription count as well as improvements in drug costs and SG&A expenses, compensated with lower prescription reimbursement rates. Moreover, EnvisionRxOptions are likely to witness consistent improvements in pharmacy network as well as initial results of SG&A decline and gains from integration and restructuring efforts.

It continues to project sales in the range of $21.5-$21.9 billion for fiscal 2020. The company projects same-store sales growth in the band of 0-1% over fiscal 2019. Moreover, Rite Aid now anticipates adjusted EBITDA to be between $515 million and $545 million compared with the earlier projection of $510-$550 million for fiscal 2020.

Further, the company estimates net loss in the band of $174-$204 million compared with the prior expectation of $235-$275 million. The company now envisions adjusted earnings in the band of 13-55 cents per share compared with the earlier guidance of flat to 56 cents. Meanwhile, capital expenditures are expected to be nearly $230 million.

Valuation

Rite Aid shares are down 8.1% in the year-to-date period and nearly 10.8% over the trailing 12-month period. Stocks in the Zacks sub-industry are down 1% but the Zacks Retail-Wholesale sector is up 5.9%. Over the past year, the Zacks sub-industry is down 5.9% but the sector is up 19.8%.

The S&P 500 index is up 4.9% in the year-to-date period and 21% in the past year.

The stock is currently trading at 0.04X forward 12-month sales, which compares to 0.32X for the Zacks sub-industry, 1.09X for the Zacks sector and 3.58X for the S&P 500 index.

Over the past five years, the stock has traded as high as 0.32X and as low as 0.01X, with a 5-year median of 0.1X. Our Outperform recommendation indicates that the stock will perform better than the market. Our $16 price target reflects 0.05X forward 12-month sales.

The table below shows summary valuation data for RAD

Valuation Multiples - RAD

		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	0.04	0.32	1.09	3.58
	5-Year High	0.32	0.78	1.1	3.58
	5-Year Low	0.01	0.24	0.8	2.54
	5-Year Median	0.1	0.46	0.92	3
EV/EBITDA TTM	Current	9.27	7.6	15.71	11.36
	5-Year High	13.94	13.29	15.71	12.85
	5-Year Low	NA	5.93	10.79	8.47
	5-Year Median	4.87	8.28	12.4	10.7
P/B TTM	Current	0.77	1.47	5.44	4.36
	5-Year High	153.6	3.18	5.86	4.42
	5-Year Low	NA	1.18	3.6	2.85
	5-Year Median	4.18	2.33	4.86	3.62

As of 02/13/2020

Industry Analysis **Zacks Industry Rank:** Top 22% (57 out of 255)

Top Peers

CVS Health Corporation **(CVS)**	Neutral
Diplomat Pharmacy, Inc. **(DPLO)**	Neutral
GNC Holdings, Inc. **(GNC)**	Neutral
Herbalife LTD. **(HLF)**	Neutral
The Kroger Co. **(KR)**	Neutral
Target Corporation **(TGT)**	Neutral
Walgreens Boots Alliance, Inc. **(WBA)**	Neutral
Walmart Inc. **(WMT)**	Neutral

Industry Comparison Industry: Retail - Pharmacies And Drug Stores

Industry Peers

	RAD Outperform	X Industry	S&P 500	GNC Neutral	WBA Neutral
VGM Score	A	-	-	A	B
Market Cap	779.52 M	779.52 M	24.53 B	185.20 M	47.46 B
# of Analysts	1	2	13	3	10
Dividend Yield	0.00%	0.00%	1.75%	0.00%	3.42%
Value Score	A	-	-	A	B
Cash/Price	0.40	0.12	0.04	0.66	0.02
EV/EBITDA	18.34	10.89	13.98	3.02	10.89
PEG Ratio	41.82	1.40	2.09	0.22	1.40
Price/Book (P/B)	0.77	1.71	3.29	NA	1.96
Price/Cash Flow (P/CF)	1.05	6.64	13.69	1.85	6.39
P/E (F1)	41.82	10.08	19.19	4.24	9.14
Price/Sales (P/S)	0.04	0.36	2.68	0.09	0.35
Earnings Yield	2.39%	9.92%	5.21%	23.74%	10.94%
Debt/Equity	6.22	0.55	0.71	-4.02	1.34
Cash Flow ($/share)	13.52	3.34	6.92	1.18	8.38
Growth Score	A	-	-	D	B
Hist. EPS Growth (3-5 yrs)	NA%	5.68%	10.85%	-46.69%	12.45%
Proj. EPS Growth (F1/F0)	NA%	14.34%	7.30%	82.36%	-2.15%
Curr. Cash Flow Growth	16.33%	-16.33%	8.56%	-38.97%	-2.42%
Hist. Cash Flow Growth (3-5 yrs)	-0.39%	-0.39%	8.36%	-21.45%	11.05%
Current Ratio	1.46	1.06	1.23	1.21	0.66
Debt/Capital	86.15%	56.90%	42.91%	NA	57.22%
Net Margin	-1.86%	2.58%	11.81%	2.67%	2.69%
Return on Equity	1.40%	-5.19%	16.92%	-18.62%	21.76%
Sales/Assets	2.20	1.70	0.54	1.29	1.85
Proj. Sales Growth (F1/F0)	-0.05%	0.39%	3.96%	-7.92%	2.21%
Momentum Score	A	-	-	B	D
Daily Price Chg	4.94%	-1.65%	0.64%	-0.90%	-1.65%
1 Week Price Chg	9.54%	4.70%	2.47%	1.40%	4.70%
4 Week Price Chg	9.38%	-5.33%	1.87%	-9.13%	-1.56%
12 Week Price Chg	48.13%	-11.00%	6.69%	-25.51%	-11.63%
52 Week Price Chg	-9.33%	-25.51%	16.42%	-25.51%	-25.71%
20 Day Average Volume	3,874,162	1,078,623	2,019,212	673,970	4,522,829
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	-0.15%
(F1) EPS Est 4 week change	13.23%	0.00%	-0.06%	0.00%	-0.17%
(F1) EPS Est 12 week change	220.83%	0.00%	-0.19%	0.00%	-1.23%
(Q1) EPS Est Mthly Chg	64.93%	0.00%	-0.16%	0.00%	-0.82%

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	A
Growth Score	A
Momentum Score	B
VGM Score	A

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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