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ANALYST QUICK NOTES

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Lowes Companies Inc. (NYSE: LOW: BUY)
Target Price: $90
Christopher Graja, CFA
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Where do we stand?

- We continue to rate Lowe's BUY but we are disappointed by lower-than-expected results in 3Q17 and by LOW's fundamental underperformance relative to rival Home Depot.

Any changes to the investment thesis?

- For the last several quarters, our thesis has been that HD has been more successful at delivering on its financial promises, but LOW has more upside potential.
- The recent change in our thinking is that we see a greater urgency for Lowe's to demonstrate that it can realize this upside potential.

So why buy LOW?

- More than 20% potential upside to our price target.
- Still believe Lowe's has the ability to:
    - Boost comparable-sales growth.
    - Slightly improve gross margins with:
        - Private brands,
        - Better merchandising,
        - Collaboration with suppliers,
        - Strategic use of the supply chain.

Recap of 3Q

- On November 16, Lowe's reported fiscal third-quarter earnings of $0.88 per share on an adjusted, non-GAAP basis. The result was below our estimate of $0.96 and below the consensus forecast of $0.96 because of weak sales in the first two months of the quarter.
- Third-quarter sales rose 9.6% to $15.7 billion, which was below the StreetAccount consensus of $15.84 billion.
- Comparable sales rose 2.7%, which was below the consensus of 3.0%, according to StreetAccount. U.S. comps increased 2.6%.
- LOW again saw weak sales in northern markets. Management said that comps came in below expectations because traffic slowed more than anticipated in August and September before rebounding in October.

A few BIG questions

- Do we still expect a multi-year housing recovery?
    - Yes
        - Investment well below historical averages.
        - Employment supportive.
        - Affordability is still good.
        - Pro market is strong.
- What about rising rates?
    - Spoke to LOW Friday and they think affordability is favorable until 30-year mortgage rates reach 6% to 6.5%.
    - Currently about 3.3%.
- Why the underperformance vs. Home Depot?
    - HD has a bigger Pro business.
    - HD may have a little more exposure to cities/metropolitan areas that may be slightly stronger than suburban markets where LOW has more concentration.
    - LOW's Orchard Hardware had come challenges from drought conditions in California.
    - HD may be executing better particularly on expense management.
- What is the next event/catalyst for LOW?
    - LOW will host an analyst meeting in North Carolina on 12/7.