MIDWAY
PARTNERS
CAPITAL MANAGEMENT

WHAT'S VALUE GOT TO DO WITH IT?

Understanding Intrinsic Value and the Differences Between Valuation and Pricing

June 2022

Qualified Clients Only

The goal of this presentation is to provide the foundation for Midway Partners Capital Management's ("Midway Partners") intrinsic value based decision making process.

The presentation will contrast the major differences between intrinsic valuation and relative pricing methodologies and dispel common myths associated with intrinsic valuation.

In Midway Partners' opinion, the presentation demonstrates why intrinsic valuation provides a superior tool on which to base investment decisions and provides an illustrative case study.

Section 1 Midway Partners’ Intrinsic Value Philosophy

Section 2 Intrinsic Value Myths

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SECTION 1

Midway Partners’ Intrinsic Value Philosophy

All investments have three fundamental components:

01 An initial cash outflow (the original investment made by the investor);

02 An interim period of cash flows, comprising inflows to the investor, or outflows/requirements to provide additional capital; and

03 A final cash inflow to the investor, larger or smaller than the initial investment (at which point, the investor no longer has a right to receive future interim cash flows).

We know this is obvious, stay with us.

These common investments all share the same three fundamental components.

01 US treasury bills/bonds

02 Purchasing the local laundry mat

03 The equity of publicly traded companies (stocks)

04 Farms

05 A Subway franchise

06 Preferred stocks

07 Loans

08 Venture capital start-ups

If all investments share the same three fundamental components, does it make sense to value a bond differently than a stock? Does it make sense to refer to a bond price using an earnings multiple?

"As of the close on April 29, 2022, the 10-year US treasury bond was trading at a 34.0x price to pre-tax earnings multiple."

No, we don't think so either.

The challenge is that fixed income investments (bonds, etc.) have known interim cash flow payments and a known final payment at maturity (the face value), while equity (stocks, etc.) investments do not.

BOND	Price	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Final
	Known	Known	Known	Known	Known	Known	Known	Known	Known
Coupon Payments		$5.0	$5.0	$5.0	$5.0	$5.0	$5.0	$5.0	$5.0
Principal Repayment									$100.0
Total	($100.0)	$5.0	$5.0	$5.0	$5.0	$5.0	$5.0	$5.0	$105.0
Return	5.0%								

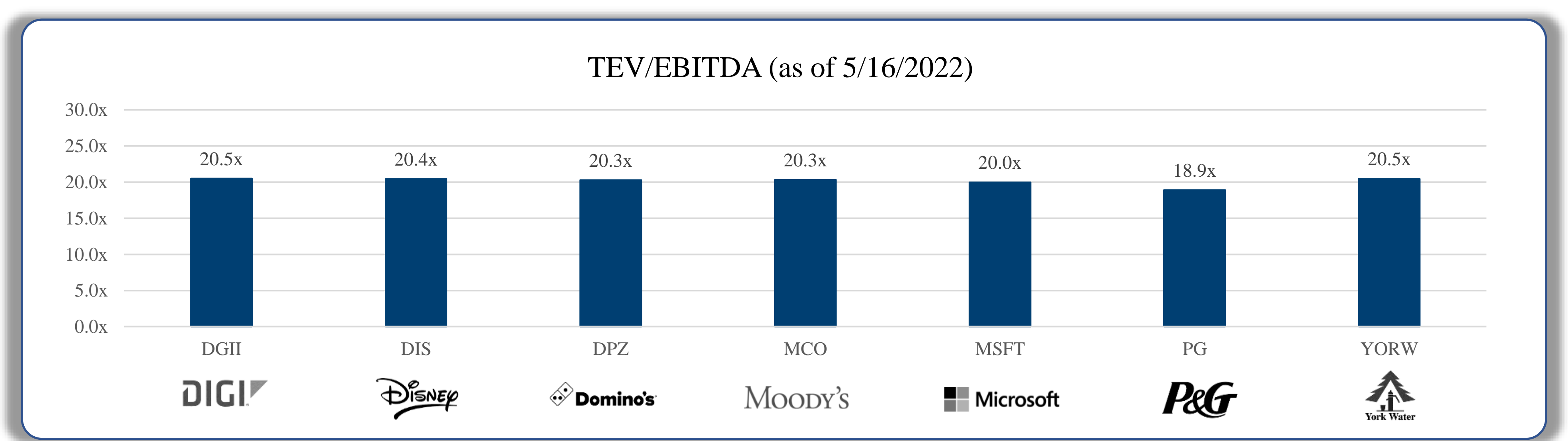
EQUITY	Price	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Final
	Known	Unknown	Unknown	Unknown	Unknown	Unknown	Unknown	Unknown	Unknown
Cash Flows		?	?	?	?	?	?	?	?
Exit Price									?
Total	($100.0)	?	?	?	?	?	?	?	?
Return	?								

This uncertainty makes valuing equity investments and understanding their potential returns more difficult than fixed income investments. To remedy this challenge, investors search for short cuts and heuristics to make the process easier.

Enter pricing multiples. These convenient short cuts include Price/Earnings, Total Enterprise Value/EBITDA, Price/Book, Price/Square Foot (for real estate), and any other pricing ratio that can be cooked up.

But what do multiples really tell us?

Let's look at a few companies that all share a similar TEV/EBITDA multiple.



Source: FactSet

Metric ($ in millions)	DGII	DIS	DPZ	MCO	MSFT	PG	YORW
Description	Internet of things technology	Family entertainment and media	Pizza franchisor	Financial services	Software and cloud technology	Branded consumer packaged goods	Water utility
Total Enterprise Value	$1,017	$245,052	$16,926	$59,363	$1,911,789	$397,419	$665
Market Capitalization	$756	$191,494	$12,127	$53,092	$1,955,767	$372,179	$563
Pricing Metrics							
TEV/LTM EBITDA	20.5x	20.4x	20.3x	20.3x	20.0x	18.9x	20.5x
TEV/LTM EBIT	45.8x	35.5x	22.3x	22.4x	23.3x	21.8x	28.5x
Price/LTM Earnings	64.2x	70.8x	25.1x	26.9x	27.0x	25.5x	32.9x
Price/LTM Cash Flow	25.4x	123.9x	24.7x	32.6x	30.7x	26.7x	-44.1x
Capital Efficiency							
LTM Sales/Capital	$0.44	$0.57	$4.45	$0.61	$0.82	$1.15	$0.19
LTM ROIC (pre-tax)	2.9%	5.0%	77.1%	26.1%	34.7%	26.3%	7.8%
Incr. Invested Capital (5 yrs)	$452	$76,688	$660	$7,184	$88,358	($1,228)	$100
Growth and Margins							
LTM Revenue CAGR (5 yrs)	11.8%	7.0%	11.4%	10.3%	16.2%	4.1%	3.4%
LTM EBITDA Margin	14.7%	15.4%	19.0%	47.6%	49.7%	26.4%	57.8%
LTM EBIT Margin	6.6%	8.9%	17.3%	43.1%	42.6%	22.9%	41.5%
LTM FCF Margin	8.8%	2.0%	11.2%	26.5%	33.1%	17.5%	-22.7%

Source: FactSet; as of 5/16/2022

The companies on the previous page could not be more different. The group includes a 200+ year old water utility company, a technology giant, and everything in between each with dramatically different growth rates, margins, capital requirements, risks, etc.

Somehow, they all have the same TEV/EBITDA multiple. Let's see if we can make some sense of this.

Does the multiple reflect the revenue growth rate?	Does the multiple reflect profit margins?	Does the multiple reflect capital efficiency?
• MSFT grew revenue at a 16.2% CAGR over the past five years. • YORW only grew revenue at a 3.4% CAGR.	• MCO has a 43.1% LTM EBIT margin. • DGII has a 6.6% LTM EBIT margin.	• PG took $1.2 billion of capital out of its business over the last five years, while growing revenue at a 4.1% CAGR. • MSFT grew revenue at a 16.2% CAGR for the last five years but required $88.4 billion of additional capital to do it.
No, it doesn't appear to.	**No, it doesn't appear to.**	**No, it doesn't appear to.**

The point is that pricing multiples provide little information about the characteristics of a business, its expectations, or its true intrinsic value:

01 Pricing multiples **do not provide** insight into the expected future revenue growth rate;

02 Pricing multiples **do not provide** insight into the expected future profit margins;

03 Pricing multiples **do not provide** insight into the additional capital required to achieve growth; and

04 Pricing multiples **do not provide** any indication of the rate of return an investor might receive on their total investment.

Here is another example.

These two companies both deserve a 20x Price/FCF multiple.

However, Company A is projected to grow quickly with a higher discount rate, and Company B is projected to grow slowly with a lower discount rate.

For the companies on slide 9, wouldn't it be helpful to estimate the rate of return and operating projections needed to justify the 20x price multiple?

What if a company is unlikely to achieve the projected performance needed to justify the multiple?

COMPANY A	Current	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Terminal
Cash Flow	$100	$115	$132	$152	$175	$201	$231	$266	$2,713
		15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	15.0%	2.0%
Discount Rate		12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	12.0%	
Discount Factor		0.89	0.80	0.71	0.64	0.57	0.51	0.45	
PV Discrete	$779	$103	$105	$108	$111	$114	$117	$120	
PV Terminal	$1,227								
Total Value	$2,006								
Multiple	20x								

COMPANY B	Current	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Terminal
Cash Flow	$100	$103	$106	$109	$113	$116	$119	$123	$2,281
		3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	2.0%
Discount Rate		7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	7.5%	
Discount Factor		0.93	0.87	0.80	0.75	0.70	0.65	0.60	
PV Discrete	$592	$96	$92	$88	$84	$81	$77	$74	
PV Terminal	$1,375								
Total Value	$1,967								
Multiple	20x								

For all the reasons above, comparing multiples is not valuation, it is pricing…

…and all it can tell us is how one company is priced relative to another in the current market.

Beware of valuation imposters:

01 Any analysis that says an asset is **priced below intrinsic value** because it is trading at a P/E of 12x and its peers are trading at 15x… is erroneous.

02 Any analysis that claims to be a valuation by projecting future earnings and **applying a pricing multiple**, and then discounts the result to the present… is erroneous.

To complete an actual valuation and calculate intrinsic value one must make four key assumptions:

01 Growth – how fast will revenue grow;

02 Profitability – what will the company earn;

03 Reinvestment – how much additional capital will need to be invested to achieve the growth; and

04 Discount Rate – what rate of return is desired.

	Intrinsic Valuation	Relative Pricing
DOES IT PROVIDE AN OBJECTIVE MEASURE OF VALUE?	**Yes – Provides an explicit value based on operating assumptions and a discount rate.**	No – Only relatively compares the earnings, revenue, etc. of an asset based on the pricing multiples of other companies in the market.
IS IT INDEPENDENT OF MARKET CONDITIONS?	**Yes – Does not rely on market pricing trends. Uses fundamentals and required rates of return.**	No – As asset prices rise, higher market multiples are used to justify even higher prices (we think this spiraling effect contributes to the psychology of asset bubbles).
DOES IT PROVIDE SPECIFIC OPERATING SCENARIOS?	**Yes – Revenue, profit, and reinvestment need to be projected. These assumptions can be reviewed for reasonableness and conservatism.**	No – Peer multiples are used to justify prices, often without regard for the specific future operating performance of the target.
DOES IT PROVIDE AN OBJECTIVE RATE OF RETURN?	**Yes – The discount rate is the estimated rate of return.**	No – There is no rate of return used.
DOES IT REFLECT INTANGIBLE ASSETS?	**Yes – Objective intangible assets such as high margins or high ROIC, can explicitly be incorporated into the intrinsic valuation.**	Not exactly – Typically perceived intangible assets are used to justify a higher pricing multiple with no objective link to value.

> "It's tough to make predictions,
> especially about the future."
>
> -Yogi Berra

The assumptions made in an intrinsic valuation will likely be wrong, and that's ok. After all, the future is uncertain.

If the projections are conservative, then the investor is justified in believing that they have a reasonable chance of achieving the discount rate of return selected, provided that the price paid for the asset matches their intrinsic value.

An intrinsic valuation gives an investor two critical pieces of information about a potential investment.

01 If the intrinsic value is **lower** than the market price, it means that the company will need to achieve operating results **greater than** what was projected, or the investor **will not** receive the rate of return that was chosen as the discount rate.

02 If the intrinsic value is **greater** than the market price, it means that the company can achieve operating results **lower** than what was projected and still **receive** the chosen discount rate, or the investor should receive a **higher** rate of return than the chosen discount rate.

Midway Partners looks to avoid scenario #1 and invest in scenario #2.

Market Price ≠ Intrinsic Value

Market price and multiple pricing strategies only tell us the dollar amount at which an asset may be currently bought or sold in the market.

Intrinsic value provides the objective worth of an asset based on the present value of an estimated set of future cash flows for a specifically selected rate of return.

SECTION 2

Intrinsic Value Myths

#	Myth	Answer	Reality
1	"Stocks are efficiently priced making it impossible to find securities selling below intrinsic value."	**FALSE**	Look at the stock price of a relatively predictable business such as Proctor & Gamble Company (PG). Over the past nine years, the PG stock had an annual range of between 12.2% - 36.7% of the average annual price. If you exclude the pandemic years of 2020 and 2021, the range as a percentage of the average annual price was between 12.2% - 32.0%. Even for mature businesses like PG, the stock price from peak to trough in any year can be significant. We believe that the intrinsic value of a mature company does not change significantly in any given year. This is evidence of pricing inefficiencies that may be exploited by focusing on situations where the market price is at a discount to a conservative estimate of intrinsic value.
2	"Intrinsic valuations are too sensitive to terminal values and discount rates."	**FALSE**	Changes to discount rates and terminal growth rates can meaningfully change the valuation conclusion. This is a strength not a weakness of intrinsic valuations. If conservative terminal growth rates and satisfactory discount rates are used, then conservative intrinsic valuations will be the output. We are comfortable basing our investment decisions on valuations that are conservative.
3	"Intrinsic value does not consider intangible value."	**FALSE**	If intangible value exists, it must show up in the business fundamentals. If not, it does not really exist, regardless of how much is written about management's brilliance, brands, or moats. Intrinsic valuations do a better job of capturing intangibles that contribute to higher margins, ROIC, etc. than pricing multiples do. Intrinsic valuations show objectively how much the intangibles contribute to value.

#	Myth	Answer	Reality
4	"Intrinsic value is not a new concept most investors are using it; therefore, no advantage exists."	**FALSE**	We believe most investors use pricing techniques masquerading as intrinsic value analyses. The discipline and expertise required to use and make investing decisions based on intrinsic value is scarce. Investing based on intrinsic value requires patience. It may take years for the price of a target to fall to a price we are comfortable paying based on conservative estimates of intrinsic value. Sometimes the price will never get there. That is OK. Having the discipline to avoid trendy overpriced situations is much harder than finding a pricing analyses to support one's confirmation bias.
5	"Intrinsic value cannot be used for start-up or early-stage companies."	**FALSE**	All investing follows the same three components. This does not change for early-stage companies. It may be more difficult to accurately forecast operating outcomes for early-stage companies. This may result in wide differences in intrinsic value estimates in the early years of a company's life, which is precisely why early-stage investments often have liquidation preferences.
6	"Intrinsic value makes an investor susceptible to poor market timing. It is better to forecast quarter to quarter."	**FALSE**	Any one year of cash flow generally accounts for between 4%-6% of the total value of a company depending on growth, discount rate, etc. If a company has a few bad years as a result of a recession, for example, it likely only impacts the intrinsic valuation by about 10%. If the company can be purchased at a 10-20% discount to conservative estimates of intrinsic value, then the investor is adequately covered in the event of a downturn in performance. This does not mean that the price of the stock may not go down in the market. It likely will, but intrinsic value is far less affected for the long-term investor.

#	Myth	Answer	Reality
7	"Intrinsic valuations are susceptible to incorrect projections and thus unreliable."	**FALSE**	Whatever projections are made for a company valuation, they will always differ from the actual performance in the future. However, it is necessary to create projected operating scenarios in order and to make judgements as to whether a company can be reasonably expected to achieve the results. If a reasonable set of projections does not deliver a value that is greater than or equal to the current market price, we view owning shares in such a company as risky and subject to suboptimal rates of return.
8	"The discount rate should be determined by an asset's risk relative to the market."	**FALSE**	Academics have perpetuated the idea that stock price volatility represents investment risk, i.e. Beta. This makes no sense. The variability in the underlying fundamentals of a business is what determines actual risk. Stock price changes may represent portfolio risk for short-term investors but makes no sense as a risk proxy for long-term investors. The discount rate should simply be the rate of return one wishes to achieve on any given investment. If you require a higher return, then you will naturally need to pay less for the free cash flow of an asset. If you are satisfied with a lower return on a bond, you will pay a higher price for it; its that simple.

SECTION 3

Intrinsic Value Case Study

To show how intrinsic valuation techniques can be used to make sound investment decisions, we highlight Target Corporation (TGT).

- TGT is a big-box retailer with 1,926 stores nationwide supported by 48 distribution centers. The company focuses on providing consumers a large variety of goods, including groceries, apparel, beauty products, home goods, electronics, and toys. TGT was founded in 1902.
- TGT ended its 2022 fiscal year (January 30, 2022) with over $100 billion of sales and $9 billion of pre-tax profit. As of the year-end filing in March 2022, TGT’s market capitalization was about $100 billion.
- TGT is well known in the investor community with wide analyst coverage.

Let’s start by reviewing TGT’s financial history.

($ in billions)

Calendar Year (1)	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	$73.3	$72.6	$72.6	$73.8	$69.5	$71.9	$75.4	$78.1	$93.6	$106.0
Growth %	*4.9%*	*-1.0%*	*0.0%*	*1.6%*	*-5.8%*	*3.4%*	*4.8%*	*3.7%*	*19.8%*	*13.3%*
EBIT	$5.2	$4.0	$4.1	$4.5	$4.4	$3.7	$4.2	$4.7	$6.8	$9.0
Growth %	*-2.2%*	*-24.3%*	*3.7%*	*10.0%*	*-3.4%*	*-15.3%*	*13.3%*	*11.4%*	*45.8%*	*32.3%*
Margin %	*7.2%*	*5.5%*	*5.7%*	*6.1%*	*6.3%*	*5.2%*	*5.6%*	*6.0%*	*7.3%*	*8.5%*
Tax Rate	34.9%	36.5%	33.0%	32.5%	32.7%	19.7%	20.3%	22.0%	21.2%	22.0%
Diluted Shares Outstanding (mm)	663.3	641.8	640.1	632.9	582.5	550.3	533.2	515.6	505.4	492.7
Total Invested Capital (2)	$31.2	$27.7	$26.6	$24.9	$22.0	$24.7	$23.5	$25.4	$28.2	$28.9
Reinvestment	$1.7	($3.6)	($1.0)	($1.7)	($2.9)	$2.7	($1.2)	$1.9	$2.7	$0.7
ROIC (pre-tax)	16.8%	14.4%	15.5%	18.2%	19.9%	15.0%	17.9%	18.4%	24.2%	31.3%
Sales to Capital	$2.3	$2.6	$2.7	$3.0	$3.2	$2.9	$3.2	$3.1	$3.3	$3.7
Free Cash Flow to Equity (3)	$2.0	$3.1	$2.7	$4.4	$3.9	$4.4	$2.5	$4.1	$7.9	$5.1
Dividends	$0.9	$1.0	$1.2	$1.4	$1.3	$1.3	$1.3	$1.3	$1.3	$1.5
Share Repurchases	$1.5	$1.0	$0.0	$3.4	$3.5	$0.9	$2.0	$1.5	$0.7	$7.3
Capital Returned	$2.4	$2.0	$1.2	$4.8	$4.8	$2.3	$3.4	$2.8	$2.1	$8.9

(1) Fiscal year ending January of the following calendar year

(2) Shareholders' equity, plus preferred, plus debt, plus operating leases

(3) Cash from operations less capital expenditures

Source: FactSet

Here is what we glean from the numbers:

- Revenue grew 1.4% compounded annually from 2011-2019; then in 2020 and 2021 growth exploded to 19.8% and 13.3% respectively.
- Pre-tax profit (EBIT) averaged about 5.9% from 2012-2019; then jumped to 7.3% and 8.5% in 2020 and 2021, respectively.
- Pre-tax ROIC over the period averaged about 19.2% and increased in 2020 and 2021.
- Over the period, TGT reduced the amount of invested capital by $2.3 billion from $31.2 billion in 2012 to $28.9 billion in 2021.
- TGT generated $40 billion of free cash flow to equity (FCFE) from 2012-2021 and returned $34.7 billion to shareholders in the form of dividends and share repurchases.
- Diluted shares outstanding were reduced from 663.3 million in 2012 to 492.7 million in 2021.

Suffice it to say that TGT has generated a consistent operating performance pre-pandemic.

But there are a few considerations before we jump into the intrinsic valuation:

- The 2020 and 2021 results look **anomalous and related to the COVID-19 pandemic**. It is unlikely that the company can maintain the revenue growth rate, margin profile, or ROIC it generated in those years.
- While the company was able to take capital out of the business over the previous ten years, it **is unlikely that it will be able to continue to reduce its invested capital** while continuing to grow in the future.

Here are our normalizing adjustments and assumptions used to generate a conservative estimate of intrinsic value.

($ in billions)

Calendar Year (1)	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	$73.3	$72.6	$72.6	$73.8	$69.5	$71.9	$75.4	$78.1	$93.6	$106.0
Growth %	*4.9%*	*-1.0%*	*0.0%*	*1.6%*	*-5.8%*	*3.4%*	*4.8%*	*3.7%*	*19.8%*	*13.3%*
EBIT	$5.2	$4.0	$4.1	$4.5	$4.4	$3.7	$4.2	$4.7	$6.8	$9.0
Growth %	*-2.2%*	*-24.3%*	*3.7%*	*10.0%*	*-3.4%*	*-15.3%*	*13.3%*	*11.4%*	*45.8%*	*32.3%*
Margin %	*7.2%*	*5.5%*	*5.7%*	*6.1%*	*6.3%*	*5.2%*	*5.6%*	*6.0%*	*7.3%*	*8.5%*
Tax Rate	34.9%	36.5%	33.0%	32.5%	32.7%	19.7%	20.3%	22.0%	21.2%	22.0%
Diluted Shares Outstanding (mm)	663.3	641.8	640.1	632.9	582.5	550.3	533.2	515.6	505.4	492.7
Total Invested Capital (2)	$31.2	$27.7	$26.6	$24.9	$22.0	$24.7	$23.5	$25.4	$28.2	$28.9
Reinvestment	$1.7	($3.6)	($1.0)	($1.7)	($2.9)	$2.7	($1.2)	$1.9	$2.7	$0.7
ROIC (pre-tax)	16.8%	14.4%	15.5%	18.2%	19.9%	15.0%	17.9%	18.4%	24.2%	31.3%
Sales to Capital	$2.3	$2.6	$2.7	$3.0	$3.2	$2.9	$3.2	$3.1	$3.3	$3.7
Free Cash Flow to Equity (3)	$2.0	$3.1	$2.7	$4.4	$3.9	$4.4	$2.5	$4.1	$7.9	$5.1
Dividends	$0.9	$1.0	$1.2	$1.4	$1.3	$1.3	$1.3	$1.3	$1.3	$1.5
Share Repurchases	$1.5	$1.0	$0.0	$3.4	$3.5	$0.9	$2.0	$1.5	$0.7	$7.3
Capital Returned	$2.4	$2.0	$1.2	$4.8	$4.8	$2.3	$3.4	$2.8	$2.1	$8.9

(1) Fiscal year ending January of the following calendar year

(2) Shareholders' equity, plus preferred, plus debt, plus operating leases

(3) Cash from operations less capital expenditures

Source: FactSet

Normalized revenue to $95 million and projected revenue growth to 3% annually. This accounts for existing same-store-sales growth and the opening of new stores. It fits more closely with TGT's historical growth, excluding the COVID years.

Normalized EBIT margins to 6%. This aligns with TGT's historic levels. While there may be near-term pressure on margins due to inflation (rising product costs, shipping, labor, etc.), long-term we estimate TGT will average about this level.

While TGT has been incredibly capital efficient over the prior ten years, we believe that a conservative projection likely requires TGT to invest to drive future growth. We estimate future ROIC to average 19.7%.

Here is our conservative intrinsic valuation with the assumptions as previously described.

- Estimated Equity Value of about $51.0 billion or $103.59 per diluted share.
- As of March 31, 2022, TGT was priced in the market at $212.22 per diluted share.

DISCOUNTED CASH FLOW ANALYSIS

($ in billions)	Normalized	1	2	3	4	5	6	7	8	9	10	Terminal
Revenue	$95.0	$97.9	$100.8	$103.8	$106.9	$110.1	$113.4	$116.8	$120.3	$124.0	$127.7	$130.2
Growth %		*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*2.0%*
EBIT	$5.7	$5.9	$6.0	$6.2	$6.4	$6.6	$6.8	$7.0	$7.2	$7.4	$7.7	$7.8
Growth %		*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	*3.0%*	
Margin %	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*
Tax Rate		*22.0%*	*22.0%*	*22.0%*	*22.0%*	*22.0%*	*22.0%*	*22.0%*	*22.0%*	*22.0%*	*22.0%*	*22.0%*
EBIT (1-t)	$4.4	$4.6	$4.7	$4.9	$5.0	$5.2	$5.3	$5.5	$5.6	$5.8	$6.0	$6.1
Total Invested Capital	$28.9	$29.7	$30.6	$31.5	$32.5	$33.5	$34.5	$35.5	$36.6	$37.7	$38.8	$39.6
Reinvestment		($0.9)	($0.9)	($0.9)	($0.9)	($1.0)	($1.0)	($1.0)	($1.1)	($1.1)	($1.1)	($0.8)
ROIC (pre-tax)	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%	19.7%
Sales to Capital		3.3x	3.3x	3.3x	3.3x	3.3x	3.3x	3.3x	3.3x	3.3x	3.3x	3.3x
FCFF		$3.7	$3.8	$3.9	$4.1	$4.2	$4.3	$4.4	$4.6	$4.7	$4.8	$5.3
Discount Rate		9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	9.0%	$76.0
Discount Factor		91.7%	84.2%	77.2%	70.8%	65.0%	59.6%	54.7%	50.2%	46.0%	42.2%	
Discrete	$26.8	$3.4	$3.2	$3.0	$2.9	$2.7	$2.6	$2.4	$2.3	$2.2	$2.0	
Terminal	$32.1											
Enterprise Value	**$58.9**											
Plus: Excess Cash	$5.9											
Less: Non-Lease Debt	($13.7)											
Equity Value	**$51.0**											
Diluted Shares (billions)	0.49											
Estimated Value/Share	**$103.59**											
Price/Share - March 31, 2022	**$212.22**											
Implied Market Cap.	**$104.6**											
% of Estimated Value	**204.9%**											

Estimated Value Per Share Sensitivity Table

		Revenue Growth				
		1%	2%	**3%**	4%	5%
Discount Rate	7%	$136.68	$144.80	$153.60	$163.13	$173.45
	8%	$112.14	$118.02	$124.39	$131.27	$138.72
	9%	$94.55	$98.90	**$103.59**	$108.67	$114.15
	10%	$81.31	$84.56	$88.05	$91.83	$95.90
	11%	$70.97	$73.40	$76.01	$78.83	$81.86

Source: Midway Partners' estimates

TGT appeared to be significantly overpriced on March 31, 2022. This tells us that two scenarios must exist:

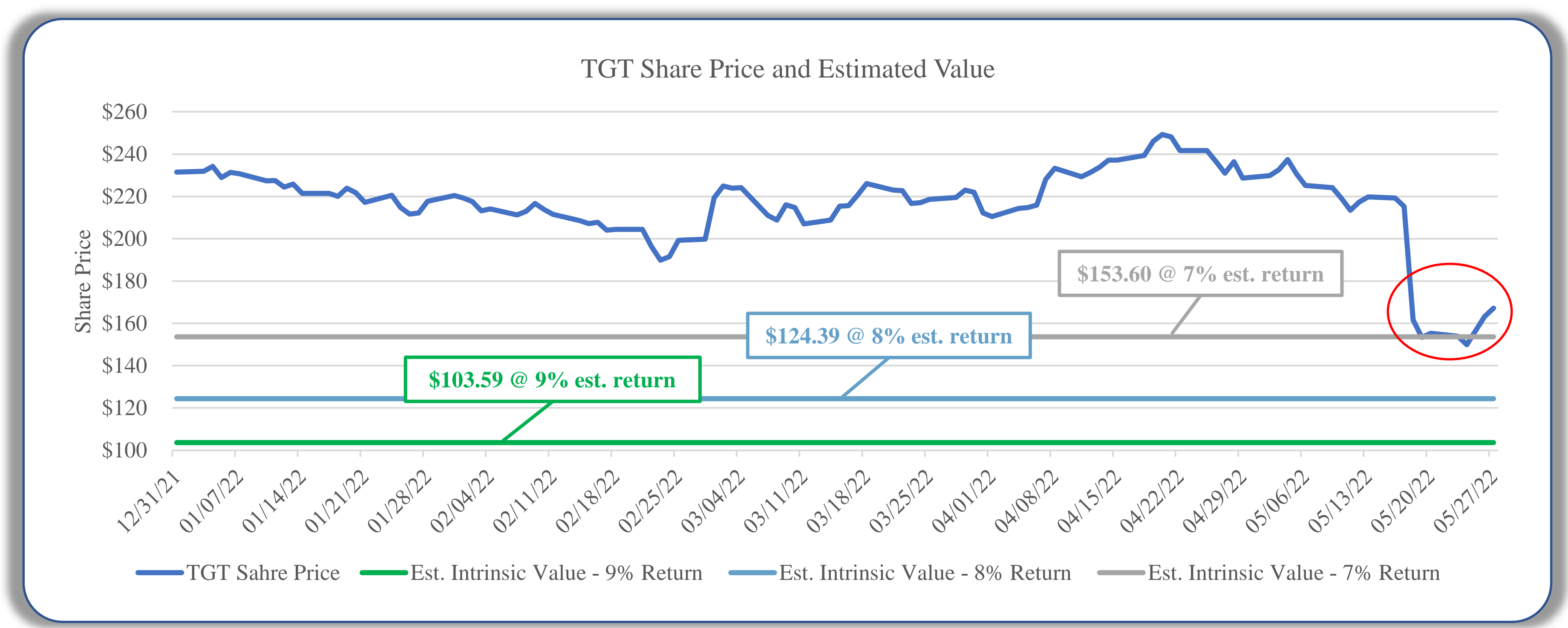
01 Either investors are **projecting higher revenue growth and profitability with less required reinvestment** than we believe is justified by historical (pre-pandemic) fundamental performance; or

02 Investors are **willing to accept a rate of return lower than 9.0%** when investing in TGT.

Regardless of which is true (likely a combination of both), we avoided TGT at prices in Q1 2022.

By May of 2022, the TGT price had dropped. The chart below shows how the TGT price compared to our estimated intrinsic value at 9.0%, 8.0%, and 7.0% discount rates.

It was possible to purchase TGT, in May 2022, at prices below the estimated intrinsic valuation given a 7.0% discount rate.



Source: FactSet and Midway Partners' estimates

This analysis shows, how an intrinsic valuation with simple, logical assumptions can unearth **unrealistic future expectations** or **unwanted rates of return**.

- We typically require estimated rates of return (discount rates) above 9.0% and have thus continued to avoid TGT stock even after the decline.
- We do not know how TGT will fundamentally perform in the future, but we know that given a conservative future operating scenario and a discount rate of 9.0%; a price above $103.59/diluted share is unjustified.

Investors paying more than $103.59/diluted share must believe that either:

- The company **will perform significantly better** than our projections (which we believed are conservative and logical given historical performance and realistic prospects for the future); or
- Are willing to **accept a lower rate of return** (7.0% or less).

The multiples-based pricing analysis below comes to the opposite conclusion as our intrinsic valuation.

It shows that on a relative pricing basis, TGT looked to be selling at a significant discount to its peers during the first quarter of 2022.

Using a pricing methodology may have led investors to incorrectly conclude that TGT offered a compelling investment at the March 31, 2022 price.

($ in millions, except share data)

At March 31, 2022	Enterprise	Market	Market	LTM			EV /		Price /
Company	Value(1)	Capitalization (1)	Price/Share	EBITDA	EBIT	Earnings/Share	EBITDA	EBIT	EPS
Best Buy (BBY)	$22,270	$21,725	$90.90	$3,874	$3,005	$10.27	5.7x	7.4x	8.9x
Costco (COST)	$253,412	$256,205	$575.85	$9,681	$7,545	$12.39	26.2x	33.6x	46.5x
Home Depot (HD)	$352,888	$312,201	$299.33	$25,902	$23,040	$15.76	13.6x	15.3x	19.0x
Lowe's (LOW)	$162,745	$136,680	$202.19	$14,492	$12,093	$12.44	11.2x	13.5x	16.3x
Walmart (WMT)	$465,638	$414,295	$148.92	$38,200	$27,542	$4.91	12.2x	16.9x	30.3x
						Average	13.8x	17.3x	24.2x
						Median	12.2x	15.3x	19.0x
Target (TGT)	**$116,186**	**$104,561**	**$212.22**	**$11,890**	**$9,248**	**$14.10**	**9.8x**	**12.6x**	**15.1x**

(1) Based on FactSet diluted shares

Source: FactSet

In conclusion, the TGT case study clearly shows the differences in conclusions drawn when using an intrinsic valuation versus a pricing strategy.

- The intrinsic valuation showed that as of March 31, 2022, **TGT did not look like a compelling investment** given conservative projections and a 9.0% discount rate.
- While the pricing analysis indicated that TGT was at a discount relative to its peer, it provided **no information** regarding future projections or estimated rates of returns.

Midway Partners' focus on intrinsic value provides a foundation for sound investment decision making.

It provides protection against market trends and overpricing, and presents the best opportunity to find compelling investments offering attractive rates of return.

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