RESEARCH REPORT

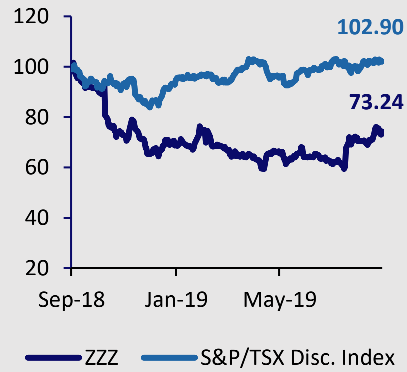
September 23, 2019

Stock Rating	BUY
Price Target	CAD $27.83
Current Price	CAD $21.93

Bear Case	Price Target	Bull Case
$21.05	$27.83	$33.08

Ticker	ZZZ
Market Cap (MM)	$815
P/E NTM	12.8x
EV/EBITDA NTM	7.8x

52 Week Performance



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Sleep Country Canada Holdings Inc.

Don’t Hit Snooze

Sleep Country is Canada’s leading mattress retailer and the only Canadian specialty mattress retailer with a nation-wide footprint. The company was taken private by Birch Hill Partners in 2008 and was relisted on the TSX in 2015.

The company generated $660MM in revenue in 2018, with $245MM in gross profit and a 16% EBITDA margin.

Investment Thesis

(1) Structurally superior business model which provides outstanding capital flexibility

(2) Favorable competitive positioning in brick & mortar retail landscape, as well as e-commerce

(3) Secular tailwinds that the company is well positioned to capitalize on

The Consumers team believes that the defensive nature of the name makes it an attractive choice to diversify our currently all discretionary, all American portfolio. We value ZZZ at $27.83, at 27% premium to the current price.

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Sleep Country Overview I

Legacy Sleep Country

Sleep Country is Canada's leading mattress retailer and the only Canadian specialty mattress retailer with a national and regionally diverse footprint, commanding an estimated 25% market share. The company launched its concept in the Vancouver market with four stores in 1994 and has since expanded across Canada with 264 corporate-owned stores and 16 distribution centers which span eight Canadian provinces (as at December 31, 2018).

Sleep Country entered the Québec market through the acquisition of Dormez-vous? Sleep Centres in January 2006 by acquiring five stores and one distribution centre. The Company began operating in the United States under the banner "Sleep America" when it acquired Sleep America, LLC, a mattress retailer located in the State of Arizona, in March 2006.

Focusing on Growth

The Company was listed on the Toronto Stock Exchange between 2003 and 2008 as an income fund, which was later acquired in 2008 by a group of investors led by Birch Hill Equity Partners Management Inc.

During this time, the company's management undertook strategic initiatives including revamping the advertising strategy, enhancing the sales and service training, redesigning and expanding the accessories line, broadening the real estate footprint across Canada, and divesting in Sleep America and exiting the U.S. market. The Company operated in the U.S. until January 2015 when it sold all of its interest in the Sleep America assets to a national U.S. mattress retailer in order to focus management's efforts on growing the Company's Canadian market share.

On July 16, 2015, the Company completed its initial public offering of 17,650,000 Common Shares for aggregate gross proceeds of $300,050,000 and the Common Shares began trading on the TSX under the ticker symbol "ZZZ".

EXHIBIT I

Total Sales Growth and Same Store Sales Growth (%)

Source(s): Company Filings

Sleep Country Overview II

B-(Endy)-ng the Rules

On December 6, 2018, the Company acquired the business of Overwater Limited, operating under the brand name Endy, an online mattress retailer operating in the Canadian market.

The objective of the acquisition of Endy is to provide the most convenient customer experience to a wider base of Canadian consumers shopping for mattresses, particularly appealing to younger shoppers. The Company remains focused on serving its customers in any way they want to shop and providing them with the choice to navigate easily between traditional and online channels.

The acquisition of Endy will, along with Sleep Country's existing e-commerce and Bloom mattress-in-a-box offerings, complement Sleep Country's national store footprint and diverse selection of sleep products.

Recent Performance

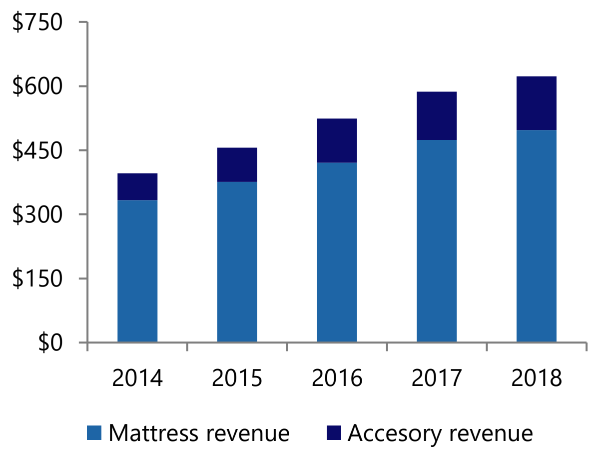
In 2018, revenues increased by 6.1% compared to 2017, from $586.9MM to $623.0MM. This was driven by the addition of 17 new stores since December 31, 2017 and a 1.4% increase in same store sales (Exhibit II & III). The increase in total revenue can be attributed to an increase in mattress sales as well as an increase in sales of the company's other offerings, namely accessories.

Mattress sales revenue increased by 4.2%, from $474.1MM to $497.0MM. Accessory revenue increased by 11.7%, from $112.8MM to $126.0MM. Operating EBITDA was $105.8MM for 2018 compared to $100.0MM for 2017, representing an increase of $5.8MM or 5.8% (Exhibit III).

Ultimately, the company has an established history of success, leading brand awareness in Canada, and a strong competitive position with an omnichannel presence.

EXHIBIT II

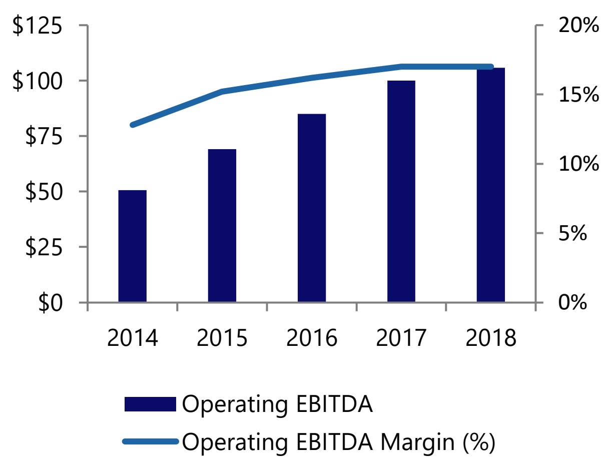
Revenue ($MM)



Source(s): Company Filings

EXHIBIT III

Operating EBITDA ($MM)



Source(s): Company Filings

The Mattress Industry I

The U.S. mattress category, which can be used as a proxy to evaluate the Canadian market, has historically been one of the most stable trending segments in the retail industry, displaying its resiliency through economic downturns (Exhibit IV).

One of the key drivers why the mattress market has been able to steadily grow at a considerable rate is the rising consumer preference towards larger and more expensive mattresses. The U.S. mattress market is mainly driven by increasing population, which is leading to increasing rate of home ownership. With the trend of fertility rates going below replacement levels, the aging population is set to accelerate in the U.S. Due to this, the demand for housing and associated markets such as mattresses is set to increase in future.

Competition

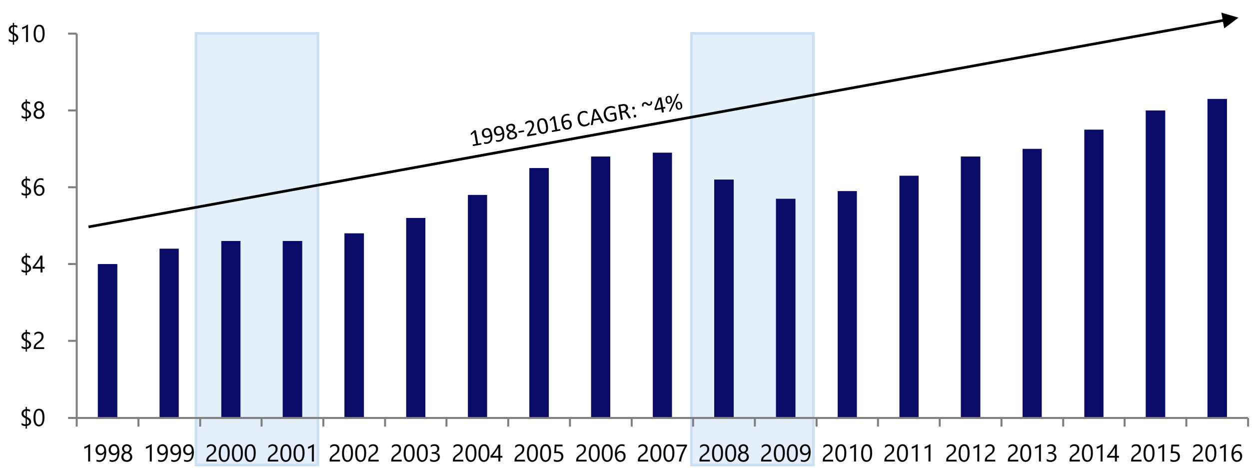
Sleep Country is looking to continue to dominate the mattress retail market in Canada, though it has some strong competitors both domestically and abroad.

The retail mattress industry is highly competitive and includes national and regional full-line furniture retailers, departmental retailers, small regional specialty mattress retailers and online retailers. The seven leading retailers in the industry include Sleep Country, Leon's Furniture, The Brick, The Hudson's Bay Company, BMTC Group, IKEA and Costco. Of these leading seven retailers, Sleep Country is the only specialty mattress retailer.

The remaining industry sales are highly fragmented amongst a number of smaller specialty mattress stores, other furniture stores, discounters and warehouse clubs and small independent retailers. It should be noted that Sears Canada, one of the largest competitors of Sleep Country, closed all of their Canadian store locations between October 2017 and January 2018.

EXHIBIT IV

U.S. Mattress and Foundation Wholesales ($Bn)



Source(s): International Sleep Products Association (ISPA)

The Mattress Industry II

The U.S. mattress industry has many more established players that are making their way into the Canadian market. Casper, which opened its first standalone Canadian store at Toronto's CF Sherway Gardens last month, is rapidly growing its Canadian business to eventually include multiple storefronts as well as a new Canadian head-office and manufacturing facility. Casper was founded as an online retailer in 2014, and is backed by Target, as well as numerous celebrities including Leonardo DiCaprio, Tobey Maguire, Adam Levine and Ashton Kutcher.

However, the Canadian space remains more attractive than the U.S. because of significantly less competition. It was a strategic decision on Sleep Country's part to stop investing in the U.S. space back in 2015, as seen through their divesture of Sleep America.

The Consumer

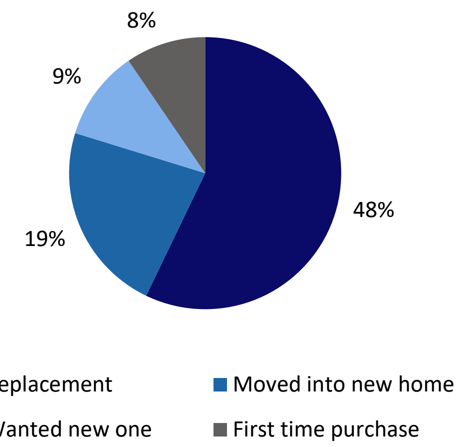
The majority of mattresses are purchased by consumers as a replacement to an existing mattress. In fact, the time consumers have kept a mattress before replacing has decreased from 10.3 years in 2007 to 8.9 years in 2016. This is another key driver of growth for the industry.

Participants in the bedding industry compete primarily based on store location, service, price, product selection, brand name recognition and advertising. However, the most frequently cited important factor in the purchase decision, for both outlet selected as well as brand purchased, is price.

With that being said, consumers are simply looking for a "competitive price", not necessarily the lowest price. Because mattresses are such a big-ticket, infrequent purchase that play a large part in everyday life (most people sleep 33% of the day), people are often willing to pay a slight premium for a better product. Further, with there being no objective way to determine whether one mattress is actually better than another, there is a degree of opacity between price and value, making side-by-side comparisons more difficult.

EXHIBIT V

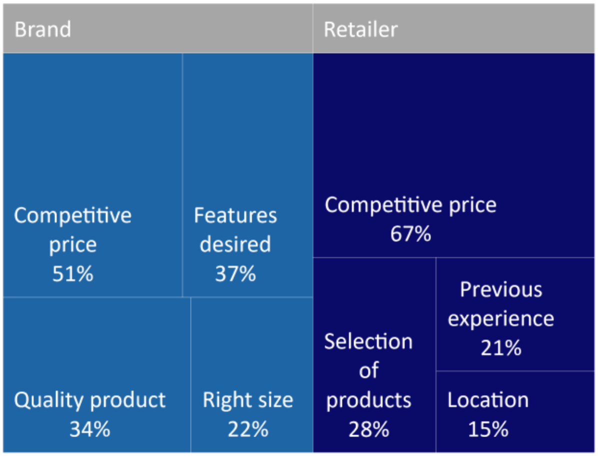
Mattress Purchase Decision Criteria (%)



Source(s): TraQline

EXHIBIT VI

Mattress Purchase Decision Criteria (%)



Source(s): TraQline

Sleep Country Business Model: Cash Flow & Capital Flexibility

Sleep Country's business model provides the firm with a high degree of capital flexibility. There are a few key reasons why this model is effective.

Negative Working Capital

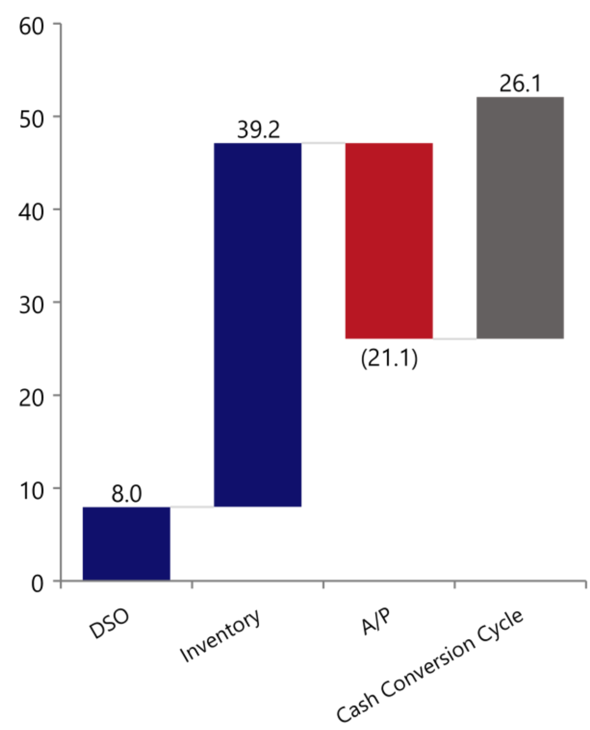
First, the nature of Sleep Country's business has allowed it to operate with negative operating working capital. That is, until the recent push into e-commerce drove the firm's working capital upwards. Recently, Sleep Country acquired "Endy", an e-commerce mattress store similar to Casper but with greater market share in Canada. This increased inventory substantially. Additionally, Sleep Country increased the SKUs available of its product "Bloom" which is also designed to compete with e-commerce players. The Consumers team is optimistic that Sleep Country will be able to improve the efficiency of their new e-commerce arm and regain negative operating working capital position from its current level of about $17M. Regardless, the fact that Sleep Country has been able to achieve negative working capital in brick and mortar retail, a traditionally capital-intensive industry, is impressive. This negative working capital has been achieved by effective use of just-in-time ("JIT") inventory. JIT inventory allows Sleep Country to avoid having its capital tied up in inventory for long periods of time. This inventory is further minimized by the "showroom" model, which allows Sleep Country to keep a limited amount of inventory in-store. Negative working capital is a positive part of the business because working capital symbolizes what money is needed to finance a company's immediate operational needs. So, the smaller the value, the less capital is tied up in basic operational needs and the more that can be used in more productive investments.

Cash Conversion Cycle

Additionally, Sleep Country has created a cash conversion cycle which is superior to peers. This further enhances its capital flexibility. In 2018, the firm's Account Receivable Turnover was 7.95 days. To contrast, the Accounts Payable Turnover for the same period was 21.07 days. So, while it takes a little over a week to receive full payment on credit sales, the firm takes about 3 weeks to pay its bills. This creates a positive cash relationship. Further, the Cash Conversion Cycle as a whole is created by adding Days Inventory Outstanding to Day Sales Outstanding and subtracting Days Payables Outstanding. This formula approximates how long it takes for a company's investment in inventory and other resources to be turned into cash from sales. Sleep Country's cash conversion cycle is 26.06 days. In comparison, Sleep Country's two most comparable, Canadian, public firms, Leon's Furniture and BMTC Group are 56.8 and 49.0 days, respectively. The main difference between these figures is that Sleep Country is far superior on both an Accounts

Exhibit VII

Cash Conversion Cycle (Days)



Source(s): Bloomberg

Sleep Country Business Model: Cash Flow & Capital Flexibility

Payable Turnover and Days Inventory Outstanding basis. While Sleep Country does not disclose how it has managed to create such a favourable cash cycle, the Consumers team hypothesizes that the crux of the system lies in supplier relations. With ~30% market share, Sleep Country is the dominant player in Canadian mattresses. For Canadian mattress suppliers this means that Sleep Country is an account that many cannot afford to lose. So, Sleep Country is able to leverage its size to create beneficial relationships with suppliers.

New Store Expenditures

Sleep Country's expenditures on new stores is another important element of why their business model provides them with so much capital flexibility. First, the stores are inexpensive. The company spends approximately $400K on a new store opening. Stores are all based off of the same design and are showrooms rather than traditional retail stores, both of which help to limit the cost of opening a new store. A related benefit of Sleep Country's new stores is that they turn cash flow positive very quickly. As this is a cost that online competitors do not incur to the same degree, it is important that this is the case. It takes a Sleep Country store less than 18 months to achieve cash on cash payback (Exhibit VIII). What's more is that if you were to separate the e-commerce portion of the business from the brick and mortar side, the negative working capital from the brick and mortar side essentially funds its own expansion. While this is overly simplistic, it provides a solid frame of reference to understand how effective the traditional business model of the company is in sustaining itself.

Conclusion

We have established that the company has created a business model that provides it with capital flexibility. We must then consider how defensible the moat is. Competition for Sleep Country does exist so it is important to recognize that once competitors reach comparable size, this moat may become void. Unfortunately, the primary reason why Sleep Country has been able to create this advantage is that they are the largest mattress retailer, meaning that they are important to suppliers and thus, have a lot of negotiating power. There is no element of loyalty or preference on the point of the supplier towards Sleep Country so it is safe to assume that if a competitor were to reach comparable size, they would also leverage these same benefits. Currently, management projects that they hold about 30% of the market, so it would take a substantial change in the composition of the market to erode this moat. So, for the foreseeable future, this is an element of the business which the company should continue to leverage. Regardless, the potential for this moat to be disrupted is an important risk to consider.

Exhibit VIII

Stores Generate Cash on Cash Payback in <1.5 years

Representative New Store Investment		
($ in thousands)	Average Investment	
Buildout and Equipping Cost Floor	$	430.0
Sample Inventory		50.0
		480.0
Less: Tenant Reimbursement		(80.0)
Cash Requirement, Net	$	400.0

New Store Results	
($ in thousands)	Year 1
Sales	$1,200-$1,500
Store 4-Wall Profitability	$333-$417
% of Sales	27.8%
Annual Cash on Cash Return	83-104%

Source(s): Company Reports

Runway for Growth

E-commerce

To retain and expand its dominant position in the Canadian mattress market, Sleep Country has augmented its portfolio of online and convenience-based offerings. By acquiring Endy, Sleep Country added a firm similar to Casper but with larger market share in Canada. Additionally, the firm has been aggressive in establishing convenience-based products which directly compete with the value proposition offered by e-commerce retailers (i.e. mattress-in-a-box offerings). This should help Sleep Country to connect with a younger, more internet savvy consumer base. What is equally or perhaps more important, however, is that these initiatives should cap the growth of competing online players in Canada, as Sleep Country will, at the very least, now offer similar value to their customers. Given that analysts expect the mattress industry could move to 20% online/80% in-store in the next 5-10 years, ensuring that Sleep Country is equipped in this realm is important. This move may prove vital to defend against any international firms that decide to enter the Canadian market, as these players will surely have strong online capabilities.

Canadian Market Penetration

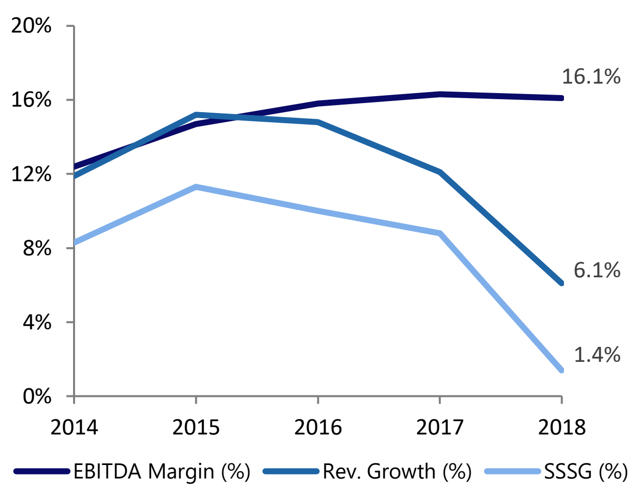
Management continues to believe that Canada can support about 325 Sleep Country stores (274 stores as of Q2 '19). While same store sales growth is positive and occasionally has double-digit years, the true growth conduit is new stores. While Sleep Country continues to expand its brick-and-mortar presence, top line growth and market share may improve. However, the concern becomes that the market is too saturated to warrant further investment into brick and mortar and management projections are overly optimistic. It is probable that when Sleep Country began operations, they started by opening stores in the most opportune markets first. Now, about 15 years into the company's growth, it seems unlikely that the same results from new stores can be attained. As well, another concern that the Consumers team has is that the firm is too top-line focused. Emphasizing facts like Sleep Country has "expanded every year" rather than emphasizing more meaningful metrics like margin growth, investor return or free cash flow raises a red flag. Expansion for expansion's sake does not create a successful investment. The fact that same stores sales growth and revenue growth have fallen and EBITDA margin has plateaued is a legitimate concern.

Sleep Accessories

Sleep Country has "evolved its focus from mattresses into a total sleep solution provider for the whole family". By selling more to each customer (i.e. headboards, eye masks, pillows), Sleep Country has the potential to become a one-stop-shop for sleep needs, expanding the share of wallet available to the company. Additionally, this initiative provides an opportunity for margin expansion. The market for sleep accessories is highly fragmented and Sleep Country only holds about 6-8% market share. If the firm is able to capitalize on this opportunity, it should result in a stronger and more diversified business.

Exhibit IX

Key Financial Metrics



Source(s): S&P Capital IQ

Competitive Dynamics: Past Cases of Online Disruption I

The business of selling mattresses is currently undergoing a structural transformation with the emergence of bed-in-a-box online retailers. As a result, sentiment toward traditional brick-and-mortar retailers has fallen in recent years.

From a historical perspective, online disruption to any consumer-related industry has typically resulted in one of two outcomes:

1. A smaller pie for everyone
   - The industry as a whole earns less economic profit
2. A larger pie for everyone that is divided differently
   - The industry as a whole earns greater economic profit, but market share shifts to those with the superior value propositions

In assessing the threat of online disruption to the mattress retailing industry, the Consumers team looked at other industries where the overall pie has shrunk, versus industries where the pie was enlarged and what the key drivers were behind each outcome. From there, we were able to anticipate what will happen to the mattress industry to determine whether or not we believe the long term outlook is favorable.

An Example of a "Shrinking Pie"

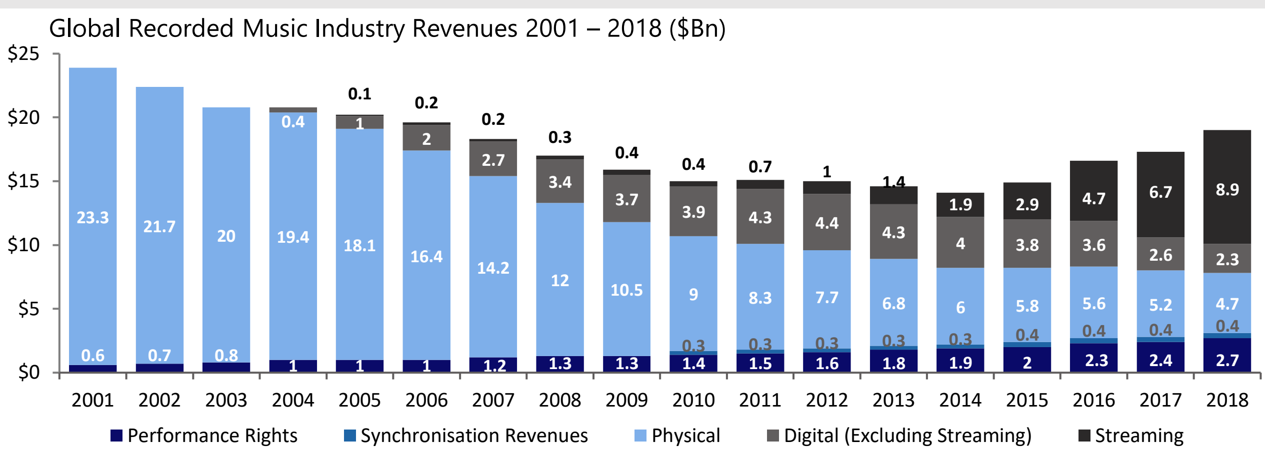
The global recorded music industry is an example of a smaller pie. In 2001, the industry was dominated by a highly profitable oligopoly comprised of Sony Music Entertainment, Warner Media, and Universal Music Group. The industry generated $23.9B in revenue, with EBITDA margins in the high teens for most companies.

Today, the industry is significantly more fragmented and includes the smaller, less-profitable incumbents, plus many new entrants that either make low or no profits (Spotify, Apple Music, Pandora, etc). Overall, the industry is generating less revenue ($19B) and far less profit (more than half of all revenue that is generated is not profitable) than it did two decades earlier.

This begs the question: what happened?

More convenient ways of listening to music were introduced at a lower price point. Both the *act* of listening to music and the *price* of listening were disrupted. It's not that listening to music has become any less popular; rather, pricing has simply become irrationally low causing the whole industry to earn less economic profit. On the whole, everybody has lost, meaning this is an industry that Consumers would not want to enter, even if we were to buy the disruptor.

Exhibit X



Source(s): IFPI

Competitive Dynamics: Past Cases of Online Disruption II

An Example of "Expanding the Pie and Dividing it Differently"

The global advertising industry is an example of an industry that grew as a result of online disruption. In this case, more effective ways of advertising were introduced at comparable price points.

The act of advertising was disrupted while the price remained rational and largely unchanged.

Because of this, the pie ended up growing, but economic profits funneled towards those that had the better value propositions (i.e. from TV/Newspaper to Facebook/Google).

The figures below illustrate this point well. As seen in Exhibit V, advertising revenues have grown over 20% in the last decade. And while traditional advertising (classified as non-internet) has consistently declined 0-3% each year, the growth in digital marketing spend has more than outpaced that with annual growth in the HSD / LDD (see Exhibit VI).

As such, this is an industry that Consumers would consider entering, if we were buying the disruptor.

Exhibit XI

Global Advertising Revenues 2010 – 2019 ($Bn)

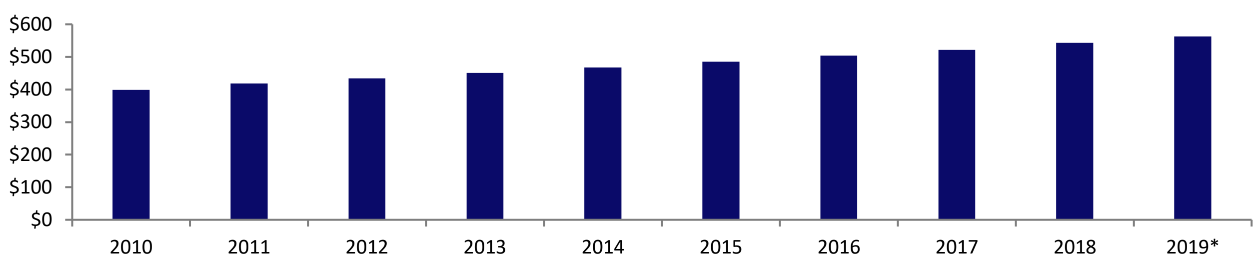
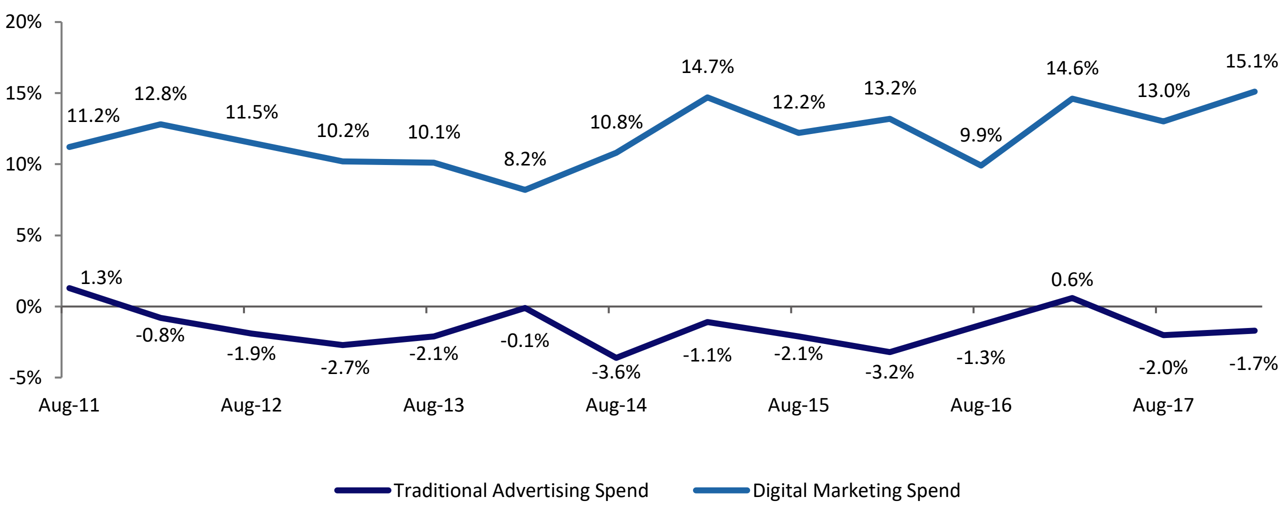


Exhibit XII

Percent Change in Traditional Advertising vs Digital Marketing Spend in the Next 12 Months



Source(s): The CMO Survey

Competitive Dynamics: Past Cases of Online Disruption III

To summarize the aforementioned findings thus far:

- An industry's economic profit pie will shrink for all participants when both the *act* and *price* of a product/service are disrupted. Examples include:
  - Music (Napster, YouTube, other streaming services)
  - Retail (Amazon and the "Retail Apocalypse")
- An industry's economic profit pie will grow and be distributed differently when there *is* disruption to the act but *not* the price of a product/service. Examples include:
  - Advertising (Facebook, Google, and other targeted ad platforms offering a better product and increasing overall ad dollars spent)
  - Orthodontics (Align and Smile Direct Club offering a better product (clear aligners) at comparable prices to traditional braces, thus increasing the number of people who get their teeth straightened)

The Mattress Industry: An Expanding Pie

Research into the online disruption being faced by mattress retailers indicates that this industry is likely to experience an expanding pie. While the act of selling has changed, prices have actually increased as a result of the emergence of online competition.

Industry Pricing

The average selling price of mattresses sold by online retailers varies, but overall many are either equivalent or greater than the cost of mattresses that Sleep Country sells in-store (~$1,000).

What is changing is not price. In fact, the value of a quality mattress has actually risen in the minds of consumers. Perceived price of a quality mattress was $929 in 2007, and rose to $1,110 in 2016.

The Act of Selling Mattresses

Online retailers have been able to offer a fundamentally different value proposition to consumers. They have made buying a mattress easier (a box makes it better for transport), and more fun (highly effective marketing campaigns), which is helping expand the mattress industry as a whole.

This can be proven by the average replacement cycle of mattresses, which has gone from 10.3 years (2007) to 8.9 years (2016).

Conclusion

As such, the mattress industry is clearly an expanding pie.

Higher ASP x More Frequent Purchases = Bigger TAM

With this kind of disruption occurring, the winners will not be those who offer the lowest prices. It will be those that are able to provide the highest value to customers through convenience, comfort and excitement.

This begs the question: in this growing industry, is Sleep Country positioned to win or lose?

Source(s): Raymond James

Competitive Dynamics: External Threats I

To assess whether or not Sleep Country will remain competitive in the evolving mattress industry, it is important to first understand their online bed-in-a-box competition.

History of Bed-in-a-Box Mattresses

The first online bed-in-a-box mattresses were launched more than a decade ago by Dorel Industries, years prior to Casper launching in 2014. Bed-in-a-box mattresses are typically made of foam, and are compressed and vacuum-sealed into a box – designed to be shipped directly to a consumer's home. Once delivered, the consumer unpacks and unrolls the mattress, which expands to a full-sized mattress.

Over the past few years, the U.S. online bed-in-a-box industry has emerged as a serious mattress purchase option. This has been driven by several factors, including the prevalence of online shopping, better foam technologies, the Millennial generation reaching its prime spending years, and the digital marketing savviness of top online bed-in-a-box players such as Casper, Leesa, and Purple.

Based on a survey published by Furniture Today, more than 85% of online mattress buyers were either "very satisfied" or "satisfied" with their purchase, with only less than 5% "not satisfied" or " not at all satisfied."

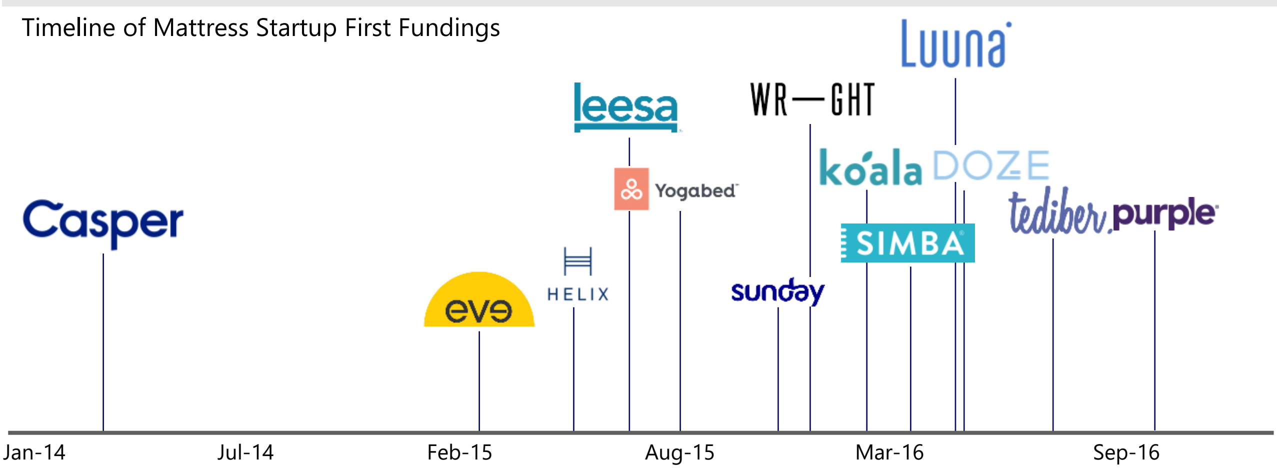
Shifting Consumer Preferences?

Despite Millennials' propensity to shop online, online mattress penetration in Canada still remains relatively low at ~6% (although this will undoubtedly grow over time). The majority of Millennials still prefer shopping at physical brick-and-mortar stores for large-ticket furniture purchases, albeit after having conducted some research online. The preference for physical locations to touch and test furniture and mattresses is even more true for older age demographics. Thus, Sleep Country and its network of 274 stores (as at Q2 '19) is arguably best positioned to service this demand as the industry stands today.

The steadfast desire amongst consumers to test their mattresses before buying can be supported by a recent trend, whereby many online-only mattress/furniture retailers are testing "pop-up shops" to showcase their products and expand their customer reach. In this environment, Sleep Country clearly has quite a large head start on its competition.

Exhibit XIII

Timeline of Mattress Startup First Fundings



Source(s): BMO Capital Markets

Competitive Dynamics: External Threats II

While we believe Sleep Country has a structurally superior business model compared to its online competition, we examined the #1 U.S. online mattress retailer, Casper, to get a better understanding of the value proposition it is providing to consumers.

Casper: Disruptive Innovation in Sleep

At its core, Casper is offering a fundamentally different value proposition to consumers with its admittedly fantastic product and brilliant marketing. When you buy a Casper, you are not just buying a slab of memory foam; *you are buying a restful sleep and overall wellness.*

While it sounds silly, Casper is essentially doing to sleeping what Lululemon did to athletic clothing at the gym, and what Align and Smile Direct did to braces. They are taking a traditionally boring, unappealing industry and making it sexy.

The Only Problem: Profitability

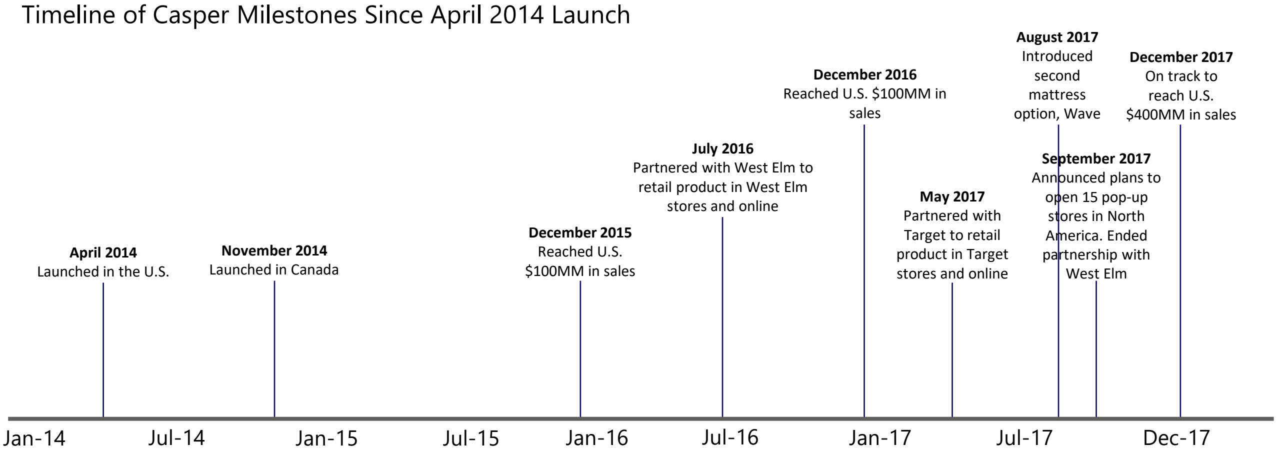
Casper has been wildly successful in its mission of being the place for "all things sleep". With that being said, the company is not even EBITDA margin positive. The same can be said for many of its peers, including Purple (-5.3% LTM EBITDA Margin).

Losses for Casper in FY 2018 were $64M on sales of $373M. The company said that it expects to be EBITDA margin positive in 2019 on revenues of $550M. Yet despite the company's lack of profitability, a $100M Series D investment in March 2019 valued the firm at $1.1B. For reference, Sleep Country has a market cap of $815M on sales of $659M.

Finally, many industry executives are bearish on Casper and its business model. In a 2019 NYT interview, Tempur Sealy CEO Scott Thompson said "What we are not doing is spending money in PR to create buzz to raise more money to fund unprofitable operations," and that Casper's main innovation is "the willingness to lose tons of money for multiple years while hoping to find a business plan or find a greater fool to buy them."

Exhibit XIV

Timeline of Casper Milestones Since April 2014 Launch



Source(s): BMO Capital Markets, The New York Times

Competitive Dynamics: External Threats III

Sleep Country's Response: The Endy Acquisition

In response to the rise of online retailers and shifting consumer preferences, Sleep Country bought Endy in November 2018 to further strengthen its competitive position in the marketplace.

History and Background

Endy was launched in 2015 by Rajen Ruparell and Mike Gettis, who still serve as Chairman and CEO, respectively.

It is currently the largest bed-in-a-box mattress retailer in Canada, with 2018 revenues of $50M. Its product offering is comprised of a single bed-in-a-box mattress, with sizes that range from Twin to California King. The company also sells accessories that include the Endy pillow, sheets, and mattress protectors.

Endy's operations are not capital intensive, as it uses third party warehousing and distribution. The company also does not do its manufacturing in-house, instead outsourcing to third parties. It should be noted that one of the company's most prominent marketing tactics is promoting the fact that all of its mattresses are produced in Canada.

Financial Details

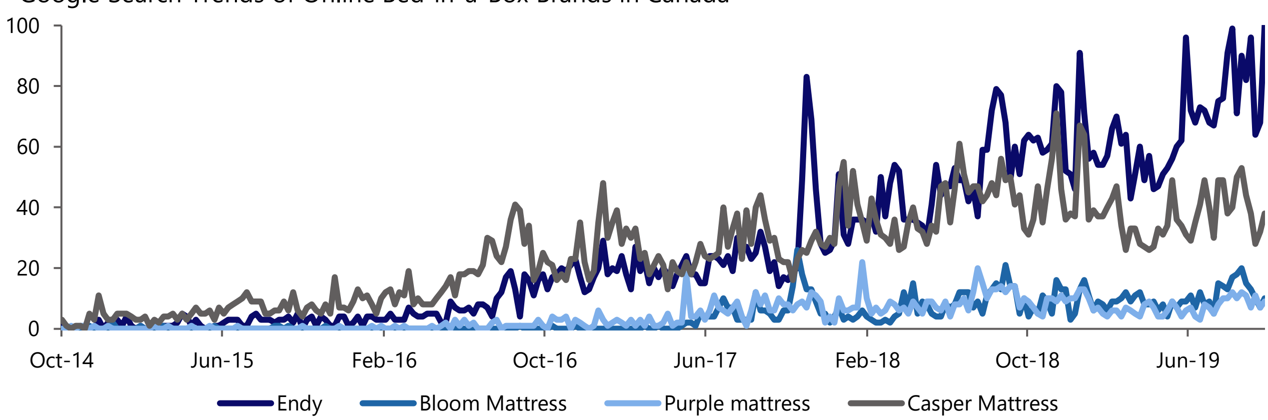
In stark contrast to nearly all of its peers, Endy is actually profitable, with LTM revenues of $50M (up 150% YoY) and LTM EBITDA of $5M as of October 2018. Sleep Country paid $63.7M for Endy, which represented a ~12.0x EBITDA multiple. Sleep Country also agreed to pay an additional $25M in the first half of 2021 contingent on whether Endy (which will continue to be run separately by current management) meets a 2020 revenue target. If the full earn-out is paid, it will reduce the transaction multiple to less than 9.0x EBITDA and imply EBITDA of ~$10M or over 30% growth on average over the next two years.

While no specific targets were outlined, synergies from the deal are expected to come in the form of Endy leveraging Sleep Country's back-end operations for logistics, warehousing and shipping, and Sleep Country leveraging Endy's marketing and e-commerce expertise to enhance its existing online presence.

Overall the consumers team views the acquisition quite favourably. The fact that Endy has needed little external investment and has been profitable since nearly day 1 speaks to the popularity of the brand that which has been supported by highly effective digital marketing.

Exhibit XV

Google Search Trends of Online Bed-in-a-Box Brands in Canada



Source(s): BMO Capital Markets, Google

Competitive Dynamics: Adapting to the Market

In addition to its acquisition of Endy, Sleep Country is also pursuing an additional organic growth initiative, "Bloom", to address the intensifying competition.

History and Background

In May 2017, Sleep Country launched its own private label bed-in-a-box mattress, Bloom, on its e-commerce website. Since its launch, management has indicated that consumer response to Bloom has been positive, both online and in-store.

The pricing of the Bloom product line is largely in line with competing bed-in-a-box brands, while margins are the same as in-store offerings. Sleep Country has uniquely differentiated Bloom on its website as a separate brand to its core in-store offerings, as shown below.

Conclusion

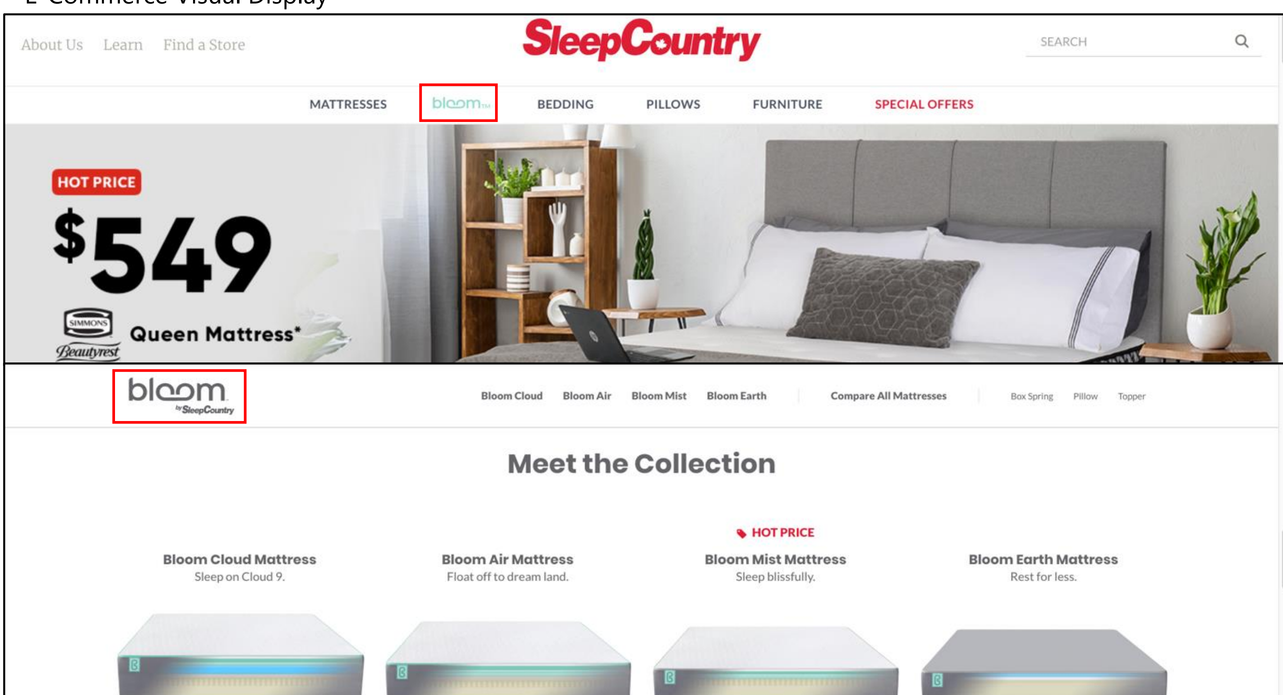
While there is a legitimate threat of competition from online retailers, Sleep Country appears well positioned to compete and win against its peers in this changing retail environment.

The company's vast retail footprint is still extremely valuable in the minds of consumers, giving Sleep Country a 274-store advantage over all of its online competitors. Additionally, the company's acquisition of Endy and in-house development of Bloom will position Sleep Country well to service both traditional and bed-in-a-box customer demand moving forward.

The Consumers team feels confident that Sleep Country will be able to take a greater portion of the mattress industry's expanding economic profit pie.

Exhibit XVI

E-Commerce Visual Display



Source(s): Sleep Country

Valuation I: Financial Model Output and DCF

QUIC values Sleep Country through a 5 year DCF. The key value drivers are gross mattress sales, accessory sales, and margin improvement.

We expect growth to remain in mid-high single digits after an initial jump from the Endy acquisition. Our forecast period assumes accessory sales outpacing mattress sales, with overall revenue accelerating in the near term before tapering to reflect historical industry averages.

EBITDA margins are expected to compress slightly in the near term, but we expect expansion by 80 – 120bps as the Endy e-commerce model gains scale and traction. Relatedly, we expect the Endy acquisition to exert pressure on ZZZ's working capital and capex in the near term, but to not leave a lasting footprint in the long term.

The team has conviction in the assumptions implied by the "Blue Sky" scenario, however the even the less favorable "Grey Sky" model prices ZZZ at only a slight discount. We believe that the defensive nature of the name makes it an attractive choice to diversify our currently all-discretionary portfolio.

QUIC values ZZZ at $27.83 per share, assuming a discount rate of 8% and terminal growth of 2%. Our valuation represents a 27% premium to the current price of $21.93.

C$ Thousands, unless otherwise stated		2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Operational Summary	Revenue	586,900	623,000	702,732	757,561	815,283	867,642	921,560	976,853	1,035,464
Blue Sky	*Growth Rate*		*6.2%*	*12.8%*	*7.8%*	*7.6%*	*6.4%*	*6.2%*	*6.0%*	*6.0%*
	Mattress Sales	474,215	497,154	561,784	601,109	643,187	681,778	722,684	766,045	812,008
	Growth Rate		*4.8%*	*13.0%*	*7.0%*	*7.0%*	*6.0%*	*6.0%*	*6.0%*	*6.0%*
	Accessories	112,685	125,846	140,948	156,452	172,097	185,865	198,875	210,808	223,456
	Growth Rate		*11.7%*	*12.0%*	*11.0%*	*10.0%*	*8.0%*	*7.0%*	*6.0%*	*6.0%*
	EBITDA Margin	16.3%	16.1%	16.0%	15.5%	16.8%	17.2%	17.0%	17.0%	17.0%
	New Stores Added	12	17	10	10	8	8	5	4	5
	Store Count	247	264	274	284	292	300	305	309	314
	Density	141,700	132,576	127,737	123,239	119,863	116,667	114,754	113,269	111,465

		2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Cash Flow Assumptions	EBITDA	95,665	100,303	112,437	117,422	136,968	149,234	156,665	166,065	176,029
	Less: D&A	(12,400)	(14,800)	(15,460)	(16,666)	(17,936)	(19,088)	(20,274)	(21,491)	(22,780)
	EBIT	83,265	85,503	96,977	100,756	119,031	130,146	136,391	144,574	153,249
	Tax Rate	26.2%	26.2%	26.2%	26.2%	26.2%	26.2%	26.2%	26.2%	26.2%
	Less: Cash Taxes	(21,800)	(22,386)	(25,390)	(26,379)	(31,164)	(34,074)	(35,709)	(37,852)	(40,123)
	Net Income	61,465	63,117	71,587	74,376	87,867	96,072	100,682	106,722	113,126
	Add: D&A	12,400	14,800	15,460	16,666	17,936	19,088	20,274	21,491	22,780
	Less: Working Capital Delta	3,000	17,300	14,055	7,576	8,153	4,338	2,304	-	-
	Gross Cash Flows	70,865	60,617	72,992	83,467	97,651	110,822	118,652	128,213	135,906
	Less: CAPEX	(25,500)	(24,400)	(35,000)	(30,302)	(24,459)	(26,029)	(27,647)	(29,306)	(31,064)
	Free Cash Flows	45,365	36,217	37,992	53,164	73,192	84,793	91,005	98,908	104,842

Valuation At December 31, 2019		
Discount Rate: 8%		
	PV of Forcast Period	322,992
	PV of Terminal Value	1,189,229
	Enterprise Value	1,512,222
	Add: Cash + ST, LT Investments	14,900
	Less: Debt	(486,300)
	Equity Value	1,040,822
	FD Shares O/S	37,400
	Price Per Share	**$ 27.83**

Terminal Growth at FY2024	
FY2025 FCF	104,842
Terminal EV (FY2024)	1,747,368
Terminal Growth	2.0%

Valuation II: Grey Sky Scenario & Summary

C$ Thousands, unless otherwise stated		2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Operational Summary	Revenue	586,900	623,000	702,732	757,561	815,283	867,642	921,560	969,626	1,020,216
Grey Sky	*Growth Rate*		*6.2%*	*12.8%*	*7.8%*	*7.6%*	*6.4%*	*6.2%*	*5.2%*	*5.2%*
	Mattress Sales	474,215	497,154	561,784	601,109	643,187	681,778	722,684	758,819	796,760
	Growth Rate		*4.8%*	*13.0%*	*7.0%*	*7.0%*	*6.0%*	*6.0%*	*5.0%*	*5.0%*
	Accessories	112,685	125,846	140,948	156,452	172,097	185,865	198,875	210,808	223,456
	Growth Rate		*11.7%*	*12.0%*	*11.0%*	*10.0%*	*8.0%*	*7.0%*	*6.0%*	*6.0%*
	EBITDA Margin	16.3%	16.1%	16.0%	16.0%	15.5%	15.5%	15.5%	15.5%	15.5%
	New Stores Added	12	17	10	10	8	8	5	4	5
	Store Count	247	264	274	284	292	300	305	309	314
	Density	141,700	132,576	127,737	123,239	119,863	116,667	114,754	113,269	111,465

		2017	2018	2019E	2020E	2021E	2022E	2023E	2024E	2025E
Cash Flow Assumptions	EBITDA	95,665	100,303	112,437	121,210	126,369	134,485	142,842	150,292	158,133
	Less: D&A	(12,400)	(14,800)	(15,460)	(16,666)	(17,936)	(19,088)	(20,274)	(21,332)	(22,445)
	EBIT	83,265	85,503	96,977	104,543	108,433	115,396	122,567	128,960	135,689
	Tax Rate	26.2%	26.2%	26.2%	26.2%	26.2%	26.2%	26.2%	26.2%	26.2%
	Less: Cash Taxes	(21,800)	(22,386)	(25,390)	(27,371)	(28,389)	(30,213)	(32,090)	(33,764)	(35,525)
	Net Income	61,465	63,117	71,587	77,172	80,043	85,184	90,477	95,196	100,163
	Add: D&A	12,400	14,800	15,460	16,666	17,936	19,088	20,274	21,332	22,445
	Less: Working Capital Delta	3,000	17,300	14,055	7,576	4,076	4,338	4,608	4,848	5,101
	Gross Cash Flows	70,865	60,617	72,992	86,263	93,903	99,934	106,144	111,680	117,507
	Less: CAPEX	(25,500)	(24,400)	(35,000)	(30,302)	(32,611)	(34,706)	(36,862)	(29,089)	(30,606)
	Free Cash Flows	45,365	36,217	37,992	55,961	61,292	65,228	69,281	82,591	86,900

Valuation At December 31, 2019		
Discount Rate: 8%		
	PV of Forcast Period	272,776
	PV of Terminal Value	985,717
	Enterprise Value	1,258,492
	Add: Cash + ST, LT Investments	14,900
	Less: Debt	(486,300)
	Equity Value	787,092
	FD Shares O/S	37,400
	Price Per Share	**$ 21.05**

Terminal Growth at FY2024	
FY2025 FCF	86,900
Terminal EV (FY2024)	1,448,341
Terminal Growth	2.0%

Valuation Summary - Dec 31, 2019	*Blue Sky*	*Grey Sky*
ZZZ Share Price @ 2019/09/20	$ 21.93	$ 21.93
DCF Value	**$ 27.83**	**$ 21.05**
Implied Return	27%	(4.0%)

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