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ANALYST QUICK NOTES
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Lowe's Companies Inc. (NYSE: LOW: BUY)
Target Price: $95
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What's New?

- We raised our target to $95 from $90

Why Buy the LOW Stock Now?

- There is about 18% total return potential to our target.

We See Additional Upside:

- We believe the housing market is still in the middle innings of a long upcycle that will continue to be a tailwind for Lowes.
- The supply of new homes and the demand for homes have been muted, which is the reason that the market hasn't already become overheated.
    - On the supply side:
        - Economic growth has been sluggish compared with previous recoveries and construction has significantly lagged population growth.
            - Now resolved glut of existing homes.
            - Scarce builder financing.
            - Shortage of construction workers.
    - On the demand side:
        - Household formation has been very low:
            - Young adults have faced high unemployment.
            - Heavy debt from college loans.
            - Concern that home ownership is not a good investment.
    - Going forward we expect mortgage rates to rise, but remain affordable.
    - We expect an improving job market to boost household formation as the millennial generation leaves the "nest."

When Would We Be in the Late Innings?

- We do not expect the current cycle to peak unless 30-year mortgage rates jump towards 6% (from a current 4%).
  - Higher interest rates do less damage to the housing market if they are being driven by stronger economic conditions as opposed to a spike in inflation expectations.
- U.S. sales of new single-family homes reach at least 700,000 units, which is still well above the 501,000 new homes sold in 2015 and 563,000 sold in 2016.
  - Even 700,000 remains well below a pace of about 900,000 annually in the late 1990’s and more than a million in the early 2000’s.
- Private Fixed Residential Investment is still near a 66-year low, at 3.6% of GDP.
  - Well below the average of 4.6% since 1946.
  - We would expect PFRI to approach and likely exceed the long-term average before this current expansion is done.
  - Based on calculations from the Federal Reserve Bank of Philadelphia’s Survey of Professional Forecasters, Private Fixed Residential Investment is only expected to reach 3.7% of GDP for 2017.
- Home prices are only now reaching 2006 peak levels and affordability is still positive.
- About two-thirds of U.S. homes are more than 25 years old and likely in need of upgrades and repairs.
- The National Association of Home Builders Remodeling Index indicates improving conditions.
- Harvard University's Leading Indicator of Remodeling Activity also points to strong growth of more than 6.5% over the next year.

What is Lowe’s Doing Right?

- On March 1, Lowe’s reported fiscal fourth-quarter earnings of $0.86 per share on an adjusted, non-GAAP basis. The result was up 46% and above our estimate of $0.78 and the consensus forecast of $0.79 helped by strong sales.
- Lowe’s provided FY18 EPS guidance of $4.64 per share, which was comfortably above the pre-release consensus of $4.52 per share.
- Comparable sales rose 5.1%, which was above the consensus of 2.4%, according to StreetAccount.
  - U.S. comps increased 5.1%.
  - LOW saw strength in big-ticket categories such as appliances and kitchens and saw strong sales to professional customers.
- Comp sales for purchases over $500 increased by 9%.
- Comp sales at Lowe’s were positive in 10 of 13 product categories and all 14 geographic regions. Sales to professional contractors continued to perform well above the company average.
- 4Q ROIC up 175 basis points to 15.83%.

Valuation

- The shares are trading at 20-times trailing earnings. The average trailing multiple of specialty retailers tracked by Bloomberg is 23.
- We believe that LOW merits a premium multiple because it is partly insulated from internet competition and still has considerable room to raise operating profitability. At a little-changed multiple of 21-times our FY18 estimate of $4.65, the LOW shares would be worth $98.