Rite Aid Inc (RAD) – Arbitrage With A 27.5% IRR

Target Price Analysis

Expected Return from $7.56 PPS (as of 8/11/16) = $8.25
27.5% IRR for 4-month hold period
(See Section I.B herein for calculations)

Rite Aid Inc. (RAD) represents an attractive arbitrage opportunity. The shares, which currently trade at around $7.50 per share, are expected to be taken out by Walgreen's Boots Alliance (WBA) at $9 per share by the end of 2016. The FTC should permit the transaction to go through, provided that WBA agrees to a certain amount of store divestitures (estimated by WBA in its most recent earnings call to be around 500). Assuming the deal were to fail because of antitrust opposition, RAD would receive a termination fee of $325 million[1], or around 30 cents per RAD share before payment of any applicable taxes (based on 1.042 billion diluted RAD shares outstanding as of 6/30/16[2]). We currently estimate that the transaction has a 75% probability of going through at $9 and a 25% probability of failing. If the latter were to occur, we believe that RAD would go to around $6. Thus, RAD currently has an expected value of $8.25, representing a 27.5% IRR over a four-month hold period.

The key risks to the deal closing are (i) the aforementioned antitrust risk and (ii) a material adverse event (MAE) occurring with respect to RAD's business. The MAE clause in the merger agreement includes an EBITDA test, which states that RAD must maintain TTM adjusted EBITDA of at least $1.075 billion as of the end of the last month immediately prior to closing, based on the company's internal financial statements. Over the past 4 fiscal quarters RAD has generated nearly $1.4 billion in adjusted EBITDA[3], so this provision should not be violated by the closing date. Even if closing does not occur until the end of Q3 FY 2017, RAD would only need to average $207MM in adjusted EBITDA for each of the next 2 quarters to satisfy the test, or 72% of the most recent quarter's number.

[1] See Section 8.2(b)(iv) of the RAD-WBA Merger Agreement.

[2] See Note 4 to financial statements on page 12 of RAD's Q2 2016 10-Q filing.

[3] Adjusted EBITDA for past 4 quarters: (i) Q1 FY17 = $286MM, (ii) Q4 FY16 = 383MM, (iii) Q3 FY16 = 373MM, and (iv) Q2 FY16 = 347MM. Total = 1.389B. Source: RAD earnings press releases for said quarters.

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I. Investment Highlights

A. Introduction to RAD

As per the company's 2015 10-K (page 2):

> Rite Aid is the third largest retail drugstore chain in the United States based on both revenues and number of stores. As of February 27, 2016, we operated 4,561 stores in 31 states across the country and in the District of Columbia. In fiscal 2016, as we continued our transformation into a retail healthcare company, we began reporting our business in two distinct segments. Our Retail Pharmacy Segment consists of Rite Aid stores, RediClinic and Health Dialog. Our Pharmacy Services Segment consists of EnvisionRx, a pharmacy benefit management (PBM) provider that we acquired in June 2015.

RAD will be combining with WBA, which is the 2nd largest drug store chain in the United States, after CVS (per Wikipedia).

B. Analysis of Arbitrage Opportunity

We estimate that the WBA-RAD merger has at least a 75% chance of closing successfully. If the merger closes, RAD shareholders will receive $9 in cash per RAD share.[4] If the merger is cancelled, RAD shares will likely fall back to their pre-merger announcement levels of approximately $6, as shown in the following chart:

[4] See Section 2.1(a) of the merger agreement: "Each share of [RAD] common stock…shall be converted into the right to receive $9.00 per share in cash, without interest."

As mentioned in the introduction, RAD would also receive a breakup fee worth about $0.30 per share if the merger is blocked on antitrust grounds, which should further cushion the blow from any cancellation of the merger (to be conservative, we have not added this to the $6 figure).

To obtain our $8.25 expected value for RAD shares, we simply perform the following calculation:

	Amount Rec'd	Weighting	Expected Value
Merger Closes	9.00	0.75	6.75
Merge Blocked	6.00	0.25	1.50
Total			8.25

(If we gave RAD credit for the $0.30 breakup fee, the expected value would increase to $8.33 per share.)

II. Merger Particulars

A. Conditions Precedent to Closing

The following are the mutual conditions precedent to the closing of the merger (see Section 7.1 of the merger agreement):

> (a) Stockholder Approval. The Company shall have obtained the Company Requisite Vote;
>
> (b) No Legal Restraints. No Law or injunction (whether temporary, preliminary or permanent) shall have been enacted, entered, promulgated or enforced by any Governmental Entity of competent jurisdiction (collectively, the "Legal Restraints") which prevents, makes illegal, prohibits, restrains or enjoins the consummation of the Merger; and
>
> (c) Antitrust Consents. The waiting period (and any extension thereof) applicable to the consummation of the Merger under the HSR Act shall have expired or been earlier terminated.

Note that RAD stockholder approval has already been received. The antitrust consents will likely be received as well (at least a 80% chance, by our estimate). First, as noted in subsection C below, WBA's management recently stated that they believe they will receive approval with approximately 500 divestitures (or about half the maximum allowable amount under the merger agreement[5]).

The following are conditions precedent necessary for WBA to close of the merger (see Section 7.2 of the merger agreement):

> (a) Representations and Warranties. (i) The representations and warranties of the Company set forth in the first sentence of Section 3.1 (Organization and Qualification; Subsidiaries), Section 3.4 (Authority), Section 3.9(b) (Absence of Certain Changes and Events) and Section 3.19 (Brokers) shall be true and correct as of the date of this Agreement and as of the Closing Date as though made on and as of such date and time (except to the extent that any such representation and warranty expressly speaks as of an earlier date, in which case such representation and warranty shall be true and correct as of such earlier date), (ii) the representations and warranties of the Company set forth in Section 3.3(a) and the first sentence and clause (i) of the second sentence of Section 3.3(b) (Capitalization) shall be true and correct in all but de minimis respects as of the date of this Agreement and as of the Closing Date as though made on and as of such date and time (except to the extent that any such representation and warranty expressly speaks as of an earlier date, in which case such representation and warranty shall be true and correct in all but de minimis respects as of such earlier date) and (iii) the representations and warranties of the Company set forth in this Agreement (other than those identified in clauses (i) and (ii)) shall be true and correct as of the date of this Agreement and as of the Closing Date as though made on and as of such date and time (except to the extent that any such representation and warranty expressly speaks as of an earlier date, in which case such representation and warranty shall be true and

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[5] See Section 6.4(d) of the merger agreement: "Notwithstanding anything in this Agreement to the contrary, in each case to the extent necessary in order to obtain the requisite Consents of Governmental Entities, Parent shall, and shall cause its subsidiaries to [divest retail stores], *provided* that (i), with respect to any sale, transfer, disposition, divestiture or hold separate of any retail stores of Parent, the Company or any of their respective subsidiaries, neither Parent nor any of its subsidiaries shall be required to (x) sell, transfer, dispose of, divest or hold separate, or (y) proffer, propose, negotiate, offer to effect or consent, commit or agree to any sale, transfer, disposal, divestiture or hold separate, in each case before or after the Effective Time, more than an aggregate of 1,000 retail stores of Parent and its subsidiaries and the Company and its subsidiaries." *(emphasis added)*

correct as of such earlier date); provided, however, that notwithstanding anything herein to the contrary, the condition set forth in this Section 7.2(a)(iii) shall be deemed to have been satisfied unless the failure of such representations and warranties of the Company to be so true and correct (without giving effect to any "Material Adverse Effect," "materiality" or similar qualifications contained therein) has had or would, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect;

(b) Performance of Obligations of the Company. The Company shall have performed in all material respects each of the obligations, and complied in all material respects with each of the agreements and covenants, required to be performed by, or complied with by, it under this Agreement at or prior to the Closing, provided that the Company shall have performed in all respects the obligations, and complied in all respects with the agreements and covenants, required to be performed by, or complied with by, it under Section 5.1(c)(xiii)(A) of this Agreement at or prior to the Closing;

(c) Certificate. Parent shall have received a certificate of the Chief Executive Officer or the Chief Financial Officer of the Company, certifying that the conditions set forth in Section 7.2(a), Section 7.2(b) and Section 7.2(d) have been satisfied; and

(d) No Material Adverse Effect. Since the date of this Agreement, there shall not have occurred a Material Adverse Effect; provided that clause (C) of the definition of Material Adverse Effect shall be excluded from such definition for the purpose of determining the satisfaction of this Section 7.2(d).

Subsections (a) through (c) should be formalities. Subsection (d) is very likely to be satisfied; however one needs to closely review the definition of Material Adverse Effect. This full text of this definition is as follows:

"Material Adverse Effect" means any event, development, circumstance, change, effect, condition, or occurrence that, individually or in the aggregate, with all other events, developments, circumstances, changes, effects, conditions or occurrences, (A) has, or would reasonably be expected to have, a material adverse effect on or with respect to the business, assets, liabilities, results of operations or financial condition of the Company and its subsidiaries, taken as a whole, (B) without limiting clause (A), results in, at Closing, a last twelve (12)-month Adjusted EBITDA of less than $1,075,000,000 determined as of the end of the last fiscal month ended prior to Closing for which internal financial statements of the Company are available, which financial statements shall be available no later than fifteen (15) days following the end of each fiscal month (it being understood that such monthly financial statements are not full financial statements and do not contain all required footnotes and other disclosures and are prepared in the Company's ordinary course of business) or (C) prevents, materially delays or materially impairs the ability of the Company to consummate the Merger and the other transactions contemplated by this Agreement; *provided, however*, in the case of clause (A) or (B), any event, development, circumstance, change, effect, condition or occurrence to the extent arising out of or resulting from any of the following after the date hereof shall not be deemed, either alone or in combination, to constitute or be taken into account in determining whether there has been, a Material Adverse Effect: (i) any change or development generally affecting the economy or the financial, debt, capital, credit or securities markets in the United States or elsewhere in the world, including as a result of changes or developments in prevailing interest or exchange rates or the disruption of any securities markets, (ii) national or international political or social conditions, (iii) the execution and delivery of this Agreement or the public announcement or pendency of the Merger or other transactions contemplated hereby, including any Parent Permitted Transaction, including the impact thereof on relationships, contractual or otherwise, with customers, suppliers, distributors, or employees of the Company or its subsidiaries (provided that this exception shall not be applied to clause (B) above), (iv) any change in any applicable Laws or applicable accounting regulations or principles, including GAAP, or interpretations thereof, (v) any hurricane, tornado, earthquake, flood, tsunami or other natural disaster or outbreak or escalation of hostilities or war (whether or not declared), military actions or any act of sabotage, terrorism or other international or national emergency, or other force

> majeure event or natural disaster or act of God or other comparable events, (vi) any change in the price or trading volume of Company Common Stock or the credit rating of the Company, in and of itself, (vii) any failure by the Company to meet (x) any published analyst estimates, expectations, projections or forecasts of the Company's revenue, earnings, cash flow, cash positions or other financial performance or results of operations for any period or (y) its internal or published projections, budgets, plans, forecasts, guidance, estimates, milestones of its revenues, earnings or other financial performance or results of operations, in and of itself, (viii) any change or development in the industries in which the Company and its subsidiaries operate, (ix) the identity of Parent or its subsidiaries (provided that this exception shall not be applied to clause (B) above), (x) any communication by Parent or its subsidiaries regarding the plans or intentions of Parent with respect to the conduct of the business of the Surviving Corporation or its subsidiaries or (xi) any action taken by the Company, or which the Company causes to be taken by any of its subsidiaries, in each case which is expressly required or permitted by this Agreement (other than pursuant to clause (a) of Section 5.1) or at Parent's express written request (*provided* that this exception shall not be applied to clause (B) above); except (A) to the extent (and only to the extent) any such event, development, circumstance, change, effect, condition or occurrence described in clauses (i), (ii), (iv), (v) or (viii) is disproportionately adverse to the business, assets, liabilities, results of operations or financial condition of the Company and its subsidiaries, taken as a whole, as compared to other participants in the industries in which the Company and its subsidiaries operate and (B) that clauses (vi) and (vii) shall not prevent or otherwise affect a determination that any events, developments, circumstances, changes, effects, conditions or occurrences underlying such changes or failures constitute or contribute to a Material Adverse Effect; *provided, further*, that the exceptions in clause (iii) above shall not apply with respect to references to Material Adverse Effect in those portions of the representations and warranties contained in Section 3.5(a) (and in Section 7.2(a) and Section 8.1(e)(i) to the extent related to such portions of such representation) to the extent the purposes of such representations and warranties is to address the consequences resulting from the execution, delivery and performance of this Agreement by the Company or the consummation of the Merger and the other transactions contemplated by this Agreement. *(emphasis added)*

We note the key requirement, that an MAE will occur if "at Closing, [the] last twelve (12)-month Adjusted EBITDA [is] less than $1,075,000,000 determined as of the end of the last fiscal month ended prior to Closing". As noted in the introduction above, though, this requirement is likely to be satisfied unless RAD's business suddenly falls off of a cliff prior to closing, as RAD's most recent TTM Adjust EBITDA is nearly $1.4 billion. Hence, we estimate a 95% chance that the MAE tests will be satisfied by RAD.

Putting our antitrust probability (80%) together with our MAE probability (95%) yields an overall probability of 76% that both are satisfied. To be slightly conservative, we round this down to 75% in our $8.25 expected value calculation (see Section I.B above).

B. Termination Fees and Specific Performance

Section 8.2(b) of the merger agreement describes the $325 million termination fee payable to RAD in the event the merger is cancelled by WBA or RAD due to antitrust reasons. Clause (d) is the key clause:

> (d) [If] this Agreement is terminated by [WBA] or [RAD] pursuant to (x) Section 8.1(b) [because the merger is blocked for antitrust reasons] or (y) Section 8.1(c) [due to the failure to receive antitrust clearance by the October 27, 2016 end date (which may be extended to January 27, 2017], <u>then [WBA] shall pay $325 million</u> (the "Parent Termination Fee") to RAD]…; *provided, however*, that the amount of the Parent Termination Fee shall be increased

> to $650 million if, following a date that is the seven (7) month anniversary of the date of this Agreement but prior to the date that is the twelve (12) month anniversary of the date of this Agreement, a Parent Permitted Transaction has been consummated or entered into or Parent has announced any plans to enter into any specific Parent Permitted Transaction…. Notwithstanding anything to the contrary herein, the Parties agree that, for purposes of this Agreement, Parent shall be deemed to have announced plans to enter into any specific Parent Permitted Transaction as a result of having made publicly available a "bear hug" letter, or a tender or exchange, take-over bid or other public offer to acquire all or a controlling interest with respect to a Parent Permitted Transaction. *(emphasis added)*

Furthermore, in the event that WBA were to unreasonably refuse to close the transaction, the merger agreement contains a section regarding specific performance, as follows:

> SECTION 9.12 Specific Performance. The Parties agree that irreparable damage for which monetary damages, even if available, may not be an adequate remedy, would occur in the event that the Parties do not perform the provisions of this Agreement (including failing to take such actions as are required of it hereunder in order to consummate this Agreement) in accordance with its specified terms or otherwise breach such provisions. The Parties acknowledge and agree that the Parties shall be entitled to an injunction, specific performance and other equitable relief to prevent breaches or threatened breaches of this Agreement and to enforce specifically the terms and provisions hereof, this being in addition to any other remedy to which they are entitled at law or in equity. Each of the Parties agrees that prior to the valid termination of this Agreement in accordance with Article VIII, it will not oppose the granting of an injunction, specific performance and other equitable relief as provided herein on the basis that (x) either Party has an adequate remedy at law or (y) an award of specific performance is not an appropriate remedy for any reason at law or equity…. *(emphasis added)*

C. Recent Events Regarding Merger

On July 6, 2016, WBA announced its Q3 FY 2016 earnings (see here). WBA included the following in its earnings press release regarding the RAD merger:

> **Rite Aid Acquisition**
>
> Walgreens Boots Alliance's proposed acquisition of Rite Aid Corporation, which was announced 27 October 2015, is progressing as planned. The transaction is subject to the expiration or termination of applicable waiting periods under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and other customary closing conditions.
>
> On 1 June 2016, the company completed a public offering of $6 billion aggregate principal amount of unsecured, unsubordinated notes with varying maturities and interest rates. The company intends to use the net proceeds to fund a portion of the cash consideration payable in connection with its pending acquisition of Rite Aid, to retire a portion of Rite Aid's existing debt and to pay related fees and expenses.
>
> Walgreens Boots Alliance is continuing its integration planning and continues to expect the Rite Aid transaction to close in the second half of calendar 2016..

In addition, the following excerpts regarding the status of the RAD merger are taken from WBA's earnings conference call (both prepared remarks and Q&A session):

Our proposed acquisition of Rite Aid is progressing as planned. As you know, we are in the process of seeking a regulatory approval in parallel our integration team is continuing its work on preliminary planning. In June, we completed a $6 billion public bond offering to support the funding of the acquisition. Also in June, I am pleased to report that we achieved our $1 billion synergy goal for fiscal 2016 from Walgreens and Alliance Boots merger.

Alvin Concepcion

Great. Thank you. Just wanted to follow-up on Rite Aid, sounds like it's still on track just wondering when you expect to hear more color from the SEC, if you could give us anymore color on the discussions and related to other changes in the number of stores divestiture you expect.

Stefano Pessina

We still believe that our initial estimate is correct. We still believe that at the end we will stay in the range of these stores that we initially indicated around 500. And time wise, we still believe that we will be able to really do the deal -- finish the deal by the end of this financial -- calendar year as we said. So by December, we believe that everything will be done. But of course, it doesn't depend on us, FTC will let us know when they are ready.

In addition, on August 10, 2016 DealReporter confirmed the likelihood of receiving FTC clearance, which caused RAD shares to spike from around $7 to around $7.50:

Walgreens (WBA)/Rite Aid (RAD) Merger Can Get FTC Approval Through Divestitures - DealReporter

Walgreens Boots Alliance's (NASDAQ: WBA) takeover of Rite Aid (NYSE: RAD) should be able to gain antitrust approval through store divestitures, according to a report late yesterday from DealReporter, citing a third-party source who has been contacted by FTC.

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Tickers relacionados: RITE AID CORP (RAD), WALGREENS BOOTS ALLIANCE INC (WBA)

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$RAD looks like FTC approval is possible.
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III. Historical Financials

A. RAD's Historical Financial Data

Below please find past 5-year financial data for RAD:

	Fiscal Year Ended: February 27, 2016 (52 weeks)(*)	February 28, 2015 (52 weeks)	March 1, 2014 (52 weeks)	March 2, 2013 (52 weeks)	March 3, 2012 (53 weeks)
	(Dollars in thousands, except per share amounts)				
Summary of Operations:					
Revenues	$ 30,736,657	$ 26,528,377	$ 25,526,413	$ 25,392,263	$ 26,121,222
Costs and expense:					
Cost of revenues	22,910,402	18,951,645	18,202,679	18,073,987	19,327,887
Selling, general and administrative expenses	7,013,346	6,695,642	6,561,162	6,600,765	6,531,411
Lease termination and impairment charges	48,423	41,945	41,304	70,859	100,053
Interest expense	449,574	397,612	424,591	515,421	529,255
Loss on debt retirements, net	33,205	18,512	62,443	140,502	33,576
Loss (gain) on sale of assets, net	3,303	(3,799)	(15,984)	(16,776)	(8,703)
Total costs and expenses	30,458,253	26,101,557	25,276,195	25,384,758	26,513,479
Income (loss) before income taxes	278,404	426,820	250,218	7,505	(392,257)
Income tax expense (benefit)	112,939	(1,682,353)	804	(110,600)	(23,686)
Net income (loss)	$ 165,465	$ 2,109,173	$ 249,414	$ 118,105	$ (368,571)
Basic and diluted income (loss) per share:					
Basic income (loss) per share	$ 0.16	$ 2.17	$ 0.23	$ 0.12	$ (0.43)
Diluted income (loss) per share	$ 0.16	$ 2.08	$ 0.23	$ 0.12	$ (0.43)
Year-End Financial Position:					
Working capital	$ 1,553,832	$ 1,736,758	$ 1,777,673	$ 1,830,777	$ 1,934,267
Property, plant and equipment, net	2,255,398	2,091,369	1,957,329	1,895,650	1,902,021
Total assets(1)	11,277,010	8,777,425	6,860,672	6,985,038	7,264,385
Total debt(1)	6,994,136	5,559,116	5,672,944	5,939,850	6,228,295
Stockholders' equity (deficit)	581,428	57,056	(2,113,702)	(2,459,434)	(2,586,756)
Other Data:					
Cash flows provided by (used in):					
Operating activities	997,402	648,959	702,046	819,588	266,537
Investing activities	(2,401,858)	(593,685)	(364,924)	(346,305)	(221,169)
Financing activities	1,413,028	(85,781)	(320,168)	(506,116)	25,801
Capital expenditures	669,995	539,386	421,223	382,980	250,137
Basic weighted average shares	1,024,377	971,102	922,199	889,562	885,819
Diluted weighted average shares	1,042,362	1,017,861	979,092	907,259	885,819
Number of retail drugstores	4,561	4,570	4,587	4,623	4,667
Number of associates	90,000	89,000	89,000	89,000	90,000

Note that revenues increased by around 4% annually during the covered period. Gross margin dollars have likewise increased from $6.79 billion to $7.83 billion, or 3.6% annually. Shareholder equity increased by around $3 billion, mainly due to the reversal of the company's tax valuation allowance in FY 2015.

Below please find the most recent 6-month financial data for RAD:

RITE AID CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(unaudited)

	Thirteen Week Period Ended	
	May 28, 2016	May 30, 2015
Revenues	$ 8,184,181	$ 6,647,561
Costs and expenses:		
Cost of revenues	6,289,881	4,788,031
Selling, general and administrative expenses	1,793,247	1,699,585
Lease termination and impairment charges	5,781	5,022
Interest expense	105,113	123,607
Loss on sale of assets, net	1,056	39
	8,195,078	6,616,284
(Loss) income before income taxes	(10,897)	31,277
Income tax (benefit) expense	(6,309)	12,441
Net (loss) income	$ (4,588)	$ 18,836
Computation of (loss) income attributable to common stockholders:		
(Loss) income attributable to common stockholders—basic and diluted	$ (4,588)	$ 18,836
Basic and diluted (loss) income per share	$ (0.00)	$ 0.02

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)

(unaudited)

	May 28, 2016	February 27, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 144,840	$ 124,471
Accounts receivable, net	1,679,166	1,601,008
Inventories, net of LIFO reserve of $1,020,147 and $1,006,396	2,623,886	2,697,104
Prepaid expenses and other current assets	107,293	128,144
Total current assets	4,555,185	4,550,727
Property, plant and equipment, net	2,257,795	2,255,398
Goodwill	1,713,475	1,713,475
Other intangibles, net	964,709	1,004,379
Deferred tax assets	1,544,890	1,539,141
Other assets	218,893	213,890
Total assets	$ 11,254,947	$ 11,277,010
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt and lease financing obligations	$ 25,640	$ 26,848
Accounts payable	1,663,436	1,542,797
Accrued salaries, wages and other current liabilities	1,290,693	1,427,250
Total current liabilities	2,979,769	2,996,895
Long-term debt, less current maturities	6,899,025	6,914,393
Lease financing obligations, less current maturities	49,737	52,895
Other noncurrent liabilities	734,912	731,399
Total liabilities	10,663,443	10,695,582
Commitments and contingencies	—	—
Stockholders' equity:		
Common stock, par value $1 per share; 1,500,000 shares authorized; shares issued and outstanding 1,048,768 and 1,047,754	1,048,768	1,047,754
Additional paid-in capital	4,835,634	4,822,665
Accumulated deficit	(5,245,798)	(5,241,210)
Accumulated other comprehensive loss	(47,100)	(47,781)
Total stockholders' equity	591,504	581,428
Total liabilities and stockholders' equity	$ 11,254,947	$ 11,277,010

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(unaudited)

	Thirteen Week Period Ended	
	May 28, 2016	May 30, 2015
Operating activities:		
Net (loss) income	$ (4,588)	$ 18,836
Adjustments to reconcile to net cash provided by operating activities:		
Depreciation and amortization	138,788	109,649
Lease termination and impairment charges	5,781	5,022
LIFO charge	13,751	5,987
Loss on sale of assets, net	1,056	39
Stock-based compensation expense	11,144	7,370
Changes in deferred taxes	(5,749)	9,540
Excess tax benefit on stock options and restricted stock	(883)	(2,820)
Changes in operating assets and liabilities:		
Accounts receivable	(74,530)	11,027
Inventories	59,440	56,204
Accounts payable	115,646	79,715
Other assets and liabilities, net	(99,912)	67,266
Net cash provided by operating activities	159,944	367,835
Investing activities:		
Payments for property, plant and equipment	(106,077)	(141,037)
Intangible assets acquired	(16,381)	(14,293)
Proceeds from dispositions of assets and investments	3,088	2,838
Net cash used in investing activities	(119,370)	(152,492)

Financing activities:		
Proceeds from issuance of long-term debt	—	1,800,000
Net payments to revolver	(20,000)	(141,000)
Principal payments on long-term debt	(5,721)	(5,577)
Change in zero balance cash accounts	2,262	(34,275)
Net proceeds from issuance of common stock	2,371	3,378
Excess tax benefit on stock options and restricted stock	883	2,820
Deferred financing costs paid	—	(34,459)
Net cash (used in) provided by financing activities	(20,205)	1,590,887
Increase in cash and cash equivalents	20,369	1,806,230
Cash and cash equivalents, beginning of period	124,471	115,899
Cash and cash equivalents, end of period	$ 144,840	$ 1,922,129
Supplementary cash flow data:		
Cash paid for interest (net of capitalized amounts of $56 and $42, respectively)	$ 71,434	$ 72,194
Cash payments of income taxes, net of refunds	$ 3,869	$ 992
Equipment financed under capital leases	$ 1,553	$ 800
Equipment received for noncash consideration	$ 632	$ 545
Conversion of the 8.5% convertible notes to common stock	$ —	$ 64,089
Gross borrowings from revolver	$ 867,000	$ 915,000
Gross payments to revolver	$ 887,000	$ 1,056,000

B. RAD's Earnings Estimates

Below are analyst estimates for earnings and revenues for RAD for this fiscal year and next fiscal year:

Earnings Estimate	Current Qtr.	Next Qtr.	Current Year	Next Year
No. of Analysts	7	7	9	7
Avg. Estimate	0.03	0.06	0.16	0.24
Low Estimate	0.01	0.04	0.09	0.15
High Estimate	0.04	0.08	0.21	0.33
Year Ago EPS	0.02	0.06	0.16	0.16

Revenue Estimate	Current Qtr.	Next Qtr.	Current Year	Next Year
No. of Analysts	7	7	9	6
Avg. Estimate	8.17B	8.37B	32.97B	34.41B
Low Estimate	7.91B	8.29B	30.94B	33.85B
High Estimate	8.3B	8.44B	33.46B	35.01B
Year Ago Sales	7.66B	8.15B	30.74B	32.97B
Sales Growth (year/est)	6.50%	2.60%	7.30%	4.40%

Assuming RAD were to fall to $6 per share following a termination of the merger agreement, this would represent a 4% forward earnings yield (0.24 / 6.00).

IV. Risk Factors

Below are some key risk factors involved in an investment in RAD shares (investors should carefully review all of the risk factors set forth RAD's SEC filings, for example here):

Risks Related to the Merger

- There can be no assurance that the proposed Merger with WBA will occur. On February 4, 2016, the proposal to adopt the Merger was approved by holders of approximately 74% of our outstanding common stock entitled to vote as of the record date. However, completion of the Merger is subject to certain conditions, including, among others, (i) the absence of any order or law prohibiting the Merger; (ii) the expiration or earlier termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended; (iii) the accuracy of the parties' respective representations and warranties, subject in some instances to materiality or "Material Adverse Effect" qualifiers, as of the date of the Merger Agreement and the closing date of the Merger; (iv) the parties' respective performance in all material respects (or, with respect to Rite Aid's specified obligations relating to incurring indebtedness, in all respects) of their respective agreements and covenants contained in the Merger Agreement at or prior to the closing of the Merger; and (v) the absence of a "Material Adverse Effect" with respect to us, since the execution of and as defined in the Merger Agreement, including the absence of any event, development, circumstance, change, effect, condition or occurrence that results in, at closing, Rite Aid's last twelve (12) months Adjusted EBITDA (as such term is defined in the Merger Agreement), being less than $1.075 billion determined as of the end of the last fiscal month ended prior to closing for which internal financial statements of Rite Aid are available. While we believe we will receive the requisite approvals, there can be no assurance that these and other conditions to closing will be satisfied at all or satisfied on the proposed terms and schedules as contemplated by the parties. Satisfaction of the closing conditions may delay the completion of the Merger, and if certain closing conditions are not satisfied prior to the end date specified in the Merger Agreement, the parties will not be obligated to complete the Merger.
- If the Merger is not completed for any reason, we will have incurred substantial expenses. We have incurred substantial legal, accounting and financial advisory fees that are payable by us whether or not the Merger is completed, and our management has devoted considerable time and effort in connection with the pending Merger. If the Merger Agreement is terminated under certain limited circumstances, the Merger Agreement may require us to pay WBA a termination fee of $325 million. For these and other reasons, a failed merger could materially adversely affect our business, operating results or financial condition. In addition, the trading price of our common stock could be adversely affected to the extent that the current price reflects an assumption that the Merger will be completed.
- The pendency of the Merger could cause disruptions in and create uncertainty regarding our business, which could have an adverse effect on our financial condition and results of operations, regardless of whether the Merger is completed. These risks, which could be exacerbated by a delay in the completion of the Merger, include the following: (i) certain vendors may change their programs or processes which might adversely affect the supply or cost of the products, which then might adversely affect our stores sales or gross profit; (ii) negotiations with third party payors might be adversely affected which then might adversely affect our stores sales or gross profit; (iii) our current and prospective associates may experience uncertainty about their future roles with WBA, which might adversely affect our ability to attract and retain key personnel; (iv) key management and other employees may be difficult to retain or may become distracted from day-to-day operations because matters related to the Merger may require substantial commitments of their time and resources, which could adversely affect our operations and financial results; (v) our current and prospective customers may experience uncertainty about the ability of our stores to meet their needs, which might cause customers to make purchases or fill their prescriptions elsewhere; (vi) our ability to pursue alternative business opportunities, including strategic acquisitions, is limited by the terms of the Merger Agreement. If the Merger is not completed for any reason, there can be no assurance that any other transaction acceptable to us will be offered or that our business, prospects or results of operations will not be adversely affected; (vii) our ability to make appropriate changes to our business may be restricted by covenants in the Merger Agreement; these restrictions generally require us to conduct our business in the ordinary course and subject us to a variety of specified limitations absent WBA's prior written consent. We may find that these and other contractual restrictions in the Merger Agreement may delay

or prevent us from responding, or limit our ability to respond, effectively to competitive pressures, industry developments and future business opportunities that may arise during such period, even if our management believes they may be advisable; and (viii) the costs and potential adverse outcomes of litigation relating to the Merger.

V. Conclusion

The above-discussed RAD merger arbitrage opportunity is attractive because (i) the spread is relatively wide, even though the merger is likely to win antitrust approval, (ii) the downside scenario if the merger fails is not overly draconian, with RAD expected to fall just $1.50 per share to around the $6 level, and (iii) the merger is likely to be consummated by the end of 2016. Given the foregoing, if nothing upsets the apple cart and the merger closes by Christmas, today's RAD purchaser is expected to obtain a ~27.5% IRR on his investment (see top of 1st page of this summary).

While the market provides many other opportunities for an investor, it is difficult to find stocks with an IRR of 27.5%. This lead to the conclusion that RAD is currently a strong buy.

VI. Disclaimer

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