Kenan–Flagler Business School
ALPHA CHALLENGE
The University of North Carolina

December 5, 2024

Team No.: 7

Students: **Katja Muller, Charlie Ghriskey, Omar Estrada**

VSCO 4 5/8 Sr. Unsecured Bonds

Recommendation: BUY
Current Price: $ 89.84
1-YR Target Price: $ 94.81

Potential Return 10.49 %

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Capital Structure & Bond Selection

We recommend the Victoria Secret & Co. 4.625% senior unsecured bond. Our base case has an annualized rate of return of 10.49%

Description	BS Out ($MM)	Price	Duration	YTW	Coupon	Coupon Type	Maturity	OAS Spread
1st Lien Secured Loans	**533.0**							
VSCO TL B 1L USD	388.0	100.19			7.957%	Variable	08/28	
VSCO REV 1L USD	145.0				6.506%	Variable	08/26	
Senior Unsecured Bonds	**600.0**							
VSCO 4 5/8 07/15/29	600.0	89.92	4.00	7.17%	4.625%	Fixed	07/29	301
Debt-like Obligations	**1,428.0**							
Operating Leases	1,428.0							
Total Debt & Debt like Outstanding	**2,561.0**							
- Cash & Cash Equivalents	169.0							
Net Debt	**2,392.0**							
+ Total Minority Interest	22.0							
+ Market Capitalization	2,797.6							
Enterprise Value	**5,211.6**							

Base Case	
Total Spread Compression:	100 bps
Implied Bond Price:	$ 94.81
Annualized Total Return:	10.49 %

Worst Case	
Total Spread Compression:	(100) bps
Implied Bond Price:	$ 88.81
Annualized Total Return:	3.93 %

One Year Time Horizon	
Current Price	$ 89.92

Capital Structure	2024E Leverage
1st Lien Secured Loans	1.0x
Senior Unsecured Bonds	2.1x
Including Operating Leases	4.7x
EV/EBITDA	9.5x

Note: *Pricing information as of 11/21/2024*
Source: Team Analysis, Bloomberg

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VS&Co., the Market Leader in U.S. Intimates Apparel

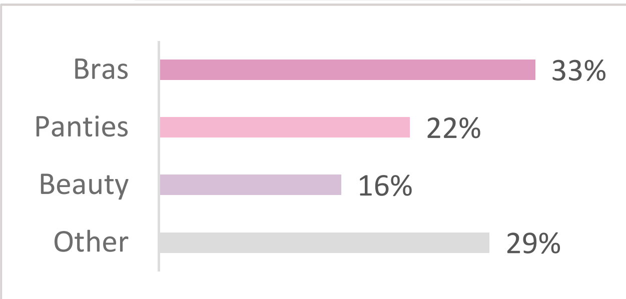
Spun off from Bath & Body Works (L Brands) in 2021, VS&Co. is the longstanding market leader in the U.S. intimates market, and one of the few big names that operates its own brick-and-mortar business

What Does VS&Co. Do?

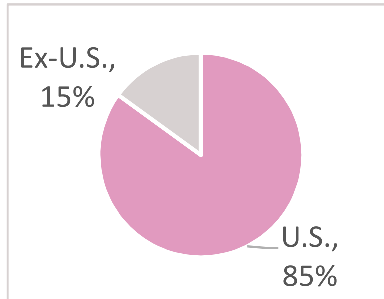
Product Development & Design → Merchandising & Sourcing → Distribution *(Retail & Wholesale)*

Where Does VS&Co. Make Their Money?

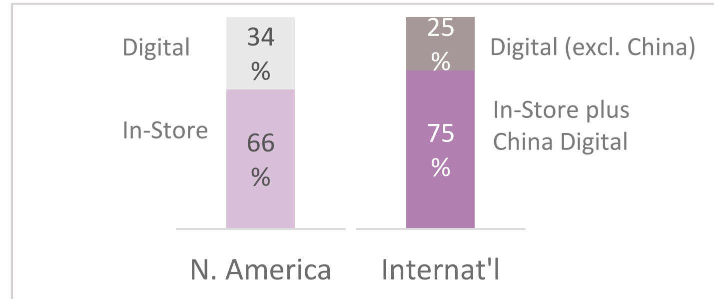
'23 Sales By Product Category



By Geography

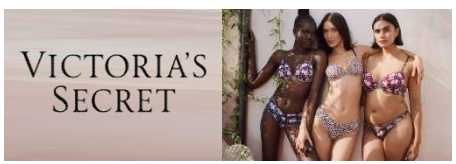


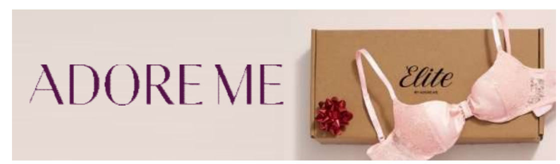
In-Store vs. Online



All charts above represent 2023 Sales

How Does VS&Co. Come to Market?

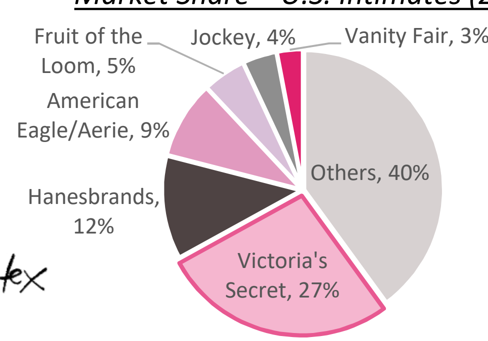




Who Does VS&Co. Compete Against?

aerie
JOCKEY
FRUIT OF THE LOOM → VANITY FAIR
Hanes → MAIDENFORM, BALI, Playtex

Market Share – U.S. Intimates (2021)



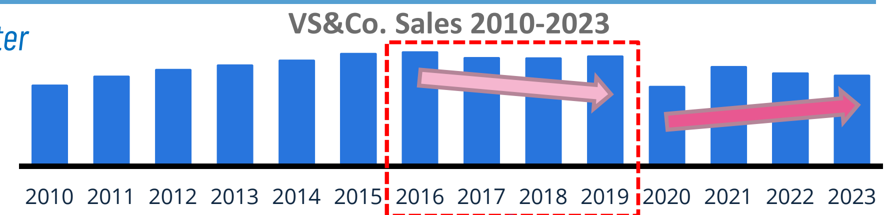
Calvin Klein
SAVAGE X FENTY
KOHL'S
macy's
Walmart

Source: Company filings, Investor Day 2023, Euromonitor

> They've had the same positioning for decades, ***associating sexy with super models***, and it ***just doesn't work anymore.***"
> *– Jefferies analyst, 2016*

The Angels' Fall from Heaven

VS&Co. is working on a turnaround, after a fall from grace in the late 2010's.



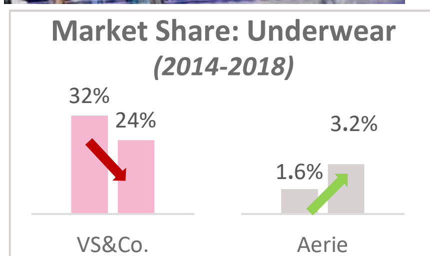
2016-2019: Execution Missteps

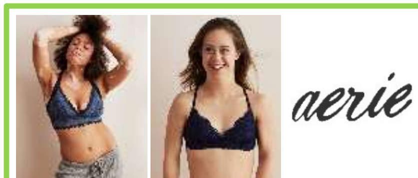
Brand struggles to connect w/ customers...

BUSINESS

Why Victoria's Secret's idea of sexy may be killing its brand

With its narrow definition of beauty, the **brand lost relevance** as consumers turned towards more **body positive brands** like Aerie



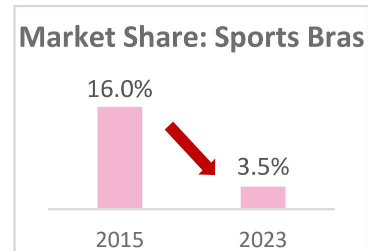


Aerie's 2018 ad campaign featured women with visible diseases or illnesses

... and to produce a winning assortment...

Category misses:

- Did not participate sufficiently in **growing sports bra** market, and bled share
- In another category mistake, they **exited swimwear**, then later reversed course



Trend Misses:

- Refused to offer **plus sizes** despite growing demand, due to brand ego about staying true to their narrowly defined look

2020-2023: The Turnaround Begins

VS&Co. took a hiatus from the Fashion Show to reintroduce their brand in a new light

A Broader Expression of "Sexy"

A VS&Co. for All Women

2023 relaunch of the Fashion Show in a new format: The World Tour

Back in the Spotlight – and in a Good Way

- 17B Press Impressions
- 14.5M Social Media Engagements
- 80% Positive Sentiment

Source: Earnings Call (Q3-2023), Euromonitor, NY Post headline, Washington Post

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Investment Thesis

VS&Co

2024+: Executing on a Customer-Centric Strategy, through a Refreshed Version of the Iconic Brand

1

Top line improvement via right sizing brick & mortar and improved product

- Closing cash-flow negative stores improves EBITDA margin
- Customer-focused product and marketing are driving an improved same-store sales trend

2

Adore Me acquisition broadens customer base & expands digital capabilities

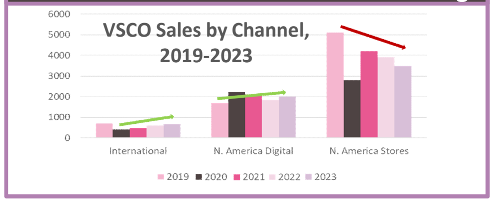
- Strategic acquisition of Adore Me enhances Digital capabilities, while broadening VS&Co.'s customer base on various dimensions

3

Operational gains boost cash flow for deleveraging

- Enhanced Operational efficiencies and strategic initiatives are bolstering cash flow, enabling targeted deleveraging and improving the company's financial position.

Context: N. Am store sales still declining



Thesis #1: Improving product & right-sizing N. Am. store count

Total Store count is stabilizing, which is driving improvements in same-store sales. Additionally, the Adore Me's strong technology platform should benefit VSCO.

Improving product to boost sales (across all channels)

New customer-focused product dev't

Priorities:

- Understanding their customers
- Serving their style needs
- Sexy "on her terms"

VSCO now knows their customer better than ever

Customer profiles (with % of market breakdown)

Bra sub-categories based in what she wants

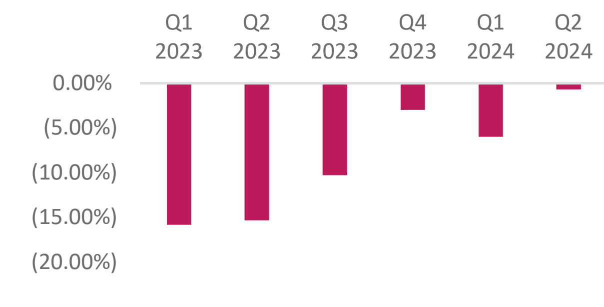
Identifying WHITESPACE

- Bra shoppers increasingly looking for **comfort**
- Challenge: Romantic style based in lace material; tends to be uncomfortable
- VS innovation priority: **Comfortable lace bras**

Clawing back in Sports Bras

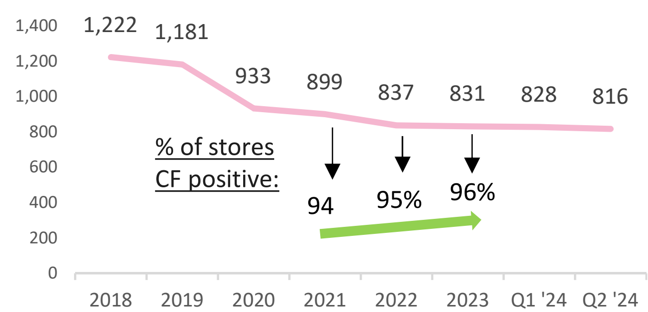
- ***Reprioritized the category*** based on importance to Customer
- ***Leveraged design expertise to create new top seller:*** Featherweight Max line, recently expanded

YoY Trend in Same Store Sales is improving



Right-sizing brick-and-mortar to improve N. America financials

VSCO continues to close stores in 'at risk' malls



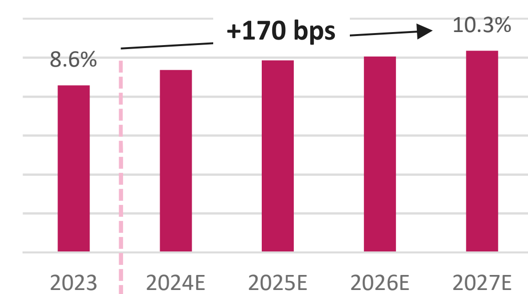
Store Count Target by 2026:

750

CF Positive Rate by 2026:

99% CF+

How does this impact EBITDA Margin go-forward?



Source: Company Filings, Investor Presentation

Thesis #2: Adore Me acquisition broadens customer base & expands digital capabilities

ADORE ME acquisition

Why Adore Me?

- #1 digitally native growth brand in intimates
- Tech powerhouse selling fashion (40% of team is Tech)

Business Models

- Home Try-On: *Stitch-Fix type model*
- VIP Membership: *subscription offering exclusive discounts and products*
- A-La-Carte: *regular purchase*

One Heck of a Deal

- Acquired 100% company in Q1 2023 for **$400M all Cash** w/ $300M further cash consideration
- **Value price**: Bought at 1.7x EV/2022 sales multiple vs. comps trading at ~3.7x

Expand Customer Reach with New-to-VS Offerings

Size

All 77 sizes
- 40% of Adore Me revenues are from non-standard sizes

Far from Store *or* Convenience Seeker

Home Try-On Model
- 32% of VS surveyed customers are interested in the Home Try-On model
- Geographic backfill for closed N. Am. stores

Value / Budget shopper

Adore Me as a Mass Market Brand
- 40% lower prices compared to VS

Increase CLV via Adore Me platform & tech

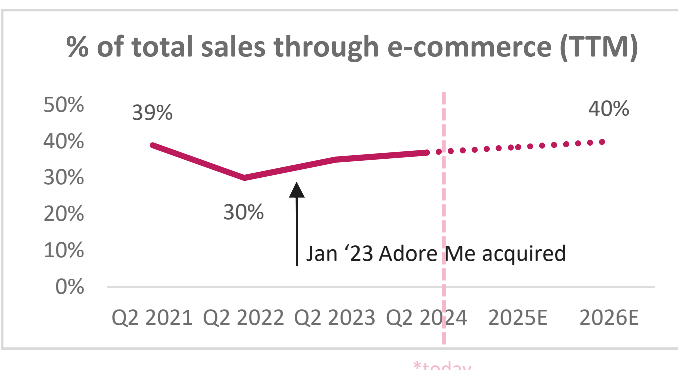
Online Marketing

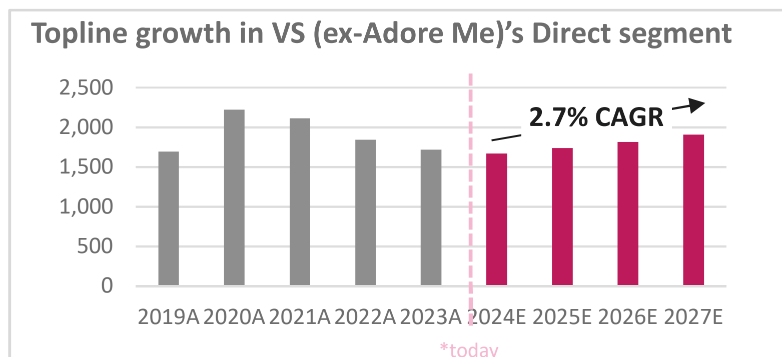
Membership
- Push drops to customer
- Exclusive discounts

Tech
- Machine Learning (ML) for marketing to measure ROI of marketing at spot level

Home Try-On

Business Model that drives higher sales
- 3x sales for HTO customer vs. average customer
- At similar profitability as other business models given expertise & tech





Source: Company Financials, Quarterly Calls

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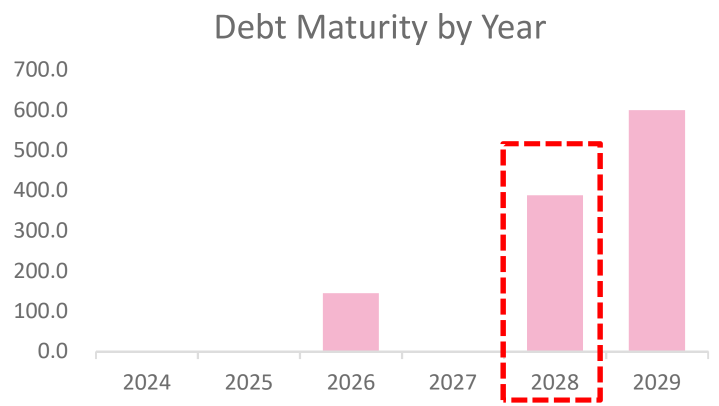
Thesis #3: Operational gains boost cash flow for deleveraging

Improvements in operations, higher gross margins, and improving same-store sales positions VS&Co. to target payment of high-interest term loan in near future, improving their credit profile.

Management has identified paying down the 2028 Term Loan, which is possible with operational gains



Description	BS Out ($MM)	Coupon	Coupon Type	Maturity
1st Lien Secured Loans	**533.0**			
VSCO TL B 1L USD	**388.0**	**7.957%**	**Variable**	**08/28**
VSCO REV 1L USD	145.0	6.506%	Variable	08/26

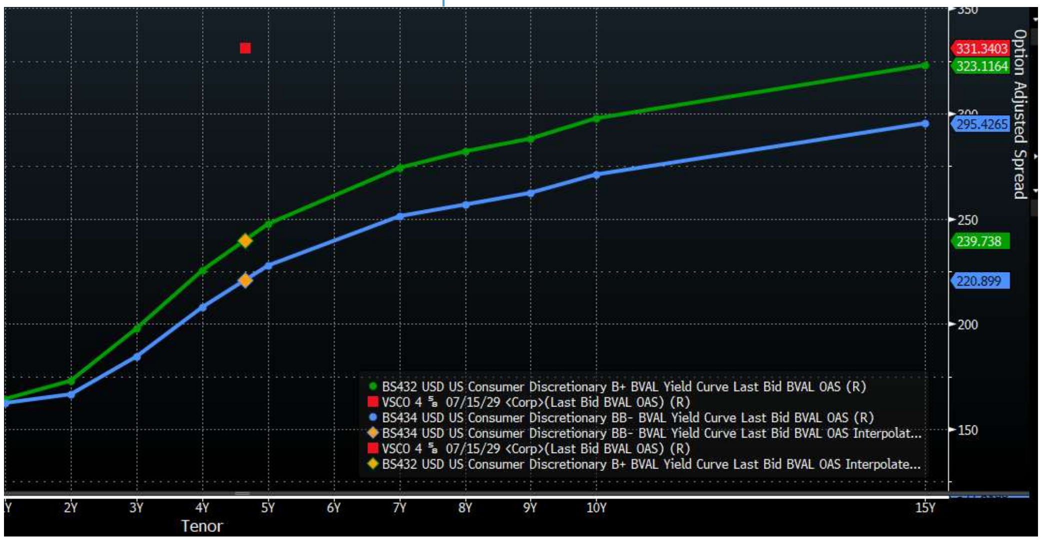
	2023A FY	2024E FY	2025E FY	2026E FY
Revenue	6,182	6,139	6,282	6,458
Gross Profit	2,242	2,279	2,370	2,475
Gross Profit Margin	36%	37%	38%	38%
Operating Income	246	315	360	409
Operating Margin	4%	5%	6%	6%
EBITDA	**530**	**575**	**619**	**649**
Adj. EBITDA	**923**	**968**	**1,012**	**1,042**
Adj. EBITDA Margin	15%	16%	16%	16%
Free Cash Flow				
EBITDA	530	575	619	649
Remaining FCF	64	78	285	353
Balance Sheet				
Cash	270	567	532	971
Long-Term Debt	1,120	1,113	734	734
Current Portion of Long-Term Debt	4	4	4	4
Long-Term Operating Leases	1,312	1,420	1,420	1,420
Net Debt	2,166	1,970	1,626	1,187
Credit Statistics				
Total Debt/EBITDA	4.6x	4.4x	3.5x	3.3x
Total Debt/Adj. EBITDA	2.6x	2.6x	2.1x	2.1x
Net Debt/EBITDA	4.1x	3.4x	2.6x	1.8x
Interest Coverage	5.4x	6.8x	7.7x	8.1x

	Moody's	S&P
Upgrade Trigger	▪ Conservative articulated financial strategy ▪ Sustained operating margins > 10% ▪ Debt/Adj. EBITDA below 1.75x	▪ Conservative approach to leverage ▪ Realizing cost improvements
Downgrade Trigger	▪ Aggressive financial strategies or liquidity deteriorates ▪ Debt/Adj. EBITDA above 3.25x ▪ EBIT/Interest sustained below 2.25x	▪ Weaker-than-expected performance ▪ Increased leverage above 3.00x Debt/EBITDA

Source: Bloomberg, Capital IQ, Moody's Investor Service, S&P Global Ratings

Relative Valuation

VSCO is trading at ~100 bps wide of USD US Consumer Discretionary Curve B+ Consumer Discretionary Curve and ~110 bps wide of the BB- curve.



VSCO is trading ~100 bps and ~110 bps wide of the B+ and BB- curve, despite a similar net leverage peers and an interest coverage slightly less than average

Company:	Victoria's Secret & Co. (VSCO)
Bond:	VSCO 4.625% 07/15/29 $600M Semi-Annual Sen. Unsec.
Rating:	Moody's (B1) | S&P (BB-)

Company	Security	Outstanding	S&P Rating	Moody's Rating	YTW	Bid OAS Spread	Net Leverage (LTM)	EBITDA / Interest	FCF / Net Debt (LTM)	Spread / Leverage
BATH & BODY WORKS INC	BBWI 5 1/4 02/01/28	451,120,000	BB	Ba2	5.55%	147.0	3.0x	4.6x	14.14%	48
MACY'S RETAIL HLDGS LLC	M 5 7/8 04/01/29	326,354,000	BB+	Ba2	6.41%	194.5	4.3x	9.3x	12.28%	45
KOHL'S CORPORATION	KSS 7 1/4 06/01/29	42,277,000	BB	Ba3	7.02%	294.8	4.7x	4.5x	9.78%	63
BATH & BODY WORKS INC	BBWI 7 1/2 06/15/29	482,312,000	BB	Ba2	5.65%	76.3	3.1x	4.5x	14.14%	25
VICTORIA'S SECRET & CO	VSCO 4 5/8 07/15/29	600,000,000	BB-	B1	7.17%	294.9	4.3x	5.5x	8.28%	69
GAP INC	GAP 3 5/8 10/01/29	750,000,000	BB	B1	5.98%	179.3	2.3x	366.0x	35.62%	79
LEVI STRAUSS & CO	LEVI 3 1/2 03/01/31	500,000,000	BB+	Ba2	5.67%	141.7	4.3x	8.4x	38.33%	33
KOHL'S CORPORATION	KSS 4 5/8 05/01/31	500,000,000	BB	Ba3	8.09%	392.0	4.7x	4.5x	9.78%	84
SALLY HOLDINGS	SBH 6 3/4 03/01/32	600,000,000	BB-	Ba2	6.24%	153.4	3.8x	5.1x	9.73%	40
							4.1x	6.5x	**Average***	
							4.3x	5.5x	**Median***	

***Note:** Average and Median figure does not include GAP INC*
Source: Bloomberg, Moody's, S&P

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Valuation – Base Case

Our base case assumes a CAGR of 1.9% with gross margins expanding 270 bps through 2027.

Financial Projections

	2021A FY	2022A FY	2023A FY	2024E FY	2025E FY	2026E FY	Base Case 2027E FY
Revenue	6,785	6,344	6,182	6,139	6,282	6,458	6,658
Gross Profit	2,760	2,258	2,242	2,279	2,370	2,475	2,592
Gross Profit Margin	41%	36%	36%	37%	38%	38%	39%
Operating Income	870	478	246	315	360	409	462
Operating Margin	13%	8%	4%	5%	6%	6%	7%
EBITDA	1,173	751	530	575	619	649	689
Adj. EBITDA	1,572	1,136	923	968	1,012	1,042	1,082
Adj. EBITDA Margin	23%	18%	15%	16%	16%	16%	16%
Free Cash Flow							
EBITDA	1,173	751	530	575	619	649	689
CapEx	(169)	(164)	(256)	(194)	(188)	(194)	(200)
Interest Expense	(27)	(60)	(99)	(85)	(80)	(80)	(80)
Taxes	(197)	(79)	(31)	(61)	(74)	(87)	(101)
Change in Working Capital	(132)	(193)	(80)	(157)	9	64	(14)
Remaining FCF	648	255	64	78	285	353	295
Balance Sheet							
Cash	490	427	270	567	532	971	1,358
Long-Term Debt	978	1,271	1,120	1,113	734	734	734
Current Portion of Long-Term Debt	4	4	4	4	4	4	4
Long-Term Operating Leases	1,314	1,201	1,312	1,420	1,420	1,420	1,420
Net Debt	1,806	2,049	2,166	1,970	1,626	1,187	800
Credit Statistics							
Total Debt/EBITDA	2.0x	3.3x	4.6x	4.4x	3.5x	3.3x	3.1x
Total Debt/Adj. EBITDA	1.5x	2.2x	2.6x	2.6x	2.1x	2.1x	2.0x
Net Debt/EBITDA	1.5x	2.7x	4.1x	3.4x	2.6x	1.8x	1.2x
Interest Coverage	43.4x	12.5x	5.4x	6.8x	7.7x	8.1x	8.6x

Source: Annual Filings, Own Analysis

Base Case Assumptions

- VSCO sales grows at a CAGR of 1.9% through 2027
- Gross Margin expands by 270 bps from 36.3% in 2023 to 38.9% by 2027
- Successful integration of Adore Me impacting Direct Sales segment positively (2.7% CAGR through 2027) and Adore Me (~20% CAGR through 2027)

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Valuation – Worst Case

Our worst case assumes a CAGR of -2.3% with gross margins declining 120 bps through 2027.

Financial Projections

	2021A FY	2022A FY	2023A FY	2024E FY	2025E FY	2026E FY	Worst Case 2027E FY
Revenue	**6,785**	**6,344**	**6,182**	**6,004**	**5,860**	**5,734**	**5,638**
% Growth (YoY)	25.3%	-6.5%	-2.6%	**-2.9%**	**-2.4%**	**-2.1%**	**-1.7%**
Gross Profit	**2,760**	**2,258**	**2,242**	**2,177**	**2,101**	**2,033**	**1,977**
Gross Profit Margin	40.68%	35.59%	36.26%	36.26%	35.86%	35.46%	35.06%
Operating Income	**870**	**478**	**246**	**208**	**136**	**67**	**1**
Operating Margin	12.8%	7.5%	4.0%	3.5%	2.3%	1.2%	0.0%
EBITDA	**1,173**	**751**	**530**	**479**	**400**	**325**	**255**
Adj. EBITDA	**1,572**	**1,136**	**923**	**869**	**790**	**715**	**645**
Adj. EBITDA Margin	23.2%	17.9%	14.9%	14.5%	13.5%	12.5%	11.4%
Free Cash Flow							
EBITDA	1173	751	530	479	400	325	255
CapEx	(169)	(164)	(256)	(194)	(188)	(184)	(180)
Interest Expense	(27)	(60)	(99)	(95)	(95)	(95)	(95)
Taxes	(197)	(79)	(31)	(61)	9	(6)	(20)
Change in Working Capital	(132)	(193)	(80)	(157)	(146)	(143)	(141)
Remaining FCF	**648**	**255**	**64**	**(28)**	**(21)**	**(103)**	**(181)**
Balance Sheet							
Cash	490	427	270	242	481	378	197
Long-Term Debt	978	1,271	1,120	1,116	1,372	1,368	1,364
Current Portion of Long-Term Debt	4	4	4	4	4	4	4
Long-Term Operating Leases	1,314	1,201	1,312	1,312	1,312	1,312	1,312
Net Debt	1,806	2,049	2,166	2,190	2,207	2,306	2,483
Credit Statistics							
Total Debt/EBITDA	2.0x	3.3x	4.6x	5.1x	6.7x	8.3x	10.5x
Total Debt/Adj. EBITDA	1.5x	2.2x	2.6x	2.8x	3.4x	3.8x	4.2x
Net Debt/EBITDA	1.5x	2.7x	4.1x	4.6x	5.5x	7.1x	9.7x
Interest Coverage	43.4x	12.5x	5.4x	5.0x	4.2x	3.4x	2.7x

Source: Annual Filings, Own Analysis

Worst Case Assumptions

- VSCO sales slows at a CAGR of -2.3% through 2027
- Gross Margin declines by 120 bps from 36.3% in 2023 to 35.1% by 2027
- Unsuccessful integration of Adore Me only growing at a 10.3% CAGR through 2027, while N.A. Stores segment slows at a -4.8% CAGR through 2027
- Unable to pay down term loan leading to higher interest and leverage for longer than expected

Risks

Risks	Mitigants
Macroeconomic trends impacting consumer discretionary spending **Medium Risk**	Victoria's Secret & Co.'s acquisition of Adore Me diversified their product offering to include price points for price sensitive customers. Additionally, their focus on starting and building on their loyalty program provides a strong base of ~32 million customers driving 70-80% of weekly sales.
VS&Co. is unable to keep up with intensifying competition & changing trends. **High Risk**	The recent Adore Me acquisition provided over 12 years of intimate product data which can support the company's push to better understand their target customer.
Declining consumer brand perception **Medium Risk**	Victoria's Secret is still the main player in their main categories with 20% of intimates and 30% of fragrances. The company has already started shifting its marketing focus to inclusivity and diversity while providing new product lines to a wider audience.

Questions

VSCO 4 5/8 Sr. Unsecured Bonds

Recommendation: BUY
Current Price: $ 89.84
1-YR Target Price: $ 94.81

Potential Return 10.49 %

One-year time horizon

Current Bond Price	$ 89.84

Base Case	
Total Spread Compression:	100 bps
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Worst Case	
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Implied Bond Price:	$ 88.81
Annualized Total Return:	3.93 %

APPENDIX

Kenan-Flagler Business School
ALPHA CHALLENGE
The University of North Carolina

Valuation – Base Case

	2019A FY	2020A FY	2021A FY	2022A FY	2023A FY	2024E FY	2025E FY	2026E FY	Base Case 2027E FY
Revenue	$7,509	$5,413	6,785	6,344	6,182	6,139	6,282	6,458	6,658
Total Revenue	$7,509	$5,413	6,785	6,344	6,182	6,139	6,282	6,458	6,658
% Growth (YoY)	*NA*	-27.9%	25.3%	-6.5%	-2.6%	(0.7%)	2.3%	2.8%	3.1%
Gross Profit	$2,063	$1,571	2,760	2,258	2,242	2,279	2,370	2,475	2,592
Gross Profit Margin	27.5%	29.0%	41%	36%	36%	**37%**	**38%**	**38%**	**39%**
Operating Income	($892)	($101)	870	478	246	315	360	409	462
Operating Margin	-11.9%	-1.9%	13%	8%	4%	**5%**	**6%**	**6%**	**7%**
D&A	$411	$326	303	274	284	277	284	292	301
Operating Lease Costs			399	385	393	390	390	390	390
EBITDA	**($480)**	**$226**	**1,173**	**751**	**530**	**575**	**619**	**649**	**689**
+ Operating lease costs	$497	$521	399	385	393	393	393	393	393
+ Unusual items	$973	$199	-	-	-	-	-	-	-
Adj. EBITDA	**$990**	**$946**	**1,572**	**1,136**	**923**	**968**	**1,012**	**1,042**	**1,082**
Adj. EBITDA Margin	13.2%	17.5%	23%	18%	15%	16%	16%	16%	16%
Free Cash Flow									
EBITDA	(480)	226	1,173	751	530	575	619	649	689
CapEx	(225)	(127)	(169)	(164)	(256)	(194)	(188)	(194)	(200)
Interest Expense	(8)	(6)	(27)	(60)	(99)	(85)	(80)	(80)	(80)
Taxes	(2)	(34)	(197)	(79)	(31)	(61)	(74)	(87)	(101)
Change in Working Capital	(190)	298	(132)	(193)	(80)	(157)	9	64	(14)
Remaining FCF	(905)	357	648	255	64	78	285	353	295
Balance Sheet									
Cash	-	335	490	427	270	567	532	971	1,358
Long-Term Debt	-	-	978	1,271	1,120	1,113	734	734	734
Current Portion of Long-Term Debt	-	-	4	4	4	4	4	4	4
Long-Term Operating Leases		1,553	1,314	1,201	1,312	1,420	1,420	1,420	1,420
Net Debt	-	1,218	1,806	2,049	2,166	1,970	1,626	1,187	800
Credit Statistics									
Total Debt/EBITDA	0.0x	6.9x	2.0x	3.3x	4.6x	4.4x	3.5x	3.3x	3.1x
Total Debt/Adj. EBITDA	0.0x	1.6x	1.5x	2.2x	2.6x	2.6x	2.1x	2.1x	2.0x
Net Debt/EBITDA	0.0x	5.4x	1.5x	2.7x	4.1x	3.4x	2.6x	1.8x	1.2x
Interest Coverage	-60.0x	37.7x	43.4x	12.5x	5.4x	6.8x	7.7x	8.1x	8.6x

Source:

Kenan–Flagler Business School ALPHA CHALLENGE The University of North Carolina

Valuation – Worst Case

	2019A FY	2020A FY	2021A FY	2022A FY	2023A FY	2024E FY	2025E FY	2026E FY	Worst Case 2027E FY
Revenue	**7,509**	**5,413**	**6,785**	**6,344**	**6,182**	**6,004**	**5,860**	**5,734**	**5,638**
% Growth (YoY)		-27.9%	25.3%	-6.5%	-2.6%	**-2.9%**	**-2.4%**	**-2.1%**	**-1.7%**
Gross Profit	**2,063**	**1,571**	**2,760**	**2,258**	**2,242**	**2,177**	**2,101**	**2,033**	**1,977**
Gross Profit Margin	27.47%	29.02%	40.68%	35.59%	36.26%	36.26%	35.86%	35.46%	35.06%
Operating Income	**(892)**	**(101)**	**870**	**478**	**246**	**208**	**136**	**67**	**1**
Operating Margin	(11.9%)	(1.9%)	12.8%	7.5%	4.0%	3.5%	2.3%	1.2%	0.0%
EBITDA	**(480)**	**226**	**1,173**	**751**	**530**	**479**	**400**	**325**	**255**
Adj. EBITDA	**990**	**946**	**1,572**	**1,136**	**923**	**869**	**790**	**715**	**645**
Adj. EBITDA Margin	13.2%	17.5%	23.2%	17.9%	14.9%	14.5%	13.5%	12.5%	11.4%
Free Cash Flow									
EBITDA	-480	226	1173	751	530	479	400	325	255
CapEx	(225)	(127)	(169)	(164)	(256)	(194)	(188)	(184)	(180)
Interest Expense	(8)	(6)	(27)	(60)	(99)	(95)	(95)	(95)	(95)
Taxes	(2)	(34)	(197)	(79)	(31)	(61)	9	(6)	(20)
Change in Working Capital	(190)	298	(132)	(193)	(80)	(157)	(146)	(143)	(141)
Remaining FCF	**(905)**	**357**	**648**	**255**	**64**	**(28)**	**(21)**	**(103)**	**(181)**
Balance Sheet									
Cash	-	335	490	427	270	242	481	378	197
Long-Term Debt	-	-	978	1,271	1,120	1,116	1,372	1,368	1,364
Current Portion of Long-Term Debt	-	-	4	4	4	4	4	4	4
Long-Term Operating Leases			1,314	1,201	1,312	1,312	1,312	1,312	1,312
Net Debt	-	(335)	1,806	2,049	2,166	2,190	2,207	2,306	2,483
Credit Statistics									
Total Debt/EBITDA	0.0x	0.0x	2.0x	3.3x	4.6x	5.1x	6.7x	8.3x	10.5x
Total Debt/Adj. EBITDA	0.0x	0.0x	1.5x	2.2x	2.6x	2.8x	3.4x	3.8x	4.2x
Net Debt/EBITDA	0.0x	-1.5x	1.5x	2.7x	4.1x	4.6x	5.5x	7.1x	9.7x
Interest Coverage	-60.0x	37.7x	43.4x	12.5x	5.4x	5.0x	4.2x	3.4x	2.7x

Source:

Pro Forma Income Statement

Income Statement for Victoria Secret & Co.

Dollars in Millions

	2019A Feb-20 FY	2020A Jan-21 FY	2021A Jan-22 FY	2022A Jan-23 FY	2023A Feb-24 FY	2024E Jan-25 FY	2025E Jan-26 FY	2026E Jan-27 FY	2027E Jan-28 FY
Net Sales	$7,509.0	$5,413.0	$6,785.0	$6,344.0	$6,182.0	$6,138.7	$6,282.3	$6,457.8	$6,658.1
Total Revenue	$7,509.0	$5,413.0	$6,785.0	$6,344.0	$6,182.0	$6,138.7	$6,282.3	$6,457.8	$6,658.1
COGS Occupancy & Buying	5,446.0	3,842.0	4,025.0	4,086.0	3,940.0	3,859.3	3,911.8	3,982.4	4,065.9
Gross Profit	$2,063.0	$1,571.0	$2,760.0	$2,258.0	$2,242.0	$2,279.5	$2,370.5	$2,475.5	$2,592.2
Selling, General, Administrative	2,235.0	1,672.0	1,890.0	1,780.0	1,996.0	1,982.8	2,035.5	2,118.2	2,203.8
Other	720.0								
Operating Income	**($892.0)**	**($101.0)**	**$870.0**	**$478.0**	**$246.0**	**$296.7**	**$335.0**	**$357.3**	**$388.3**
Interest Expense	8.0	6.0	27.0	60.0	99.0	85.0	80.0	80.0	80.0
Other non-operating (income) / expense	(1.0)	(1.0)	0.0	1.0	0.0	(1.0)	0.0	0.0	0.0
Pretax income	(899.0)	(106.0)	843.0	417.0	147.0	212.7	255.0	277.3	308.3
Income taxes (benefit)	(2.0)	(34.0)	197.0	79.0	31.0	61.0	73.1	79.5	88.4
Net Income (loss) attr to NCI	0.0	0.0	0.0	(10.0)	7.0	1.0	0.0	0.0	0.0
Net income	**($897.0)**	**($72.0)**	**$646.0**	**$348.0**	**$109.0**	**$150.7**	**$181.9**	**$197.8**	**$219.9**
Diluted WA Shares		**93**	**90**	**84**	**79**	**79**	**79**	**79**	**79**
EPS		**($0.77)**	**$7.18**	**$4.14**	**$1.38**	**$1.91**	**$2.30**	**$2.50**	**$2.78**
EBIT	**($892.0)**	**($101.0)**	**$870.0**	**$478.0**	**$246.0**	**$296.7**	**$335.0**	**$357.3**	**$388.3**
EBITDA	($480.0)	$226.0	$1,173.0	$751.0	$530.0	$574.9	$618.8	$649.0	$689.1
Adj. EBITDA	$990.00	$946.00	$1,572.00	$1,136.00	$923.00	$967.93	$1,011.76	$1,041.96	$1,082.06
EBITDA Margin	*(6.4%)*	*4.2%*	*17.3%*	*11.8%*	*8.6%*	*9.4%*	*9.8%*	*10.0%*	*10.3%*
Adj. EBITDA Margin	*13.2%*	*17.5%*	*23.2%*	*17.9%*	*14.9%*	*15.8%*	*16.1%*	*16.1%*	*16.3%*

Source:

Pro Forma Balance Sheet

Balance Sheet for Victoria Secret & Co.

Dollars in Millions

	2020A Jan-21 FY	2021A Jan-22 FY	2022A Jan-23 FY	2023A Feb-24 FY	2024E Jan-25 FY	2025E Jan-26 FY	2026E Jan-27 FY	2027E Jan-28 FY
Cash and Cash Equivalents	335.0	490.0	427.0	270.0	$566.8	$531.8	$970.8	$1,358.3
Accounts Receivable, net	121.0	162.0	141.0	152.0	$149.3	$139.6	$143.5	$148.0
Inventories	701.0	949.0	1,052.0	985.0	$1,017.6	$978.0	$918.2	$937.4
Other Current Assets	82.0	90.0	117.0	126.0	142.0	142.0	142.0	142.0
Current Assets	$1,239.0	$1,691.0	$1,737.0	$1,533.0	$1,875.7	$1,791.4	$2,174.5	$2,585.7
PPE, Gross	3,792.0	3,795.0	3,716.0	3,616.0	3,670.9	3,859.4	4,053.1	4,252.8
- Accumulated Depreciation	2,714.0	2,838.0	2,870.0	2,773.0	2,917.9	3,201.6	3,493.3	3,794.0
Operating Lease Assets	1,590.0	1,369.0	1,232.0	1,351.0	1,420.0	1,412.0	1,412.0	1,412.0
Goodwill	0.0	0.0	365.0	367.0	367.0	367.0	367.0	367.0
Other Long-term Assets and intangibles	322.0	327.0	531.0	506.0	497.0	497.0	497.0	497.0
Total Assets	**$4,229.0**	**$4,344.0**	**$4,711.0**	**$4,600.0**	**$4,912.7**	**$4,725.1**	**$5,010.3**	**$5,320.5**
Accounts Payable	338.0	538.0	481.0	513.0	496.8	456.4	464.6	474.4
Accrued Expenses and Other	782.0	714.0	737.0	810.0	752.0	752.0	752.0	752.0
Current Debt	0.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Current Operating Lease Liabilities	421.0	340.0	310.0	267.0	257.0	257.0	257.0	257.0
Other	15.0	102.0	47.0	20.0	6.0	6.0	6.0	6.0
Total Current Liabilities	$1,556.0	$1,698.0	$1,579.0	$1,614.0	$1,515.8	$1,475.4	$1,483.6	$1,493.4
Long-term Debt	0.0	978.0	1,271.0	1,120.0	1,113.0	734.0	734.0	734.0
Long-term Operating Lease Liabilities	1,553.0	1,314.0	1,201.0	1,312.0	1,420.0	1,420.0	1,420.0	1,420.0
Other long-term liabilities	229.0	97.0	259.0	116.0	100.0	100.0	100.0	100.0
Total Liabilties	3,338.0	4,087.0	4,310.0	4,162.0	4,148.8	3,729.4	3,737.6	3,747.4
Paid-in Capital	887.0	126.0	196.0	239.0	266.0	266.0	266.0	266.0
Retained Earnings	0.0	126.0	186.0	178.0	475.9	707.8	984.7	1,285.1
Other	4.0	5.0	19.0	21.0	22.0	22.0	22.0	22.0
Total Equity	$891.0	$257.0	$401.0	$438.0	$763.9	$995.8	$1,272.7	$1,573.1
Total Liabilities and Equity:	**$4,229.0**	**$4,344.0**	**$4,711.0**	**$4,600.0**	**$4,912.7**	**$4,725.1**	**$5,010.3**	**$5,320.5**

Source:

Pro Forma Cash Flow Statement

Kenan-Flagler Business School
ALPHA CHALLENGE
The University of North Carolina

Cash Flow Statement for Victoria Secret & Co.

Dollars in Millions

	2019A Feb-20 FY	2020A Jan-21 FY	2021A Jan-22 FY	2022A Jan-23 FY	2023A Feb-24 FY	2024A Jan-25 FY	2025E Jan-26 FY	2026E Jan-27 FY	2027E Jan-28 FY
Operating Activities									
Net Income	(897.0)	(72.0)	646.0	338.0	116.0	$151.7	$181.9	$218.9	$242.4
Depreciation and Amortization of Assets	411.0	326.0	303.0	274.0	284.0	277.3	283.7	291.7	300.7
Stock Based Compensation	38.0	25.0	33.0	48.0	56.0	58.0	58.0	58.0	58.0
(Increase) / decrease in working capital	(190.0)	298.0	(132.0)	(193.0)	(80.0)	(157.1)	8.9	64.1	(14.0)
Accounts Receivable	14.0	36.0	(21.0)	22.0	(13.0)	2.7	9.7	(3.9)	(4.5)
Inventories	20.0	141.0	(247.0)	2.0	36.0	(32.6)	39.6	59.8	(19.3)
Accounts Payables, Accrued Expenses, other	(118.0)	49.0	173.0	(163.0)	(11.0)	(77.2)	(40.4)	8.2	9.7
Income Taxes Payable	(49.0)	(25.0)	119.0	(67.0)	(26.0)	(24.0)	0.0	0.0	0.0
Other Assets and Liabilities	(57.0)	97.0	(156.0)	13.0	(66.0)	(26.0)	0.0	0.0	0.0
Other non cash adjustments	953.0	97.0	1.0	(28.0)	13.0	0.0	0.0	0.0	0.0
Cash Flow from Operating Activities	$315.0	$674.0	$851.0	$439.0	$389.0	$329.8	$532.5	$632.7	$587.2
Free Cash Flow	$90.0	$547.0	$682.0	$275.0	$133.0	$135.9	$344.1	$439.0	$387.4
Investing Activities									
Capital Expenditures	(225.0)	(127.0)	(169.0)	(164.0)	(256.0)	(193.9)	(188.5)	(193.7)	(199.7)
Acquisition, Net Cash	0.0	0.0	0.0	(369.0)	1.0	0.0	0.0	0.0	0.0
Other investing activities	(18.0)	4.0	0.0	(22.0)	1.0	0.0	0.0	0.0	0.0
Cash Flow from Investing Activities	($243.0)	($123.0)	($169.0)	($555.0)	($254.0)	($193.9)	($188.5)	($193.7)	($199.7)
Financing Activities									
Issuance (Repayment) of LT Debt	5.0	(58.0)	981.0	291.0	(154.0)	(4.0)	(379.0)	0.0	0.0
Dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Share Repurchase	0.0	0.0	(250.0)	(250.0)	(125.0)	0.0	0.0	0.0	0.0
Stock Issuances	0.0	0.0	0.0	5.0	3.0	0.0	0.0	0.0	0.0
Other financing activities	(197.0)	(407.0)	(1,258.0)	12.0	(15.0)	0.0	0.0	0.0	0.0
Cash Flow from Financing Activities	($192.0)	($465.0)	($527.0)	$58.0	($291.0)	($4.0)	($379.0)	$0.0	$0.0
Exchange rate impact	(4.0)	4.0	0.0	(3.0)	(1.0)	0.0	0.0	0.0	0.0
Net change in cash	(124.0)	90.0	155.0	(61.0)	(157.0)	131.9	(34.9)	439.0	387.4
Beginning cash balance	369.0	245.0	335.0	490.0	429.0	434.9	566.8	531.8	970.8
Ending cash balance	245.0	335.0	490.0	429.0	272.0	566.8	531.8	970.8	1,358.3

Source:

Indenture Key Provisions

Term	Description
Notes	4.625% Bonds due 07/15/2029
Issuer	Victoria's Secret & Co.
Principal Amount	$600,000,000
Coupon Rate	4.625% paid semi-annual
Maturity Date	July 15, 2029
Covenants	1. Negative Pledge 2. Change of Control (@ 101.00) 3. Limit of Indebtedness 4. Cross Default 5. Negative Covenant 6. Certain Sale of Assets 7. Restriction on Activities 8. Restrictive Covenant 9. Merger Restrictions 10. Limitation on Subsidiary Debt 11. Restricted Payments
Events of Default	▪ Percentage of Bondholders ▪ Litigation ▪ 30 days Grace Period for Missed Payments

Source: Company filings

Bond Holders

Holder Name	Portfolio Name	Source	Opt	Position	% Out	Latest Chg	File Dt
		All	All				
1. Allianz SE		ULT-AGG		53,357	8.89	69	11/14/24
2. Lord Abbett & Co LLC	Multiple Portfolios	MF-AGG		29,125	4.85	-2,804	08/31/24
3. Blackrock Inc		ULT-AGG		22,504	3.75	1,606	11/15/24
4. St James's Place PLC		ULT-AGG		19,000	3.17	19,000	03/31/24
5. State of Wisconsin Investment Board		Research		18,920	3.15	12,420	09/30/22
6. American Beacon Advisors Inc	Multiple Portfolios	MF-AGG		18,108	3.02	0	09/30/24
7. State Street Corp		ULT-AGG		14,383	2.40	-14	11/15/24
8. SEI Investments Co		ULT-AGG		11,170	1.86	293	10/31/24
9. Invesco Ltd		ULT-AGG		11,074	1.85	7,634	11/15/24
10. Nordea Bank Abp		ULT-AGG		8,352	1.39	-195	09/30/24
11. Chubb Ltd		ULT-AGG		7,988	1.33	1,000	06/30/24
12. Nationwide Life and Annuity Insurance Co	Multiple Portfolios	Sch-D		7,063	1.18	3,106	06/30/24
13. Nationwide Life Insurance Co	Multiple Portfolios	Sch-D		6,707	1.12	2,394	06/30/24
14. Banca Mediolanum SpA		ULT-AGG		6,430	1.07	1,215	06/28/24
15. FIL Ltd		ULT-AGG		5,761	0.96	16	11/14/24
16. Thrivent Financial for Lutherans	Multiple Portfolios	MF-AGG		5,663	0.94	0	07/31/24
17. Northern Trust Corp	Multiple Portfolios	MF-AGG		5,544	0.92	0	10/31/24
18. FMR LLC		ULT-AGG		5,021	0.84	-1,027	09/30/24
19. Voya Investment Management LLC	Multiple Portfolios	MF-AGG		4,880	0.81	4,880	09/30/24
20. Candoris ICAV	Multiple Portfolios	MF-AGG		4,800	0.80	-4,200	09/30/24
21. Impax Asset Management Group PLC	Multiple Portfolios	MF-AGG		4,125	0.69	0	09/30/24
22. Touchstone Advisors Inc	Multiple Portfolios	MF-AGG		3,940	0.66	550	09/30/24
23. ARES MANAGEMENT CORP		ULT-AGG		3,904	0.65	0	09/30/24
24. Nordea Asset Management Holding AB	Multiple Portfolios	MF-AGG		3,250	0.54	1,300	09/30/24
25. Bayerische Landesbank	Multiple Portfolios	MF-AGG		2,955	0.49	22	09/30/24
26. Nationwide Mutual Insurance Co	Multiple Portfolios	Sch-D		2,800	0.47	800	06/30/24
27. Brigade Capital Management LP	Multiple Portfolios	MF-AGG		2,570	0.43	0	09/30/24
28. Bank of New York Mellon Corp/The		ULT-AGG		2,189	0.36	451	11/14/24
29. Goldman Sachs Group Inc/The		ULT-AGG		2,174	0.36	-7,390	07/31/24
30. Advent Capital Management LLC	Multiple Portfolios	MF-AGG		2,169	0.36	0	07/31/24

Source:

Equity Holders

#	Holder Name	Portfolio Name	Source	Opt	Position	% Out	Latest Chg	File Dt
			All	All				
1.	Blackrock Inc		13G		12,779,927	16.27	0	09/30/24
2.	Vanguard Group Inc/The		ULT-AGG		8,868,908	11.29	-22,090	09/30/24
3.	Bbrc International Pte Ltd		Form 4		7,763,409	9.89	-355,395	02/02/23
4.	WindAcre Partnership LLC/The		13G		5,588,190	7.12	-818,610	12/31/23
5.	State Street Corp		ULT-AGG		3,231,794	4.12	-58,028	09/30/24
6.	Ameriprise Financial Inc		ULT-AGG		2,203,209	2.81	602,447	09/30/24
7.	Arrowstreet Capital LP	Arrowstreet Capital LP	13F		1,919,132	2.44	49,527	09/30/24
8.	Fuller & Thaler Asset Management Inc	Fuller & Thaler Asset Management Inc	13F		1,878,481	2.39	284,838	09/30/24
9.	Geode Capital Management LLC	Geode Capital Management LLC	13F		1,794,221	2.28	24,967	09/30/24
10.	PRIMECAP Management Co	PRIMECAP Management Co	13F		1,771,616	2.26	-15,757	09/30/24
11.	Hood River Capital Management LLC	Hood River Capital Management LLC	13F		1,735,948	2.21	1,735,948	09/30/24
12.	Victory Capital Management Inc	Victory Capital Management Inc	13F		1,713,389	2.18	-144,761	09/30/24
13.	T Rowe Price Group Inc		ULT-AGG		1,632,853	2.08	104,191	09/30/24
14.	Charles Schwab Corp/The		ULT-AGG		1,608,466	2.05	76,858	09/30/24
15.	Forest Avenue Capital Management LP	Forest Avenue Capital Management LP	13F		1,589,936	2.02	1,589,936	09/30/24
16.	Goldman Sachs Group Inc/The		ULT-AGG		1,511,874	1.93	1,052,318	09/30/24
17.	Cramer Rosenthal McGlynn LLC	Cramer Rosenthal McGlynn LLC	13F		1,313,256	1.67	675,291	09/30/24
18.	DE Shaw & Co LP		ULT-AGG		1,274,487	1.62	17,605	09/30/24
19.	Dimensional Fund Advisors LP	Dimensional Fund Advisors LP	13F		1,181,065	1.50	264,048	09/30/24
20.	FMR LLC		13G		1,120,428	1.43	-3,938,356	06/28/24
21.	Roxbury Capital Management LLC	Multiple Portfolios	MF-AGG		1,075,229	1.37	1,075,229	11/13/24
22.	Schonfeld Strategic Advisors LLC	Schonfeld Strategic Advisors LLC	13F		907,596	1.16	907,596	09/30/24
23.	Northern Trust Corp	Northern Trust Corp	13F		813,545	1.04	319,548	09/30/24
24.	Balyasny Asset Management LP	Balyasny Asset Management LP	13F		790,044	1.01	-740,772	09/30/24
25.	Two Sigma Investments LP		ULT-AGG		784,628	1.00	96,467	09/30/24
26.	Renaissance Technologies LLC	Renaissance Technologies LLC	13F		760,200	0.97	619,500	09/30/24
27.	Citadel Advisors LLC	Citadel Advisors LLC	13F		657,854	0.84	-899,975	09/30/24
28.	Broad Bay Capital Management LP	Broad Bay Capital Management LP	13F		654,434	0.83	139,434	09/30/24
29.	Morgan Stanley		13G		619,484	0.79	-4,400,090	05/31/24
30.	Franklin Resources Inc		ULT-AGG		570,549	0.73	-68,861	09/30/24
31.	Bank of New York Mellon Corp/The		ULT-AGG		568,588	0.72	-83,851	09/30/24
32.	Invesco Ltd		ULT-AGG		548,657	0.70	-84,191	09/30/24
33.	Bank of America Corp	Bank of America Corp	13F		469,292	0.60	83,495	09/30/24
34.	Waters Martin		Form 4		460,151	0.59	34,217	03/20/24
35.	Walleye Capital LLC	Walleye Capital LLC	13F		405,077	0.52	-70,082	09/30/24
36.	Gotham Asset Management LLC	Gotham Asset Management LLC	13F		373,017	0.48	-70,689	09/30/24
37.	Principal Financial Group Inc	Principal Financial Group Inc	13F		369,510	0.47	-17,367	09/30/24
38.	MARSHALL WACE		ULT-AGG		336,504	0.43	-281,691	09/30/24
39.	Prisma Asset Management SGIIC SA	Multiple Portfolios	MF-AGG		328,226	0.42	51,521	07/31/24
40.	JPMorgan Chase & Co	JPMorgan Chase & Co	13F		314,767	0.40	-97,396	09/30/24
41.	Tudor Investment Corp	Tudor Investment Corp	13F		310,795	0.40	220,885	09/30/24

Source:

Bond Liquidity & Callable Info

Bond Liquidity

Trade Recap for 11/21							
17:18:58	B	628	89.893	7.222	291.7	T 4 1/8	10/31/29
14:44:35	B	25	89.860	7.231	292.8	T 4 1/8	10/31/29
09:22:57	D	500	89.997	7.193	291.7	T 4 1/8	10/31/29
09:22:57	S	500	90.027	7.185	290.9	T 4 1/8	10/31/29
09:19:17	B	9	89.909	7.217	294.3	T 4 1/8	10/31/29
Trade Recap for 11/20							
16:40:34	B	1000+	89.750	7.259	297.6	T 4 1/8	10/31/29
16:40:34	B	1000	89.750	N.A.	N.A.		
15:06:54	D	10	90.209	7.134	285.3	T 4 1/8	10/31/29
15:06:54	S	10	90.271	7.117	283.6	T 4 1/8	10/31/29
15:00:38	B	1000+	90.000	7.191	291.9	T 4 1/8	10/31/29
Trade Recap for 11/19							
17:08:02	S	5	90.096	7.163	290.0	T 4 1/8	10/31/29
13:29:31	B	62	90.222	7.129	288.0	T 4 1/8	10/31/29
11:29:36	S	29	90.222	7.129	287.8	T 4 1/8	10/31/29
10:13:13	S	200	90.119	7.157	291.1	T 4 1/8	10/31/29
10:13:13	D	200	90.089	7.165	292.0	T 4 1/8	10/31/29

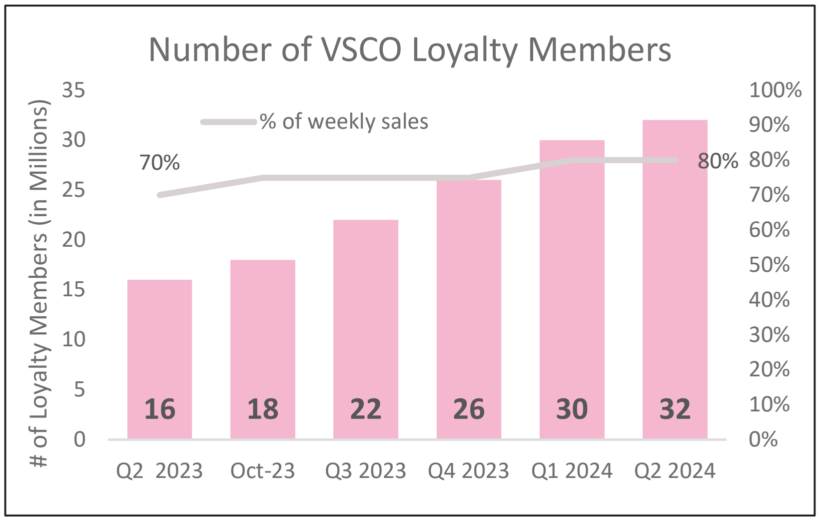
Bond Callable Info

YTC	Date	Price	Yield
Maturity	07/15/2029	100.00	7.243895
Custom	07/15/2029	100.00	7.243895
Next Call	12/23/2024	102.313	180.499584
Worst Call	07/15/2029	100.00	7.243895

May be called anytime starting 07/15/2024

Source:

VS Loyalty Program



Loyalty members doubled in 1- year…
and drive 70-80% of weekly sales

Source: Company filings

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Management

Hillary Super, CEO
Previously CEO of Savage X Fenty (Private Intimates Co.) & Anthropologie Group (Urban Outfitters Subsidiary)

Melinda McAfee, CHO/CLO
Joined VSCO in 2021
ex-EXPRESS General Counsel & In-House Counsel for Abercrombie & Fitch

Tim Johnson, CFO
Joined VSCO in 2021
Previously CFO and CAO of Big Lots

Dein Boyle, COO
Joined VSCO in 2020
Previously COO of PINK

Source:

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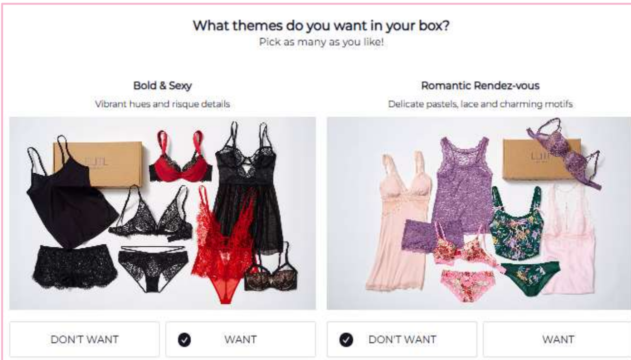
Adore Me Elite Boxes/DailyLook: Customers Preference Data

Subscriptions style boxes like Adore Me Elite Boxes provide recurring revenue, but also provide a lot of information on consumer preferences on color, style, sizes, patterns, etc.

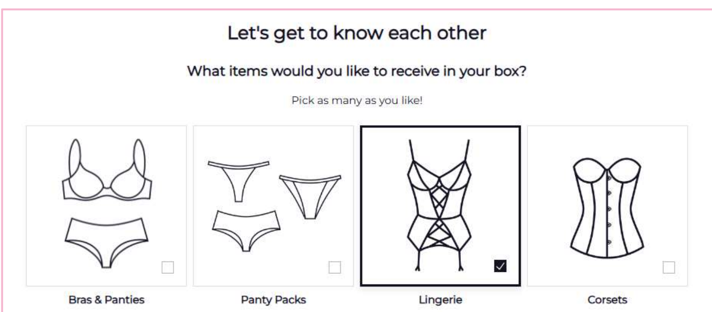
Elite Boxes (like Home Chef)

Curated Boxes



Price Sensitivity

Style Preferences



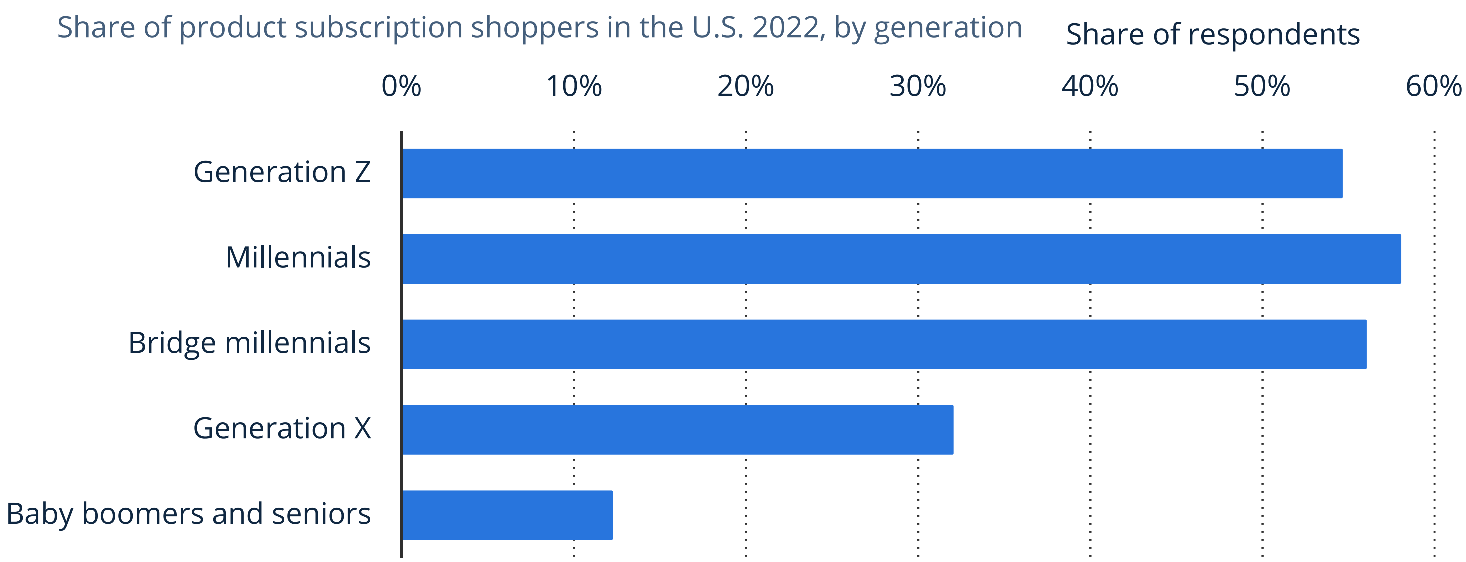
Daily Look (like Stich Fix)
Customers provide:

- Instagram/Pinterest/Facebook handles
- Style/Color/Size preferences
- Primary occupation information
- Whether or not they are a Mother
- Whether they shop at competing stores

Source: Team Research

Popularity of subscription services in the U.S. (a/o 2022)

Share of consumers receiving deliveries from an online subscription service in the United States as of April 2022, by generational cohort



Description: As of April 2022, Millennials in the United States were the most likely generational cohort to receive deliveries due to signing up for an online subscription service (58 percent). Bridge millennial consumers followed, with 56 perce deliveries as a result of an online subscription.
Note(s): United States; April 8th to 18th, 2022; 2,658 respondents
Source(s): PYMNTS

Source:

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The University of North Carolina

November 24th, 2024

Students: Karn Dalal, Fenghua Lu, Stephen Monrad

Investment Recommendation:
Buy PENN 4 1/8 Senior Unsecured at $90.475 (6.64%)

Investment Summary

- Tranche Size: $400M
- Moody's: B3; S&P: B-
- Target Spread: 161bps; Expected 1-Year Total Return: ~10% (6.6pp YTW + 3.5pp price appreciation from ~75bps spread compression)

Why the opportunity exists?

- Penn Entertainment is trading wide to peers because it recently started ESPN BET, an online sports betting business (OSB) that is currently pre-profit. Sales & Marketing investments in the online business run through operating expenses and therefore depress earnings, arguably creating an accounting distortion.

Investment Thesis

- The online business has strong drivers to gain market share and margins should inflect in the near-term
- Penn has the option to terminate their ESPN BET agreement early at the end of 2026, the three-year mark for the partnership, capping potential losses
- Casino regulation necessitates participation from land-based operators, positioning PENN well for OSB expansion
- PENN's land-based casino business is GFC-tested and more stable than peers
- Corporate governance and financial policy have been creditor-friendly

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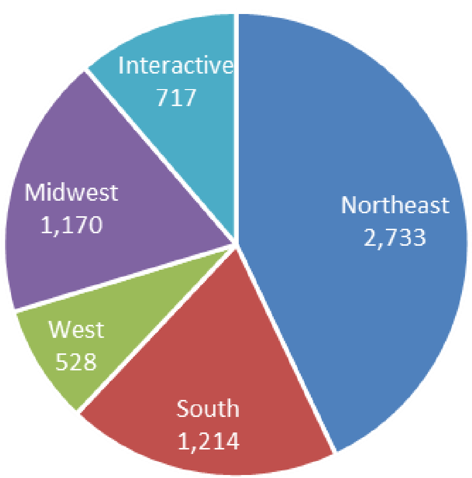
Penn Entertainment

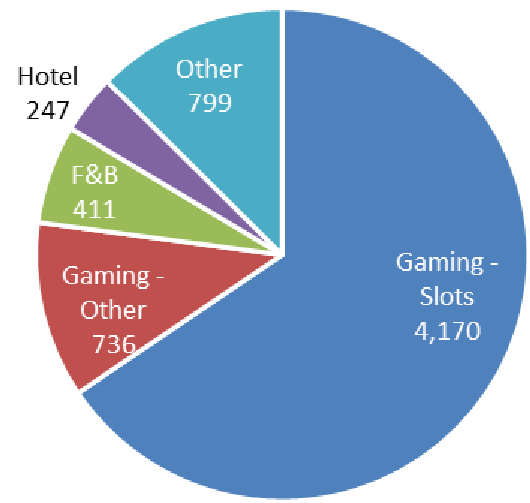
PENN Entertainment Background

- Penn Entertainment is the fourth largest casino operator in the world based on revenue, operating 43 properties in 20 states.
- Penn generated $6.30bn in revenue and $1,181mn in LTM EBITDAR , leaving leverage at 9.3x.
- The enterprise value is $14.1B, with 11B of debt and $3.1B of market capitalization.
- The company assigned a new CEO, Jay Snowden in 2020. He led Penn's acquisition of Barstool Sports, its subsequent sale, and established the ESPN BET partnership in November 2023.

FY23 Revenue by Segment ($mm)



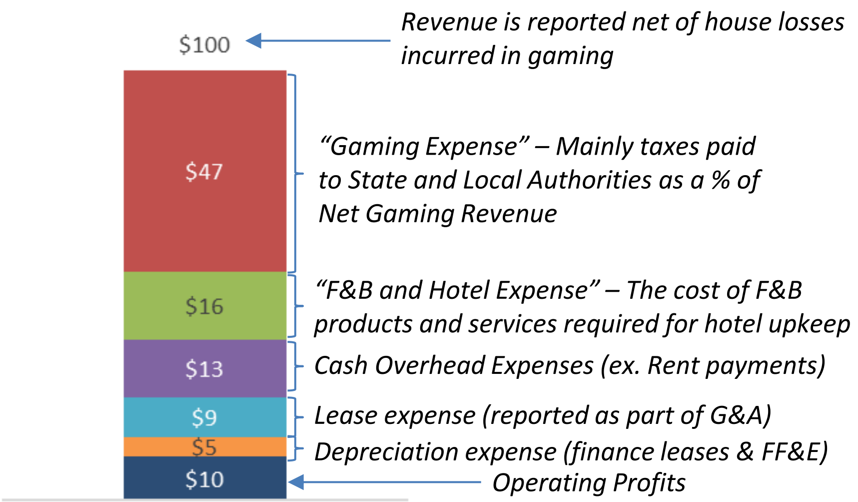
FY23 Revenue by Source ($mm)

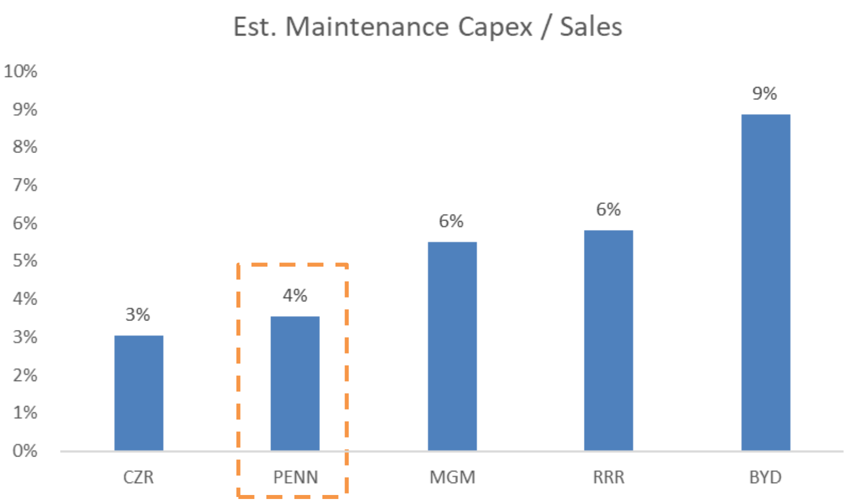


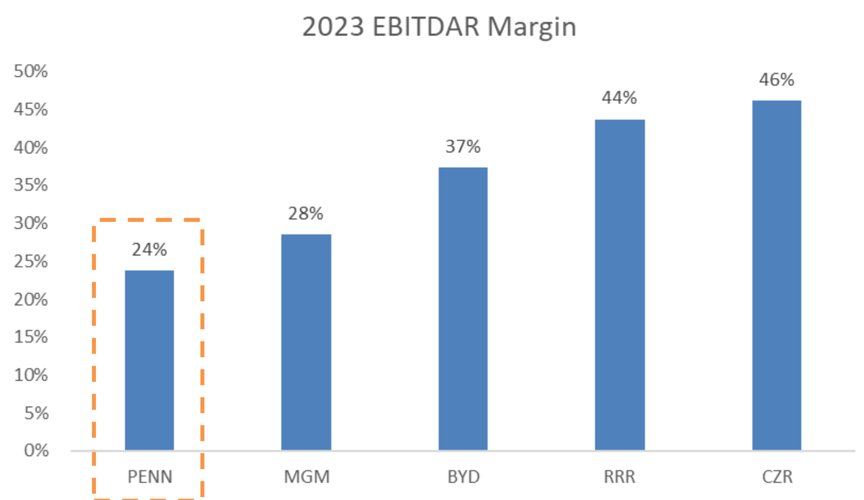
Note: Segment Revenue and EBITDAR breakdowns proportionately allocate eliminations and other expenses.

Consumer Gaming Spend Displays Modest Cyclicality and GDP Growth; Operators Experience Moderate Operating Leverage, Modest Capex Requirements, and Varying Margins

Breakdown of $100 of Revenue for PENN







Note: Maintenance Capex / Sales based on 2024E estimates for PENN and CZR, capex ex. China for MGM, capex ex. Corporate for BYD, and RRR investment presentation. Data from company filings, FRED.

Capital Structure

Instrument	Principal	Rate	Maturity Date	Price	YTW	OAS/Spread (bps)	Ratings
Amended Revolving Credit Facility Due 2027	-	TSFR + 2.00%	5/3/2027			200	Ba3/BB-
Amended Term Loan A Facility Due 2027	488	TSFR + 2.00%	5/3/2027	98.50	8.0	200	Ba3/BB-
Amended Term Loan B Facility Due 2029	978	TSFR + 2.75%	5/3/2029	100.25	7.4	275	Ba3/BB-
Finance Leases	2,128	5.2%	-				
Operating Leases	4,026	7.7%	-				
Financing Obligation	2,397	-	-				
Other Long-Term Obligations	198	3.0%	-				
Total Secured Debt and Leases	10,215						
2.75% Convertible Notes Due 2026	331	2.8%	3/15/2026	108.28	NM	NM	B3/B
4.125% Notes Due 2029	400	4.1%	7/1/2029	90.12	6.6	302	B3/B
5.625% Notes Due 2027	400	5.6%	1/15/2027	98.34	6.4	268	B3/B
Total Debt	11,345						
Cash	(834)						
TTM EBITDAR	1,084						
Gross Secured Leverage	9.4x						
Net Secured Leverage	8.7x						
Gross Unsecured Leverage	10.5x						
Net Unsecured Leverage	9.7x						

TTM EBITDA Expenses $723mm of losses in the pre-profit Interactive Segment; Adjusting for those losses results in EBITDAR of $1,808mm, and ***net unsecured leverage of 5.8x***

Note: Data from Company Filings, Bloomberg

Investment Thesis

Thesis Point #1: ESPN BET is Poised to Gain Market Share and Sees Tailwind from De-regulation

Significant user acquisition powered by ESPN’s brand name

- In November 2023, PENN launched its partnership with ESPN to commercialize ESPN BET.
  - PENN gets an exclusive partnership with ESPN
  - 10-year term subject to early termination rights in year 3
  - PENN Sportsbook embedded in ESPN content and programming; ESPN receives warrants on PENN common stock and $150mm annual fee

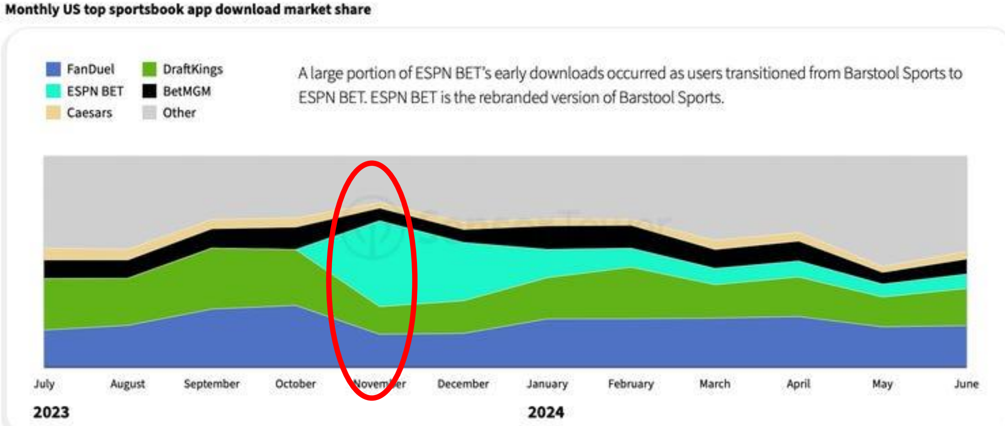
Revenue expansion supported by de-regulation

- ESPN BET currently operates in 19 out of the 38 states where online sports betting is legal, providing room for both in-state and new state expansion.
- New York was approved in September 2024, the 4th highest US State in gambling revenue. Missouri is close to approve sports betting legalization.
- Online Sports Betting will enjoy a higher operating leverage than land-based casinos. With technology and ESPN contract in place, geographical expansion will enable PENN to gain substantial EBITDA upside.

ESPN BET disrupted US sportsbook app market downloads in November 2023.

ESPN BET set a record for most US sportsbook downloads in a month in November 2023.

Monthly US top sportsbook app download market share



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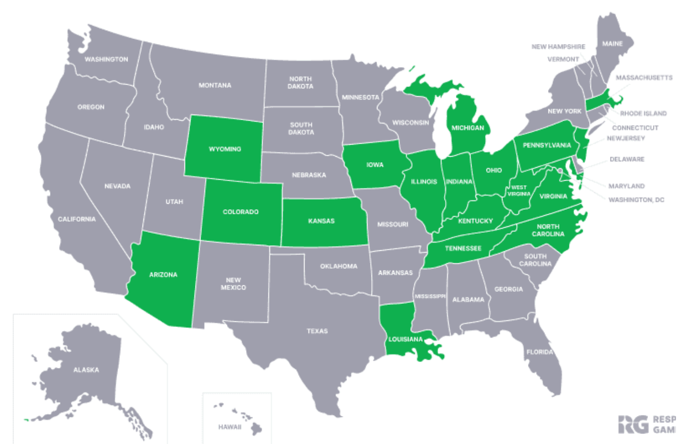
ESPN BET footprint



Thesis Point #2: Interactive Losses are Poised to Inflect in Near Term

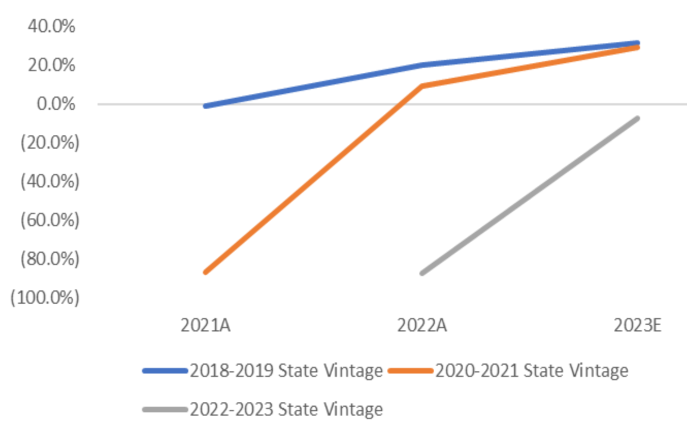
ESPN's reputation and direct accounting linking will allow moderation of sales and marketing (S&M) costs for Penn faster than peer OSBs:

- Draftkings's (NASDAQ: DKNG) early customer vintages turn profitable even without the brand name of ESPN, implying a low dependence on ongoing S&M expense to retain customers in the business.
  - S&M has declined meaningfully for DraftKings since the inception of its online sports betting business in 2017.

What if promotional costs stay "higher-for-longer"…

- Penn may choose to terminate ESPN BET at the end of 2026 if losses persist
- Given on management's revenue and EBITDA guidance for 2024, we extrapolate a customer acquisition cost of $5 per $1 of new revenue under conservative assumptions. With this punitive assumption, Penn's long-term leverage would return to 5x after early termination.

DKNG Customer Contribution Margin by Vintage



DKNG Customer Acquisition Cost Estimates

	S&M Expense per $New Revenue		As% of 2019
2018	$	4.23	222%
2019	$	1.91	100%
2020	$	1.70	89%
2021	$	1.44	75%
2022	$	1.26	66%
2023	$	0.84	44%

Note: From Draftkings 2023 September Investor Presentation

Thesis Point #3: PENN offers Stable Performance/Downside Protection

Downturn Performance:
- PENN's revenue was resilient throughout the Great Financial Crisis falling only 2.8% from 2007 to 2009
- 95% of its locations are regional rather than destination (most resilient in recession)

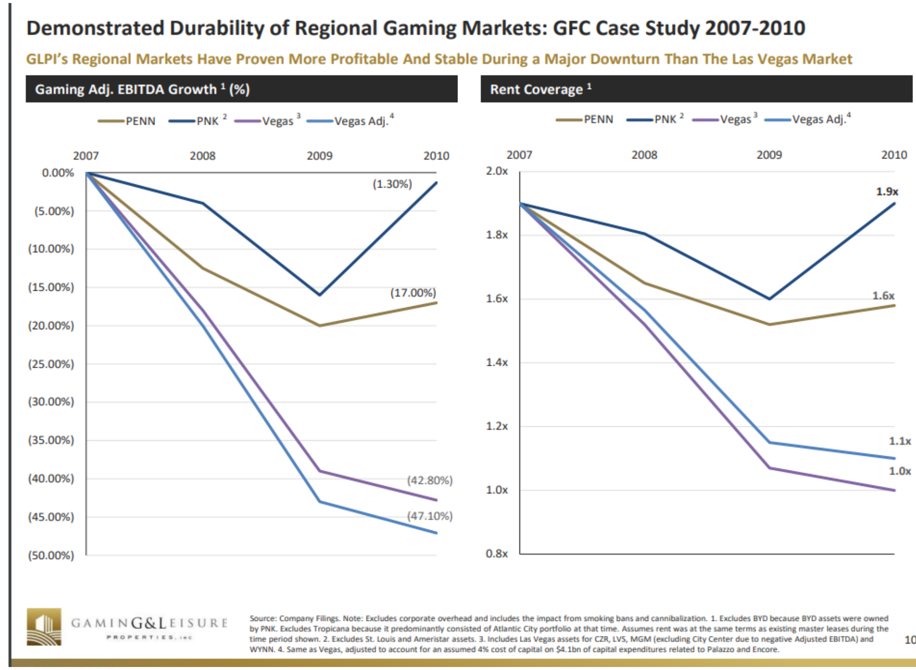
Highly Dependent Consumers:
- Gambling is one of the most addictive activities due to profound psychological effects on the Reward System including instant gratification, intermittent reinforcement, and compulsion.

Hard Assets:
- PENN current has ~$3.6B of PP&E on the balance sheet – carried at historical cost so this could be higher

Liquidity:
- PENN has a robust liquidity position of $1.81B including $834M of cash and $979M of untapped revolver

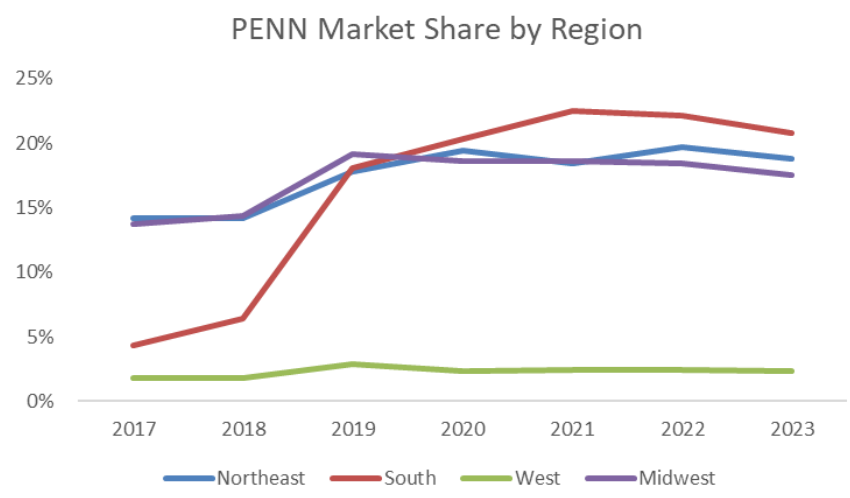
Geographically Diversified:
- Penn operates across 20 states limiting regulatory or catastrophic risk

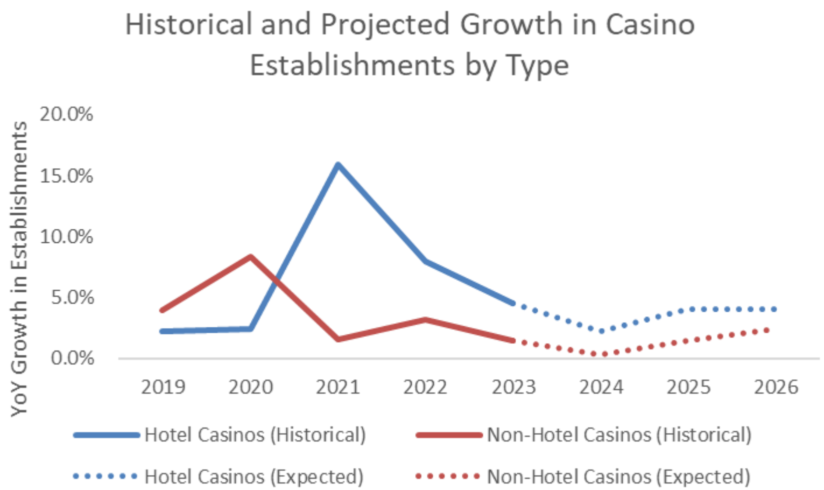
No Customer Concentration:
- They have over 31 million members signed up in the customer loyalty program

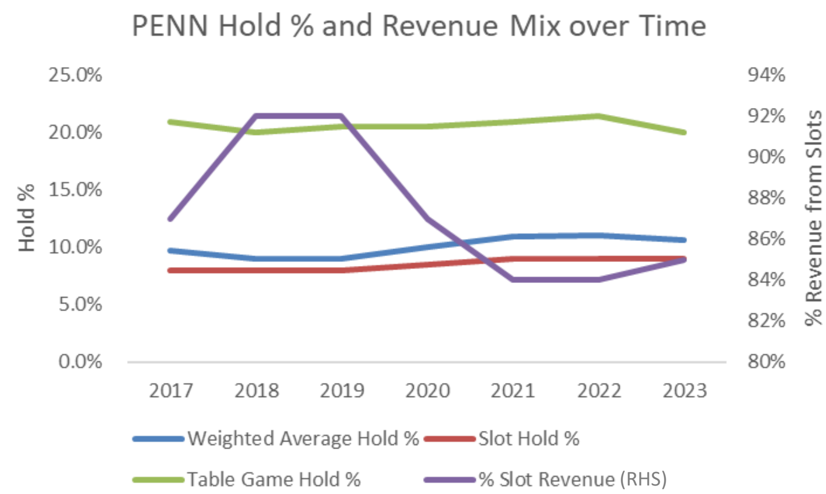


Thesis Point #4: PENN Maintains a Strong and Profitable Land-based Business; Supply Additions Going Forward are Expected to be Modest

- PENN's market shares in land-based casinos have been stable across key reported regions. State Gross Gaming Revenues are adjusted to remove iGaming and sports betting.
- Hold rates have been essentially constant in the last five years, signaling a strong market position and sustained profitability.
- Future supply additions are expected to be limited, further supporting the profitability of the business.







Note: Market size data from American Gaming Association, Casino establishment count history and projects from IBISWorld, PENN gaming revenues, hold % and revenue mix from company filings. Market share calculations exclude estimated iGaming and sports betting revenues from definition of market size, based on AGA disclosures.

Thesis Point #5: Built-in Checks-and-Balances from Debt Covenants and the Corporate Governance Setup will Govern Penn's Investment Decisions.

Terms of Credit Agreement Amendment Required Moderate Financial Policy

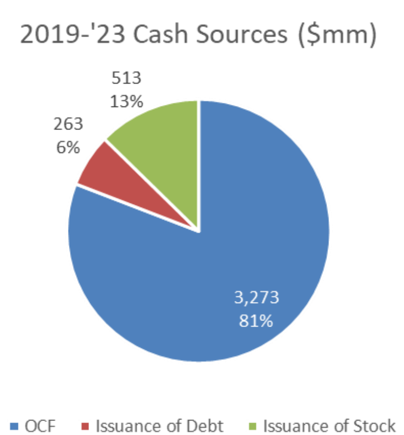
- The Debt/EBITDAR ratio used in PENN's maintenance covenant permits the company to add back losses in the Interactive Segment, but requires that share repurchases be paused.

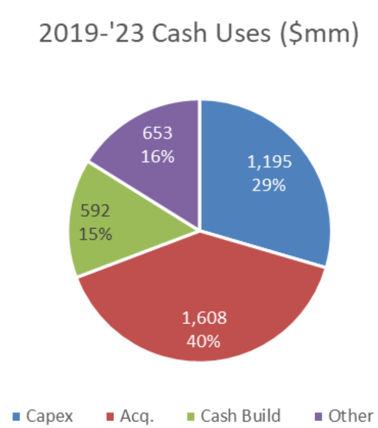
Alignment of interest between Board of Directors and creditors

- Two members of the Board of Directors are shareholders to Gaming & Leisure Properties (GLPI), Penn's largest lessor for the land-based casino business.
- Peter M Carlino, Penn Entertainment's founder, Chairman Emeritus of the Board and shareholder (~4%), is the current CEO of GLPI.

Responsible track record of capital allocation policies during organic and inorganic investments

- The company paused share buybacks when it began investing in Interactive.
- Considerations for the acquisitions of Pinnacle Entertainment (2018) and theScore (2021) included equity issuances, resulting in 72% and 43% LTVs
- PENN was a net issuer of shares during Covid, driven by significant issuance in May of 2020 despite a depressed equity valuation at the time





Board of Directors

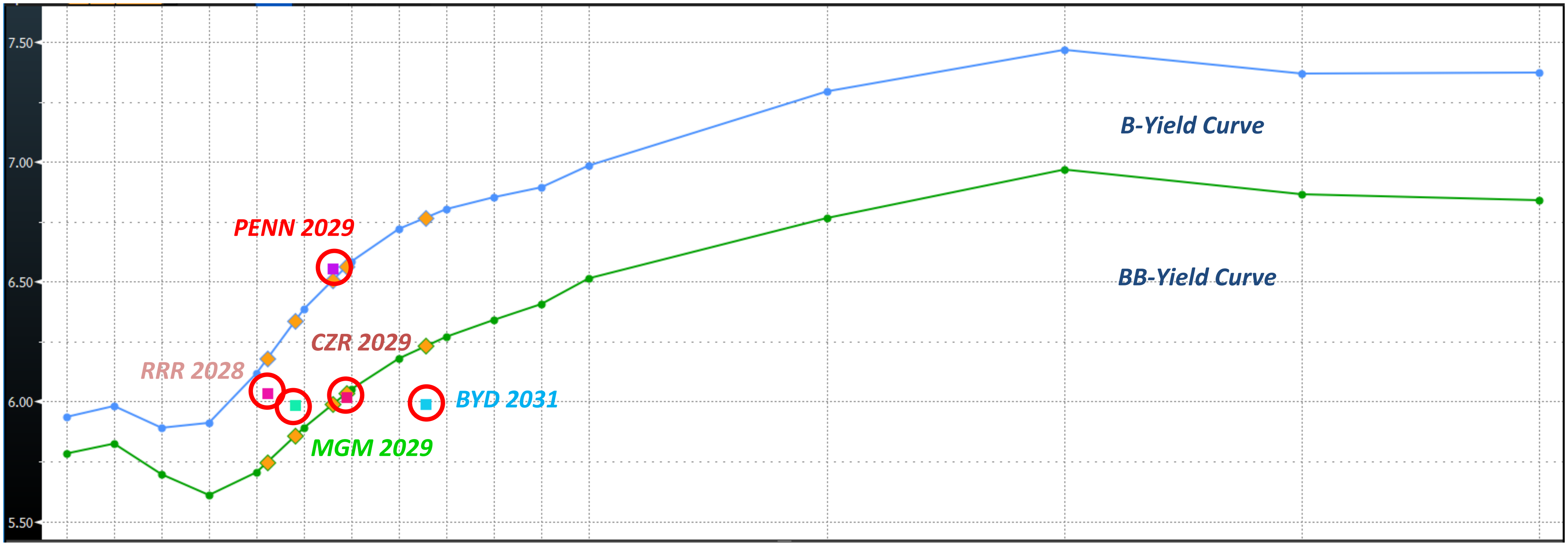
	Independent	GLPI Connection
Vimla Black-Gupta	Yes	
Anuj Dhanda	Yes	
David Handler	Yes	Shareholder
Marla Kaplowitz	Yes	
Ronald Naples	Yes	
Saul Reibstein	Yes	Former Executive
Jane Scaccetti	Yes	
Jay Snowden	No	
Barbara Shattuck Kohn	Yes	

Valuation

Valuation and Relative Value

- PENN 2029s trade wide to curve and peers, suggesting opportunity for price improvement as investments from the Interactive segment moderates.

						Leverage		Concentration		
Ticker	Principal ($mm)	S&P	Coupon	Maturity	Ask Yield	Total Leverage	Net Leverage	Hotel, Food & Beverage	Las Vegas	Regional
PENN	400	B-	4.125%	7/1/2029	6.64%	10.5x	9.7x	23%	5%	95%
MGM	750	BB-	4.750%	10/15/2028	5.72%	7.1x	6.5x	50%	50%	39%
CZR	1,200	B-	4.625%	10/15/2029	6.04%	6.4x	6.2x	45%	17%	83%
RRR	500	B	4.625%	12/1/2031	6.36%	4.7x	4.6x	34%	100%	0%
BYD	1,000	BB	4.750%	12/1/2027	5.53%	2.9x	2.7x	30%	39%	61%



Note: Data from Bloomberg

Capital-Light Operating Model Limits Liquidation Value but Enables Strong FCF Conversion Ratio

Liquidation Analysis

	Reported	(Disc.) / Prem.	Liq. Value	Notes
Cash and Eq.	878	0%	878	
Receivables	252	(40%)	151	
Other Current Assets	203	0%	203	
PP&E	3,498	(65%)	1,224	
JVs	87	472%	495	15x JV Div.
Intangibles and Other	10,621	(100%)	0	
Total Assets	15,538		2,951	
Working Liabilities	1,480		1,480	
Net Assets to Secured	14,058		1,472	
Gross Secured Debt	10,215		10,215	
Recovery	***100%***		***14%***	
Net Assets to Unsecured	3,844		0	
Gross Unsecured Debt	1,131		1,131	
Recovery	***100%***		***0%***	

Covenants:

- Unlimited RP subject to 4x net leverage test; RP basket builds with 50% net income and is subject to 2x FCCR test; General RP not to exceed greater of $500mm and 50% of cash flow
- Incurrence of debt subject to 2x FCCR test; exceptions for credit facility debt permitted up to greater of $3.05b and 3x secured leverage, $375mm of purchase money indebtedness, foreign subsidiary indebtedness of $250mm, and $250mm of development debt
- Asset sales >$250mm require cash consideration and application of proceeds to debt paydown or investment
- Company does not pay a dividend, though has done repurchases and acquisitions

Risks & Mitigants

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Risk	Mitigant
Elevated Leverage:	First material maturity is in 2026; funded debt is minimal, lease agreements are long-dated (~10 year terms); regional gambling spend is cyclically insensitive
Heavy Sports Betting Competition:	Low-Switching costs allows ESPN Bet to attract users from competitors; The sports betting market continues to grow faster amid higher-than expected sports wagers for NFL season; growing share
Highly Regulated Industry:	Legalization of sports betting is at 38 states and growing with Missouri coming up in November; ESPN Bet continues to win licenses to operate in new states (NY)
Macroeconomic Weakness:	Although gambling is consumer discretionary it is far more addictive than other consumer discretionary purchases. Gambling spend is modest for the typical PENN customer (regional, drive-to casinos). Revenue barely declined in the GFC.
Significant Losses in Interactive Segment	PENN and ESPN can both terminate at the 3 year mark if market share does not take-off as anticipated
Aggressive Capital Allocation	Historical capital allocation has often included equity checks; PENN has limited repurchase ability until covenant waiver period ends

Summary Outputs

PENN Base Case Financial Summary

	2023	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Revenue	6,363	6,648	7,377	8,235	8,967	9,772	10,508	10,860
EBITDAR	1,513	1,341	1,607	1,924	2,189	2,484	2,750	2,862
Gross Debt	11,171	11,131	11,090	11,049	11,006	10,963	11,497	11,943
Cash	(1,072)	(886)	(929)	(500)	(500)	(500)	(500)	(500)
Net Debt	10,099	10,245	10,162	10,549	10,506	10,463	10,997	11,443
Leverage	6.7x	7.6x	6.3x	5.5x	4.8x	4.2x	4.0x	4.0x
OCF	456	355	587	833	1,020	1,244	1,436	1,469
Capex	(360)	(500)	(505)	(234)	(239)	(244)	(248)	(253)
FCF	96	(145)	83	599	781	1,001	1,188	1,216
FCF/EBITDAR	0.1x	NM	0.1x	0.3x	0.4x	0.4x	0.4x	0.4x

PENN Recession Case Financial Summary

	2023	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Revenue	6,363	6,648	6,982	7,429	8,411	9,199	9,918	10,251
EBITDAR	1,513	1,341	1,449	1,601	1,966	2,254	2,514	2,618
Gross Debt	11,171	11,131	11,090	11,049	11,006	10,963	10,919	10,968
Cash	(1,072)	(886)	(779)	(500)	(500)	(500)	(500)	(500)
Net Debt	10,099	10,245	10,311	10,549	10,506	10,463	10,419	10,468
Leverage	6.7x	7.6x	7.1x	6.6x	5.3x	4.6x	4.1x	4.0x
OCF	456	355	438	557	870	1,069	1,256	1,302
Capex	(360)	(500)	(505)	(234)	(239)	(244)	(248)	(253)
FCF	96	(145)	(66)	323	631	825	1,007	1,048
FCF/EBITDAR	0.1x	NM	NM	0.2x	0.3x	0.4x	0.4x	0.4x

Appendix

Model Cases

Revenue Assumptions

Base	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Northeast	8%	27%	-32%	56%	6%	2%	0%	7%	7%	3%	3%	3%	3%
South	76%	678%	-72%	56%	-1%	-7%	0%	3%	3%	3%	3%	3%	3%
West	15%	47%	-53%	72%	12%	-9%	0%	3%	16%	3%	3%	3%	3%
Midwest	12%	261%	-77%	62%	5%	1%	0%	3%	3%	3%	3%	3%	3%
Interactive	0%	0%	0%	0%	0%	8%	40%	45%	34%	28%	24%	17%	4%

Recession	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Northeast	8%	27%	-32%	56%	6%	2%	0%	0%	0%	8%	3%	3%	3%
South	76%	678%	-72%	56%	-1%	-7%	0%	-4%	-4%	8%	3%	3%	3%
West	15%	47%	-53%	72%	12%	-9%	0%	-4%	9%	8%	3%	3%	3%
Midwest	12%	261%	-77%	62%	5%	1%	0%	-4%	-4%	8%	3%	3%	3%
Interactive	0%	0%	0%	0%	0%	8%	40%	45%	34%	28%	24%	17%	4%

Income Statement

Kenan-Flagler Business School
ALPHA CHALLENGE
The University of North Carolina

Penn Entertainment
Earnings Model
(US$ in millions except per-share data)

Quarter-end	12/31/2016	12/31/2017	12/31/2018	12/31/2019	12/31/2020	12/31/2021	12/31/2022	12/31/2023	12/31/2024	12/31/2025	12/31/2026	12/31/2027	12/31/2028	12/31/2029	12/31/2030
INCOME STATEMENT	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	**2029E**	**2030E**
Net Revenue															
Segments															
Northeast		$1,756.6	$1,891.5	$2,399.9	$1,639.3	$2,552.4	$2,695.9	$2,738.4	$2,738.4	$2,928.1	$3,130.8	$3,224.8	$3,321.5	$3,421.2	$3,523.8
South		224.2	394.4	3,068.9	849.6	1,322.2	1,314.2	1,216.4	1,216.4	1,252.9	1,290.5	1,329.2	1,369.1	1,410.1	1,452.4
West		380.4	437.9	642.5	302.5	521.4	581.9	528.5	528.5	544.4	631.1	650.0	669.5	689.6	710.3
Midwest		735.0	823.7	2,970.6	681.4	1,102.7	1,159.6	1,172.6	1,172.6	1,207.8	1,244.0	1,281.3	1,319.8	1,359.4	1,400.1
Other		51.7	40.4	45.6	105.9	406.3	(13.0)	(11.8)	(12.3)	(13.7)	(15.3)	(16.6)	(18.1)	(19.5)	(20.1)
Interactive				-	-	-	663.1	718.8	1,004.0	1,458.0	1,954.4	2,498.4	3,110.3	3,647.1	3,793.0
Net Revenue	**$3,034.4**	**$3,148.0**	**$3,587.9**	**$9,127.5**	**$3,578.7**	**$5,905.0**	**$6,401.7**	**$6,362.9**	**$6,647.6**	**$7,377.4**	**$8,235.5**	**$8,967.1**	**$9,772.0**	**$10,507.9**	**$10,859.5**
% growth		*4%*	*14%*	*154%*	*-61%*	*65%*	*8%*	*-1%*	*4%*	*11%*	*12%*	*9%*	*9%*	*8%*	*3%*
Adjusted EBITDAR															
Segments															
Northeast		$549.3	$583.8	$720.7	$478.9	$848.4	842.5	$831.0	$791.0	$860.8	$935.7	$966.9	$999.2	$1,032.4	$1,066.8
South		62.6	119.0	369.8	318.9	587.0	548.1	494.1	454.1	468.0	482.4	497.2	512.5	528.2	544.4
West		72.7	114.3	198.8	82.2	195.0	220.1	204.2	204.2	210.4	244.9	252.4	260.0	267.9	276.0
Midwest		249.7	294.3	403.6	258.3	488.1	501.2	496.6	496.6	511.2	526.3	541.8	557.7	574.2	591.1
Other		16.2	12.0	11.6	35.3	(33.2)	1.6	-	-						
Interactive						-	(74.9)	(402.5)	(500.0)	(336.4)	(156.3)	42.6	268.2	463.4	501.9
Adjusted Property EBITDAR	**913.6**	**950.5**	**1,123.3**	**1,704.5**	**1,173.6**	**2,085.3**	**2,038.6**	**1,623.4**	**1,445.9**	**1,714.0**	**2,033.0**	**2,300.9**	**2,597.6**	**2,866.1**	**2,980.1**
Total corporate expense	$69.8	$104.6	$80.1	$99.3	$78.8	$102.9	$99.2	$110.8	$105.0	$107.1	$109.2	$111.4	$113.7	$115.9	$118.2
Adjusted EBITDAR	**$843.8**	**$845.9**	**$1,043.2**	**$1,605.2**	**$1,094.8**	**$1,982.4**	**$1,939.4**	**$1,512.6**	**$1,340.9**	**$1,606.9**	**$1,923.8**	**$2,189.4**	**$2,483.9**	**$2,750.2**	**$2,861.9**
% growth		*0%*	*23%*	*54%*	*-32%*	*81%*	*-2%*	*-22%*	*-11%*	*20%*	*20%*	*14%*	*13%*	*11%*	*4%*
Margin		*27%*	*29%*	*18%*	*31%*	*34%*	*30%*	*24%*	*20%*	*22%*	*23%*	*24%*	*25%*	*26%*	*26%*
Incremental Margin		*2%*	*45%*	*10%*	*9%*	*38%*	*-9%*	*1100%*	*-60%*	*36%*	*37%*	*36%*	*37%*	*36%*	*32%*
Stock-based compensation	6.9	7.8	12.0	14.9	14.5	35.1	58.1	85.9	89.7	99.6	111.2	121.1	131.9	141.9	146.6
Non-operating items for Kansas JV	10.3	5.9	5.1	3.7	4.7	7.7	7.6	2.9							
Income from unconsolidated affiliates	14.3	18.7	22.3	28.4	13.8	38.7	23.7	25.3	25.8	26.3	26.8	27.4	27.9	28.5	29.1
Rent expense associated with triple net leases				366.4	419.8	454.4	149.6	591.1	602.9	615.0	627.3	639.8	652.6	665.7	679.0
Other (history included leases)	(1.9)	100.9	100.7	205.7	685.5	54.4	158.9	486.1							
Depreciation	271.2	267.1	269.0	414.2	366.7	344.5	567.5	435.1	462.4	489.9	502.6	515.6	528.9	542.5	556.3
Total Operating Income	**$543.0**	**$445.7**	**$634.1**	**$571.9**	**($410.2)**	**$1,047.6**	**$974.0**	**($113.8)**	**$160.1**	**$376.1**	**$655.9**	**$885.5**	**$1,142.5**	**$1,371.7**	**$1,450.9**
Interest income	24.2	3.6	1.0	0.6	-	-	-	-							
Interest expense, net	(459.2)	(466.8)	(539.4)	(534.8)	(543.2)	(561.7)	(739.9)	(424.4)	(477.3)	(477.3)	(475.6)	(473.8)	(471.9)	(470.1)	(493.0)
Income from unconsolidated affiliates	14.3	18.7	22.3	28.4	13.8	38.7	23.7	25.3	25.8	26.3	26.8	27.4	27.9	28.5	29.1
Other	(1.7)	(26.2)	(10.9)	20.0	105.4	2.5	(82.5)	13.3							
Extraordinary items	-	-	(17.2)	-	-	-	-	-							
Income tax benefit (expense)	(11.3)	498.5	3.6	(43.0)	165.1	(118.6)	46.4	8.2	72.9	18.7	(51.8)	(109.8)	(174.6)	(232.5)	(246.8)
Net income	**$109.3**	**$473.5**	**$93.5**	**$43.2**	**($669.1)**	**$408.5**	**$221.7**	**($491.4)**	**($218.6)**	**($56.1)**	**$155.4**	**$329.4**	**$523.9**	**$697.6**	**$740.3**
Net loss of non-controlling interest	-	-	(0.0)	(0.8)	0.4	(0.3)	(0.1)	-							
Net income to PENN	**$109.3**	**$473.5**	**$93.5**	**$44.0**	**($669.5)**	**$408.8**	**$221.8**	**($491.4)**	**($218.6)**	**($56.1)**	**$155.4**	**$329.4**	**$523.9**	**$697.6**	**$740.3**

Balance Sheet

(US$ in millions, except per-share data)

BALANCE SHEET	2016	2017	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Assets															
Cash and equivalents	$229.5	$278.0	$479.6	$437.4	$1,853.8	$1,863.9	$1,624.0	$1,071.8	$886.4	$928.5	$500.0	$500.0	$500.0	$500.0	$500.0
Restricted cash															
Receivables	61.9	62.8	106.8	88.7	96.4	195.0	246.4	319.0	333.3	369.9	412.9	449.6	489.9	526.8	544.4
Prepaid income taxes	-	-	-	-	-	-	-	-							
Prepaid expenses & other	107.9	60.3	91.2	116.7	134.8	164.7	143.0	268.2	280.2	311.0	347.1	378.0	411.9	442.9	457.7
Deferred income taxes	-	-	-	-	-	-	-	-							
Total Current Assets	**399.3**	**401.0**	**677.7**	**642.8**	**2,085.0**	**2,223.6**	**2,013.4**	**1,659.0**	**1,499.9**	**1,609.4**	**1,260.0**	**1,327.5**	**1,401.8**	**1,469.7**	**1,502.2**
Gross PP&E	4,790.9	4,939.3	9,318.2	7,872.8	7,648.6	8,046.0	8,546.8	7,980.4	8,480.4	8,984.9	9,219.0	9,457.8	9,701.3	9,949.7	10,203.1
Less: Accumulated depreciation	(1,970.6)	(2,182.6)	(2,449.4)	(2,752.6)	(3,119.3)	(3,463.8)	(4,031.3)	(4,466.4)	(4,928.8)	(5,418.6)	(5,921.3)	(6,436.9)	(6,965.8)	(7,508.3)	(8,064.6)
Net property and equipment, at cost	2,820.4	2,756.7	6,868.8	5,120.2	4,529.3	4,582.2	4,515.5	3,514.0	3,551.6	3,566.3	3,297.7	3,020.9	2,735.5	2,441.4	2,138.5
Investment / advances to JVs	156.2	148.9	128.5	128.3	266.8	255.1	248.6	84.9	84.9	84.9	84.9	84.9	84.9	84.9	84.9
Goodwill	989.7	1,008.1	1,228.4	1,270.7	1,157.1	2,822.5	2,689.5	2,695.1	2,695.1	2,695.1	2,695.1	2,695.1	2,695.1	2,695.1	2,695.1
Deferred income taxes, non-current	-	390.9	80.6	-	-	-	-	-							
Advances to the Jamul Tribe	91.4	20.9	-	-	-	-	-	-							
Miscellaneous and other Intangibles	517.6	508.3	1,977.1	7,032.5	6,629.1	6,988.7	8,035.1	8,111.2	8,111.2	8,111.2	8,111.2	8,111.2	8,111.2	8,111.2	8,111.2
Assets held for sale	-	-	-	-	-	-	-	-							
Restricted assets for sale	-	-	-	-	-	-	-	-							
Total Other Assets	1,754.8	2,077.1	3,414.6	8,431.5	8,053.0	10,066.3	10,973.2	10,891.2	10,891.2	10,891.2	10,891.2	10,891.2	10,891.2	10,891.2	10,891.2
Total Assets	**4,974.5**	**5,234.8**	**10,961.0**	**14,194.5**	**14,667.3**	**16,872.1**	**17,502.1**	**16,064.2**	**15,942.7**	**16,066.8**	**15,448.9**	**15,239.6**	**15,028.5**	**14,802.3**	**14,531.9**
Liabilities															
Accounts payable	35.1	26.0	30.6	40.3	33.2	53.3	40.1	36.6	38.2	42.4	47.4	51.6	56.2	60.4	62.5
Accrued expenses	101.9	125.7	204.7	631.3	575.1	798.5	804.7	1,021.9	1,067.6	1,184.8	1,322.6	1,440.1	1,569.4	1,687.6	1,744.1
Other current liabilities	257.1	286.4	373.3	193.5	215.7	242.4	250.5	390.2	390.2	390.2	390.2	390.2	390.2	390.2	390.2
Current portion of financing obligation to GLPI	56.6	56.2	67.8	40.5	36.0	39.0	63.4	41.3	41.3	41.3	41.3	41.3	41.3	41.3	41.3
Income taxes payable	-	-	-	-	-	-	-	-							
Total current liabilities	**450.7**	**494.4**	**676.3**	**905.6**	**860.0**	**1,133.2**	**1,158.7**	**1,490.0**	**1,537.4**	**1,658.8**	**1,801.5**	**1,923.2**	**2,057.1**	**2,179.5**	**2,238.0**
Total Ending Debt	**4,890.2**	**4,762.8**	**9,534.0**	**10,882.6**	**11,033.2**	**11,380.6**	**12,535.4**	**11,171.1**	**11,131.1**	**11,090.3**	**11,048.7**	**11,006.3**	**10,963.0**	**11,496.9**	**11,942.8**
Discount on Sr Secured Credit Facility Term B	(0.6)	(2.6)	(2.7)	(2.4)	(86.2)	(73.1)	(4.6)	(4.6)	(4.6)	(4.6)	(4.6)	(4.6)	(4.6)	(4.6)	(4.6)
Debt issuance costs	(16.5)	(27.4)	(38.4)	(31.5)	(32.8)	(30.6)	(35.7)	(35.7)	(35.7)	(35.7)	(35.7)	(35.7)	(35.7)	(35.7)	(35.7)
Long-term debt	**4,873.0**	**4,732.8**	**9,492.9**	**10,848.7**	**10,914.2**	**11,276.9**	**12,495.1**	**11,130.8**	**11,090.8**	**11,050.0**	**11,008.4**	**10,966.0**	**10,922.7**	**11,456.6**	**11,902.5**
Deferred income taxes	126.9	-	-	244.6	126.3	189.1	33.9	117.6	117.6	117.6	117.6	117.6	117.6	117.6	117.6
Other LT liabilities	67.1	80.8	60.6	343.7	111.0	175.8	217.8	126.2	126.2	126.2	126.2	126.2	126.2	126.2	126.2
Other LT liabilities	**194.1**	**80.8**	**60.6**	**588.3**	**237.3**	**364.9**	**251.7**	**243.8**	**243.8**	**243.8**	**243.8**	**243.8**	**243.8**	**243.8**	**243.8**
Total Shareholders' Equity	**(543.3)**	**(73.1)**	**731.2**	**1,852.7**	**2,656.2**	**4,097.8**	**3,597.7**	**3,202.1**	**3,073.3**	**3,116.7**	**2,397.7**	**2,109.1**	**1,807.3**	**924.9**	**150.1**
Noncontrolling interests	-	-	(0.0)	(0.8)	(0.4)	(0.7)	(1.1)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)	(2.5)
Total Liabilities and Shareholder's Equity	**4,974.5**	**5,234.8**	**10,961.0**	**14,194.5**	**14,667.3**	**16,872.1**	**17,502.1**	**16,064.2**	**15,942.7**	**16,066.8**	**15,448.9**	**15,239.6**	**15,028.5**	**14,802.3**	**14,531.9**
Check	-	(0.0)	-	-	-	-	-	-	-	-	-	-	-	-	-

Cash Flow Statement

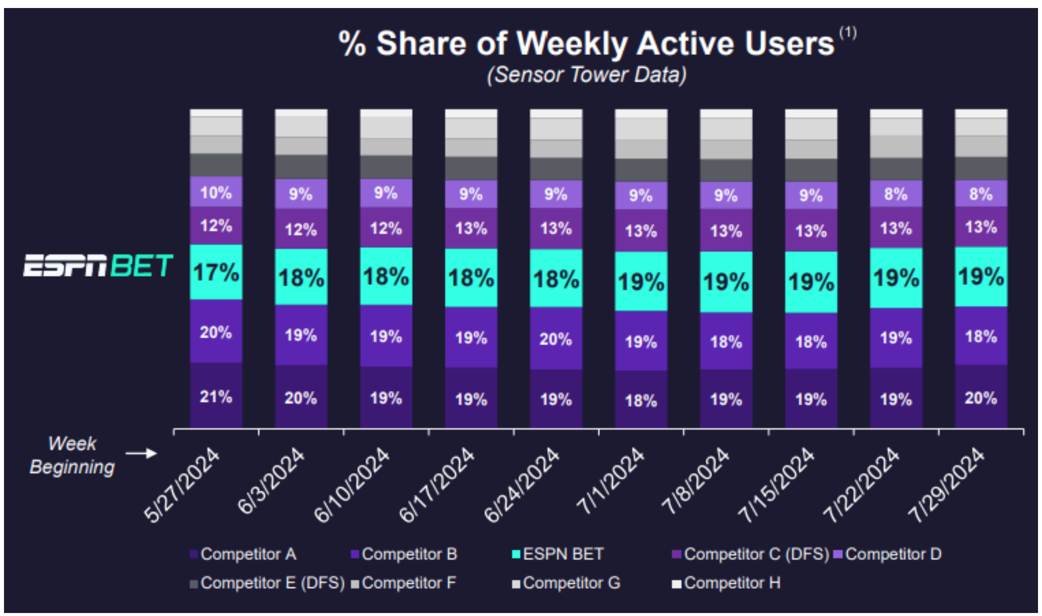
ALPHA CHALLENGE
Kenan–Flagler Business School
The University of North Carolina

(US$ in millions except per-share data)

CASH FLOW STATEMENT	2016	2017	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Cash flows from operations															
Net Income	$109.3	$473.5	$93.5	$43.2	($669.1)	$420.5	$221.7	($491.4)	($218.6)	($56.1)	$155.4	$329.4	$523.9	$697.6	$740.3
Depreciation and amortization	271.2	267.1	269.0	414.2	366.7	344.5	567.5	435.1	462.4	489.9	502.6	515.6	528.9	542.5	556.3
Amortization of deferred financing costs	7.2	7.0	6.4	7.7	16.3	22.8	9.0	8.1							
Other loss/(gain) on assets	(1.2)	(6.7)	3.6	79.0	(29.2)	1.1	7.9	0.1							
Charge for stock compensation	6.9	7.8	12.0	14.9	14.5	35.1	58.1	85.9	89.7	99.6	111.2	121.1	131.9	141.9	146.6
Loss/(Gain) from joint ventures	(14.3)	(18.7)	(22.3)	(28.4)	(13.8)	(38.7)	(23.7)	(25.3)	(25.8)	(26.3)	(26.8)	(27.4)	(27.9)	(28.5)	(29.1)
Distributions from joint ventures	26.3	26.5	27.0	29.0	21.8	31.8	33.8	33.3	25.8	26.3	26.8	27.4	27.9	28.5	29.1
Other	-	113.8	17.9	-	623.4	-	118.2	469.6							
Deferred income taxes	8.7	(517.9)	(26.7)	21.1	(118.3)	(4.5)	(150.7)	(32.7)							
(Increase) decrease in current assets	-	-	-	-	-	-									
Accounts receivable	(5.9)	(9.2)	(1.7)	27.0	(16.5)	(82.3)	(81.2)	(74.8)	(14.3)	(36.6)	(43.0)	(36.7)	(40.4)	(36.9)	(17.6)
Insurance receivable	-	-	-	-	-	-	-	-							
Prepaid Expenses and other current assets	(0.5)	(7.2)	13.3	9.7	13.5	(32.3)	(24.1)	(66.3)	(12.0)	(30.8)	(36.2)	(30.8)	(33.9)	(31.0)	(14.8)
Other Assets	(4.9)	1.7	1.5	(2.3)	(12.8)	(21.7)	(2.2)	(18.2)							
(Decrease) increase in current liabilities	-	-	-	-	-	-	-	-							
Accounts payable	(7.5)	(0.3)	(6.1)	4.4	(6.6)	(30.4)	(13.4)	(8.6)	1.6	4.2	4.9	4.2	4.6	4.2	2.0
Accrued expenses	1.5	23.8	(29.4)	(3.9)	(40.9)	138.4	17.4	25.9	45.7	117.2	137.8	117.5	129.3	118.2	56.5
Accrued interest	(0.7)	7.2	2.2	-	-	-	-	-							
Accrued salaries and wages	(6.7)	15.8	0.1	-	-	-	-	-							
Gaming, property, and other taxes	3.4	8.5	(19.9)	-	-	-	-	-							
Income taxes payable	19.1	20.4	(3.3)	(7.2)	(32.5)	10.2	27.3	(50.2)							
Other current liabilities	(7.0)	46.3	15.6	95.6	222.3	101.6	112.6	165.4							
Net cash provided by operating activities	**$404.8**	**$459.1**	**$352.8**	**$703.9**	**$338.8**	**$896.1**	**$878.2**	**$455.9**	**$354.6**	**$587.4**	**$832.7**	**$1,020.2**	**$1,244.4**	**$1,436.4**	**$1,469.2**
Cash flows from investing activities															
Expenditures for property and equipment	(97.2)	(99.3)	(92.6)	(190.6)	(137.0)	(244.1)	(263.4)	(360.0)	(500.0)	(504.5)	(234.1)	(238.8)	(243.5)	(248.4)	(253.4)
Advances to Jamul tribe	86.6	(2.3)	-	-	-	-	-	-							
Investment in joint ventures	-	(0.5)	18.9	-	(140.4)	(1.4)	-	-							
Proceeds from sale of PP&E	18.2	1.0	0.4	(0.5)	16.1	1.5	4.9	0.5							
Investment in corporate debt securities	-	-	-	-	-	-	-	-							
Acquisitions and Investments	(86.9)	(129.3)	(1,945.2)	(398.0)	(3.0)	(877.6)	(15.0)	(314.6)							
Other	-	8.8	595.4	-	32.7	-	-	-							
Distributions from joint venture	-	-	-	(18.4)	(2.1)	(100.2)	14.9	(68.5)							
Net cash provided by investing activities	**($79.3)**	**($221.6)**	**($1,423.1)**	**($607.5)**	**($233.7)**	**($1,221.8)**	**($258.6)**	**($742.6)**	**($500.0)**	**($504.5)**	**($234.1)**	**($238.8)**	**($243.5)**	**($248.4)**	**($253.4)**
Cash flows from financing activities															
Proceeds from exercise of options	11.6	10.4	7.4	1.9	62.7	10.8	6.9	5.3							
Proceeds from issuance of preferred stock	-	-	-	-	-	-	-	-							
Proceeds/payments from long-term debt	(298.7)	(179.6)	1,172.7	(18.6)	20.5	335.6	(37.5)	(37.5)	-	-	-	-	-	578.0	491.0
Principal payments on financing obligation with GLI	(50.5)	(57.9)	(67.4)	(51.6)	(26.7)	(36.0)	(63.2)	(39.2)	(40.0)	(40.8)	(41.6)	(42.4)	(43.3)	(44.1)	(45.0)
(Increase) in unamortized financing cost	(1.8)	(19.6)	(4.1)	-	-	-	-	-							
Proceeds / (Repurchase) of common stock		(24.8)	(50.0)	(24.9)	1,288.8	-	(601.1)	(149.8)			(985.6)	(739.0)	(957.5)	(1,721.8)	(1,661.7)
Proceeds/payments from insurance fin.	(0.5)	(0.2)	2.2	(3.3)	(1.2)	(0.1)	-	-							
Other	6.9	82.6	211.2	16.0	(34.0)	29.6	(134.1)	(45.1)							
Net cash provided by financing activities	**($333.0)**	**($189.0)**	**$1,271.9**	**($80.5)**	**$1,310.1**	**$339.9**	**($829.0)**	**($266.3)**	**($40.0)**	**($40.8)**	**($1,027.2)**	**($781.5)**	**($1,000.8)**	**($1,188.0)**	**($1,215.8)**
Effect of exchange rate fluctuations on cash, other	-	-	-	(58.1)	1.2	(4.1)	(30.5)	0.8							
Net increase in cash & cash equivalents	**($7.5)**	**$48.5**	**$201.6**	**($42.2)**	**$1,416.4**	**$10.1**	**($239.9)**	**($552.2)**	**($185.4)**	**$42.1**	**($428.5)**	**$0.0**	**$0.0**	**$0.0**	**($0.0)**
Cash and cash equivalents, beginning	237.0	229.5	278.0	479.6	437.4	1,853.8	1,863.9	1,624.0	1,071.8	886.4	928.5	500.0	500.0	500.0	500.0
Cash and cash equivalents, end	**$229.5**	**$278.0**	**$479.6**	**$437.4**	**$1,853.8**	**$1,863.9**	**$1,624.0**	**$1,071.8**	**$886.4**	**$928.5**	**$500.0**	**$500.0**	**$500.0**	**$500.0**	**$500.0**

Sports Betting Market Share Data – by Revenue and by Users

Sports Betting Revenue / Market Size Calcs	2018	2019	2020	2021	2022	2023	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Total US Sports Betting Market Size	431	910	1,541	4,358	7,540	11,071	15,400	17,747	19,718	21,524	23,379	24,314	25,287
x Interactive Segment Market Share					9%	6%	7%	8%	10%	12%	13%	15%	15%
Interactive Segment Revenue					663	719	1,004	1,458	1,954	2,498	3,110	3,647	3,793
Growth						8%	40%	45%	34%	28%	24%	17%	4%
Sports Betting Market Size Growth		111%	69%	183%	73%	47%	39%	15%	11%	9%	9%	4%	4%



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Management Compensation Metrics

Executive Compensation

Significant portion of our target executive compensation is at risk. In 2023, 90% of our Chief Executive Officer's total target compensation and 80% (on average) of our other Named Executive Officers' total target compensation was at risk, subject to achievement of pre-set performance goals or tied to our long-term stock price performance.

2023 Target CEO Compensation

2023 Average Other NEOs Target Compensation

PERFORMANCE METRICS[1]		WEIGHTING[2]		THRESHOLD 50% Payout	TARGET 100% Payout	MAXIMUM 150% Payout	ATTAINMENT	PAYOUT % of Target	WEIGHTED PAYOUT % of Target
OMNICHANNEL[3]	Loyalty DB Activations	21.4%	Adjusted 1.172M; Unadjusted 2.324M	Unadjusted: 1.105M; Adjusted: 0.890M	Unadjusted: 1.300M; Adjusted: 1.047M	Unadjusted: 1.495M; Adjusted: 1.2042M	112.0%	139.8%	30.0%
	Loyalty App Registrations	21.4%	Adjusted 318K; Unadjusted 390K	Unadjusted: 298K; Adjusted: 252K	Unadjusted: 350K; Adjusted: 297K	Unadjusted: 405K; Adjusted: 342K	107.2%	124.0%	26.6%
	Retail to Online Registrations	21.4%	Adjusted 68K; Unadjusted 202K	Unadjusted: 98K; Adjusted: 73K	Unadjusted: 115K; Adjusted: 86K	Unadjusted: 132K; Adjusted: 99K	79.5%	0.0%	0.0%
	Online to Retail Activations	21.4%	Adjusted 14K; Unadjusted 21K	Unadjusted: 10K; Adjusted: 9K	Unadjusted: 12K; Adjusted: 10K	Unadjusted: 14K; Adjusted: 12K	136.5%	150.0%	32.1%

	COMPONENT	CEO	OTHER NEOS	KEY CHARACTERISTICS	2023 PERFORMANCE METRICS
FIXED PAY	Base Salary	10%	20%	• Fixed cash compensation designed to compensate executives for their day- to-day responsibilities based on the job responsibilities, individual performance, experience, expertise and qualifications	N/A
VARIABLE PAY	**SHORT-TERM INCENTIVE PROGRAM ("STIP")**				
	Short-Term Incentive Plan ("STIP")	26%	20%	• Cash compensation tied to the achievement of pre-determined quantitative performance goals • Aligns a significant portion of target cash compensation to the achievement of near-term EBITDAR goals that support our long-term growth strategy	Adjusted EBITDAR
	LONG-TERM INCENTIVE PROGRAM ("LTIP")*				
	Performance- Based Equity (50% Weighting of Total LTIP)	32%	30%	• Equity incentive designed to motivate achievement of pre-set performance goals throughout a three-year performance period to drive long-term shareholder value • Performance metrics reflect key drivers of our long-term growth, including incentives to advance our omnichannel growth strategy, as well as to encourage progress on key sustainability initiatives • Settling in shares of our restricted stock to align interests of our executives with those of our shareholders, promote an ownership mentality, and motivate long-term shareholder value creation	**Omnichannel** • Loyalty Database Activations • Loyalty App Registrations • Retail to Online Registrations • Online to Retail Activations **Interactive** • iCasino Handle • Online Sportsbook Handle **ESG/Sustainability** • **Key metrics** that promote inclusive culture across our organization, encourage inclusive leadership and incentivize progress on making our operations more energy efficient
	Stock Options (50% Weighting of Total LTIP)	32%	30%	• Equity incentives motivate executives to build long-term shareholder value • Award vests ratably over a four-year period to encourage long-term retention	Stock options only deliver value to executives to the degree our stock price appreciates after the grant date, strongly aligning executive interests with shareholder value creation and motivating sustained, long-term outperformance

PENN Cost Structure Detail

PENN Revenue and Cost Breakdown		Notes
Gaming		
Gross Gaming Revenue	46,064	
x Hold Percentage	10.7%	85% slots w/ 7-11% hold and 15% table and other games with 12-28% holds
Net Gaming Revenue	4,906	
Expense	(2,989)	Mainly state taxes levied as a fraction of gross revenue
Gaming Gross Profit	1,916	
Gross Margin	*39%*	
F&B and Hotel		
Revenue	1,457	
Expense	(1,011)	
FB&H Gross Profit	446	
Gross Margin	*31%*	
Total Gross Profit	2,362	
Fixed Expenses	(850)	
EBITDAR	1,513	
Margin	*24%*	
Leases	(591)	Lease expense mainly flows into G&A expense on P&L
EBITDA	922	
Margin	*14%*	
Depreciation	(289)	Excludes ~$60mm of amortization related to acquired intangibles
EBITA	633	
Margin	*10%*	

Management / CEO

- **CEO of Penn Entertainment is Jay Snowden**. Jay previously joined the firm in 2011, serving as president and chief operating officer. He assumed the role of CEO in 2020 leading Penn's acquisition of Barstool Sports, its subsequent sale, and then establishing a license agreement with ESPN. Share performance has been sub-par since taking over (declining by 27% since Jan 2020). He bought $1M of PENN's shares in September, and currently sits on the board of directors.

- **CFO of Penn Entertainment** is Felicia Hendrix. She joined Penn Gaming in March 2021. This is her first experience as a CFO, previously serving in equity research covering gaming for over 20 years at Barclays and Lehman Brothers.

Credit Agreement Amendment Notes

- On February 15, 2024 (the “Amendment Effective Date”), PENN entered into a First Amendment (the “Amendment Agreement”) with its various lenders amending its Amended Credit Facilities (as amended, amended and restated, supplemented, or otherwise modified from time to time prior to the Amendment Effective Date, the “Existing Credit Agreement”). **The Amendment Agreement amends the Existing Credit Agreement to provide that, during the period beginning on the Amendment Effective Date and ending on the earlier of** (i) the date that is two business days after the date on which the Company delivers a covenant relief period termination notice to the administrative agent and (ii) **the date on which the administrative agent receives a compliance certificate for the quarter ending December 31, 2024** (the “Covenant Relief Period”), **the Company will make an adjustment to exclude specified amounts of Interactive segment Adjusted EBITDAR** (as defined in Note 15, “Segment Information”) in its calculations to comply with the maximum total net leverage ratio or minimum interest coverage ratio (as such terms are defined in the Second Amended and Restated Credit Agreement). We will continue to be required to maintain specified financial ratios and to satisfy certain financial tests when our Covenant Relief Period terminates after December 31, 2024.
  - Previous leverage test: 4.5x
  - Previous FCCR test: 2.0x

- Solely for purposes of determining actual compliance (and not compliance on a Pro Forma Basis) with any covenant in Section 10.08 during the Covenant Relief Period and only if and for so long as the Covenant Relief Period Conditions are satisfied, for each Test Period ending March 31, 2024, June 30, 2024, September 30, 2024 and December 31, 2024 (each, a “Specified Test Period”), to **exclude the negative “Adjusted EBITDAR” for such Test Period, if any, attributable to the Interactive segment on a trailing twelve months basis as defined and reported in Borrower’s quarterly or annual report**, as applicable, for such Test Period, as filed with the SEC; provided that the aggregate amount of adjustments made to Consolidated EBITDA for any Test Period pursuant to this clause (F) shall not exceed the corresponding amount for such Test Period set forth on Schedule 1 hereto; provided, further, that this clause (F) shall have no further force or effect from and after the Covenant Relief Period Termination Date.”

ESPN BET Termination Clause Notes

- The Sportsbook Agreement has an initial 10-year term and may be extended for an additional ten years upon mutual agreement of PENN and ESPN. In consideration for the media marketing services and brand and other rights provided by ESPN, PENN will pay $150.0 million per year in cash pursuant to the Sportsbook Agreement for the initial 10-year term and issue the warrants pursuant to the Investment Agreement (as defined and described in more detail below). **In addition, the Sportsbook Agreement may be terminated by either party** (i) in the case of an uncured material breach by or bankruptcy of the other party, **(ii) if at the end of year three of the term the Sportsbook has not achieved a specified level of market share based on gross gaming revenue in the states in which the Sportsbook operates while branded ESPN BET**, (iii) in certain circumstances, if the other party or certain of its officers is the subject of a criminal or other investigation by federal or state authorities, is charged with certain crimes or commits certain other acts, including those which would reasonably be expected to cause material damage to the terminating party's reputation or brand, or (iv) in certain circumstances involving non-compliance with data privacy laws. In addition, ESPN has the right to terminate the Sportsbook Agreement if (i) a repeated material breach by PENN of the terms of the ESPN intellectual property license or an uncured material breach by PENN of the terms of the ESPN intellectual property license that results in material harm to the reputation or goodwill associated with the ESPN brand or name, (ii) in certain circumstances where PENN commits a material failure of specified product and technology guidelines or certain customer service level metrics, (iii) if at the end of year three or year seven of the term the Sportsbook's market access is not at least a specified percentage of the total market access by the online sportsbook operator with the most expansive market access, subject to certain exceptions, (iv) if ESPN undergoes certain transactions involving a significant change in ownership of ESPN, subject to the payment of a termination fee to PENN, or (v) in certain circumstances if PENN undergoes certain transactions involving a significant change in ownership of PENN, including such a transaction involving a competitor of The Walt Disney Company ("TWDC"). PENN has the right to terminate the Sportsbook Agreement (i) if ESPN undergoes certain transactions resulting in a significant change in ownership of ESPN involving a competitor of PENN, (ii) in certain circumstances related to the suitability of ESPN, TWDC, or certain of their respective officers for gaming regulatory purposes, or (iii) in certain circumstances if PENN is unable to utilize the ESPN BET brand in states comprising a specified percentage of the aggregate population for all states in which PENN conducts online sports betting in the United States.

Supply Additions - South

- Nebraska: Omaha WarHorse, construction began 2021, completed 2024
- Illinois: Bally's Chicago, Chicago Wind Creek Chicago, Golden Nugget Danville, Hard Rock Casino Rockford, Walker's Bluff Casino, American Place completed 2023-2024 – projects began after 2019 "Rebuild Illinois" Law
- Louisiana: Harrah's Casino and Hotel Renovation into Caesars New Orleans, construction began 2021, completed 2024

Kenan–Flagler Business School
ALPHA CHALLENGE
The University of North Carolina

pitney bowes

December 5 , 2024

Team Number: 2

Student Names: Sebastian Hartmann, Rachael Kim, Edward Rippon

Kenan–Flagler Business School ALPHA CHALLENGE The University of North Carolina

INVESTMENT SUMMARY

PBI 7.25% Senior Unsecured Notes Due 2029

Recommendations : Buy

- **Target spread**: **210bps (-70bps)**, base-case target **total return of ~9% p.a.**

CUSIP	**724479AQ3**
Rank	**Sr. Unsecured**
Coupon	**7.25%**
Maturity	**3/15/2029**
Outstanding	**USD 350,000,000**
Rating	**B (S&P) / B2 (Moody's)**
Current Price	**97.98**
YTW	**7.80%**
OAS Spread	**280 bps**

Investment Thesis

1 **Strength of the Business Model**

- Core business benefits from **economies of scale**
- **High margin**, **recurring revenue streams**

2 **Holistic Business Transformation**

- **Refocusing on the core** by **divesting a loss-making segment** after 5 years
- **Cost reduction efforts** to support **deleveraging**

3 **Solid Cash Flow**

- **Supports deleveraging process**
- Generates solid cash flows **even in a bear-case scenario**

<PBI 29’ OAS Spread>

BUSINESS DESCRIPTION

PBI is a legacy leader in Shipping and Mailing, with solid business model and expertise

Founded in 1920, with the invention of the postage meter, headquartered in Connecticut and employs approx. 11,000 worldwide

Core Businesses

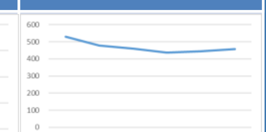
	Products	Revenue Model
SendTech Solutions Mailing & shipping solutions (sending, tracking, analytics)	· **Equipment**: Postage meters, Folding machines, Parcel Lockers · **Software**: Comparing rates of multi-carrier live rate, creating labels, stamp printing, ship request, electronic return receipt, customization (ex: Shipping 360, PitneyTrack, SendPro, Relay)	· **Subscription Fees, Transaction Fee**: postage meters, mailing systems, and software solutions · **Supplies and Consumables**: Ink, paper · **Equipment Sales** : Postage meters, folding machines, parcel lockers
Presort Services Outsourcing facilities for sortation and processing	· **Services Facility**: Verify address, merge mail streams, sort to optimize ZIP density, qualify for postal discounts (ex: First-Class Mail, Marketing Mail)	· **Service fees**
Global Ecommerce Technology platform for Cross-border package delivery & analytics	· **Software**: Access our broad network of carriers to get discounted rates and consolidated bill, automation, tracking, analytics (ex: ShipAccel, Borderfree)	· **Subscription Fees, Transaction Fee**

SendTech Solutions – Equipment:

SendTech Solutions – Software:

Revenue

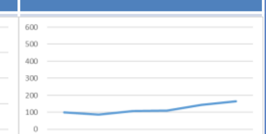
EBITDA



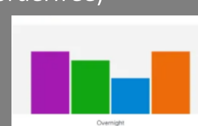
Presort Services:

Revenue

EBITDA



Global Ecommerce:



Revenue

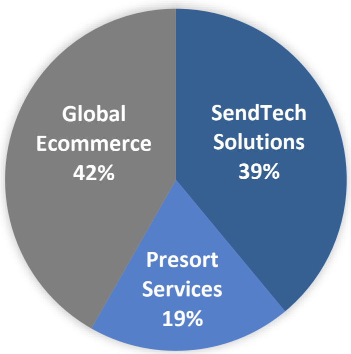
EBITDA

BUSINESS DESCRIPTION

PBI divested five years of loss-making segment, driven by leadership overhaul

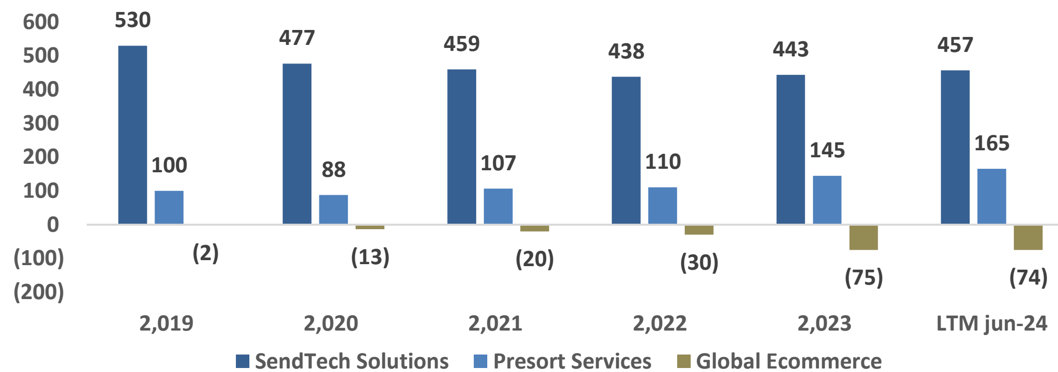
Revenue by Segment and Region:

Revenue LTM Jun-24: $3.3 bn



EBITDA by Segment*:

EBITDA LTM June-24: $371 mm

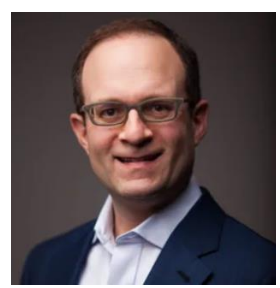


*Excludes corporate expenses and D&A of $208 mm and $31 mm in LTM respectively

Recent Changes in Management

Hestia Capital Management LLC

- With prior success of restructuring GameStop, <u>**acquired a 6.9% stake in PBI in Nov 2022**</u> (9.1% by May 2023)
- Proposed four independent directors, including Hestia's founder, Kurt Wolf



Lance Rosenzweig, CEO

- <u>**Appointed interim CEO in May 2024 and permanent CEO in October 2024**</u>
- Experienced public company executive and private equity operating partner with board roles at several companies

CAPITAL STRUCTURE

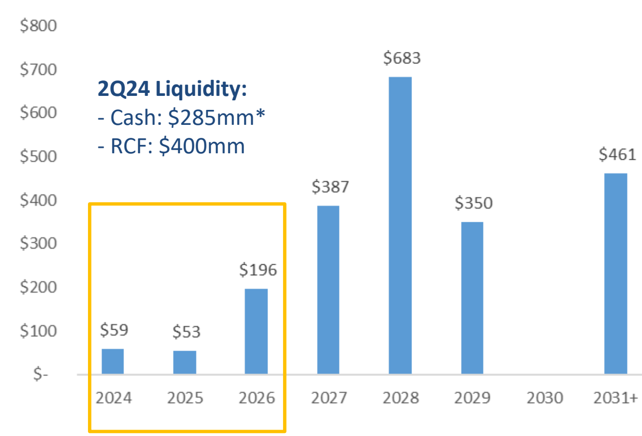
We view the 2029 Notes as an optimal choice within the capital structure, being the most liquid note, while providing reasonable duration

Key Points

- **<u>Manageable Medium-Term Debt Schedule</u>**: Robust liquidity, including $400mm available through its revolving credit line
- **<u>Leverage</u>**: Expected to decline from 4.5x in Q3 2024 to 3.5x by 2026, highlighting the effectiveness of ongoing deleveraging efforts

Security	Type	Maturity	Coupon	Mid Price	YTW	OAS Spread	Rating	Outstanding ($mm)	%	Leverage*
Revolving Facility - $400 m	1st lien	3/19/2026						0		
Term loan March 2026	1st lien	3/19/2026	SOFR + 2.25 %	-	-	-		250		
Term loan March 2028	1st lien	3/17/2028	SOFR + 4.00 %	-	-	-		434		
Private Placement 2028	1st lien	3/19/2028	SOFR + 6.90 %					272		
Total Sr. Secured								**956**	**45%**	**1.6x**
PBI 6 ⅞ 03/15/27	Note - USD	3/15/2027	6.875%	99.8	7.0%	238	B2 / B	380		
PBI 7 ¼ 03/15/29	Note - USD	3/15/2029	7.250%	99.1	7.5%	281	B2 / B	350		
PBI 5 ¼ 01/15/37	Note - USD	1/15/2037	5.250%	60.0	11.4%	706	B3 / B	36		
PBI 6.7 03/07/43	Note - USD	3/7/2043	6.700%	21.6	8.3%	-	B3 / B	425		
Other debt								0.2		
Total Sr. Unsecured								**1,191**	**55%**	**4.5x**
Total Debt								**2,147**		
(-) Cash & Cash Equivalents in Parent Company								285		
Net Debt								**1,862**		
(+) Cash in Pitney Bowes Bank								291		
(+) Market Cap								1,463		
Enterprise Value (EV)								**3,034**		**7.4x**
Debt to EV								**71%**		

Amortization Schedule ($mm)



*Excludes Pitney Bowes Banks' cash of $290M

INVESTMENT THESIS #1
Strength of the Business Model

PBI is the dominant player with a strong, high-margin, recurring business in a mature market with limited competition

	Industry Fundamentals	Company Advantages
SendTech Solutions	• Decline in physical mail volumes • Offset by growth in digital solutions • Diverse range of industries and clients	• **Strong and Recurring Business Model** - Long-term subscription models making **stable revenue streams** - **Scalability and automation** based on mail management expertise - Service Bundling and Cross-selling - New B2B Shipping Solutions growing at **double-digit rate** • **Solid Customers Base** - **Serves 600,000+ unique clients**, including 90% of the Fortune 500 · Enterprise: Amazon, eBay, Mastercard · Retailers and E-commerce: Walmart, Target · Government agencies: State, Federal agencies
Presort Services	• Decline in physical mail volumes • Parcel's continuous growth (5% CAGR) • Ongoing consolidation	• **The Largest Presort Services Provider (33 Centers)** - Most of the competitors are **small regional players** - **High barriers to entry**, due to required volume for economies of scale • **Largest workshare partner to USPS, with a 100+ year partnership** - **USPS handles 40% of the total parcel market** • **Increasing M/S through acquisitions & exit of regional players** - Skymail International (Salt Lake City, UT): Acquired in October 2022 - Pittsburgh Mailing (Pittsburgh, PA): Acquired in September 2022 - ProSORT (Naperville, IL): Acquired in 2017

INVESTMENT THESIS #2
Holistic Business Transformation

PBI's recent divestiture of Global E-commerce business and Cost Rationalization Program are expected to significantly enhance financial stability from Q4 2024 through 2025

Transformation of Segments

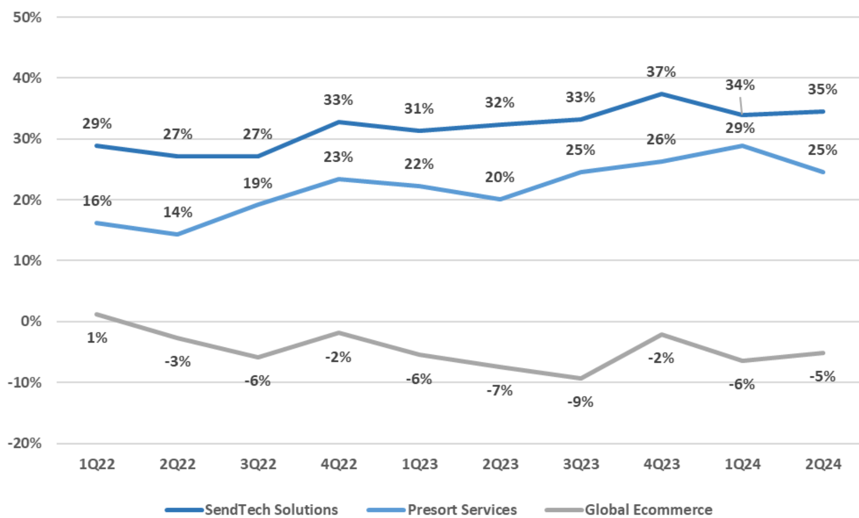
Exit of Global E-commerce Business (Aug-24)

- **Reason**: Highly competitive market and Unprofitable operation
- **Benefit**: Eliminate ~$136 mm in annual losses
- **Cost**: One-time cash costs of $150 mm
- **Impact**: Expected to boost margins, EBITDA margin by 10%

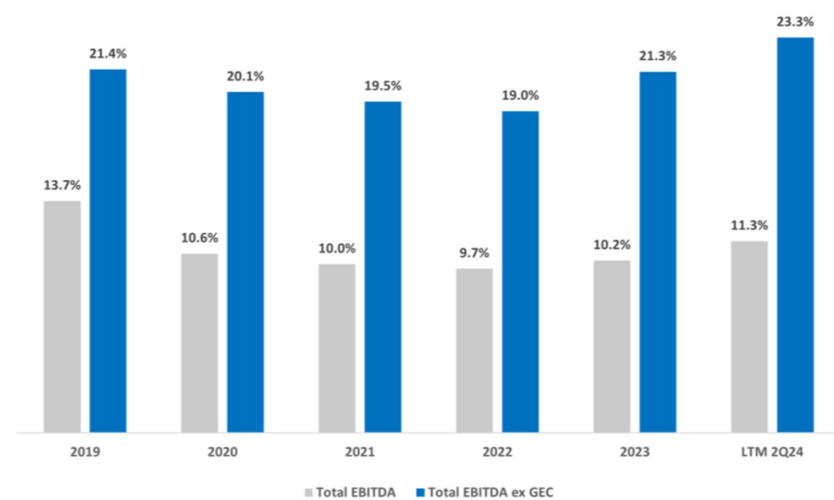
Cost Rationalization Program

- **Launch**: Initiated by interim CEO Lance Rosenzweig in May 2024
- **Achievements**: Reduced $70m in saving by July 2024
- **Goal**: Targeting up to $160M in savings
- **Impact**: Earnings impact to start late 2024, and full savings by 2025. Deleveraging from 4.9x in 2Q24 to 3.4x in 2026

EBITDA Margin by Segment



EBITDA Margin ex GEC



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INVESTMENT THESIS #3
Solid Cash Flow – Base Case

PBI's improved cash flow will support deleveraging process

Free Cash Flow Projections

Data in $mm	Historical				Base Case			
SEGMENTS	**FY20 A**	**FY21 A**	**FY22 A**	**FY23 A**	**FY24 E**	**FY25 E**	**FY26 E**	**FY27 E**
SendTech Solutions	1,414	1,398	1,360	1,293	1,295	1,282	1,282	1,307
Presort Services	521	573	602	618	636	649	649	649
Global Ecommerce	1,619	1,703	1,576	1,355	761	0	0	0
Total Revenues	**3,554**	**3,674**	**3,538**	**3,266**	**2,692**	**1,931**	**1,931**	**1,956**
Variation YoY	*10.9%*	*3.4%*	*-3.7%*	*-7.7%*	*-17.6%*	*-28.3%*	*0.0%*	*1.3%*
SendTech Solutions	477	459	438	443	453	455	464	473
Presort Services	88	107	110	145	178	175	169	169
Global Ecommerce	(13)	(20)	(30)	(75)	(42)	0	0	0
Corporate expense	(200)	(208)	(204)	(211)	(202)	(174)	(162)	(164)
Corporate D&A	25	27	28	30	32	23	23	23
Total EBITDA	**376**	**366**	**343**	**332**	**420**	**480**	**494**	**501**
CASH FLOW	**FY20 A**	**FY21 A**	**FY22 A**	**FY23 A**	**FY24 E**	**FY25 E**	**FY26 E**	**FY27 E**
EBITDA	**376**	**366**	**343**	**332**	**420**	**480**	**485**	**492**
EBITDA Margin	*10.6%*	*10.0%*	*9.7%*	*10.2%*	*15.6%*	*24.8%*	*25.1%*	*25.2%*
Variation YoY	*-14.3%*	*-2.7%*	*-6.3%*	*-3.1%*	*26.5%*	*14.2%*	*1.1%*	*1.5%*
Net Interest expenses	(106)	(97)	(90)	(100)	(180)	(169)	(159)	(126)
Taxes	(7)	11	(3)	21	7	(35)	(49)	(57)
Change in Working Capital	120	96	(32)	(17)	13	(15)	6	3
CAPEX	(105)	(184)	(125)	(103)	(100)	(80)	(81)	(82)
Restructuring charges					(136)	(50)	0	0
Free Cash Flow	**278**	**192**	**93**	**133**	**24**	**130**	**203**	**230**
FCF Margin	*7.8%*	*5.2%*	*2.6%*	*4.1%*	*0.9%*	*6.8%*	*10.5%*	*11.8%*
Dividends Paid	(34)	(35)	(35)	(35)	(35)	(35)	(35)	(35)
FCF - Dividends	**243**	**157**	**58**	**97**	**(11)**	**95**	**167**	**195**
BALANCE SHEET								
Cash	921	732	670	601	513	510	450	526
Bank Cash	133	149	229	277				
Total Debt	2,564	2,324	2,205	2,146	2,087	2,034	1,838	1,750
LEVERAGE RATIOS								
Net Debt / EBITDA	4.3x	4.3x	4.4x	4.6x	3.7x	3.1x	2.8x	2.4x
Net Debt ex Bank / EBITDA	4.7x	4.7x	5.1x	5.4x	4.4x	3.7x	3.4x	3.0x
EBITDA / Interest Expenses	3.6x	3.8x	3.8x	3.3x	2.3x	2.8x	3.1x	3.9x

1) Key Assumption

- Revenue Growth
  - SendTech Solutions: -2.5%/-1%/0% for 2024/2025/2026
  - Presort Services: 3% in 2024, 2% in 2025 and then 0%.
- Restructuring Charges
  - 136mm (2024), 50mm (2025)
- Margins: stable after 2025, first year without GEC business

2) Takeaways

- Revenues: Stabilizing around $1.95–$1.99bn (2025–2027)
- EBITDA Margins: ~25% from 2025
- Cash Flow: steady at around $180-$200mm after 2025
- Net Debt/EBITDA: Improves from 4.6x (2023) to 3.4x (2026)

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RELATIVE VALUATION

PBI 2029 Notes should trade closer to peers as the company deleverages

Comp Table

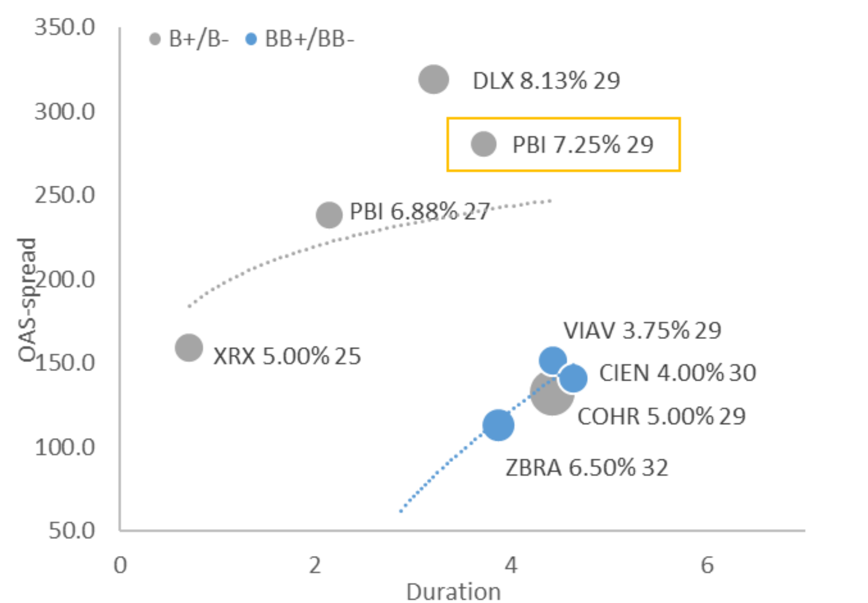
Issuer	Name	Coupon	Outstanding ($mm)	Maturity	Duration	Price	YTW	OAS-Spread	Leverage	Moody´s	S&P	Industry
CIENA CORP	CIEN 4 01/31/30	4.0%	400	1/31/2030	4.6	92.6	5.7%	141	1.0	Ba1	BB	Communications Equip.
ZEBRA TECHNOLOGIES CORP	ZBRA 6 1/2 06/01/32	6.5%	500	6/1/2032	3.9	102.2	5.9%	113	1.9	Ba2	BB	Electronic Equip. and Instr.
VIAVI SOLUTIONS INC	VIAV 3 3/4 10/01/29	3.8%	400	10/1/2029	4.4	91.2	5.8%	152	2.0	Ba2	BB	Communications Equip.
DELUXE CORP	DLX 8 ⅛ 09/15/29	8.1%	450	9/15/2029	3.2	101.4	8.1%	319	3.6	Ba3	B	Commercial Printing
COHERENT CORP	COHR 5 12/15/29	5.0%	990	12/15/2029	4.4	96.0	5.9%	133	2.5	B1	B+	Electronic Components
XEROX HOLDINGS CORP	XRX 5 08/15/25	5.0%	388	8/15/2025	0.7	98.5	7.0%	159	4.4	B1	BB-	Tech. Hardware, Storage and Peri.
PITNEY BOWES INC	PBI 6 7/8 03/15/27	6.9%	380	3/15/2027	2.1	98.9	7.4%	238	4.6	B2	B	Office Ser. and Supplies
PITNEY BOWES INC	PBI 7 1/4 03/15/29	7.3%	350	3/15/2029	3.7	99.1	7.8%	281	4.6	B2	B	Office Ser. and Supplies

Recommendation

- **Bull Case:** Tighten 150 bps to 130 bps / Annual Return: ~10%
- **Base Case:** Tighten 70 bps to 210 bps / Annual Return: ~9%
- **Bear Case**: Trade 70 bps wider to 350 bps / Annual Return: ~7%

PBI 29' trades:
- **150 bps wider** than the average of technology BB peers
- **80 bps wider** than the average B-rated companies with 3.5-4.5 duration (ex materials, energy, financials, and utilities)

Technology Sector: Spread vs Leverage



Source: Bloomberg.

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KEY RISKS TO THESIS

While we believe the SendTech Solutions business may require ongoing monitoring, the potential returns from PBI's rapid transformation currently outweigh the risks

Restructuring Costs	Low	• **RISK**: Higher than expected cost related to exit from E-Commerce business • **MITIGANT**: $50 mm increase in restructuring costs would have an estimated impact of only 0.1x on leverage levels
Increase in Interest Rates	Low	• **RISK**: after interest swaps, 37% of debt remains floating • **MITIGANT**: 100 bps rate increase would impact earnings by $8 mm, representing 5% of 2025 net income. This scenario is unlikely, as rates are already elevated
Sendtech Negative Revenue Trend	Moderate	• **RISK**: Economic slowdown could negatively impact deliveries • **MITIGANT**: While an economic downturn may delay deleveraging, the company has sufficient liquidity to withstand a severe recession, similar to that of 2020
Declining Presorting Market Volumes	Low	• **RISK**: The sorting market could experience a declining volume trend • **MITIGANT**: As the largest presorting company, they can leverage economies of scale and increase market share as regional players exit

Team Number: 2

Student Names: Sebastian Hartmann, Rachael Kim, Edward Rippon

APPENDIX

SPREAD CHART

PBI 2029 OAS Spread Chart

OWNERSHIP STRUCTURE

Hestia Capital has Pushed for Structural Changes in PBI

Top 5 Investors	% of Ownership
The Vanguard Group	10.3%
BlackRock	9.3%
Hestia Capital Management LLC	8.8%
State Street Global Advisors	3.6%
The Capital Management Corporation	2.3%

Hestia Capital Management

- Founded by Kurt Wolf
- Deep value hedge fund
- Activist investor that acquired a stake in PBI at the end of 2022
- Pursued structural changes at GameStop in 2020

Timeline of Changes proposed by Hestia

- **Apr-2023:** Hestia proposed five independent candidates for PBI's nine-member Board at the Annual Meeting and called for the removal of the CEO, alongside a six-pillar plan for a value-enhancing turnaround.
- **May-2023:** At the Annual Meeting, four of the proposed directors, including Kurt Wolf, the founder of Hestia, were elected.
- **Oct-2023:** Marc Lautenbach stepped down as President, CEO, and Board Member. An internal interim CEO was appointed.
- **May-2024:** Lance Rosenzweig, a director proposed by Hestia in May 2023, was appointed interim CEO, and cost savings of $60M-$100M were announced.
- **Aug-2024:** PBI announced its exit path for the Global E-commerce Segment.
- **Oct-2024**: Lance Rosenzweig was appointed permanent CEO, and Milena Alberti-Perez, director proposed by Hestia in May 2023, was elected as non-executive Chair.

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ALTERNTIVE SCENARIOS

Bear/Bull Case

Free Cash Flow Projections

Data in $mm	Historical				Bear Case			Bull Case		
SEGMENTS	**FY20 A**	**FY21 A**	**FY22 A**	**FY23 A**	**FY24 E**	**FY25 E**	**FY26 E**	**FY24 E**	**FY25 E**	**FY26 E**
SendTech Solutions	1,414	1,398	1,360	1,293	1,295	1,256	1,218	1,295	1,282	1,282
Presort Services	521	573	602	618	636	636	636	636	649	662
Global Ecommerce	1,619	1,703	1,576	1,355	761	0	0	761	0	0
Total Revenues	**3,554**	**3,674**	**3,538**	**3,266**	**2,692**	**1,892**	**1,854**	**2,692**	**1,931**	**1,944**
Variation YoY	*10.9%*	*3.4%*	*-3.7%*	*-7.7%*	*-17.6%*	*-29.7%*	*-2.0%*	*-17.6%*	*-28.3%*	*0.7%*
SendTech Solutions	477	459	438	443	453	414	402	453	481	481
Presort Services	88	107	110	145	162	153	146	181	179	182
Global Ecommerce	(13)	(20)	(30)	(75)	(42)	0	0	(42)	0	0
Corporate expense	(200)	(208)	(204)	(211)	(202)	(170)	(171)	(202)	(164)	(155)
Corporate D&A	25	27	28	30	32	23	22	32	23	23
Total EBITDA	**376**	**366**	**343**	**332**	**404**	**420**	**400**	**423**	**518**	**531**
CASH FLOW	**FY20 A**	**FY21 A**	**FY22 A**	**FY23 A**	**FY24 E**	**FY25 E**	**FY26 E**	**FY24 E**	**FY25 E**	**FY26 E**
EBITDA	**376**	**366**	**343**	**332**	**404**	**420**	**400**	**423**	**518**	**531**
EBITDA Margin	*10.6%*	*10.0%*	*9.7%*	*10.2%*	*15.0%*	*22.2%*	*21.6%*	*15.7%*	*26.8%*	*27.3%*
Variation YoY	*-14.3%*	*-2.7%*	*-6.3%*	*-3.1%*	*21.7%*	*3.9%*	*-4.7%*	*27.4%*	*22.5%*	*2.4%*
Net Interest expenses	(106)	(97)	(90)	(100)	(180)	(175)	(169)	(180)	(169)	(159)
Taxes	(7)	11	(3)	21	11	(21)	(29)	7	(43)	(58)
Change in Working Capital	120	96	(32)	(17)	22	1	2	13	(15)	6
CAPEX	(105)	(184)	(125)	(103)	(100)	(80)	(78)	(100)	(80)	(82)
Restructuring charges					(136)	(50)	0	(136)	(50)	0
Free Cash Flow	**278**	**192**	**93**	**133**	**20**	**94**	**126**	**27**	**161**	**238**
FCF Margin	*7.8%*	*5.2%*	*2.6%*	*4.1%*	*0.8%*	*5.0%*	*6.8%*	*1.0%*	*8.3%*	*12.3%*
Dividends Paid	(34)	(35)	(35)	(35)	(35)	(35)	(35)	(35)	(35)	(35)
FCF - Dividends	**243**	**157**	**58**	**97**	**(15)**	**59**	**91**	**(8)**	**126**	**203**
BALANCE SHEET										
Cash	921	732	670	601	509	469	432	515	543	518
Bank Cash	133	149	229	277						
Total Debt	2,564	2,324	2,205	2,146	2,087	2,034	1,938	2,087	2,034	1,838
LEVERAGE RATIOS										
Net Debt / EBITDA	4.3x	4.3x	4.4x	4.6x	3.9x	3.7x	3.7x	3.7x	2.8x	2.4x
Net Debt ex Bank / EBITDA	4.7x	4.7x	5.1x	5.4x	4.6x	4.4x	4.4x	4.4x	3.4x	3.0x
EBITDA / Interest Expenses	3.6x	3.8x	3.8x	3.3x	2.2x	2.4x	2.4x	2.4x	3.1x	3.3x

Bear Case Key Assumption

- Revenue Growth
  - SendTech Solutions: negative trend until 2026
  - Presort Services: flat after 2024.
- Margins: decreasing

Bull Case Key Assumption

- Revenue Growth
  - SendTech Solutions: negative trend until 2026
  - Presort Services: 3% in 2024 and then 2%
- Margins: increasing 200bps , with higher cost reductions at corporate level

MANAGEMENT & BOARD

Main executives and recent board members changes

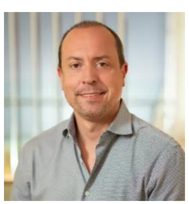
CEO and Board Director

Lance Rosenzweig: Appointed as interim CEO in May 2024, and permanent CEO in October 2024. Background on driving efficiencies and simplifying corporate structures. Previously served as CEO of Support.com, Inc., a provider of customer and technical support solutions and security software, and a s CEO of Startek Inc., a global business process outsourcing company. Has served as a member of the board at several public and private companies, including Boingo Wireless, Inc., where he was chairman of the board, and NextGen Healthcare.

Board of Directors

Milena Alberti-Perez: Non-Executive Chairman since 2023. Former CFO of Getty Images and MediaMath, with leadership experience as CFO at Penguin Random House (2015–2017)

Kurt Wolf: CEO of Hestia Capital Management, previously served as a director at GameStop and Edgewater Technology



Todd Everett: Advisor to ecommerce companies like Doddle Parcel and Fetch Package. Former strategic advisor to 101 Commerce and held leadership roles at Newgistics, a PBI subsidiary

Catherine Levene: Experienced digital innovator, ex-President of Meredith Corporation's National Media Group. Co-founded Artspace Marketplace and held executive roles at The New York Times and DailyCandy

Julie Schoenfeld: Technology entrepreneur with over 30 years of experience. Former CEO of Strobe (acquired by Cruise Automation/GM) and Perfect Market (acquired by Taboola). Board experience includes public and private companies

Paul Evans: Leadership in corporate transformations. Former COO of America's Auto Auction, interim CEO at Hill International, and CFO at Sevan Multi-Site Solutions and MYR Group. Served on the boards of Hill International and GameStop during key transitions.

PRIMARY RESEARCH : IR CALL

Focus on high-margin segments, wind down GEC, and reduce debt

IR Team : Alexander Brown, Director of Investor Relations:

- **Business Segments**

  SendTech Solutions: 30%+ EBITDA margins, growing shipping B2B software contributes 16% of sales
  Presort Services: 20% EBIT margins through scale (organic growth), M&A planned of regional players
  Global E-commerce: $150 million in costs is conservative; segment consolidation ceased in August

- **Financial Strategy**

  Debt Management: Prioritizing high-cost debt reduction after near-term obligations
  Banking Operations: Manages $600M in deposits, offering low-cost postage financing
  Cash Optimization: Repatriating international cash and reducing U.S. cash balances

- **Cost Management and Outlook**

  Cost Savings: Aggressive cost reduction initiatives underway, funded by corporate cash
  CapEx: Consistent investment of around $70 million annually for SendTech and Presort Services

Note: (PBI is in a quiet period ahead of Q3 earnings, only able to share fundamental/high level)

3Q24 Earning Call Summary

Progress on GEC Exit, boosting annual guidance, increased cost savings, improved cash optimization

GEC Exit
- Progressing well and expected to be largely complete by year-end
- Target one-time costs of approximately $150 million
- Expected to improve go-forward earnings by approximately $136 million annually

Cost Reduction
- Removed $90 million in annualized costs by the end of Q3
- Increased net cost savings forecast to $150-$170 million, up from $120-$160 million

Cash Optimization
- Repatriated $117 million back to the U.S. year-to-date
- Implemented cash pooling system to maintain lower overseas cash levels
- Expect to maintain $100 million lower corporate cash levels post-GEC exit

Debt Reduction
- Over $100 million of excess cash available for debt paydown
- In discussions with lending partners on strategic deleveraging options

Guidance
- Full year revenue expected to decline at a low-single-digit rate
- Raised EBIT guidance to $355-$360 million
- Implementing PB Bank receivables purchase program to accelerate cash realization from leases

Q&A Highlights
- Shift towards lease extensions in SendTech, resulting in less equipment sales revenue but more recurring revenue
- Presort business performing well with expectations for continued strong results
- Cost savings being realized across all segments, including corporate. Future savings expected from indirect or external spend
- 2025 outlook includes tailwinds from shipping business growth and cost savings, with headwinds from IMI migration completion
- GEC wind-down progressing well, with potential for a few outlier creditor issues
- Considering various factors for debt restructuring, including near-term maturities and higher-cost debt
- Management working to rebuild credibility with the market through transparency and clear communication

	Sendtech			Presort		
($ millions)	2024 3Q	2023 3Q	% Change	2024 3Q	2023 3Q	% Change
Revenue	$313	$327	-4%	$166	$152	9%
Adjusted Segment EBITDA	$114	$109	5%	$55	$37	47%
Adjusted Segment EBIT	$104	$99	5%	$46	$29	59%

COVENANTS

Summary of covenants

7.250% SENIOR NOTES DUE 2029

- Limitations on further indebtedness
- Limitations on liens
- Limitations on asset sales
- Restricted payments - Yes
- Change of Control – Yes, at 101%

Term Loan Only

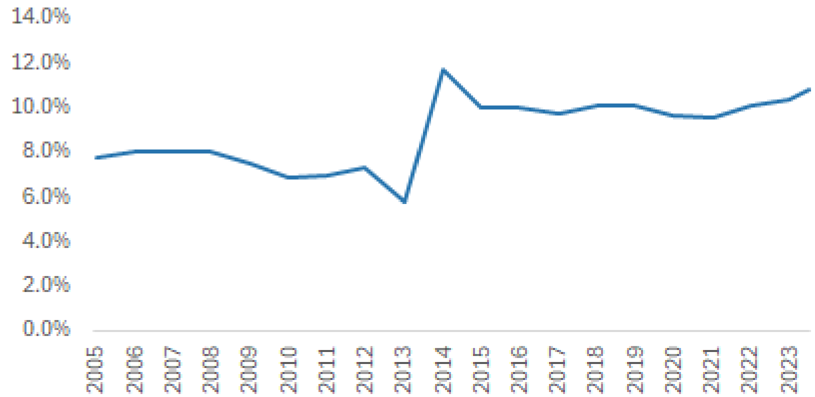
- Interest Coverage Test – ICR > 2.5x
- Leverage Ratio Test – Leverage < 4.0x
- Using consolidated adjusted pro forma EBITDA

PITNEY BOWES BANK

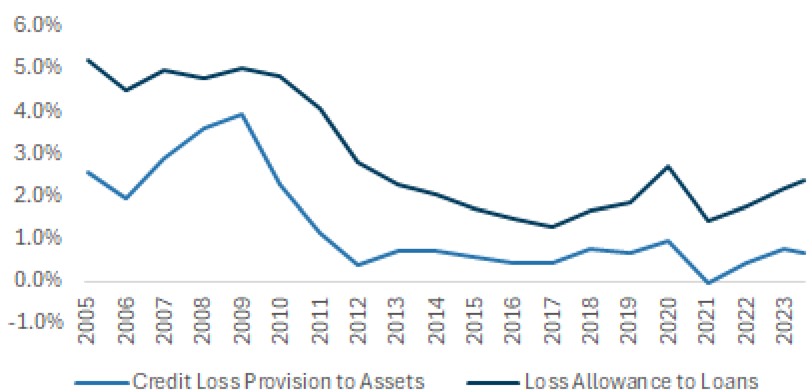
Risk Ratios

Balance Sheet ($mm)	2019	2020	2021	2022	2023	Jun-24
Cash	$109	$133	$149	$229	$277	$291
Securities	$362	$378	$350	$230	$220	$230
Net Loans	$233	$214	$223	$277	$333	$334
Assets	**$748**	**$769**	**$767**	**$790**	**$871**	**$899**
Deposits	$624	$651	$658	$657	$741	$742
Liabilities	**$670**	**$696**	**$698**	**$749**	**$815**	**$841**
Equity	**$78**	**$73**	**$69**	**$41**	**$56**	**$59**
Ratios ($mm)	**2019**	**2020**	**2021**	**2022**	**2023**	**Jun-24**
Loan/Deposits	37%	33%	34%	42%	45%	45%
Core Capital Ratio	10.1%	9.6%	9.6%	10.1%	10.3%	10.8%
NIM /Avg Assets	10.5%	9.0%	5.8%	6.2%	7.2%	7.5%
Credit Loss Provision to Assets	0.6%	1.0%	-0.1%	0.4%	0.8%	0.6%
Net Charge-Offs to Loans	1.9%	2.5%	1.0%	0.7%	1.2%	1.2%
Loan Loss Provision to Net Charge-Offs	109%	131%	-22%	200%	168%	136%
Loss Allowance to Loans	1.8%	2.7%	1.4%	1.8%	2.2%	2.4%

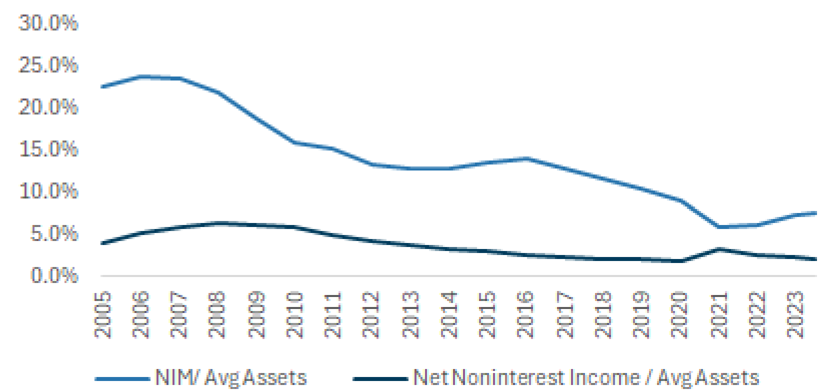
Core Capital Ratio



Credit Risk



NIM & Non-interest Income



Source: FDIC

GAP INC.

Alpha Challenge
Kenan–Flagler Business School
The University of North Carolina

MONTH DATE: November 24, 2024

Team Number: Credit Team 6

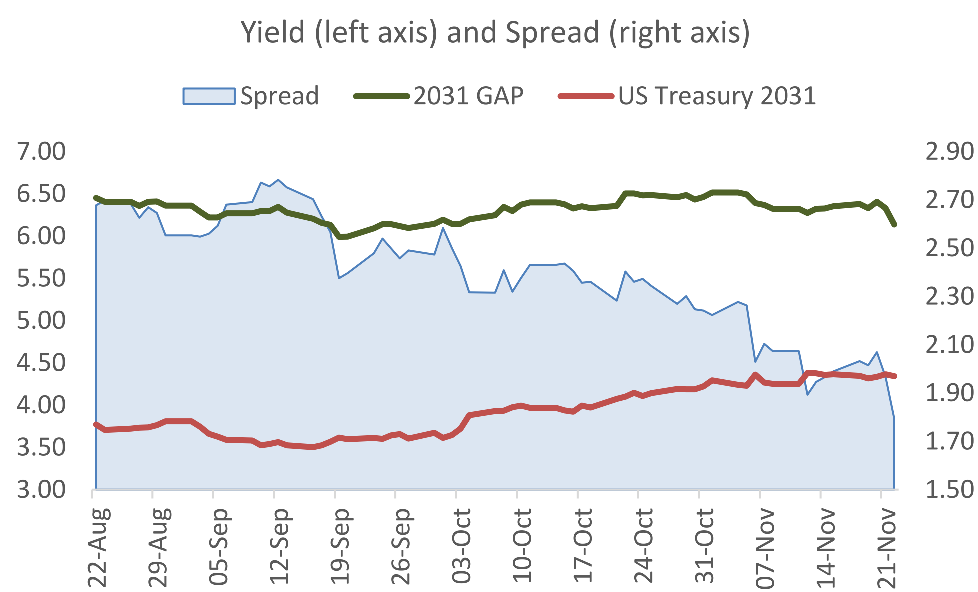
Students: Mariano Salinas, Ashlyn Colbert, Juan Franco Lazo Diaz

Investment Summary

- **Recommendation**: BUY The Gap Inc. 3.685% 2031 Senior Unsecured Notes (BB/B1) trading at **86.375** with a **6.33% yield to maturity** and ~**236bps** spread (as of 10/18/2024).
- **Target Spread**: **214 bps** and base-case target total return of **~6.6%** p.a.
- **Key Factors**:
    - **Leadership's Proven Playbook**
    - **Catalysts for Brand Renewal**
    - **Capture Margin Expansion**

UPDATE

- **Recommendation change to** HOLD The Gap Inc. 3.685% 2031 Senior Unsecured Notes (BB/B1) trading at **88** with a **6.12% yield to maturity** and ~**176bps** spread (as of 10/18/2024).



Company Overview

Gap is a global retailer that designs, manufactures, and sells apparel, accessories, and footwear through iconic brands like Gap, Old Navy, and Banana Republic

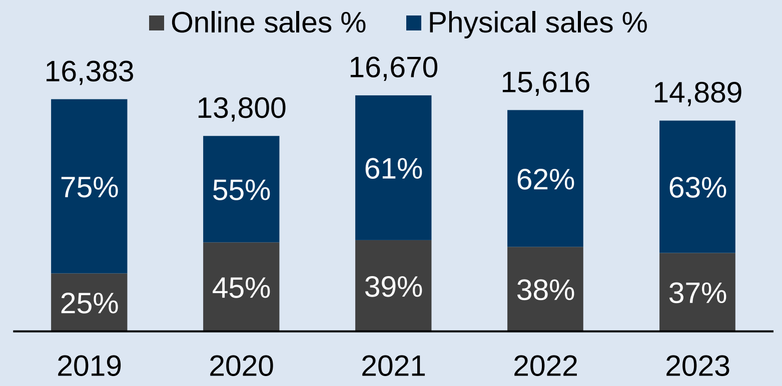
Company Background

- Gap Inc. was founded in 1969 by Donald Fisher & Doris F. Fisher. With 3,000+ stores worldwide and an extensive online presence, Gap Inc. serves millions of customers, offering a range of products that cater to diverse styles.
- Gap Inc. operates as an omni-channel retailer, offering apparel, accessories, and personal care products through its iconic brands—Old Navy, Gap, Banana Republic, and Athleta.

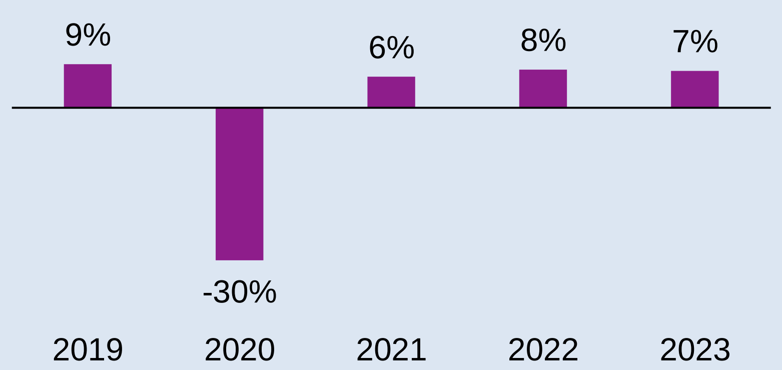
Current Challenges & Recovery

- Gap's stock has increased 16% following the Q3-24 earnings release but remains ~25% below its COVID-era highs, reflecting operational missteps and macroeconomic headwinds.
- Before Q3-24, the stock struggled due to underperformance, but recent results have signaled improving trends.
- Gap's recent moves under new leadership are beginning to show results, with improving profitability and a positive market reaction.

Total Revenues *(FY19-FY23 in USD)*



% EBITDA Margin *(FY19-FY23)*

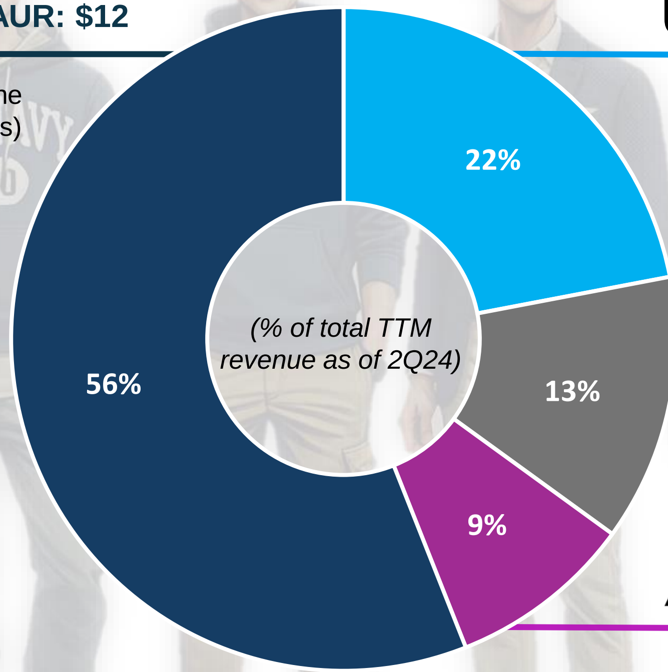


Portfolio of Iconic American Brands

Gap Inc. is the largest specialty apparel company in the U.S. and a house of iconic American brands including Old Navy, Gap, Banana Republic, and Athleta

OLD NAVY — **AUR: $12**

Affordable on-trend clothing for the family; targeted at women (35-44 yrs) with children; audience is 90% female



GAP — **AUR: $20**

Timeless yet on-trend clothing targeted at millennials (25-35 yrs), marked by frequent online shopping and brand loyalty

BANANA REPUBLIC — **AUR: $40**

Gap's most luxurious brand targeted at young professionals

ATHLETA — **AUR: $60**

Female athleisure brand known for inclusive sizing, closest competitor is Lululemon

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Capital Structure and Leverage Overview

GAP INC.

Gap Inc.'s total debt stands at **$5.47 billion**, with a mix of secured debt and unsecured senior notes maturing in 2029 and 2031. The company's net debt is **$3.25 billion** after accounting for cash and equivalents.

We now put a HOLD recommendation on the 2031 notes after exceeding expectations from October valuation; now in line to Consumer Discretionary BB+ benchmarks.

We don't anticipate refinancing risks as forecasted ratios remain strong, even in a downside scenario with potential rating downgrades, supporting the ability to roll over the 2029 note.

Category ($ in millions)	Amt. Outstanding	Price	Yield	Coupon	Gross Leverage	Net Leverage	LTV
Revolving Credit Facility matures 7/13/2027	-	-	-	NA			
Operating Lease Liabilities	3,997	-	-	-			
Total Secured Debt	**$ 3,997**	**-**	**-**	**-**	**1.4x**	**0.6x**	***32%***
3.625% Senior Notes due 10/1/2029	750	90.4	5.93%	3.625%			
3.875% Senior Notes due 10/1/2031	750	87.6	6.12%	3.875%			
Total Debt	**$ 5,470**				**1.9x**	**1.1x**	***43%***
(-) Cash And Equivalents	2,219-	-	-				
Net Debt	3,251-	-	-				
(+) Market Capitalization	9,359-	-	-				
Enterprise Value	**$ 12,610 -**	**-**	**-**				

Note: Market data as of 11/24/2024

LTM EBITDAR	**$ 2,879**

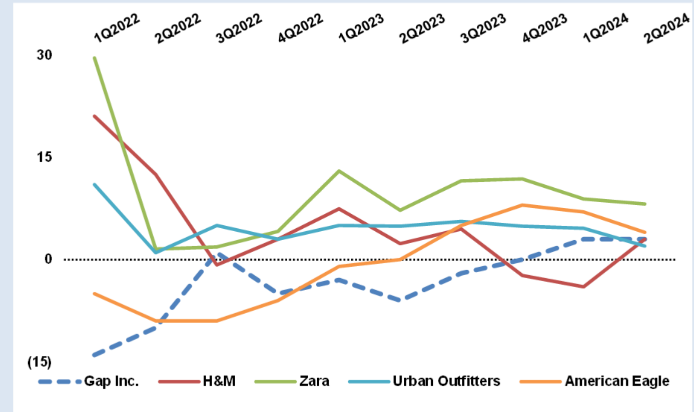
Investment Thesis

Revival of a Classic American Brand

Under seasoned leadership, Gap Inc. Is positioned to catalyze growth through tailored brand strategies and capitalize on margin expansion across its portfolio.

Per the chart to the chart comparing Gap Inc. to competitors, Gap Inc. Is on a positive trajectory, correcting YoY same store sales as of 1Q24.

Same Store Sales – Median (%)



1. New leadership brings expertise in reinvigorating classic American brands

Under CEO Richard Dickson's leadership, Gap Inc. is executing a promising turnaround. Q2 results, including the 6th consecutive quarter of market share gains, validate this. The management's renewed focus on brand revitalization, operational excellence, and inventory management sets the stage for sustainable growth and enhanced shareholder value undergoing a significant brand revitalization, with a focus on improving cultural relevance and optimizing cost and inventory management

2. Tailored strategies serve as catalysts to drive brand growth

Gap's multi-brand strategy offers diverse growth opportunities. Old Navy posted its 4th consecutive quarter of positive comps, up 5% in Q2. The Gap brand gained market share for the 5th consecutive quarter, while Athleta is expected to return to positive comps in Q3. This brand-specific approach, coupled with innovative marketing, positions Gap Inc. for continued market share gains across apparel segments

3. Capture margin expansion through operational rigor

Gap's operational efficiency drive promises substantial margin growth. In 2Q24, the company already demonstrated potential with 500bp gross margin expansion and 490bp operating margin improvement. With continued focus on inventory management and cost control, Gap Inc. is positioned for sustainable profitability gains, outpacing industry averages

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Investment Thesis #1
Leadership's Proven Playbook

GAP INC.

Turnaround Potential

- In Aug 2023, Gap appointed Richard Dickson CEO with experience revitalizing deteriorating iconic American brands (credited with the high-profile turnaround of Mattel's Barbie)
- Prior to Dickson, Gap was chronically unable to execute marketing & product strategies that resonated with consumers
- Data shows that if Gap gives consumers a reason, they will visit
- Gap's cost structure has already been significantly revamped

Richard Dickson, CEO

Prior to joining Gap, Richard served as President & COO of Mattel, where he was instrumental in growing Mattel's brands and accelerating the company's transformation. He also held executive positions at The Jones Group and Bloomingdale's, and co-founded Gloss.com

Gap 'Playbook' Strategic Initiatives

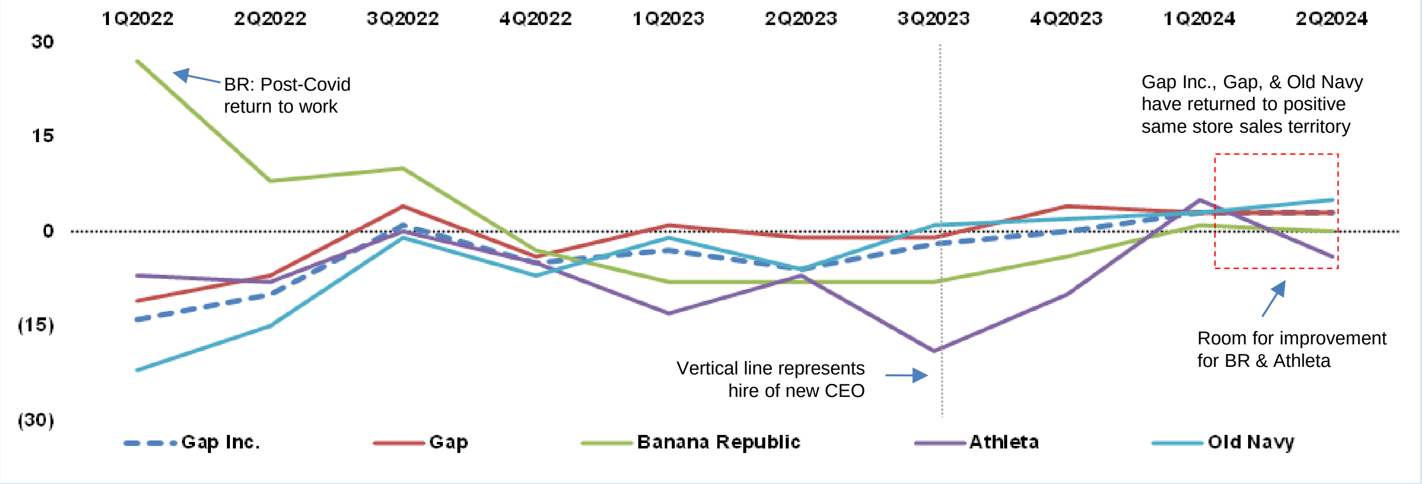
1) Financial and operational rigor

2) Brand reinvigoration

3) Operating platform

4) Culture reenergization

Same Store Sales – Median (%) *(1Q22 to 2Q24)*



Investment Thesis #2
Catalysts for Brand Renewal

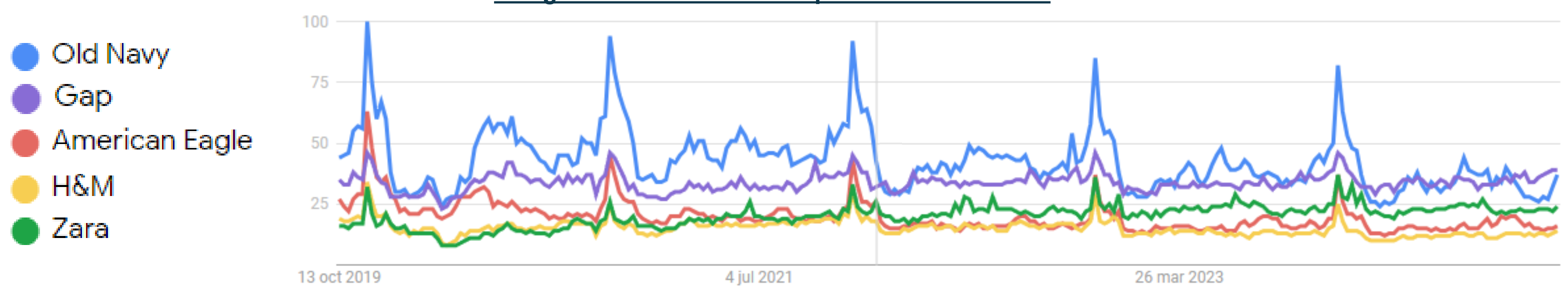
To drive customer acquisition, Gap, Inc. is executing culturally relevant marketing through unique media mixes with compelling value proposition and trend-right products...

It's working: *Apparel market was down 2% in 2Q24 yet Gap, Inc. brands gained market share with growth across all income cohorts*

OLD NAVY	GAP	BANANA REPUBLIC	ATHLETA
Gross margins nearing historical highs Largest brand in value space and leading market share in key categories including women's, denim, dresses, active, kids, and baby	Leveraging nostalgic brand heritage Success of marketing campaigns and focus on declaring trend statements (e.g., baggy and oversized trend) Successful collaborations driving relevance and new customer acquisition	Currently recruiting for a new Banana Republic brand leader Reestablishing the brand in the premium lifestyle space Focus on stability in men's business New flagship store concept in SoHo resonating with customers	After strategic period of heavy discounting, return to positive comps with broadened customer base, improved product sell-through, cleaner inventory position Brand refresh including partnerships with high-profile female athletes Focus on capturing athleisure market share

Old Navy and Gap have consistently maintained higher search interest relative to competitors, indicating strong customer engagement across multiple categories:

Google Trends chart of comparable retail brands



Investment Thesis #3
Capture margin expansion

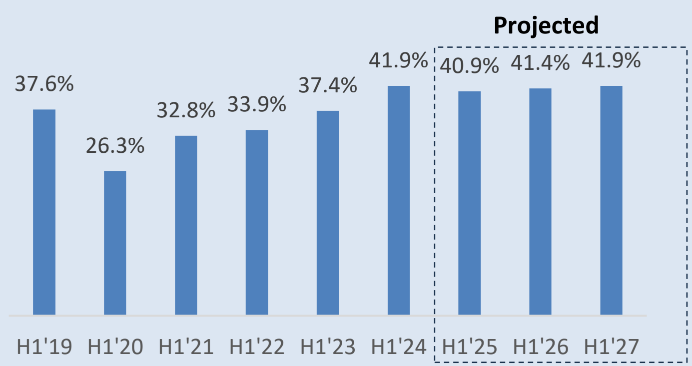
GAP INC.

"We have spent the last couple of years really rightsizing the business model... closing North America specialty stores that we potentially had overexpanded back in the heyday.. pivoting to be much more digital.. so really focusing on a much healthier core."

Focus on Gross Margin Expansion:

- Brand Premiumization: Athleta and Banana Republic are poised to drive higher margins through premium pricing and less reliance on promotions.
- Inventory Discipline: Gap's tighter control over inventory levels will continue to limit markdowns, preserving margin over the next 3-5 years.
- Operational Rigor: Ongoing supply chain optimizations and reduced dependency on volatile commodity costs will further bolster margins.

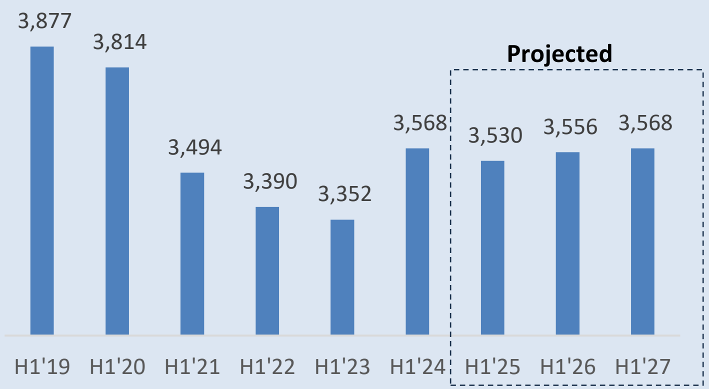
Gross Margin (All Brands) ***(H1'19 to H1'24)***



Driving Operating Leverage

- Over the last 18 months, Gap has taken significant steps to reduce SG&A expenses (e.g., reduced fixed costs associated with rent, labor, and utilities).
- The closure of over 350+ underperforming stores and the restructuring of corporate overhead will have long-term benefits on SG&A, improving operating margins.
- Gap is committed to further cost-saving initiatives, particularly in areas like technology and marketing, which will help maintain leaner SG&A.

Total Stores (All Brands) ***(H1'19 to H1'24)***



Valuation

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Base Case Projections

GAP INC.

	FY'23A	FY'24E	FY'25E	FY'26E	FY'27E	24-27 CAGR
Financial Metrics						
Old Navy Global	8,203	8,433	8,562	8,656	8,751	*1.2%*
Gap Global	3,341	3,296	3,358	3,420	3,498	*2.0%*
Banana Republic Global	1,939	1,878	1,793	1,807	1,846	*(0.6%)*
Athleta North America	1,360	1,391	1,439	1,501	1,576	*4.2%*
Other	46	56	56	56	56	*0.0%*
Total Revenue By Brand	$ 14,889	$ 15,055	$ 15,207	$ 15,440	$ 15,727	*1.5%*
% Growth YoY		*1%*	*1%*	*2%*	*2%*	
Gross Profit	$ 5,779	$ 6,099	$ 6,222	$ 6,394	$ 6,592	*2.6%*
% Margin	*38.8%*	*40.5%*	*40.9%*	*41.4%*	*41.9%*	
EBITDA	$ 1,088	$ 1,541	$ 1,818	$ 1,969	$ 2,132	*11.4%*
% Margin	*7.3%*	*10.2%*	*12.0%*	*12.8%*	*13.6%*	
EBITDAR	$ 1,945	$ 2,380	$ 2,640	$ 2,775	$ 2,921	*7.1%*
% Margin	*13.1%*	*15.8%*	*17.4%*	*18.0%*	*18.6%*	
Free Cash Flow	$ 1,110	$ 801	$ 814	$ 819	$ 822	*0.9%*
% Margin	*7.5%*	*5.3%*	*5.3%*	*5.3%*	*5.2%*	
Leverage Ratios						
Cash & Cash Equivalents	$ 1,873	$ 2,437	$ 2,307	$ 2,291	$ 2,318	*(1.7%)*
Net Debt	$ 3,568	$ 3,022	$ 3,152	$ 3,168	$ 3,141	
Payout Ratio	0.4x	0.3x	1.0x	0.8x	0.7x	
Net Debt / EBITDAR	1.8x	1.3x	1.2x	1.1x	1.1x	
Interest Coverage	21.6x	27.7x	32.2x	33.9x	35.7x	
Vs. Consensus						
Total Revenue		**$ 15,055**	**$ 15,207**	**$ 15,440**	**$ 15,727**	*1.5%*
Consensus		$ 15,001	$ 15,217	$ 15,561	$ 15,772	
Free Cash Flow Margin		*5.3%*	*5.3%*	*5.3%*	*5.2%*	
Consensus		*5.2%*	*5.3%*	*5.2%*	*5.2%*	

Assumptions:

- All three brands are projected to see stable revenue driven by strategic marketing efforts, brand reinvigoration, and category leadership (e.g., Old Navy's value segment and Athleta's athleisure).
- Margin expansion driven by brand premiumization (Banana Republic, Athleta), cost control (store closures, SG&A efficiency), and improved inventory management.

Improving Credit Profile:

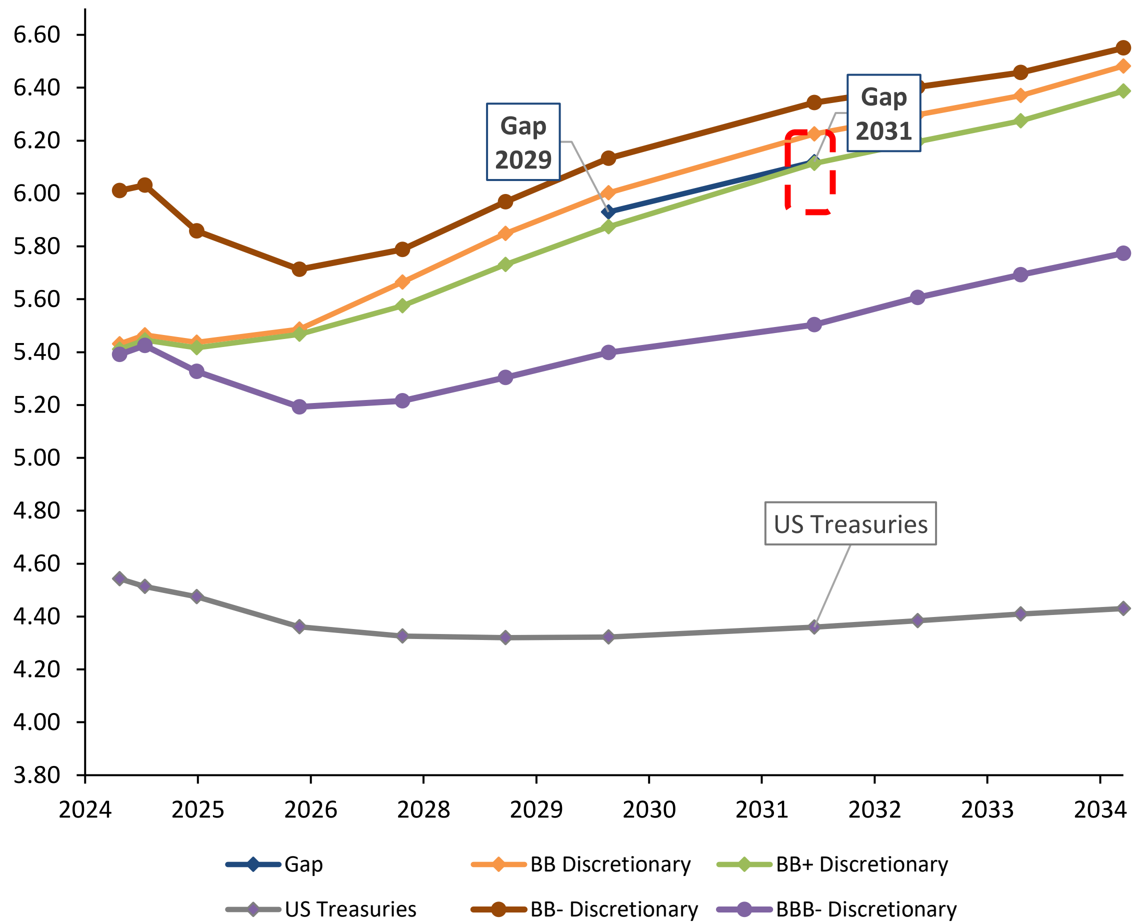
- Leverage reduction will be driven by $1.0B+ FCF generation annually and disciplined debt management, positioning Gap for a potential credit rating upgrade.
- Improved leverage, strong interest coverage, and lower financing costs support Gap's long-term stability.
- Strong FCF and balance sheet return to share buybacks (payout ratio > .75x)

Our View vs. Consensus:

- After the latest results, consensus has aligned with us. Now consensus is emphasizing the long-term benefits of the turnaround and cost reduction.
- Deleveraging is now exceeding expectations, potentially leading to a credit rating upgrade.

Mind the GAP Spread: 2031 bond compressed to 176bps, in line with BB+ comps, exceeding our October recommendation

Yield Curves as of 11/23/2024



BB- Discretionary 2031: 6.34%

BB Discretionary 2031: 6.23%

BB+ Discretionary 2031: 6.11%

GAP 2031: 6.12% YTW

BBB- Discretionary 2031: 5.50% bps

October valuation:

With our forecast indicating robust financial performance, we expect GAP to receive an upgrade from S&P from BB to BB+, resulting in a 22 bps compression on the 2031 note, positioning it midway between B+ (Moody's current rating) and BB+ (S&P's new rating).

If both agencies issue upgrades (bull case), there is potential for a 34 bps compression, positioning the note halfway between BB- and BB+ levels.

The market has already priced in an upgrade, with current spreads at 176 basis points in line with BB+ benchmark.

	Moody's: B1	S&P: BB	Bear	Base	Bull
Upgrade trigger	• Sustained sales and margin growth • Debt/EBITDA below 3.5x • EBIT/Interest above 3.5x	• Achieving performance milestones (Banana Republic and Athleta) • EBITDAR margins no less tan 14%	Not met	Partia lly	Met
Downgrade trigger	• Operating margins deterioration • Debt/EBITDA above 4.25x • EBIT/Interest below 2.5x	• Profitability or cashflow deterioration • Debt/EBITDAR above 3.0x	Met	Not met	Not met

Parent	Total EV (in mlns)	Security	S&P Rating	S&P Outlook	S&P Recovery	Price	OAS	YTW	LTV	Duration	LTM Net Leverage	LTM Net Coverage	NTM FCF / Debt
GAP INC/THE	$ 11,351	GAP 3 5/8 10/01/29	BB	STABLE	3(65%)	90.4	161.8	5.93%	48%	4.3%	1.1x	35.1x	13%
GAP INC/THE	$ 11,351	GAP 3 7/8 10/01/31	BB	STABLE	3(65%)	87.6	176.2	6.12%	48%	5.8%	1.1x	35.1x	13%
ADVANCE AUTO PARTS	$ 6,180	AAP 3.9 04/15/30	BB+	NEG	3(65%)	89.4	195.6	6.26%	69%	4.7%	3.1x	15.4x	2%
ADVANCE AUTO PARTS	$ 6,180	AAP 3.9 04/15/30	BB+	NEG	3(65%)	89.4	193.8	6.24%	69%	4.7%	3.1x	15.4x	2%
BATH & BODY WORKS INC	$ 11,742	BBWI 6 5/8 10/01/30	BB	STABLE	4(45%)	101.0	144.5	6.32%	46%	3.3%	2.4x	6.0x	14%
MACY'S RETAIL HLDGS LLC	$ 9,599	M 5 7/8 03/15/30	BB+	STABLE	4(45%)	96.0	224.8	6.78%	63%	4.4%	2.3x	18.8x	12%
NORDSTROM INC	$ 7,215	JWN 4 1/4 08/01/31	BB+	NEG	3(65%)	88.4	206.9	6.40%	59%	5.6%	2.4x	11.0x	11%
NORDSTROM INC	$ 7,215	JWN 4 1/4 08/01/31	BB+	NEG	3(65%)	88.5	204.9	6.38%	59%	5.6%	2.4x	11.0x	11%
NORDSTROM INC	$ 7,215	JWN 4 3/8 04/01/30	BB+	NEG	3(65%)	91.4	198.5	6.29%	59%	4.6%	2.4x	11.0x	11%
PATRICK INDUSTRIES INC	$ 4,485	PATK 4 3/4 05/01/29	BB-	STABLE	4(35%)	95.2	158.2	6.00%	36%	3.9%	3.1x	6.5x	20%
MEDIAN							197.0	6.31%	59%	4.7%	2.4x	11.0x	11%

Source: CapIQ; Net Debt / EBITDA calculated as Net Debt (incl. operating leases) / (EBITDA+lease adjustment for EBITDA)

Risks & Mitigants

Risks	Mitigants
Macro-Economic Weakness and Consumer Spending Slowdown Apparel retailers like Gap Inc. face heightened risk as lower-income consumers cut back on non-essential purchases.	Strong positioning as a value-driven brand allows Gap to capture budget-conscious shoppers looking for affordable fashion alternatives. Additionally, Gap's diversified brand portfolio, which spans across price points and demographics, helps mitigate concentrated exposure to any single consumer segment
Brand-Specific Performance Old Navy contributes significantly to Gap's revenue, and any slowdown in its performance poses a risk to the company's overall financial health. Weaker performance at Athleta and Banana Republic could limit the company's ability to fully capitalize on its portfolio's potential.	Gap has been actively investing in brand reinvigoration across its entire portfolio. Management is focusing on improving brand relevance, particularly for Athleta and Gap, through targeted marketing and product innovation. This diversification of growth drivers should reduce reliance on Old Navy alone
Cost Inflation and Supply Chain Pressures Gap faces ongoing risks from rising input costs (e.g., raw materials, freight) and potential disruptions in its global supply chain.	Gap has been proactive in managing these risks through better sourcing strategies and leveraging economies of scale. The company's ability to pass through some cost increases, along with its focus on operational efficiencies, such as tighter inventory management and cost-saving initiatives, should help cushion the impact of future cost inflation.
Political Risk - Global Tariffs Some politicians could apply tariffs as high as 60% on Chinese imports and 10-20% tariffs globally	GAP is not heavily dependent on China, which would likely be most affected by such tariffs. GAP's primary suppliers are from Vietnam (29%) and Indonesia (18%). Additionally, if a global tariff were to be applied, it would also impact GAP's competitors, who similarly rely on imported goods.

Appendix

Indenture information

The indenture governing both the 2029 and 2031 bonds was executed on September 27, 2021. The same indenture governs both the 3.625% Senior Notes due 2029 and the 3.875% Senior Notes due 2031, outlining the covenants, rights, and obligations for both sets of bondholders.

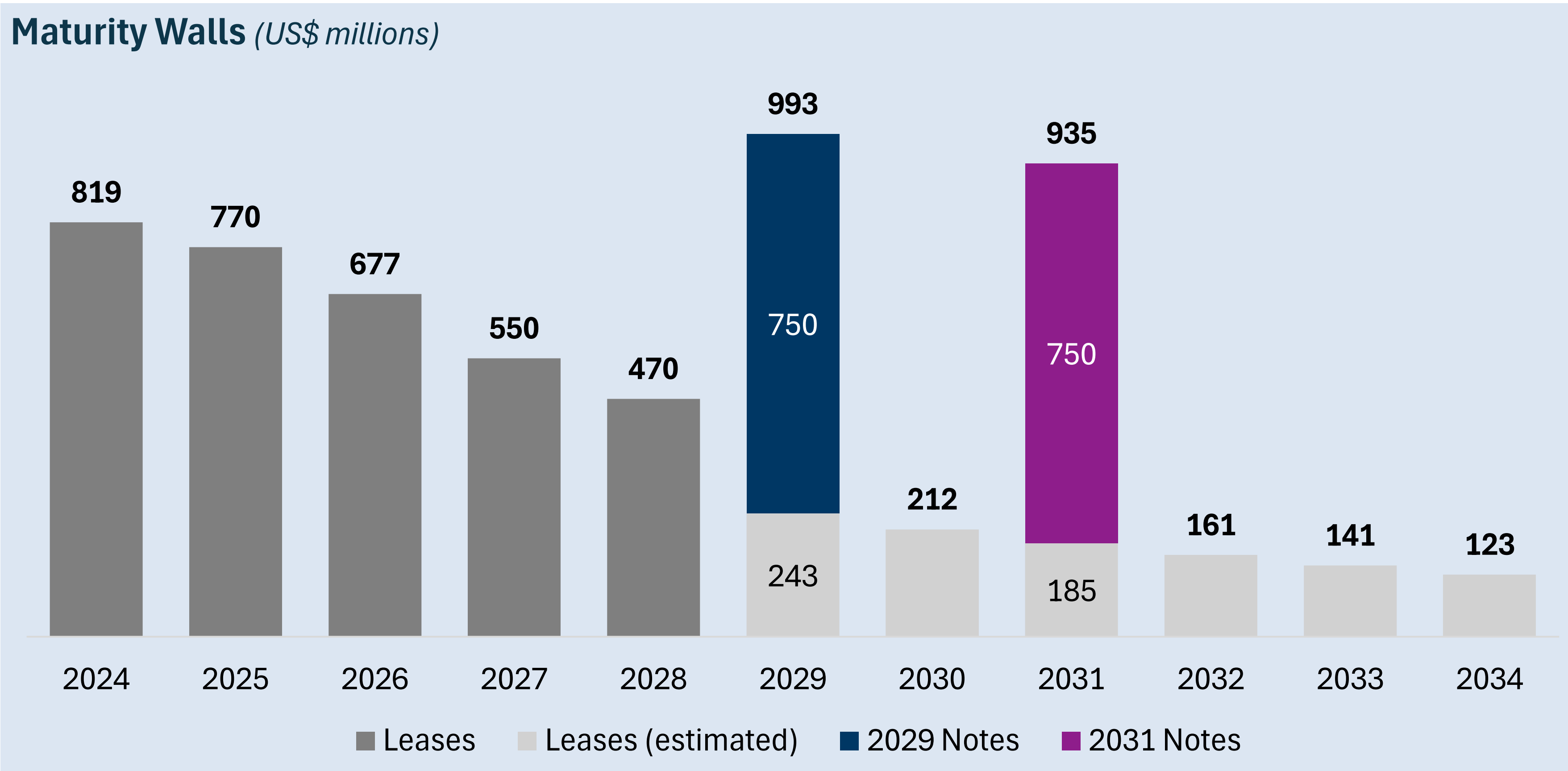
Covenants:

- Limitation on Liens: The company and its subsidiaries are restricted from granting or incurring liens unless the bonds are equally and ratably secured. Certain permitted liens are excluded from this limitation.
- Limitation on Sale-Leaseback Transactions: The company is restricted from engaging in sale and leaseback transactions unless the net proceeds are used to retire funded debt or certain other conditions are met.
- Change of Control Offer: If there is a change of control triggering event, the company must offer to repurchase the bonds at 101% of the principal amount plus accrued interest
- Future Guarantors: Certain future subsidiaries that meet specific criteria will be required to guarantee the bonds.

Rank:

- The 2031 bond is a senior unsecured obligation, ranking equally with other senior unsecured debt of Gap Inc. and its guarantors.
- It is subordinated to secured debt, including the Existing **ABL Credit Agreement** and the Senior Secured Notes due 2023, 2025, and 2027, to the extent of the collateral securing those obligations. As of the FY2023, the outstanding balance of this facility is zero.
- The ABL Credit Agreement facility matures in July 2027 and has a borrowing capacity of USD 2.2 billion.

Maturity Walls



**The lease schedule beyond 2028 was not provided by the firm, but they indicated that the total payments amount to US$1.762 billion, with the final payment occurring in 2047. We have assumed a gradual, smoothed payment distribution over this period, as reflected in the chart through 2034.*

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Downside Case

GAP INC.

	FY'23A	FY'24E	FY'25E	FY'26E	FY'27E
Financial Metrics					
Old Navy Global	8,203	8,288	8,187	8,105	8,024
Gap Global	3,341	3,296	3,155	3,027	2,917
Banana Republic Global	1,939	1,878	1,775	1,711	1,670
Athleta North America	1,360	1,391	1,362	1,335	1,308
Other	46	56	56	56	56
Total Revenue By Brand	$ 14,889	$ 14,910	$ 14,536	$ 14,235	$ 13,977
% Growth YoY		*0%*	*(3%)*	*(2%)*	*(2%)*
Gross Profit	$ 5,779	$ 6,042	$ 5,600	$ 5,413	$ 5,245
% Margin	*38.8%*	*40.5%*	*38.5%*	*38.0%*	*37.5%*
EBITDA	$ 1,088	$ 1,251	$ 917	$ 827	$ 742
% Margin	*7.3%*	*8.4%*	*6.3%*	*5.8%*	*5.3%*
EBITDAR	$ 1,945	$ 2,089	$ 1,739	$ 1,632	$ 1,531
% Margin	*13.1%*	*14.0%*	*12.0%*	*11.5%*	*11.0%*
Free Cash Flow	$ 1,110	$ 779	$ 265	$ 228	$ 273
% Margin	*7.5%*	*5.2%*	*1.8%*	*1.6%*	*2.0%*
Leverage Ratios					
Cash & Cash Equivalents	$ 1,873	$ 2,414	$ 2,445	$ 2,441	$ 2,480
Net Debt	$ 3,568	$ 3,045	$ 3,014	$ 3,018	$ 2,979
Net Debt / EBITDAR	1.8x	1.5x	1.7x	1.8x	1.9x
Interest Coverage	21.6x	24.3x	21.2x	19.9x	18.7x

Assumptions & Commentary:

- With ~$2.4B in cash and strong free cash flow generation, Gap is well-positioned to manage its debt obligations and avoid liquidity crises, even if revenue growth slows.
- Gap Inc. owns valuable brands such as Old Navy, Gap, and Athleta, which could be sold individually to raise substantial capital if needed. This offers a significant backstop for debt repayment even in a downside scenario.
- Declines in EBITDAR margins below the 14% threshold (S&P downgrade trigger) would pose a risk to the credit profile.
- In a downside scenario, Net Debt/EBITDAR could rise above 3.0x, triggering a downgrade by S&P, especially if performance milestones are not met.
- Moody's downgrade could be triggered if Debt/EBITDA exceeds 4.25x due to a deterioration in operating margins, which is a key risk if sales trends worsen further.

Recent Executive Leadership Hires

Sally Gilligan, Chief Supply Chain & Transformation Officer (Jan 2024)

With over 20 years at Gap, Sally has held various roles, incl: Chief Growth Transformation Officer, Chief Information Officer, and Sr. VP of Product Operations and Supply Chain Strategy. Before joining Gap, she worked in management consulting and financial services

Erick Chan, Chief Business Officer (Jan 2024)

With over 20 years of financial and operational leadership experience, Erick served as CFO of the LA Clippers, COO for The Bouqs Company, and CFO for Loot Crate, where he helped scale the company from a startup to $165M revenue

Sven Gerjets, Chief Technology Officer (Jun 2024)

Sven brings over two decades of experience in leveraging technology to fuel business growth and operational excellence, holding executive roles at industry giants including Mattel, Time Warner Cable, and DIRECTV

Chris Blakeslee, CEO Athleta (Aug 2023)

Chris brings expertise in the apparel retail and wholesale industries, within marketing, sales, product management, operations, and supply chain. He served as President of sister companies Alo Yoga and Bella+Canvas, where he led Alo to $1B+ in sales in 2022, nearly doubling its YoY growth

Kenan–Flagler Business School
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The University of North Carolina

December 5, 2024

Team Number: 1

Students:
David Oropeza
Amanda Kane
Melinda Wang

Investment Summary

Investment Recommendation:

- **BUY** Crocs Inc.**,** 4.125% Senior Unsecured Note 8/15/31 (BB) trading at 87.177 – 6.498% yield to worst and 215bps OAS
- **Target Spread**: 170bps and a base-case total return of 8.4%

- **Capital Structure**: Common Equity $6,182.6MM | Total Debt $1,465MM

- **Thesis 1:** Crocs Inc. has built strong brand equity and operations over time, as demonstrated by their increased prices and margins and track record of virality and marketing successes.

- **Thesis 2:** The market is overly pessimistic with HEYDUDE's future growth, as HEYDUDE maintains strong margins and is leveraging the "Crocs brand playbook" to build brand awareness and equity.

- **Thesis 3:** Crocs Inc.'s strong free cash flow generation enables them to quickly deleverage, improving credit metrics and capital structure for unsecured debt holders.

Note: Market values spreads are as of 11/15/2024

Company Overview

Crocs Inc. is a world leader in casual footwear operating in over 80 countries and generating $4 billion in annual revenues.

Key Facts:

- Crocs was founded in 2002 and was initially designed to be a slip-resistant boating shoe.
- The company consists of 2 brands: Crocs and HEYDUDE
    - HEYDUDE was purchased by Crocs inc. in 2021 and was formally added to the Crocs Inc. portfolio in 2022.
- Crocs products are sold in over 80 countries through DTC and Wholesale distribution channels

Product Examples:

crocs

HEY DUDE

Clogs/ fuzzy clogs

Collections & Collaborations

Wendy / Wally

Collections & Collaborations

Boots

Crocs at Work

Sneakers

Boots

Jibbitz

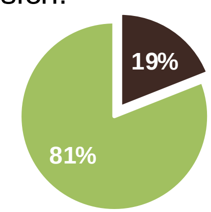
Socks

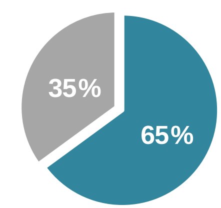
Patches

Insoles

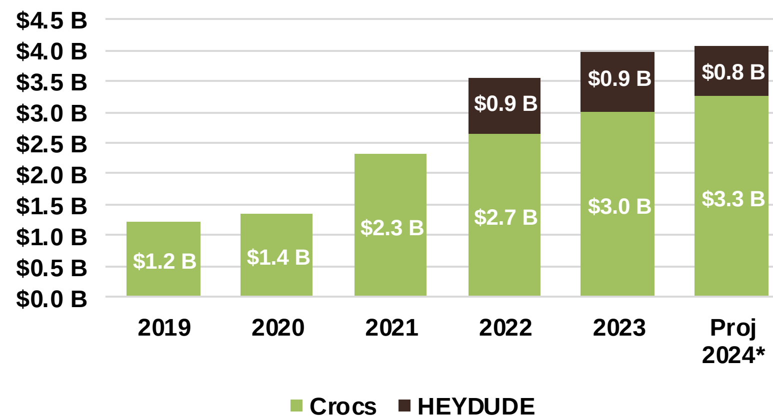
Revenue Breakdown:

By division:





Annual Revenue:



* Projected revenue is based off management guidance

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The 2031 notes are trading at a steep discount to par and have a long duration which will allow for further spread compression.

Notable points:

- The 2031 Notes were selected as the longer duration bonds offer a higher potential yield and spread compression.
- Debt / Equity = 102.8%, Total Debt / EBITDA = 1.3x, Net Debt / EBITDA = 1.2x, EBIT / Interest Expense = 9.7x

Capital Structure:

Facility	Debt Out ($MM)	Secure	Price	Call Price	Next Call Date	Market Value ($MM)	Current YTW	Coupon	S&P/ Fitch Rating	Spread
Total Secured Debt										
Term Loan B Facility maturing 2029	575	Y	-	-	-	575	-	-	-	-
Revolving Facility	190	Y	-	-	-	190	-	-	-	-
Total Unsecured Debt										
2029 Notes	350	N	92.091	102.125	12/18/24	322.32	6.362%	4.25	BB	201.71
2031 Notes	350	N	87.177	102.063	8/15/31	305.12	6.498%	4.125	BB	215
Total Debt Outstanding	**1,465**					**1,392**				
- Cash & Cash Equivalents	186.1					186.1				
Net Debt	**1,278.9**					**1,206.3**				
Total Minority Interest	0					0				
Market Capitalization	6,182.6					6,182.6				
Enterprise Value	**7,461.5**									

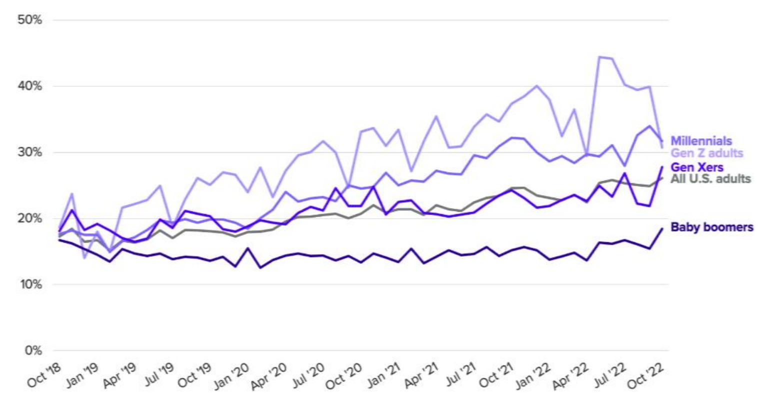
Note: Debt Outstanding as of 9/30/2024, market values and spreads as of 11/15/2024

Investment Thesis

Thesis 1: Crocs has built strong brand equity and operations over time, as demonstrated by their increased prices and margins and track record of virality and marketing successes.

1 Crocs has strong brand equity and virality, with flexibility to meet macro consumer trends

Crocs total purchasing consideration



Recent Collaborations

Sold out in hours

Barbie

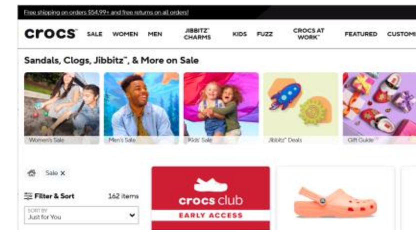
Satisfy

Diplo

Simone Rocha

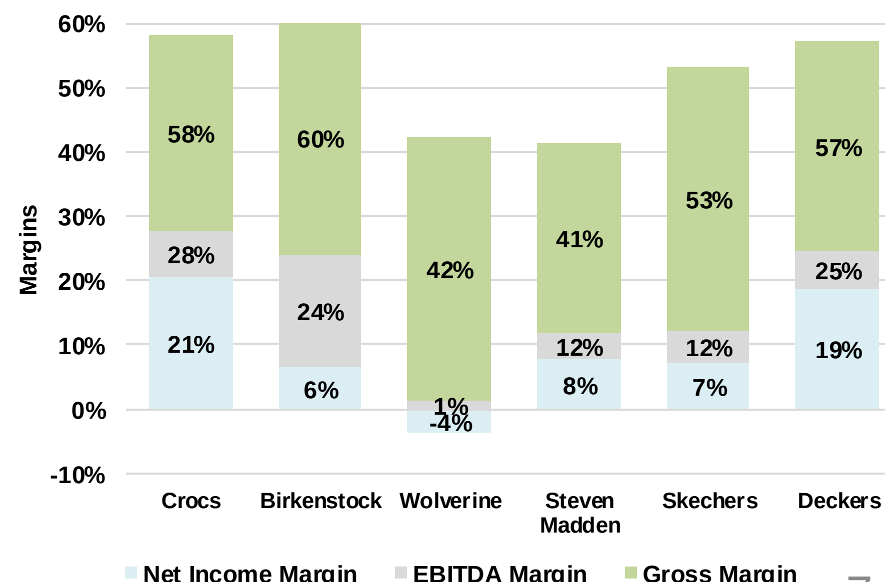
2 Crocs Inc. maintains strong operating margins with a focus on company-owned U.S. DTC sales and distribution

DTC Retail



DTC eCommerce

LTM CROX Peer Margin (%)



Source: Capital IQ.

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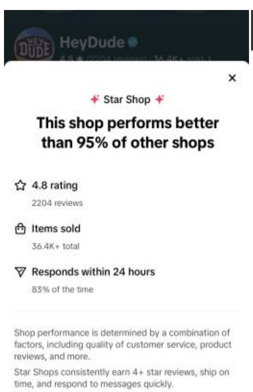
Thesis 2: The market is overly pessimistic with HEYDUDE's future growth, as HEYDUDE maintains strong margins and is leveraging the "Crocs brand playbook" to build brand awareness and equity.

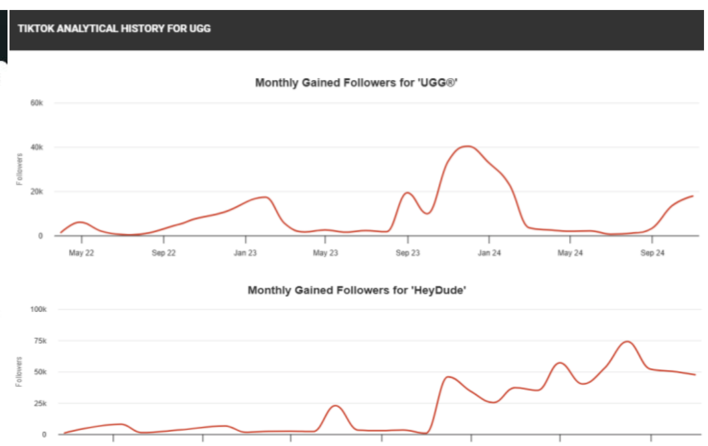
1 Crocs Inc. has been heavily investing in building HEYDUDE's brand awareness and equity.

Shift from short-term performance marketing to long-term brand marketing

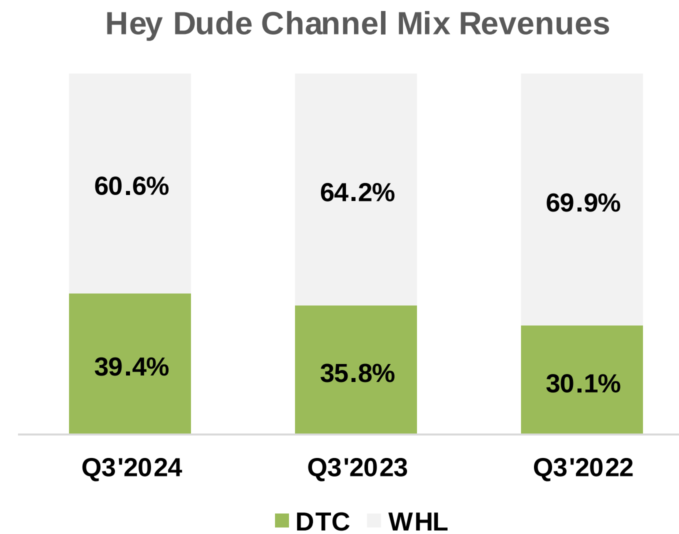
Sydney Sweeney
Global Ambassador

Jelly Roll Collab
sold out in minutes





2 HEYDUDE is building a foundation to scale profitability, with improving margins and strategic channel mix.



	Q3 2024	Q3 2023
Avg sell price	$29.77	$28.26
Gross margin	47.9%	42.8%

Source: Capital IQ

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Thesis 3: Crocs' strong free cash flow generation enables them to quickly deleverage, improving credit metrics and capital structure for unsecured debt holders.

Key Assumptions:

Bear	Crocs Revenue Growth (annual): 0% US, 5% INT HEYDUDE Revenue Growth (annual): -15%	Gross Margin Crocs: 50% Gross Margin HEYDUDE:35%
Base	Crocs Revenue Growth: 3% US, 8% INT HEYDUDE Revenue Growth: 0% in 2025; 5% beginning in 2026	Gross Margin Crocs: 62% Gross Margin HEYDUDE:48%
Bull	Crocs Revenue Growth: 8% US, 15% INT HEYDUDE Revenue Growth: 10%	Gross Margin Crocs: 66% Gross Margin HEYDUDE: 50%

USD Millions	2020	2021	2022	2023	2024E	2025E	2026E	2027E	2027 Bear	2027 Bull
Revenues	1,386	2,313	3,555	3,962	4,151	4,364	4,590	4,830	3,967	5,664
EBITDA	242	715	890	1,091	1,147	1,178	1,278	1,358	651	1,634
Net Income (Loss)	313	726	540	793	769	823	885	993	431	1,211
Cash from Ops.	267	567	603	930	803	1,024	793	1,130	463	1,303
Free Cash Flow	225	511	499	815	731	933	700	1,044	377	1,218
Cash & Cash Equivalents	136	213	192	149	125	184	708	1,755	768	1,998
Total Assets	1,119	1,545	4,502	4,644	4,701	4,810	5,299	6,550	5,505	6,950
Long-term Debt	180	771	2,298	1,641	1,351	899	722	722	830	678
EBITDA Margin	17.4%	30.9%	25.0%	27.5%	27.6%	27.0%	27.9%	28.1%	16.4%	28.9%
Total Debt/EBITDA	0.74x	1.08x	2.61x	1.53x	1.18x	0.76x	0.57x	0.53x	1.27x	0.41x
Net Debt/EBITDA	0.18x	0.78x	2.39x	1.39x	1.07x	0.61x	0.01x	-0.76x	0.09x	-0.81x
EBITDA / Interest Exp.	35.85x	33.03x	6.54x	6.76x	10.32x	12.53x	17.01x	37.97x	15.85x	48.69x

IG Metrics

Source: Own financial Projections

Valuation
& Risk

Our base case valuation calls for 170bps target spread in one year, for total annualized return of 8.8% (returns calculated based on 2031 bonds).

Scenario Analysis:

- **Bear:** 4.6% return 1Y. Target Spread 250.
- **Base:** 8.4% return 1Y. Target Spread 170
- **Bull:** 11.3% return 1Y. Target Spread 110

	Moody's	S&P	Base	Bear	Bull
Upgrade Trigger	Rev growth HEYDUDE>0% Var Margins YoY>0% Debt/EBITDA<2x EBITDA/Int exp>3.5x	Rev growth Crocs>0% Rev growth HEYDUDE>0% Debt/EBITDA<2x	Met	Not Met	Met
Downgrade Trigger	Debt/EBITDA>3.5x EBITDA/Int exp<2.75x	Rev growth<0% Debt/EBITDA>2x	Not Met	Partially Met	Not Met

Issuer	Security	OAS	Amt Out	Coupon	Maturity Date	Price	Yield	D/E	Net Debt/ EBITDA	S&P	Moody	Fitch
Crocs Inc	CROX 4 ⅛ 08/31	215	350MM	4.125	15/08/2031	87.14	6.51	0.82x	1.07x	BB	B2	N.A.
Wolverine World Wide	WWW 4 08/29	288	550MM	4	15/08/2029	87.42	7.18	2.89x	10.60x	B-	Caa2	N.A.
Bath & Body Works	BBWI 6.95 03/33	257	284MM	6.95	1/03/2033	99.88	6.97	-3.12x	2.40x	B+	B1	WD
GAP	GAP 3 ⅞ 10/31	188	750MM	3.875	1/10/2031	86.79	6.27	1.88x	1.20x	BB	B1	N.A.
VF Corp	VFC 2.95 04/30	167	750MM	2.95	23/04/2030	86.09	5.99	5.24x	5.10x	BB	Ba1	N.A.
GAP	GAP 3 ⅝ 10/29	164	750MM	3.625	1/10/2029	90.28	5.95	1.88x	1.20x	BB	B1	N.A.
LEVI	LEVI 3 ½ 03/31	142	500MM	3.5	1/03/2031	88.03	5.8	1.20x	1.50x	BB+	Ba2	BB+
Under Armour	UA 3 ¼ 06/26	119	600MM	3.25	15/06/2026	96.7	5.46	0.67x	1.40x	BB-	Ba3	N.A.

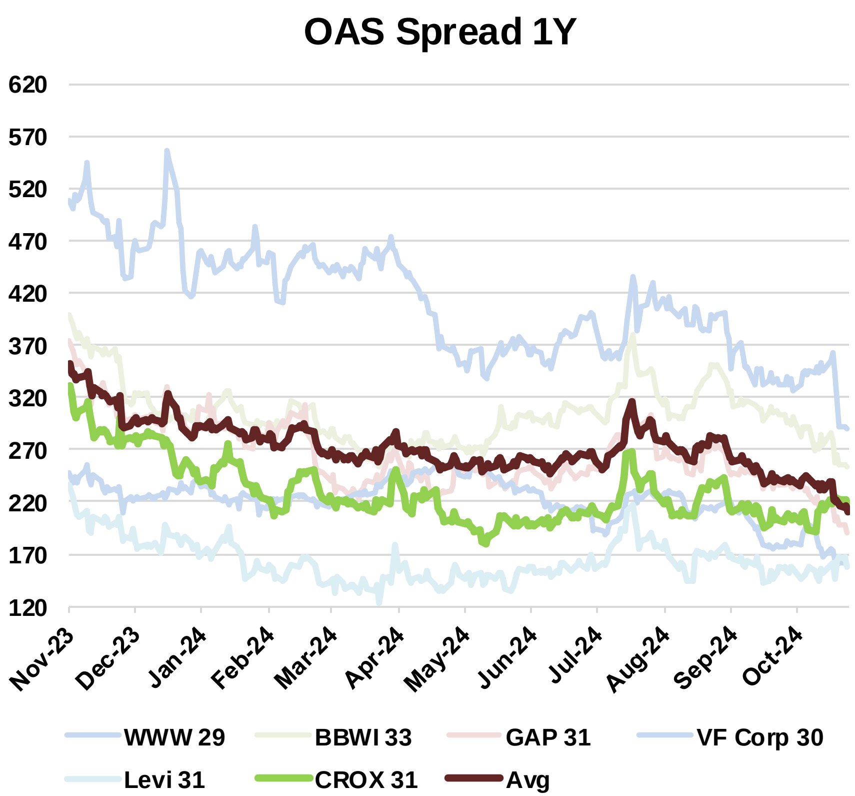
Source: Bloomberg

Note: Comp Table (as of 11/17/2024)

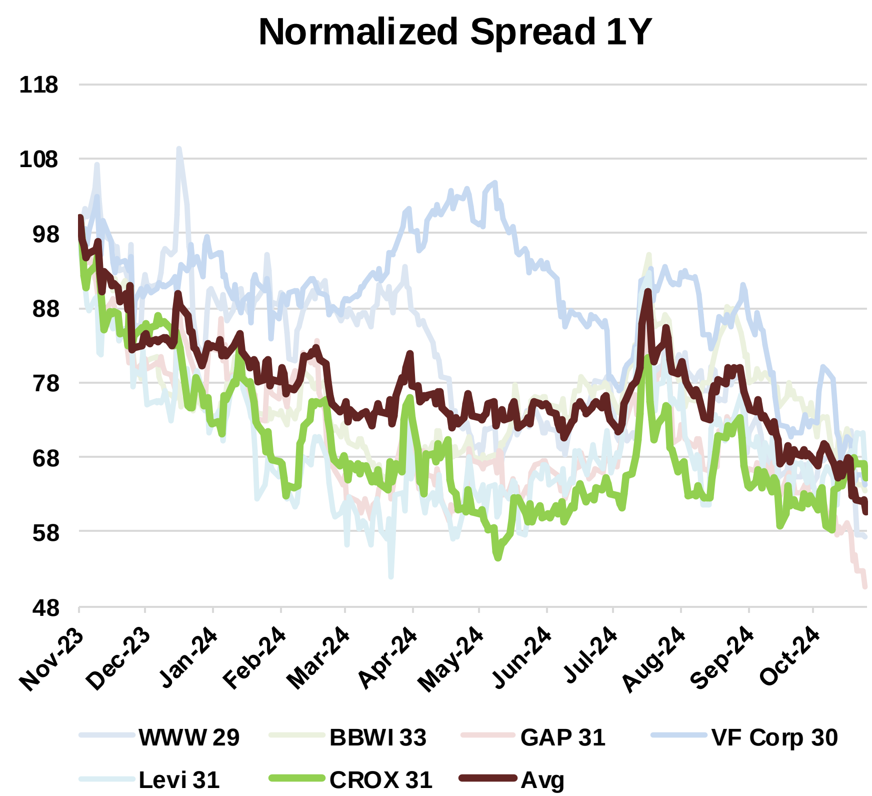
Crocs Inc.'s current spread offers a compression opportunity, trading at a historical discount despite strong cash flow and margins that justify a peer premium.

OAS Spread

- CROX current spread appears undervalued compared to its history and financial numbers.
- Spread should be trading closer to 170.



Source: Bloomberg



Source: Bloomberg

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Risks and Mitigants

Risks	Mitigants
Crocs Inc.'s large international business leads to currency risk	Crocs Inc. actively uses derivatives to hedge currency risk
All manufacturing and supply chain is done through third-party contracts with overseas countries	Crocs Inc. has been working to diversify their supply chain over the past few years with a particular focus on reducing reliance on China. Products are manufactured in Argentina, Bosnia-Herzegovina, Brazil, China, Indonesia, Mexico, India and Vietnam.
Buyback program and authorization, especially when the price of the stock is low	Crocs Inc. must maintain at least a 2:1 fixed charge coverage ratio after any repurchases are made.
Dependency on brand and management	Crocs Inc. and management have proven track records in building and monetizing brand equity and have shown success in recent limited drops selling out quickly. In particular, the company recently hired Terence Reilly to run HEYDUDE. Prior to this role, Terence Reily was responsible for the branding strategy that took Stanley from \$70M to \$750M in annual revenue.
Low diversification of revenue sources / brands	Crocs Inc. has been investing in and building new revenue streams (e.g., Jibbitz), and HEYDUDE represents the potential to begin building a house of brands like Deckers.
Management may be considering additional large M&A opportunities	Crocs Inc. management is incentivized to become investment grade and must maintain at least a 2:1 fixed charge coverage ratio after any M&A activities.
Bonds have low trading liquidity	We recommend Crocs Inc. bonds as a buy and hold strategy.

Appendix

Currency	USD			*Text*	*Ratio*
Units	Thousands		**Legend**	Formula	Non-Relevant Item
Fiscal Year	Jan-Jan			Projection	*Constant Ratio*

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Modeled Income Statement

Income Statement	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**2026E**	**2027E**	**2028E**	**2029E**	**2030E**	**2031E**
Revenues	1,385,894	2,313,416	3,554,985	3,962,347	4,151,139	4,600,407	5,102,370	5,663,674	6,291,853	6,995,454	7,784,174	8,669,028
Cost of Goods Sold	-636,003	-893,196	-1,694,703	-1,752,337	-1,702,706	-1,880,651	-2,084,739	-2,312,731	-2,567,628	-2,852,832	-3,172,198	-3,530,098
Crocs				-1,204,989	-1,271,826	-1,412,073	-1,569,304	-1,745,752	-1,943,951	-2,166,788	-2,417,549	-2,699,984
HEYDUDE				-531,117	-426,011	-468,578	-515,435	-566,979	-623,677	-686,045	-754,649	-830,114
Gross Profit	749,891	1,420,220	1,860,282	2,210,010	2,448,433	2,719,756	3,017,631	3,350,944	3,724,225	4,142,621	4,611,976	5,138,930
Selling, General and Administrative Exp	-535,824	-737,156	-1,009,526	-1,173,227	-1,369,052	-1,528,638	-1,637,647	-1,785,683	-1,951,270	-2,136,640	-2,344,323	-2,581,902
EBIT	214,067	683,064	850,756	1,036,783	1,079,381	1,191,118	1,379,984	1,565,261	1,772,955	2,005,981	2,267,653	2,557,027
Interest Expense	-6,742	-21,647	-136,158	-161,351	-111,175	-94,085	-73,804	-33,561	-33,561	-27,966	-27,966	-27,966
Interest Income	215	775	1,020	2,406	4,345	3,566	4,477	27,207	69,915	111,546	169,224	227,276
Currency Translation Gain(Loss)	-1,128	-140	3,228	-1,240	-3,928							
Other Income/expense	510	1,797	-338	-326	302							
Earnings before Taxes	206,922	663,849	718,508	876,272	968,925	1,100,599	1,310,658	1,558,907	1,809,310	2,089,560	2,408,910	2,756,337
Provision for Income Tax	105,882	61,845	-178,349	-83,706	-199,736	-214,617	-292,277	-347,636	-403,476	-465,972	-537,187	-614,663
Net Income (Loss)	312,804	725,694	540,159	792,566	769,189	885,982	1,018,381	1,211,271	1,405,834	1,623,588	1,871,723	2,141,674
EBITDA	241,686	715,040	889,985	1,091,087	1,147,487	1,256,421	1,447,886	1,633,987	1,842,228	2,075,930	2,338,241	2,628,194
Dep & Am	27,619	31,976	39,229	54,304	68,106	65,303	67,902	68,726	69,273	69,949	70,588	71,167
P&L Ratios												
Gross Margin	*54.11%*	*61.39%*	*52.33%*	*55.78%*	*58.98%*	*59.12%*	*59.14%*	*59.17%*	*59.19%*	*59.22%*	*59.25%*	*59.28%*
EBIT Margin	*15.45%*	*29.53%*	*23.93%*	*26.17%*	*26.00%*	*25.89%*	*27.05%*	*27.64%*	*28.18%*	*28.68%*	*29.13%*	*29.50%*
EBITDA Margin	*17.44%*	*30.91%*	*25.03%*	*27.54%*	*27.64%*	*27.31%*	*28.38%*	*28.85%*	*29.28%*	*29.68%*	*30.04%*	*30.32%*
Net Income Margin	*22.57%*	*31.37%*	*15.19%*	*20.00%*	*18.53%*	*19.26%*	*19.96%*	*21.39%*	*22.34%*	*23.21%*	*24.05%*	*24.70%*
SG&A	*38.66%*	*31.86%*	*28.40%*	*29.61%*	*32.98%*	*33.23%*	*22.20%*	*22.20%*	*22.20%*	*22.20%*	*22.20%*	*22.20%*
Crocs Gross margin				*60.01%*	*61.78%*	*61.78%*	*61.78%*	*61.78%*	*61.78%*	*61.78%*	*61.78%*	*61.78%*
HEYDUDE Gross margin				*44.06%*	*48.27%*	*48.27%*	*48.27%*	*48.27%*	*48.27%*	*48.27%*	*48.27%*	*48.27%*
Operating margin per brand							**30.05%**					
Crocs				*35.82%*	*36.87%*	*36.20%*	*36.20%*	*36.20%*	*36.20%*	*36.20%*	*36.20%*	*36.20%*
HEYDUDE				*22.37%*	*18.22%*	*18.22%*	*18.22%*	*18.22%*	*18.22%*	*18.22%*	*18.22%*	*18.22%*
Rev growth	*12.62%*	*66.93%*	*53.67%*	*11.46%*	*4.76%*	*10.82%*	*10.91%*	*11.00%*	*11.09%*	*11.18%*	*11.27%*	*11.37%*
Efective Interest Expense rate	*3.50%*	*4.55%*	*8.80%*	*8.09%*	*7.37%*	*8.46%*	*4.95%*	*4.95%*	*4.13%*	*4.13%*	*4.13%*	*4.13%*
Efective Interes Income rate	*0.17%*	*0.44%*	*0.50%*	*1.41%*	*3.17%*	*2.12%*	*3.50%*	*3.50%*	*3.50%*	*3.50%*	*3.50%*	*3.50%*
Dep & Amort Rate	*29.13%*	*27.53%*	*3.70%*	*2.71%*	*3.35%*	*3.19%*	*3.30%*	*3.30%*	*3.30%*	*3.30%*	*3.30%*	*3.30%*
Effective Tax rate	*-51.17%*	*-9.32%*	*24.82%*	*9.55%*	*20.61%*	*19.50%*	*-22.30%*	*-22.30%*	*-22.30%*	*-22.30%*	*-22.30%*	*-22.30%*

Currency	USD			Text	*Ratio*
Units	Thousands		**Legend**	Formula	Non-Relevant Item
Fiscal Year	Jan-Jan			Projection	*Constant Ratio*

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Modeled Balance Sheet

	2020	2021	2022	2023	2024	2025	2026E	2027E	2028E	2029E	2030E	2031E
Cash and Cash Equivalents	135,802	213,197	191,629	149,288	124,940	210,714	777,332	1,997,578	3,187,020	4,834,982	6,493,606	8,628,423
Accounts Receivables	160,663	194,881	314,436	326,818	413,889	445,410	447,808	571,430	564,093	684,349	713,918	842,340
Incomes Taxes Receivable	1,857	22,301	14,752	4,413	2,913	2,913	2,913	2,913	2,913	2,913	2,913	2,913
Inventories	175,121	213,520	471,551	385,054	389,806	385,283	453,204	552,331	564,029	676,333	702,884	831,941
Prepaid Expenses and Other Assets	17,856	22,605	33,605	45,129	45,226	42,926	33,242	34,370	40,179	39,189	37,981	36,992
Restricted Cash	1,542	65	2	2	0	0						
Total Current Assets	492,841	666,569	1,025,975	910,704	976,773	1,087,247	1,714,500	3,158,621	4,358,234	6,237,765	7,951,302	10,342,609
Operating Lease Right-of-use Assets	167,421	160,768	239,905	287,440	303,758	303,758	303,758	303,758	303,758	303,758	303,758	303,758
Plant, Property and Equipment, Net	57,467	108,398	181,529	238,315	250,499	284,796	319,621	345,327	375,329	404,013	430,961	458,231
Deferred Tax Asset	350,784	567,201	528,278	667,972	659,861	659,861	659,861	659,861	659,861	659,861	659,861	659,861
Goodwill	1,719	1,600	714,814	711,588	711,602	711,602	711,602	711,602	711,602	711,602	711,602	711,602
Other Intangible Asset, Net	37,636	28,802	1,800,167	1,792,562	1,781,284	1,772,848	1,762,991	1,753,844	1,744,342	1,735,018	1,725,605	1,716,236
Restricted Cash	1,929	3,663	3,254	3,807	0	0						
Other Assets	8,926	8,067	7,875	31,446	17,053	17,053	17,053	17,053	17,053	17,053	17,053	17,053
Total Non Current Assets	625,882	878,499	3,475,822	3,733,130	3,724,057	3,749,918	3,774,886	3,791,444	3,811,945	3,831,305	3,848,840	3,866,741
Total Assets	1,118,723	1,545,068	4,501,797	4,643,834	4,700,830	4,837,164	5,489,386	6,950,066	8,170,179	10,069,071	11,800,142	14,209,351
Accounts Payable	112,778	162,145	230,821	260,978	281,399	402,056	215,977	474,723	282,460	553,821	412,552	676,142
Accrued Expenses	126,704	166,887	239,424	285,771	212,204	233,375	243,783	229,788	235,649	236,407	233,948	235,334
Current Portion of Long-term Debt	0	0	24,362	23,328	0	0	0	0	0	0	0	0
Current Lease Liabilities	47,064	42,932	57,456	62,267	66,900	66,900	66,900	66,900	66,900	66,900	66,900	66,900
Income Taxes Payable	5,038	16,279	89,211	65,952	106,753	106,753	106,753	106,753	106,753	106,753	106,753	106,753
Total Current Liabilities	291,584	388,243	641,274	698,296	667,256	809,084	633,413	878,163	691,762	963,880	820,153	1,085,130
Long-term Debt	180,000	771,390	2,298,027	1,640,996	1,351,260	872,008	677,975	677,975	677,975	677,975	677,975	677,975
Long-term Lease Liabilities	146,401	149,237	215,119	269,769	285,879	288,888	291,229	293,676	296,232	298,904	301,696	304,614
Deferred Tax Liabilities	0	176	302,030	12,912	12,824	12,824	12,824	12,824	12,824	12,824	12,824	12,824
Other Liabilities	4,131	2,372	2,579	2,767	3,067	2,728	2,854	2,883	2,822	2,853	2,853	2,843
Deferred Income Taxes	205,974	219,568	224,837	565,171	572,362	572,362	569,965	571,563	571,297	570,942	571,267	571,168
Total Non Current Liabilities	536,506	1,142,743	3,042,592	2,491,615	2,225,393	1,748,810	1,554,847	1,558,921	1,561,150	1,563,498	1,566,615	1,569,424
Total Liabilities	828,090	1,530,986	3,683,866	3,189,911	2,892,649	2,557,894	2,188,261	2,437,084	2,252,912	2,527,378	2,386,768	2,654,554
Common Stock - Par Value	105	106	110	110	110	110	110	110	110	110	110	110
Additional Paid in Capital	482,385	496,036	797,614	826,685	851,228	851,228	851,228	851,228	851,228	851,228	851,228	851,228
Treasury Stock - Common	-688,849	-1,684,262	-1,695,501	-1,888,869	-2,329,548	-2,736,436	-2,737,897	-2,736,690	-2,737,008	-2,737,199	-2,736,966	-2,737,057
Retained Earnings (Accumulated Defici	553,346	1,279,040	1,819,199	2,611,765	3,380,954	4,266,937	5,285,317	6,496,588	7,902,422	9,526,010	11,397,734	13,539,408
Other - + other accumulated	-56,354	-76,838	-103,491	-95,768	-94,563	-102,568	-97,633	-98,254	-99,485	-98,457	-98,732	-98,891
Total Shareholders Equity	290,633	14,082	817,931	1,453,923	1,808,182	2,279,271	3,301,125	4,512,982	5,917,267	7,541,692	9,413,374	11,554,797
Total Liabilities & Shareholders Equity	1,118,723	1,545,068	4,501,797	4,643,834	4,700,830	4,837,164	5,489,386	6,950,066	8,170,179	10,069,071	11,800,142	14,209,351

Currency	USD		Text	*Ratio*
Units	Thousands	**Legend**	Formula	Non-Relevant Item
Fiscal Year	Jan-Jan		Projection	*Constant Ratio*

Modeled Cash Flow

Income Statement	2020	2021	2022	2023	2024	2025	2026E	2027E	2028E	2029E	2030E	2031E
Cash Flow												
Net Income	312,861	725,694	540,159	792,566	769,189	885,982	1,018,381	1,211,271	1,405,834	1,623,588	1,871,723	2,141,674
Depreciation & Amort.	27,619	31,976	39,229	54,304	68,106	65,303	67,902	68,726	69,273	69,949	70,588	71,167
Other Assets related	21,411	310	9,063	9,706								
Stock-Based Compensation	16,361	38,122	31,303	29,072	it is considered in the variation of accrued expenses							
Other Operating Activities	-49,253	-166,427	126,458	-7,261								
Change in Acc. Receivable	-47,045	-35,063	-56,766	-13,317	-89,130	-31,521	-2,398	-123,622	7,337	-120,256	-29,569	-128,422
Change In Inventories	-4,468	-41,799	-88,844	88,428	-4,632	4,523	-67,921	-99,127	-11,698	-112,304	-26,551	-129,058
Change in Acc. Payable	45,587	73,316	80,330	83,892	-58,117	141,828	-186,079	258,746	-192,263	271,361	-141,269	263,590
Change in Other Net Operating Assets	-33,800	-20,500	-39,200	-60,300	-67,478	26,479	22,433	-12,677	2,609	4,420	1,541	5,293
Cash from Ops.	266,902	567,165	603,142	930,444	802,709	1,092,594	852,318	1,303,318	1,281,091	1,736,759	1,746,463	2,224,245
Capital Expenditure	-42,033	-55,916	-104,190	-115,625	-71,821	-91,164	-92,870	-85,285	-89,773	-89,309	-88,123	-89,068
Cash Acquisitions	0	0	-2,046,881	0	0	0	0	0	0	0	0	0
Divestitures	0	0	0	0								
Other Investing Activities	271	-9	-20	-46								
Cash from Investing	-41,762	-55,925	-2,151,091	-115,671	-71,821	-91,164	-92,870	-85,285	-89,773	-89,309	-88,123	-89,068
Proceeds from Bank Borrowings	210,000	390,000	2,169,898	257,905								
Repayment of Bank Borrowings	-235,000	-485,000	-575,285	-923,703								
Total Use of Revolving line of Credit	-25,000	-95,000	1,594,613	-665,798	-318,941	-479,253	-194,032					
Long-Term Debt Issued	0	700,000	0	0								
Long-Term Debt Repaid	0	0	0	0	0	0						
Total LT Debt	0	700,000	0	0	0	0	0	0		0	0	0
Repurchase of Common Stock	-173,892	-1,020,119	-11,477	-192,105	-437,775	-406,888	-1,461	1,207	-318	-191	233	-92
Total Dividends Paid	0	0	0	0								
Other Financing Activities	854	-14,519	-53,477	-1,736	-2,759	-29,515	2,664	1,005	-1,558	704	50	-268
Cash from Financing	-198,038	-429,638	1,529,659	-859,639	-759,474	-915,656	-192,830	2,213	-1,876	513	283	-360
Foreign Exchange Rate Adj.	126	-3,950	-3,750	3,078								
Net Change in Cash	27,228	77,652	-22,040	-41,788	-28,157	85,774	566,618	1,220,245	1,189,442	1,647,962	1,658,624	2,134,817

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Currency	USD		Text	*Ratio*
Units	Thousands	**Legend**	Formula	Non-Relevant Item
Fiscal Year	Jan-Jan		Projection	*Constant Ratio*

Modeled Key Ratios

Income Statement	2020	2021	2022	2023	2024	2025	2026E	2027E	2028E	2029E	2030E	2031E
Profitability												
ROA	27.96%	46.97%	12.00%	17.07%	16.36%	18.32%	18.55%	17.43%	17.21%	16.12%	15.86%	15.07%
ROE	107.63%	5153.34%	66.04%	54.51%	42.54%	38.87%	30.85%	26.84%	23.76%	21.53%	19.88%	18.53%
Asset Turnover												
Total Asset Turnover	1.49x	1.74x	1.18x	0.87x	0.89x	0.96x	0.99x	0.91x	0.83x	0.77x	0.71x	0.67x
Fixed Asset Turnover	26.43x	27.90x	24.52x	18.88x	16.98x	17.19x	16.88x	17.03x	17.46x	17.95x	18.65x	19.50x
Accounts Receivable Turnover	9.99x	13.01x	13.96x	12.36x	11.21x	10.71x	11.42x	11.11x	11.08x	11.21x	11.13x	11.14x
Inventory Turnover	3.66x	4.60x	4.95x	4.09x	4.39x	4.85x	4.60x	4.60x	4.60x	4.60x	4.60x	4.60x
Accounts Payable Turnover	6.10x	6.50x	8.63x	7.13x	6.28x	5.50x	6.75x	6.70x	6.78x	6.82x	6.57x	6.49x
Cash conversion cycle	75.28	50.58	56.81	66.60	56.69	42.39	56.41	56.90	57.67	57.62	55.76	55.06
Days of inventory	98.25	78.32	72.76	87.99	81.91	74.18	78.26	78.26	78.26	78.26	78.26	78.26
Days of Sales outstanding	36.05	27.66	25.79	29.13	32.12	33.62	31.51	32.39	32.49	32.12	32.33	32.31
Days Payable	59.02	55.40	41.74	50.52	57.34	65.41	53.36	53.76	53.08	52.77	54.83	55.51
Short Term Liquidity												
Current Ratio	1.69x	1.72x	1.60x	1.30x	1.46x	1.34x	2.71x	3.60x	6.30x	6.47x	9.69x	9.53x
Quick Ratio	1.09x	1.17x	0.86x	0.75x	0.88x	0.87x	1.99x	2.97x	5.48x	5.77x	8.84x	8.76x
Long Term Solvency												
Total Debt/Equity	0.62x	54.78x	2.84x	1.14x	0.75x	0.38x	0.21x	0.15x	0.11x	0.09x	0.07x	0.06x
Total Debt/Capital	0.37x	1.56x	2.91x	2.01x	1.59x	1.02x	0.80x	0.80x	0.80x	0.80x	0.80x	0.80x
LT Debt/Equity	0.62x	54.78x	2.81x	1.13x	0.75x	0.38x	0.21x	0.15x	0.11x	0.09x	0.07x	0.06x
LT Debt/Capital	0.37x	1.56x	2.88x	1.99x	1.59x	1.02x	0.80x	0.80x	0.80x	0.80x	0.80x	0.80x
Total Liabilities/Total Assets	0.74x	0.99x	0.82x	0.69x	0.62x	0.53x	0.40x	0.35x	0.28x	0.25x	0.20x	0.19x
Credit Ratios												
EBIT / Interest Exp.	31.75x	31.55x	6.25x	6.43x	9.71x	12.66x	18.70x	46.64x	52.83x	71.73x	81.08x	91.43x
EBITDA / Interest Exp.	35.85x	33.03x	6.54x	6.76x	10.32x	13.35x	19.62x	48.69x	54.89x	74.23x	83.61x	93.98x
(EBITDA-CAPEX) / Interest Exp.	29.61x	30.45x	5.77x	6.05x	9.68x	12.39x	18.36x	46.15x	52.22x	71.04x	80.46x	90.79x
Total Debt/EBITDA	0.74x	1.08x	2.61x	1.53x	1.18x	0.69x	0.47x	0.41x	0.37x	0.33x	0.29x	0.26x
Net Debt/EBITDA	0.18x	0.78x	2.39x	1.39x	1.07x	0.53x	-0.07x	-0.81x	-1.36x	-2.00x	-2.49x	-3.03x
Total Debt/(EBITDA-CAPEX)	0.90x	1.17x	2.96x	1.71x	1.26x	0.75x	0.50x	0.44x	0.39x	0.34x	0.30x	0.27x
Net Debt/(EBITDA-CAPEX)	0.21x	0.85x	2.71x	1.55x	1.14x	0.57x	-0.07x	-0.85x	-1.43x	-2.09x	-2.58x	-3.13x

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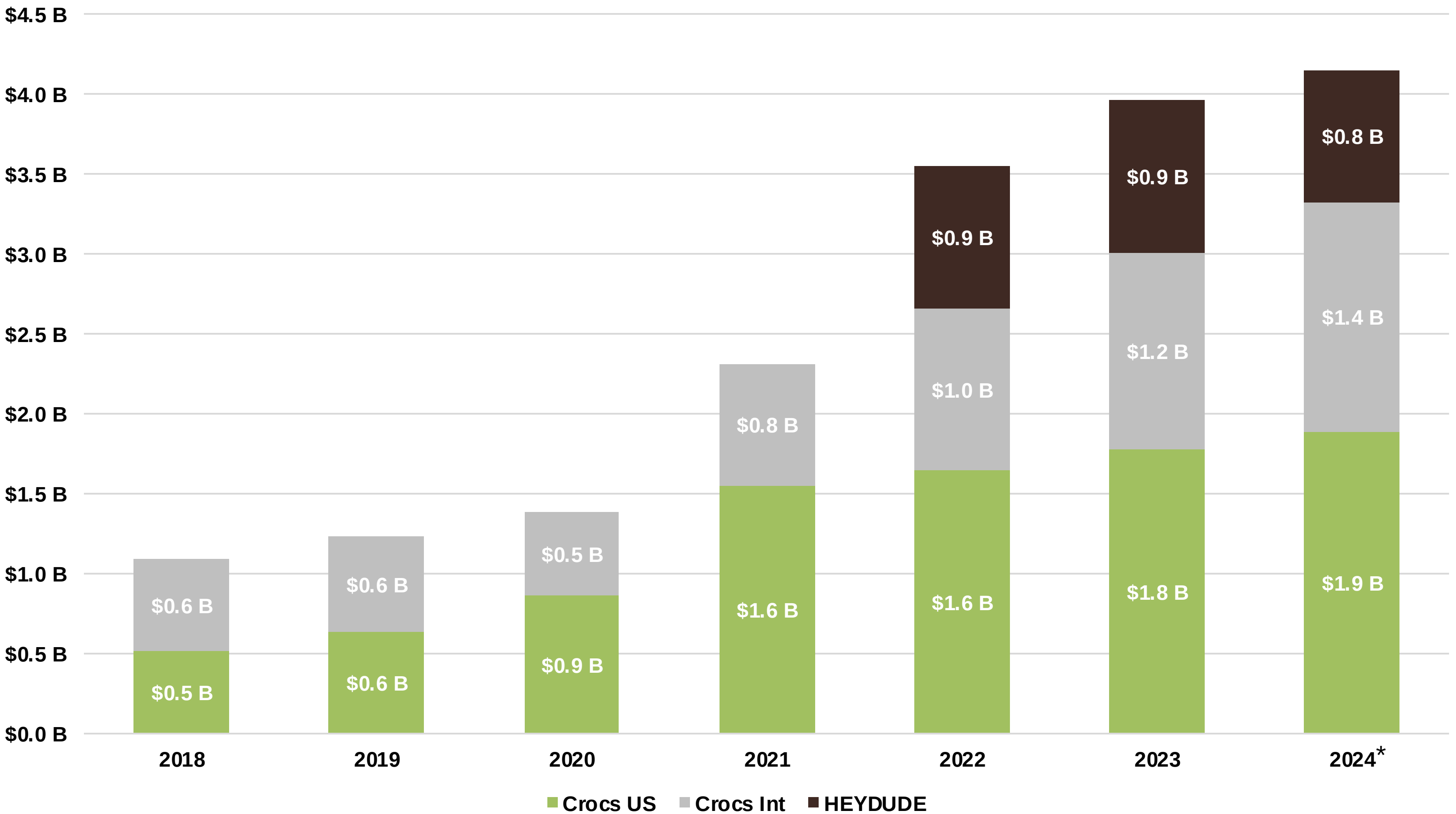
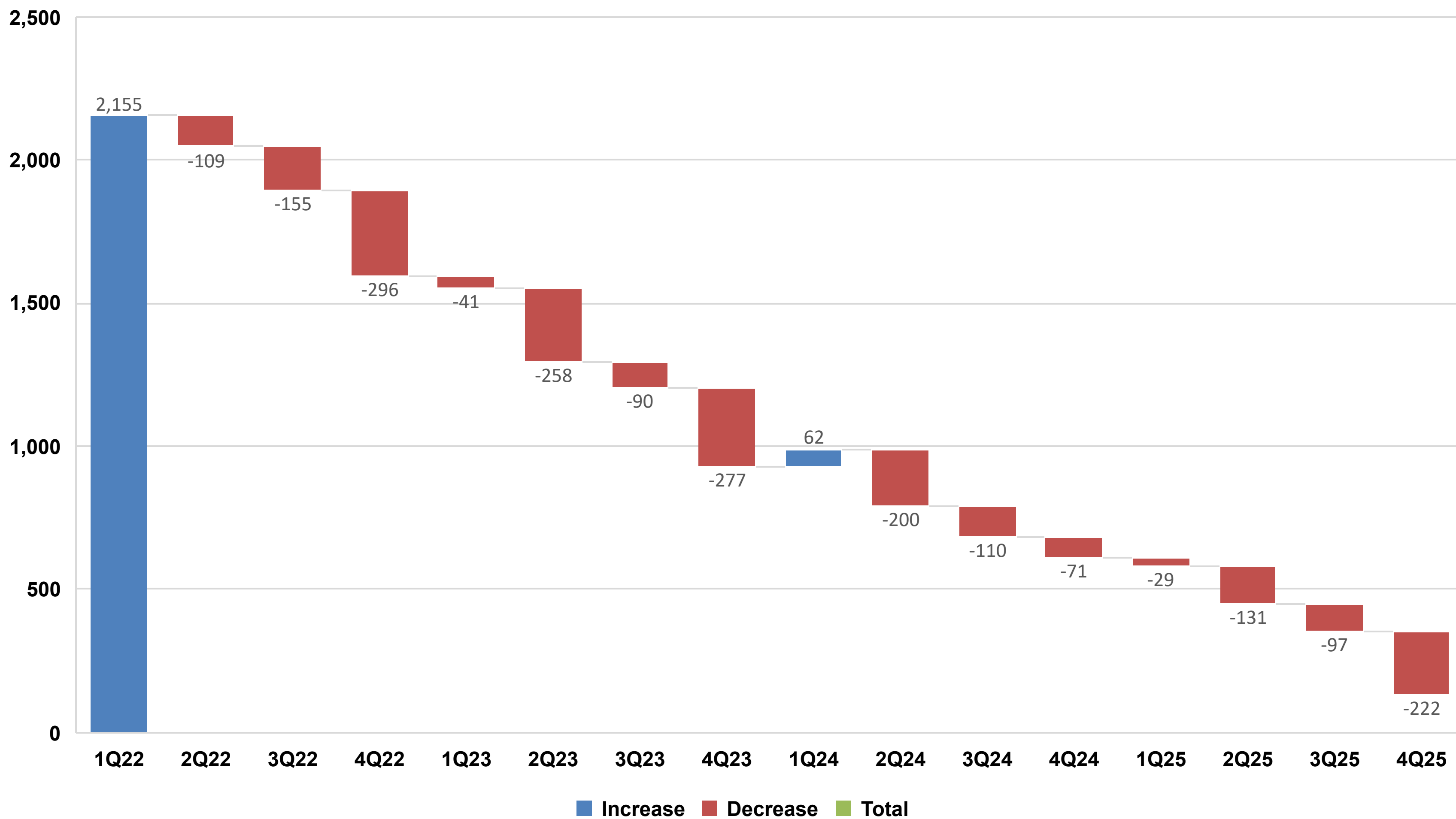
Crocs Inc. revenue breakdown

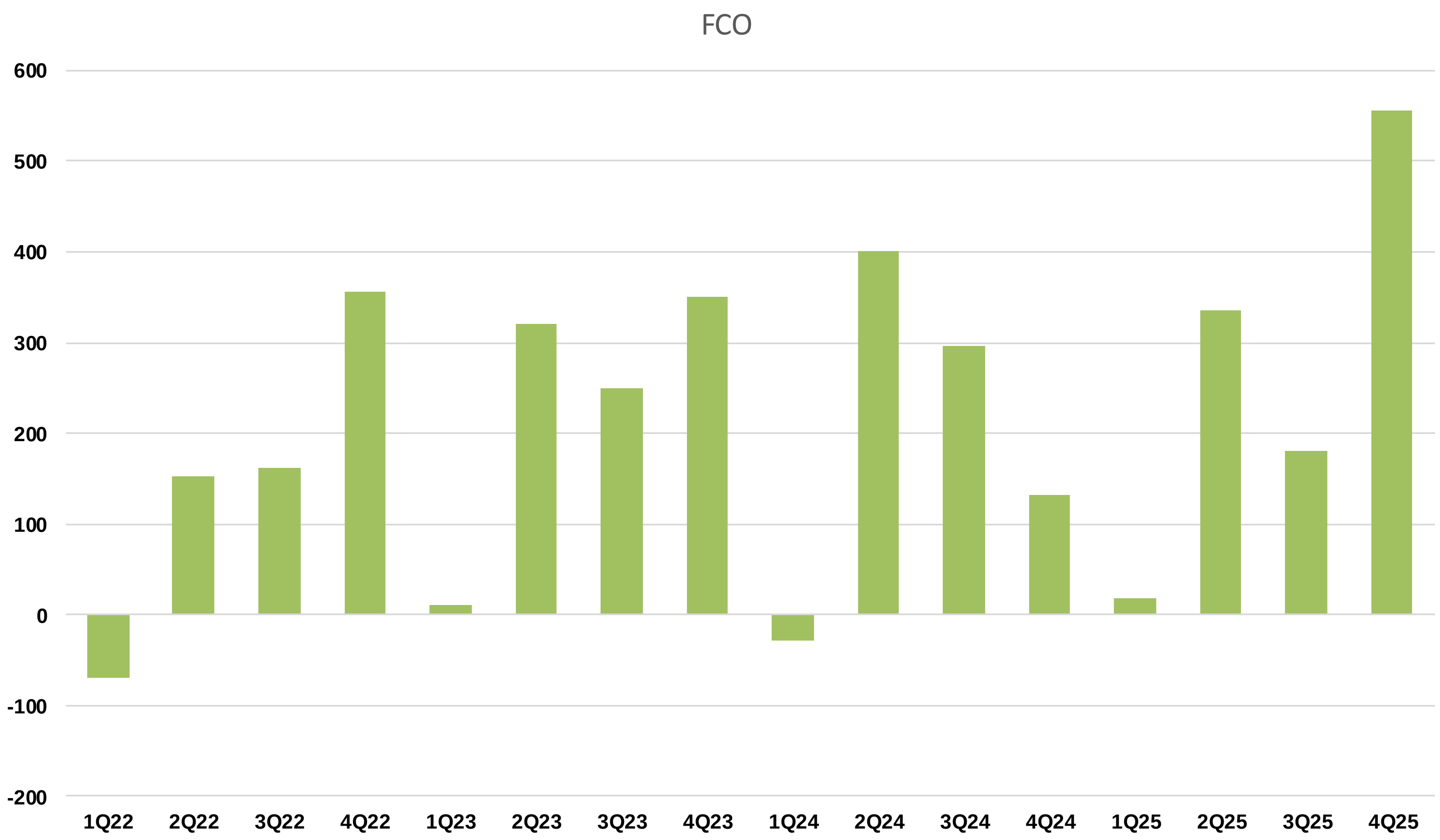


*Based on model projects

Crocs Inc. consistently works to deleverage their capital structure



Free cashflows from operations



CROX 2031 Notes offer an estimated 74% recovery value on investment

High Recovery Value:

- We estimate a 64% recovery for the notes at par. Considering a current price of 87.14, it represent 74% of recovery percent of the investment.

Assets (thousands)	2Q24	Recovery (%)	Recovery
Current Assets			
Cash and Cash Equivalents	186,122	100%	186,122
Accounts Receivables	383,269	75%	287,452
Incomes Taxes Receivable	2,913	0%	0
Inventories	367,191	50%	183,596
Prepaid Expenses and Other Assets	50,923	0%	0
Total Current Assets	990,420		**657,169**
Non-Current Assets			
Operating Lease Right-of-use Assets	303,758	0	0
Plant, Property and Equipment, Net	243,358	50%	121,679
Deferred Tax Asset	659,861	0%	0
Goodwill	711,602	0%	0
Other Intangible Asset, Net	1,783,677	25%	445,919
Restricted Cash	3,421	0	0
Other Assets	17,053	50%	8,527
Total Non-Current Assets	3,722,730		**576,125**
Total Assets	4,713,150		**1,233,294**

Total Recovery	**1,233,294**
Liquidation cost	61,665
Proceeds Available	1,171,629
1L Secured claims	721,952
Proceeds Available	449,677
1L recovery	100%
Senior Unsecured	700,000
Sr. Unsecured recovery of 100 Nominal	**64%**

Crocs Inc. Leadership

Andrew Rees, CEO
- CEO since 2014
- More than 25 years experience in footwear and retail industry
- Previously served as VP of Strategic Planning and VP of Retail Operations for Reebok

Anne Mehlman, EVP & Brand President Crocs
- Appointed May 2024
- CFO for Crocs from 2018-2024
- Previously CFO for Zappos.com

Terence Reilly, EVP & Brand President HEYDUDE
- Appointed May 2024
- President at Stanley from 2020-2024 where he was responsible for building the company from $70M to $750M in revenue
- Before Stanley Terence was the CMO at Crocs

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December 5th, 2024

Team Number: 9

Students: Maggie Kochevar, Nishant Patel, Xiaojun Zhu

Investment Summary

Investment recommendation:

Buy Ball Corp BALL 2.875% 2030 senior unsecured bond (Ba1/BB+) trading at 5.5% yield to worst and 183 bps spread (as of 09/19/24)

Target spreads: 141 bps, and base case total return 4.059%

Thesis #1: Ball is ending period of high capex and M&A

Thesis #2: Previous capacity expansions set Ball up to take advantage of international shifts from other packaging materials to metal

Thesis #3: Ball's new more credit-friendly capital allocation priorities can enable upgrade opportunity to investment grade

Capital structure and bond selection

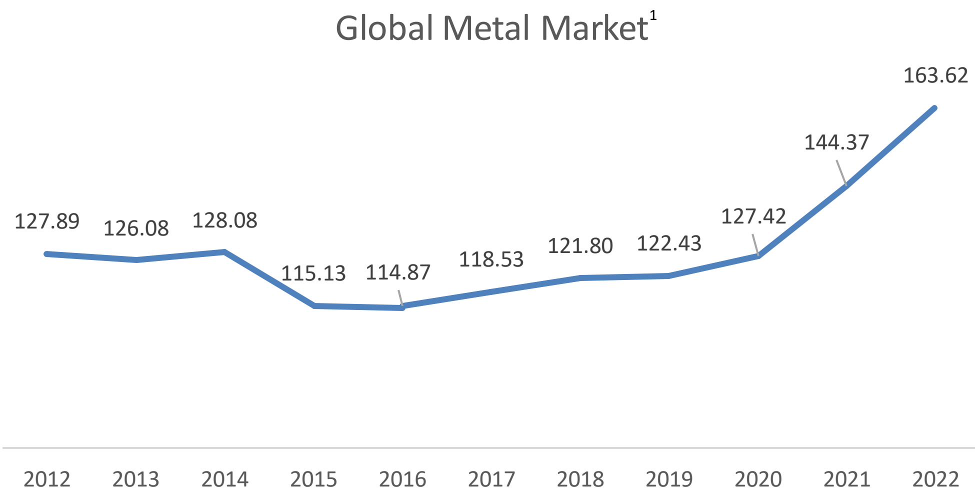
- Only 7.3% of its total debt outstanding is maturing in the next 2-3 years versus average of 32.6% in the packaging industry
- We view senior note maturing in 2030 to be most attractive given the **attractive yields and longer duration**

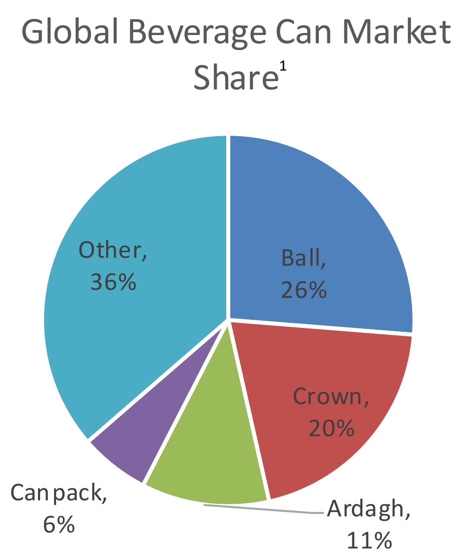
Credit Facility	Out. ($)	Currency	Guaranteed?	Secured?	Price*	Bid YTW*	Coupon	Spread*	S&P Rating	Leverage
Revolver maturing 06/28/2027		USD	-	Y	-	-	5.938	-	-	
1st lien term loan B maturing 7/31/2025	371	USD	-	Y	-	-	9.354	-	-	
Term loan A maturing 06/28/2027	625	USD	-	Y	-	-	5.938	-	-	
2nd lien term loan B maturing 7/31/2026	121	USD	-	Y	-	-	5.938	-	-	
Secured Loan Outstanding	**1117**									**0.53x**
5.25% senior note maturing 07/01/25	189	USD	Y	N	100.11	5.40	5.250	121	BB+	
4.875% senior note maturing 03/15/26	256	USD	Y	N	99.85	5.16	4.875	153	BB+	
1.5% senior note maturing 03/15/27	579	EUR	Y	N	96.18	2.95	1.500	78	BB+	
6.875% senior note maturing 03/15/28	750	USD	Y	N	103.60	5.42	6.875	136	BB+	
6% senior note maturing 06/15/29	1000	USD	Y	N	103.67	5.48	6.000	166	BB+	
2.875% senior note maturing 08/15/30	1300	USD	Y	N	89.05	5.50	2.875	183	BB+	
3.125% senior note maturing 09/15/31	850	USD	Y	N	89.15	5.49	3.125	178	BB+	
Unsecured Loan Outstanding	**4925**									**2.35x**

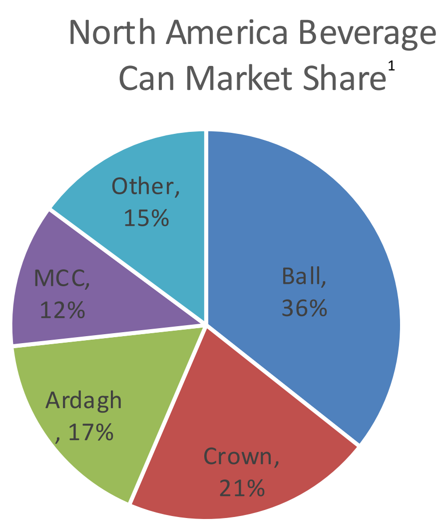
*Pricing date: 09/19/24. Source: BVAL

Industry and company overview

Ball Corp is the #1 market leader in the growing, acyclical sustainable packaging industry







Ball has investment-grade-like core business:

1) Metal packaging industry is constantly growing with CAGR 2.5%.
2) The industry is consolidated with top 4 companies making up 85% of market share in North America and 64% globally. Ball has the #1 market share both in North America and globally.
3) Ball's business is relatively less cyclical because its biggest customers are consumer staple companies, and it has long-term customer contracts that create high switching costs.
4) Competitive advantage from innovation abilities and global manufacture footprints.

[1]J.P. Morgan

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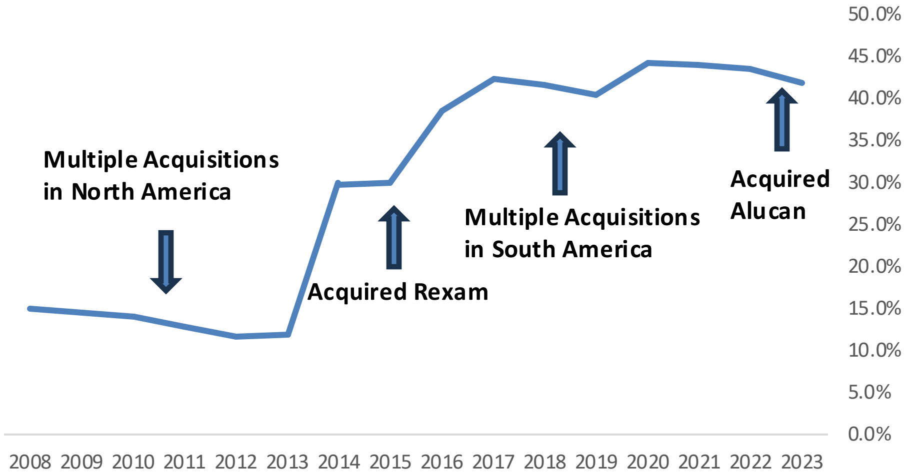
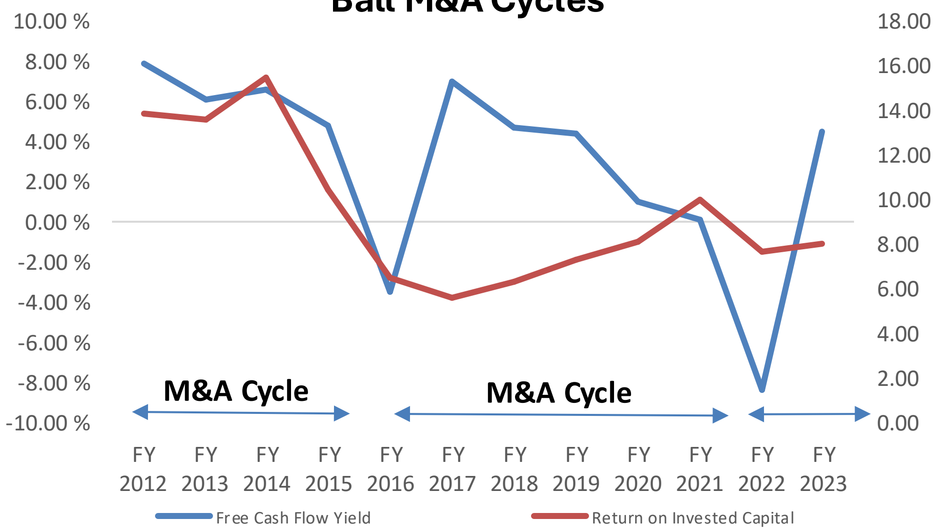
Investment Thesis 1 – Ending high capex & M&A period

Ball expanded significantly through inorganic growth and now is at the end of an aggressive M&A cycle

Ball Market Share by Revenue [1]



Ball M&A Cycles



[1]Bloomberg

Ball's growth strategy:

- Ball uses M&A to solidify its position and expand footprints in the global markets
- Expanding market shares shows management can identify opportunities and add value
- Improving return on invested capital/EPS showcased management's ability to integrate and capture synergies
- We believe there's limited chance of acquisitions in the next two years, which is favorable to credit investors
- **Management guided next M&A cycle starting in 2029**

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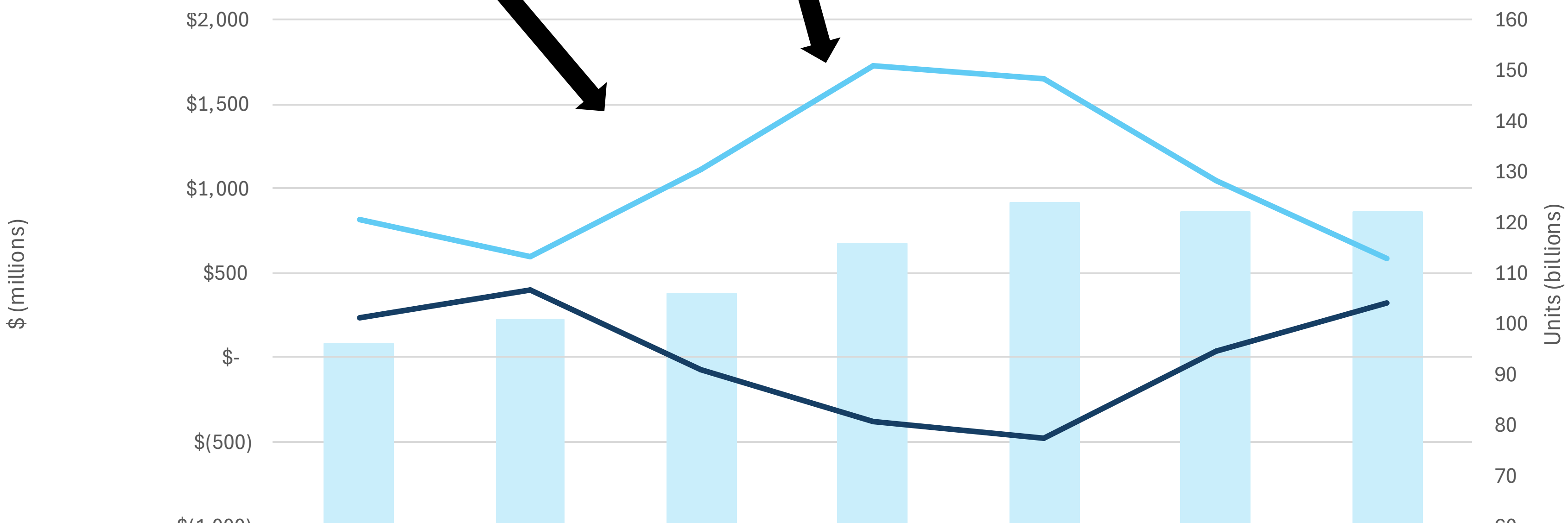
Investment Thesis 1 – Ending high capex & M&A period

Ball invested heavily in growth capex to expand production capacity but is now reverting to typical levels

Rise of specialty cans due to new beverage products and changing consumer preferences

Increased international expansion



	2018	2019	2020	2021	2022	2023	LTM
Total bev can capacity	96	101	106	116	124	122	122
Capex	$816	$598	$1,113	$1,726	$1,651	$1,045	$592
Free cash flow	$238	$396	$(68)	$(380)	$(483)	$34	$324

Total bev can capacity   Capex   Free cash flow

Ball now set up for higher FCF as capex declines and capacity is built out to meet near-term demand

Investment Thesis 2 – Ball set to capture ESG tailwinds

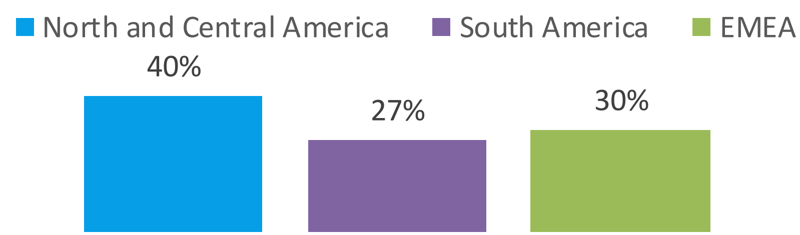
Ball has manufacturing capacity to take advantage of increased demand in EMEA and South America

Trend: Metal beverage cans benefitting from sustainability tailwinds

- 75% of all aluminum ever produced is still in use today[1]
- Metal cans have double the recycling rates of plastic and glass bottles[2]
- Recycled aluminum is 95% less energy intensive to produce than new aluminum[1]
- A recycled can is able to be back on store shelves within 60 days[3]

Opportunity: Room for metal to take more market share from plastic and glass in EMEA and South America

Beverage Can Penetration[3]



Catalysts: EU Regulation + Brazil market strength

- EU passed Packaging and Packaging Waste Regulation in 2024 which requires packaging to be recyclable in an economically feasible way by 2030
- In Brazil, metal taking share from returnable glass in better economic environment

Capacity: Ball has manufacturing capacity to meet increased demand

- Ball recently built 2 new plants in EMEA and 2 in South America that can easily add new manufacturing lines
- Management does not anticipate any greenfield plant needs in EMEA within next 3 years

On track to meet 3-5% EMEA and 4-6% South America growth targets at more attractive margins

[1]Aluminum Association [2]Container Recycling Institute (US, excludes deposit containers) [3]Ball Corp

Investment Thesis 3 – Credit-friendly capital allocation policy to lower leverage and open doors to upgrade

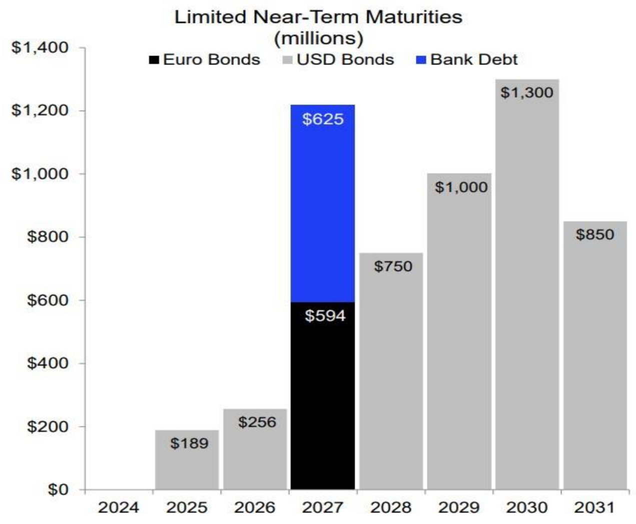
Ball will prioritize financial de-risk in its capital allocation strategy, the first time since 1998

Leverage target:

3.5x → 2.5x

*"..We're committed to achieve high returns with a **reduced risk profile**."*

Senior Credit Facility	2024 Out. ($)	2023 Out. ($)	Covenant Heavy?	Cost vs Average
Term loan A maturing 06/28/2027	625	1325	Y	Lower
Senior Notes				
5.25% senior note maturing 07/01/25	189	1000	Y	Higher
4.875% senior note maturing 03/15/26	256	750	Y	Higher
1.5% senior note maturing 03/15/27	579	607	Y	Higher



Refinance Analysis	
Tenor	7-10 years, same as previous bonds
Coupon	6% to 7% based on treasury curve forward projections
Issuance environments	**Primary market is expected to be active with investors to weigh on longer duration bonds**
Access to capital market	**Good relationships with diversified banks and board investors access**

Key takeaways:

- Ball **already committed $2B debt paydown**, on track to achieve its future leverage goal
- Ball paid down debt across near maturity terms and debt with higher cost and heavy covenants, **avoiding maturity mismanagement**
- The **refinance risk is moderate** given investor appetites on longer tenor bonds and Ball's good access to capital markets

Investment Thesis 3 – Credit-friendly capital allocation policy to lower leverage and open doors to upgrade

Credit-friendly capital allocation strategy enables upgrade opportunities

Moody's upgrade trigger

Leverage sustained below 3.5x + Free cash flow to debt sustained above 10% + EBITDA to interest sustained above 6.0x = Ratings upgrade to BBB-

= Investment Grade Rising Star

Met in valuation cases?

Base + Bull + Bear	Base + Bull	Bull	Bull
Base: 2.8x by 2026 Bull: 2.4x by 2025 Bear: 3.5x by 2026	Base: >10% by 2025 Bull: >10% by 2025	Bull: 6.3x by 2026	**As of 2026:** **Leverage: 2.4X** **FCF to Debt: 17%** **Interest coverage: 6.3x**

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Valuation Summary

Income statement metrics	Base			Bear			Bull		
	FY24	FY25	FY26	FY24	FY25	FY26	FY24	FY25	FY26
Revenue	11918	12305	12707	11853	12172	12502	11928	12393	12878
Revenue growth		*3%*	*3%*		*3%*	*3%*		*4%*	*4%*
EBITDA	1993	2300	2626	1983	2277	2585	1994	2316	2659
EBITDA growth		*15%*	*14%*		*15%*	*14%*		*16%*	*15%*
EBITDA margin	*17%*	*19%*	*21%*	*17%*	*19%*	*21%*	*17%*	*19%*	*21%*
Cash flow metrics									
EBITDA	1993	2300	2626	1983	2277	2585	1994	2316	2659
Capex	-656	-677	-699	-672	-1104	-1134	-583	-606	-630
Interest	-320	-339	-345	-320	-392	-398	-320	-321	-292
Taxes	-190	-248	-311	-188	-234	-293	-190	-254	-327
Dividends	-252	-233	-292	-252	-220	-276	-252	-239	-307
Free cash flow to debt holders	**576**	**803**	**979**	**550**	**327**	**483**	**649**	**896**	**1104**
Free Cashflow	**-59**	**717**	**932**	**-97**	**227**	**413**	**17**	**824**	**1080**
Balance sheet metrics									
Cash	989	1336	1867	951	821	849	1065	1513	2177
Total debt (including operating leases)	5286	6024	7460	5286	7015	9157	5285	5502	6477
Credit metrics									
Interest coverage	3.8	4.5	5.3	3.8	3.8	4.5	3.8	4.7	6.3
Leverage (including operating leases)	2.7	2.6	2.8	2.7	3.1	3.5	2.7	2.4	2.4
Net leverage (including operating leases)	2.2	2.0	2.1	2.2	2.7	3.2	2.1	1.7	1.6
Free cashflow to debt	-1%	12%	12%	-2%	3%	5%	0%	15%	17%

Key assumptions:

Base case:
Revenue CAGR 2.16%
CAPEX remains GAPP D&A as guided by the company
Debt issuance solely for refinance
Long-term debt paydown to reach leverage target

Bear case:
Revenue CAGR 1.79%
Company enter M&A period due to slower organic growth
CAPEX reverts back to 5-year high
Debt issuance at 5-year high
Lower than average long-term debt paydown

Bull case:
Revenue CAGR 2.59%
CAPEX remains at GAPP D&A
Debt issuance at 5-year low level
Higher than average long-term debt paydown

Upgrade opportunities in all cases

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Peer Comps

Ball's credit metrics approaching investment grade levels

	LTM Ball Corp		LTM Packaging BBB- to BBB+ average		LTM Packaging BB- to BB+ average		LTM Crown Holdings Inc		LTM Silgan Holdings Inc		LTM International Paper Co
Income statement metrics											
Revenue	$	12,318	$	7,594	$	7,819	$	11,760	$	5,780	$	18,640
Revenue growth		*-6%*		*2%*		*-2%*		*0%*		*-3%*		*2%*
EBITDA	$	1,673	$	1,111	$	1,408	$	1,800	$	808	$	1,720
EBITDA growth		*-2%*		*16%*		*-7%*		*12%*		*-10%*		*-31%*
EBITDA margin		*14%*		*14%*		*15%*		*18%*		*13%*		*8%*
Cash flow metrics												
EBITDA	$	1,673	$	1,111	$	1,408	$	1,800	$	808	$	1,720
Capex	$	(592)	$	(451)	$	(450)	$	(434)	$	(245)	$	(966)
Interest	$	(340)	$	(102)	$	(279)	$	(378)	$	(165)	$	(463)
Taxes	$	(653)	$	(180)	$	(131)	$	(114)	$	(90)	$	(340)
Dividends	$	(248)	$	(328)	$	(178)	$	(119)	$	(81)	$	(642)
Free cash flow	$	(160)	$	50	$	369	$	755	$	227	$	(691)
Cash taxes on aerospace sale	$	484										
Adjusted free cash flow	$	324										
Balance sheet metrics												
Cash	$	1,440	$	542	$	1,014	$	1,740	$	369	$	1,159
Total debt	$	6,164	$	3,844	$	6,294	$	7,730	$	3,810	$	6,020
Credit metrics												
Interest coverage		3.0x		15.0x		3.1x		3.7x		4.0x		3.3x
Leverage		3.7x		3.5x		4.5x		4.3x		4.7x		3.5x
Net leverage		2.8x		3.0x		3.8x		3.3x		4.3x		2.8x

Key takeaways:

- Leverage is most meaningful differentiating factor between BB and BBB rated packaging companies
- Ball approaching 3.5x leverage, the BBB packaging average and current leverage of International Paper – Ball's #1 market share analogue in the North American containerboard industry

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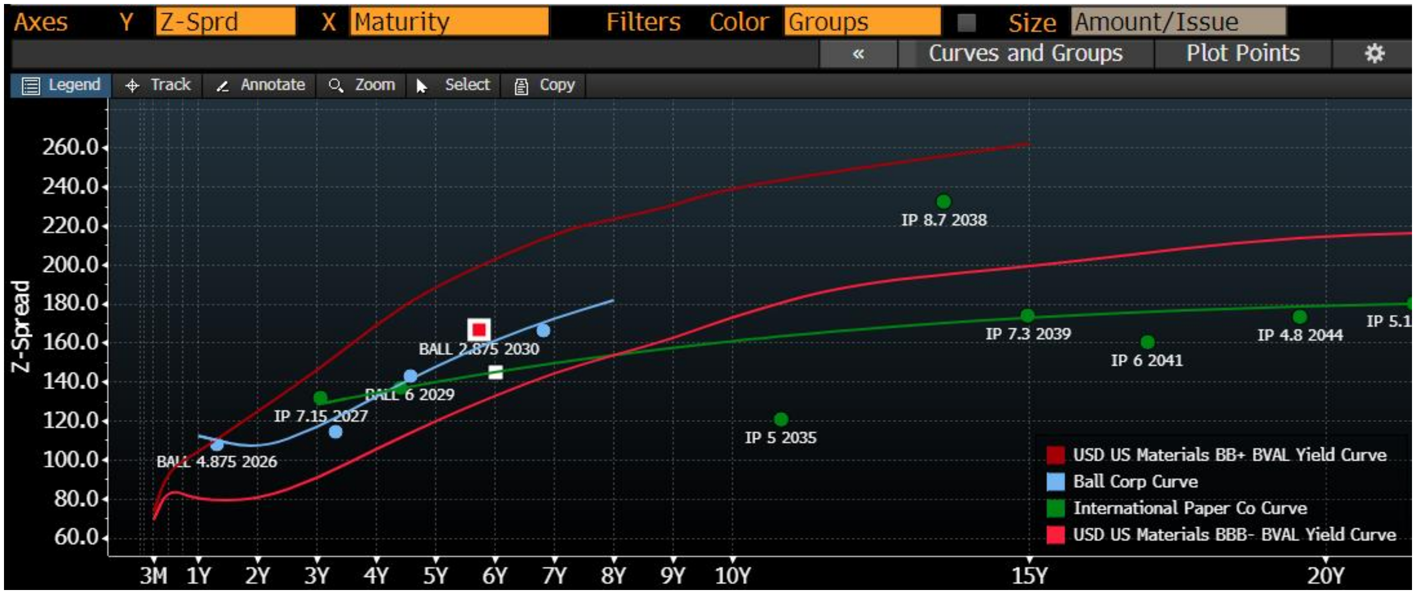
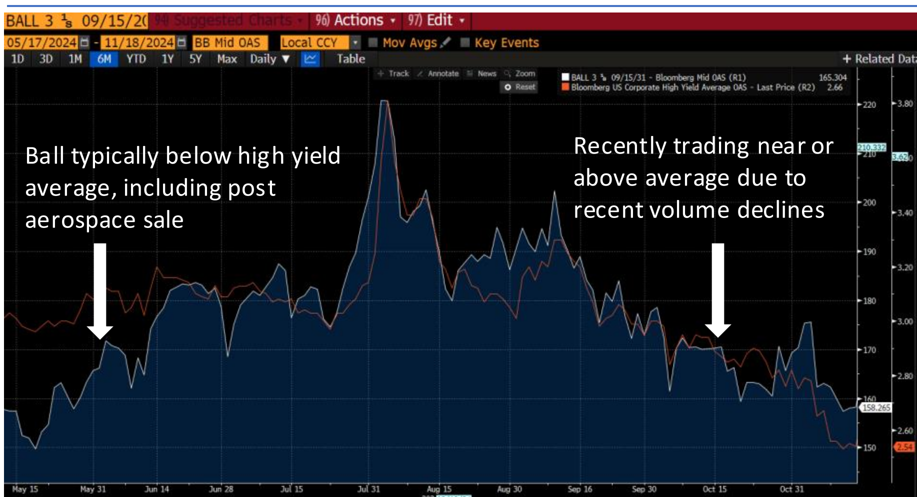
Valuation Summary

Opportunity to buy BALL 2.875% 2030 at attractive relative value

Ball issuer curve vs USD US Materials Curve



Ball spreads vs. US high yield average



- **Base case:** Spread tightens 20 bps to BBB- materials curve; target spread 141 bps
- **Bear case:** Spread widens 30 bps closer to BB+ materials curve; spread 191 bps
- **Bull case:** Spread tightens 30 bps to International Paper curve; target spread 131 bps

Thesis Risks and Mitigants

There are risks to the future Ball

Risks	Mitigants
• Consumer **price sensitivity is increasing** causing slowdown in ESG tailwinds	• **Regulation changes** are a **much larger and more consistent** driver of ESG tailwinds • Consumer price sensitivity is only in the **short term** and expected to begin to take a back seat to sustainability in the long term
• Product is a **commodity** which creates **lower margins and profitability** as industry grows	• M&A and industry growth should allow for sustained profitability as Ball continues to **capture more market share** especially in **developing regions** • Ball is looking to **introduce other product like aluminum cups** to differentiate their offering
• Ball could enter new M&A cycle earlier than cited resulting in **higher leverage**	• **Sustained future profitability** with topline growth and easy **access to capital markets** should allow Ball to continue down current path with limited risk
• **High customer and product concentration** post high-risk threats	• ESG tailwinds are causing **market growth** and Ball continues to be the **industry leader** best positioned to capture future opportunities

Appendix

Historical Financials

Ball is in a stronger credit position following the sale of aerospace business and end of high capex period

	FY19	FY20	FY21	FY22	FY23	LTM
Income statement metrics						
Revenue	$ 11,474	$ 11,781	$ 13,811	$ 15,349	$ 14,029	$ 12,318
Revenue growth	*-1%*	*3%*	*17%*	*11%*	*-9%*	*-6%*
EBITDA	$ 1,610	$ 1,671	$ 1,991	$ 1,886	$ 1,959	$ 1,673
EBITDA growth	*-2%*	*4%*	*19%*	*-5%*	*4%*	*-2%*
EBITDA margin	*14%*	*14%*	*14%*	*12%*	*14%*	*14%*
Cash flow metrics						
EBITDA	$ 1,610	$ 1,671	$ 1,991	$ 1,886	$ 1,959	$ 1,673
Capex	$ (598)	$ (1,113)	$ (1,726)	$ (1,651)	$ (1,045)	$ (592)
Cash interest	$ (324)	$ (316)	$ (283)	$ (330)	$ (459)	$ (340)
Cash taxes	$ (110)	$ (112)	$ (133)	$ (134)	$ (169)	$ (653)
Dividends	$ (182)	$ (198)	$ (229)	$ (254)	$ (252)	$ (248)
Free cash flow	$ 396	$ (68)	$ (380)	$ (483)	$ 34	$ (160)
Cash taxes on aerospace sale						$ 484
Adjusted free cash flow						$ 324
Balance sheet metrics						
Cash	$ 1,798	$ 1,366	$ 563	$ 548	$ 695	$ 1,440
Total debt	$ 7,817	$ 7,790	$ 7,725	$ 8,948	$ 8,569	$ 6,164
Credit metrics						
Interest coverage		3.6	4.8	3.9	2.8	3.0x
Leverage	4.9	4.7	3.9	4.7	4.4	3.7x
Net leverage	3.7	3.8	3.6	4.5	4.0	2.8x

Key takeaways:

- **Return to strong free cash flow generation** after end of high capex period of capacity expansion
- **Stronger balance sheet after sale of aerospace business:** sold for $5.6bn closed in February 2024; used $2bn of after cash proceeds on debt reduction, $2bn on share repurchases, and the remainder kept as cash on balance sheet
- **Adjusted leverage target:** below 2.5x (current company-adjusted level)
- **Liquidity:** $1.4bn cash on hand and full availability under $1.7bn revolving credit facility due 2027
- **Capital allocation priorities:** dividends and share repurchases, opportunistic M&A in aluminum packaging, reinvesting in the business

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Valuation Assumptions

Sales growth Assumptions	31-Dec-19	30-Dec-20	30-Dec-21	30-Dec-22	30-Dec-23	29-Dec-24	29-Dec-25	29-Dec-26	note
Beverage Packaging, North & Central America									
Best						-4.00%	3%	3%	
Base	2.85%	6.68%	15.37%	14.34%	-10.95%	-4.00%	2.16%	2.16%	analyst estimates
Weak						-5.00%	1.50%	1.50%	
Active						-4.00%	2.16%	2.16%	
Beverage Packaging , EMEA									
Best						0.70%	5.00%	5.00%	3-5% emea target
Base	1.71%	3.08%	19.15%	9.83%	-11.91%	0.53%	4.32%	4.32%	analyst estimates
Weak						0.50%	3.80%	3.80%	
Active						0.53%	4.32%	4.32%	
Beverage Packaging, South America									
Best						2.50%	5%	5%	4-6% SA target
Base	-1.82%	17.71%	9.76%	4.56%	-7.02%	2.32%	4.17%	4.17%	analyst estimates
Weak						2.10%	3.60%	3.60%	FY24 data similar to analyst estimates given most quarters are reported
Active						2.32%	4.17%	4.17%	
Others									
Best						4.20%	4.20%	4.20%	
Base	-45.51%	-54.37%	60.19%	37.57%	4.20%	4.20%	4.20%	4.20%	flat assumption
Weak						4.20%	4.20%	4.20%	
Active						4.20%	4.20%	4.20%	

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Valuation Assumptions

Cost Assumptions	31-Dec-19	30-Dec-20	30-Dec-21	30-Dec-22	30-Dec-23	29-Dec-24	29-Dec-25	29-Dec-26	Note
inventory % Sales	11.10%	11%	13%	14%	11%	12.18%	12.18%	12.18%	average of past five year
COGS & % Sales	80.20%	79.14%	80.26%	83.17%	80.97%	79.00%	77.00%	75.00%	gradually decreasing to achieve 500MM savings
SG&A % Sales	3.36%	4.46%	4.29%	4.08%	3.98%	4.03%	4.03%	4.03%	average of past five year
Other Opex % Sales		2.22%	1.03%	0.46%	1.09%	1.20%	1.20%	1.20%	average of past five year
Tax Assumption	11.68%	14.41%	15.48%	17.99%	15.11%	14.93%	14.93%	14.93%	average of past five year

Free Cash Flow Assumptions	31-Dec-19	30-Dec-20	30-Dec-21	30-Dec-22	30-Dec-23	29-Dec-24	29-Dec-25	29-Dec-26	Note
Capex % Sales									
Best						4.89%	4.89%	4.89%	maintain current low level
Base	5.21%	9.45%	12.50%	10.76%	7.45%	5.50%	5.50%	5.50%	**company guidance gaap d&a = capex**
Weak						5.67%	9.07%	9.07%	average of capex during M&A periods
Active						5.50%	5.50%	5.50%	
Debt paydown % Total Debt									
Best						-39.20%	-15.00%	0.00%	Company has band-with for more paydown
Base	-23.41%	-35.86%	-9.65%	-50.36%	-26.70%	-39.20%	-9.65%	-5.00%	FY24 data given, assume company revert back to minimum debt paydown after reaching the target
Weak						-39.20%	-5.00%	-5.00%	FY24 data given, assume company de-prioritize deleverage goal
Active						-39.20%	-9.65%	-5.00%	
Debt Issuance									
Best						0	1000.00	1000.00	Assume company refinance less debt
Base						0	1250.00	1750.00	Assume company only refinance
Weak						0	2000.00	2500.00	5 year high borrow level
Active						0.00%	1250.00	1750.00	

Valuation Assumptions

Debt Schedule	Int Rate	Amount Out ($M)	29-Dec-24	29-Dec-25	29-Dec-26
Revolver due June '27	5.94%	-			
1st lien term loan A due July '27	5.94%	625	625	625	625
1st lien term loan B due June '25	9.35%	371	371	0	0
2nd lien term loan B due July '26	13.60%	121	121	121	0
5.250% Sr. Notes due Jul'25	5.25%	189	189	0	0
4.875% Sr. Notes due Mar'26	4.88%	256	256	256	0
1.50% Sr. Notes due Mar'27 (EUR)	1.50%	634	634	634	634
6.876% Sr. Notes due Mar'28	6.88%	750	750	750	750
6.000% Sr. Notes due Jun'29	6%	1000	1000	1000	1000
2.875% Sr. Notes due Aug'30	2.88%	1300	1300	1300	1300
3.125% Sr. Notes due Sep'31	3.13%	850	850	850	850
*Refinance term loan B '25				500	500
*Refinance 5.25% '25 bond				750	750
*Refinance 4.875% '26 bond					500
Total		**$6,096**			

Interest Expense		29-Dec-24	29-Dec-25	29-Dec-26
Revolver due June '27		**$-**		
1st lien term loan A due July '27		37	37	37
1st lien term loan B due June '25		35	0	0
2nd lien term loan B due July '26		16	16	
5.250% Sr. Notes due Jul'25		10	0	0
4.875% Sr. Notes due Mar'26		12	12	0
1.50% Sr. Notes due Mar'27 (EUR)		10	10	10
6.876% Sr. Notes due Mar'28		52	52	52
6.000% Sr. Notes due Jun'29		60	60	60
2.875% Sr. Notes due Aug'30		37	37	37
3.125% Sr. Notes due Sep'31		27	27	27
Total interest expense from refinancing			88	123
*Refinance term loan B '25	Forward SOFR + 450 bps	0	38	38
*Refinance 5.25% '25 bond	US10 + 225 bps	0	51	51
*Refinance 4.875% '26 bond	US 10 + 225 bps	0		34
Interest Expense		**$296**	**$339**	**$345**

Covenant Analysis

BALL 2 ⅞ 08/15/30 Corp | Actions | Settings | Page 4/13 | Security D

94) Notes | 95) Buy | 96) Sell

25) Bond Description | 26) Issuer Description

Pages
- 11) Bond Info
- 12) Addtl Info
- 13) Reg/Tax
- 14) Covenants
- 15) Guarantors
- 16) Bond Ratings
- 17) Identifiers
- 18) Exchanges
- 19) Inv Parties
- 20) Fees, Restrict
- 21) Schedules
- 22) Coupons
- 23) Impact

Quick Links
- 32) ALLQ Pricing
- 33) QRD Qt Recap
- 34) TDH Trade Hist
- 35) CACS Corp Action
- 36) CF Filings
- 37) CN Sec News
- 38) HDS Holders
- 60) Send Bond

Covenants

	Covenant	
51)	Negative Pledge	Yes
52)	Change of Control	Yes @ 101.00
	Fundamental Change	No
	Limit of Indebtedness	No
53)	Cross Default	Yes
	Negative Covenant	Yes
54)	Certain Sales of Assets	Yes
	Restriction on Activities	Yes
	Debt Service Coverage Ratio	No
	Free Cash Flow To Debt Service Ratio	No
	Restrictive Covenant	Yes
55)	Merger Restrictions	Yes
56)	Limitation on Sale-and-Leaseback	Yes
	Limitation on Subsidiary Debt	No
	Restricted Payments	No
57)	Ratings Trigger	Yes
	Collective Action Clause	No
	Material Adverse Change Clause	No
	Force Majeure	No

/30 Corp | Actions | Settings | Page 11/13 | Security

94) Notes | 95) Buy | 96) Sell

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- 23) Impact

Schedules

Call Schedule

Call with minimum 15 days notice

Callable on and anytime after date(s) shown

Date	Price
05/15/2030	100.000

Capital Allocation

Capital Allocation De-risk Strategy:

- **De-risk pension liability** >> uk pension plan buy-in will reduce pension liability and aerospace sale will lower the liability to lowest point in decades.
- **Enhance cash flow generation:**
  - **Less aggressive CAPEX**: GAPP D&A = CapEx by driving plant efficiencies and scale existing footprints
  - **Improving working capital:** inventory reduction to meet demand and drive cashflow