



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

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**Team Number: 1**

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### Investment Recommendation:

- **BUY** Central Garden & Pet (CENT), 4.125% Senior Unsecured Note 4/30/31 (BB) trading at 90.61 – 5.88% yield to worst and 190bps OAS
  - **Target Spread:** 160bps and a base-case total return of 7.5%
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- **Capital Structure:** Common Equity \$2,093.3MM | Total Debt \$1,189.67MM | \$2.1MM Total Minority Interest
  - **Thesis 1:** Central Garden & Pet is well-positioned to capture growth with its sales and distribution networks and diversified portfolio
  - **Thesis 2:** Central Garden & Pet has been focused on both building operational efficiencies and e-commerce capabilities, aiding margin improvements and future growth.
  - **Thesis 3:** Central Garden & Pet's capacity investments will result in strong free cash flow and credit metrics, prompting an upgrade opportunity

# **Company Overview**

Central Garden & Pet has grown and developed over 65 brands through strategic acquisition, product launches, and divestitures.

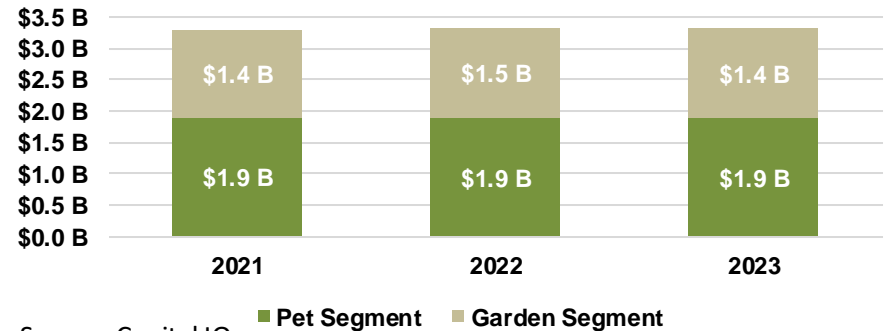
**Key Facts:**

- CGP was founded in 1980 as a distribution company and went public in 1993.
- The company operates a manufacturing, sales and distribution network that strategically supports their garden and pet brands.
- The company is the #2 retailer in both lawn and garden consumables and pet supplies.

**Product Categories:**

Pets	Garden
<b>Dog &amp; Cat</b> Premium chews, toys, and more	<b>Wild Bird</b> Wild bird feed, bird feeders, bird houses and accessories
<b>Small Animal &amp; Bird Supplies</b> Supplies & food for animals and birds	<b>Fertilizers &amp; Controls</b> Soil supplements and stimulants, lawn and garden fertilizers
<b>Animal Health</b> Wellness products such as flea & tick control	<b>Grass Seed</b> Numerous varieties of grass seeds
<b>Live Fish Small Animals</b> Aquarium fish & plants, reptiles and small animals	<b>Live Plants</b> Flowers, trees, shrubs and other plants
<b>Aquatics &amp; Reptile Supplies</b> Aquariums, terrariums accessories and more	<b>Packet Seed</b> Vegetable, herb, and flower seeds & seed starter
<b>Outdoor cushions</b> Arden-branded and private label outdoor cushions	

**Revenue Breakdown:**



Source: Capital IQ

**Top performing brands:**

**Pet:**



#1 Pet Bird & Small Animal



#1 Suet



#2 Fly Control



#2 Aquatics



#2 Dog Toys



#3 Calming Products

**Garden:**



#1 Wild Bird



#2 Grass Seed & Fertilizer



#2 Packet Seeds



#3 Controls



Central Garden & Pet has a favorable capital structure with no secured debt and low leverage.

### Notable Points:

- The 2031 Notes were selected as the longer duration bonds offer a higher potential yield and spread compression.
- Bonds are callable at a premium until 2029 and at par thereafter.
- Debt / Equity = 74.65%, Total Debt / EBITDA = 3.44x, Net Debt / EBITDA = 1.58x, EBIT / Interest Expense = 4.01x

### Capital Structure:

Facility	Debt Out (\$MM)	Secure	Price	Call Price	Next Call Date	Market Value	Current YTW	Coupon	S&P/ Fitch Rating	Spread
<b>Total Secured Debt</b>										
Revolving Credit Facility matures 12/16/26	-	Y	-	-	-	-	-	SOFR+1%	BBB-	
<b>Total Unsecured Debt</b>										
5.125% Senior Unsecured Note 2/01/28	300.00	N	98.682	101.71	11/15/24	299.46	5.566%	5.125%	BB	91
4.125% Senior Unsecured Note 10/15/30	500.00	N	91.742	102.06	10/15/25	459.05	5.774%	4.125%	BB	178
4.125% Senior Unsecured Note 4/30/31	400.00	N	90.610	102.06	4/30/26	369.83	5.897%	4.125%	BB	190
Other Notes Payable	0.472	N				0.47				
Adjustments	(10.8)					(10.8)				
<b>Total Debt Outstanding</b>	<b>1,189.67</b>					<b>1,118.01</b>				
- Cash & Cash Equivalents	570.4					570.4				
<b>Net Debt</b>	<b>619.27</b>					<b>547.61</b>				
Total Minority Interest	2.1					2.1				
Market Capitalization	2,093.3					2,093.3				
<b>Enterprise Value</b>	<b>2,714.67</b>									

**Note:** Debt Outstanding as of 6/29/2024, market values and spreads as of 10/17/2024

# **Investment Thesis**

**Thesis 1:** Central Garden & Pet is well-positioned to capture growth with its sales and distribution networks and diversified portfolio.

## CGP Company Strengths:

### 1 Supply chain breadth & capabilities

Private label low-cost manufacturing

Third-party brand distribution

58 sales and distribution facilities

Strengthen retailer relationships

Address consumer preferences

Diversify revenue streams

### 2 Strong partnerships with key retailers:

Key Pet retailers:



Key Garden retailers:



### 3 Diversified portfolio, even within verticals

Premium wild bird feed:



Value wild bird feed with premium options:



**Thesis 2:** Central Garden & Pet has been focused on both building operational efficiencies and e-commerce capabilities, aiding margin improvements and future growth.

**CGP Multi-Year Cost & Simplicity Program**

Removing Underperforming Segments	Streamlining Supply Chain Operations	Aligning M&A Synergies
Close low-margin private label bed lines & facility	Southeast consolidation of four distribution facilities into one	Combine outdoor cushion business with pet bed business

Improved margins, cash flow, and efficiencies to enable future growth

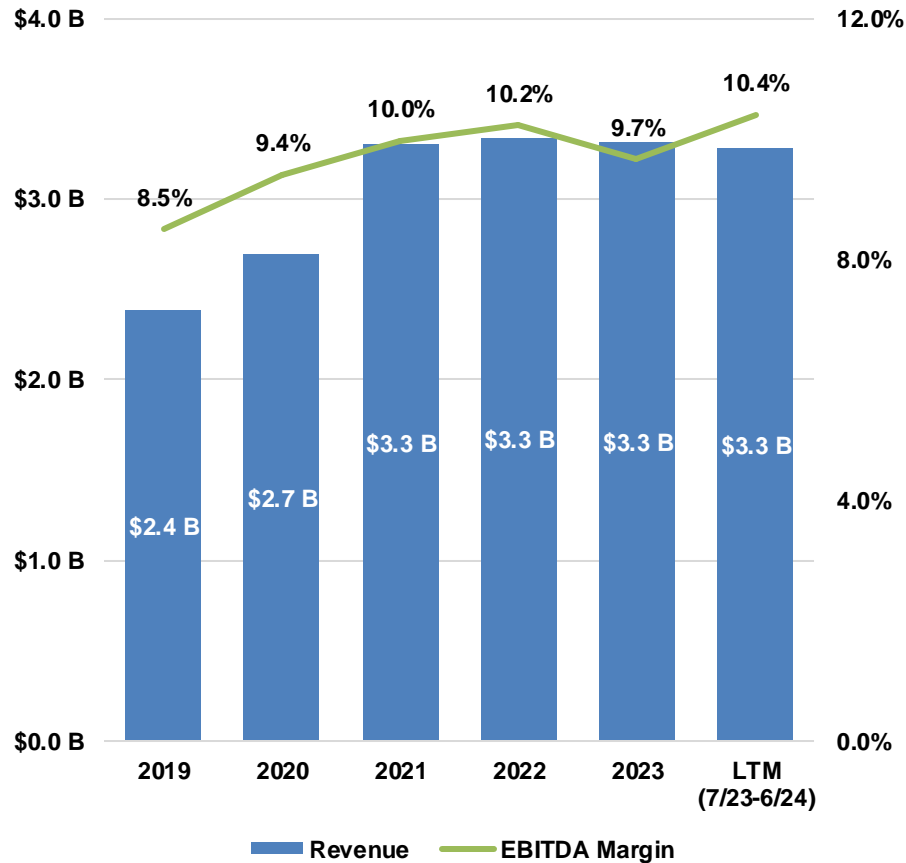
Innovate in higher margin & higher growth branded products	Invest in future capabilities to meet consumer needs & trends	Take advantage of future M&A opportunities & synergies
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**Profitero**



**Revenue & EBITDA Margins**



Source: Capital IQ



### Thesis 3: Central Garden & Pet's capacity investments will result in strong FCF and credit metrics, prompting an upgrade opportunity.

#### Key Assumptions:

<b>Bear</b>	Revenue: -5% (annual growth), Gross Margin: 25% (SG&A constant), Days of Inventory: 155
<b>Base</b>	Revenue: 0% (annual growth), Gross Margin: 30% (SG&A constant), Days of Inventory: 135
<b>Bull</b>	Revenue: 5% (annual growth), Gross Margin: 35% (SG&A constant), Days of Inventory: 120

USD Millions	2022	2023	2024E	2025E	2026E	2027E	2027 Bear	2027 Bull
Revenues	3,339	3,310	3,297	3,330	3,300	3,300	3,145	3,671
EBITDA	341	321	346	352	370	369	197	579
Net Income (Loss)	156	125	148	160	179	186	47	355
Cash from Ops.	-34	382	275	222	225	364	248	490
Free Cash Flow	-149	328	228	174	176	316	201	442
Cash & Cash Equivalents	177	489	645	786	777	911	533	1,248
Total Assets	3,282	3,379	3,638	3,829	3,740	3,910	3,625	4,248
Long-Term Debt	1,186	1,188	1,189	1,189	1,039	889	889	889
EBITDA Margin	10.2%	9.7%	10.5%	10.6%	11.1%	11.1%	6.1%	15.8%
Total Debt/EBITDA	3.48x	3.70x	3.44x	3.38x	2.81x	2.41x	4.51x	1.54x
Net Debt/EBITDA	2.92x	2.14x	1.58x	1.15x	0.71x	-0.06x	2.21x	-0.62x
EBITDA / Interest Exp.	5.85x	5.63x	5.94x	5.98x	6.70x	7.73x	4.13x	12.13x

Net Debt/EBITDA projections imply upgrade opportunity

Investment grade credit metrics

# **Valuation & Risk**

Our base case valuation calls for 160bps target spread in one year, for total annualized return of 7.95% (returns calculated based on 2031 bonds).

- **Bear:**  
Trade wider to ~250bps for 2.4% 1Y total return.
- **Base:**  
Tighten to ~160bps for 7.50% 1Y total return.
- **Bull:**  
Tighten to ~100bps for 10.6% 1Y total return.

	S&P	Fitch	Base	Bear	Bull
<b>Upgrade Trigger</b>	EBITDA Margin > 15% Net Debt/EBITDA < 2.5	Total Debt/EBITDA < 3 Top-Line Growth 2-4% EBITDA Margin > 10%	Fitch: Met S&P: Partially Met	Not Met	Met [IG Credit Metrics]
<b>Downgrade Trigger</b>	Net Debt/EBITDA > 3.75 Low cash flow generation	Total Debt/EBITDA > 4 EBITDA < 250MM	Not Met	Partially Met	Not Met

Issuer	Bonds	OAS	Amt Out	Coupon	Maturity	Dt	Price	Yield	Total D/E	Net Debt/ EBITDA	S&P	Moody	Fitch
Central Garden & Pet	CENT 4 ½ 04/31	190	400MM	4.125	4/30/31		90.61	5.88	87.4%	1.9x	BB	B1	BB
Perrigo Co.	PRGO 6 ½ 09/32	153	715MM	6.125	9/30/32		100.59	5.98	93.8%	6.3x	B+	Ba3	BB
Scotts Miracle-Gro Co.	SMG 4 04/31	174	474.98MM	4	4/1/31		90.64	5.76	Neg. Eq. -1910.5%	4.5x	B-	B2	N.A.
Prestige Consumer Healthcare Inc.	PBH 3 ¾ 04/31	159	600MM	3.75	4/1/31		90.09	5.6	65.6%	2.5x	BB	B1	N.A.
Spectrum Brands Holdings	SPB 3 ⅞ 03/31	204	128.03MM	3.875	3/15/31		88.72	6.02	31.3%	1.2x	B+	B2	BB
Scotts Miracle-Gro Co.	SMG 4 ⅜ 02/32	172	400MM	4.375	2/1/32		91.48	5.83	Neg. Eq. -1910.5%	4.5x	B-	B2	N.A.
Tempur Sealy Int., Inc.	TPX 3 ⅞ 10/31	201	800MM	3.875	10/15/31		87.9	6.02	752.4%	3.2x	BB *-	Ba2 *-	BB+ *-

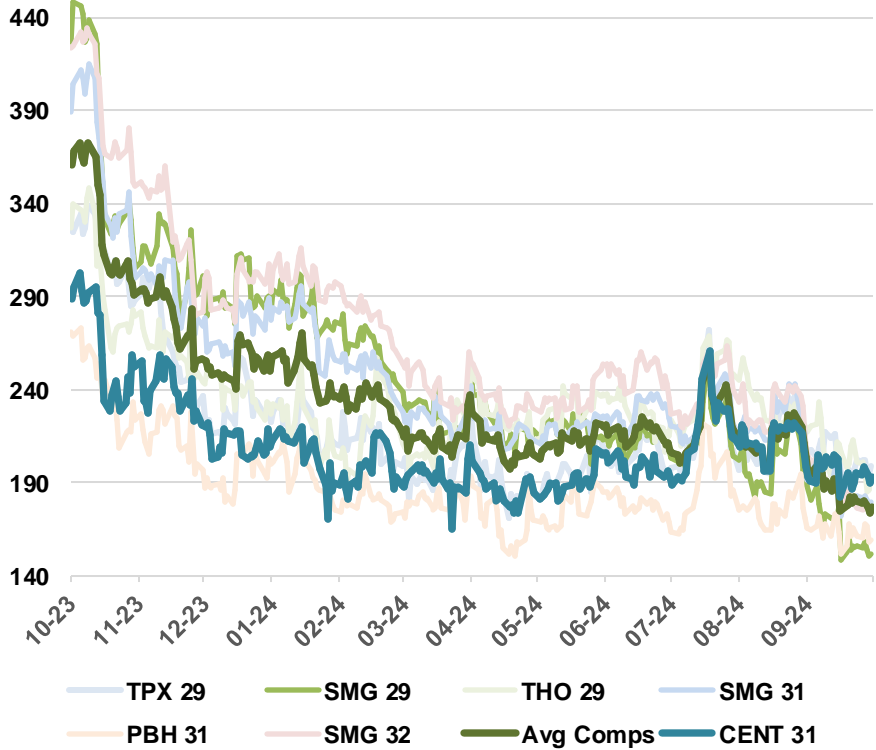
Note: Comp Table (as of 10/17/2024)

Central Garden & Pet's current spread signals a compression opportunity.

**OAS Spread**

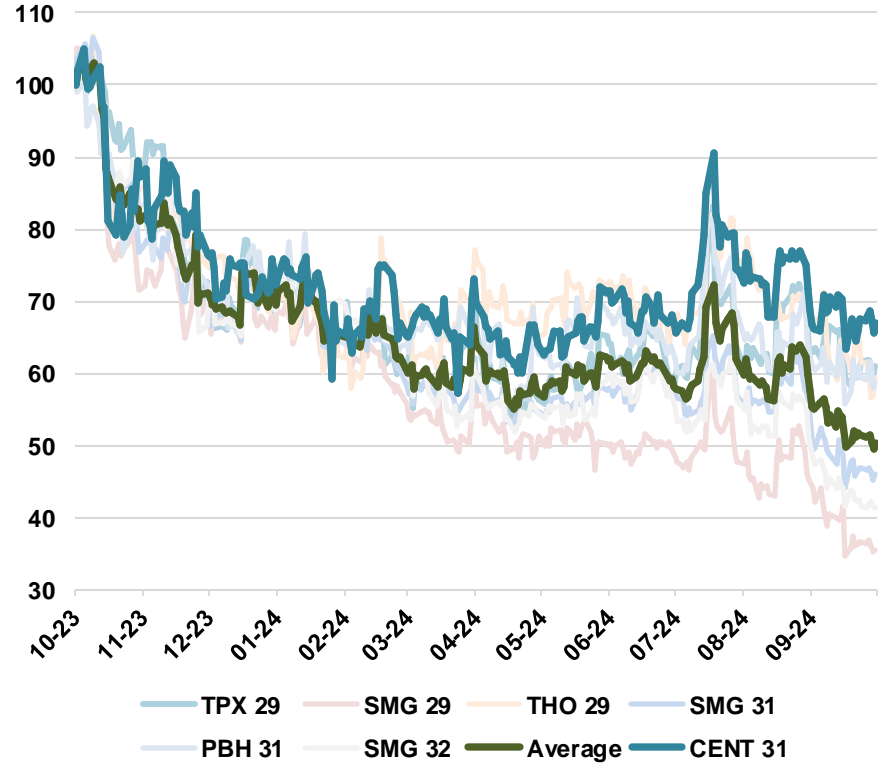
- CGP's current spread appears undervalued compared to peers and the benchmark.
- We expect the spread to be trading closer to 160 in the future, considering the rally that had the Avg. Comp.

**Comp Spreads**



Source: Bloomberg

**Normalized Spreads 1Y**



Source: Bloomberg

## Central Garden & Pet can pay its senior unsecured debt solely using current assets.

### High Recovery Value:

- CGP currently holds no secured debt, the senior secured debt will have access to any recoverable assets.

<b>Assets</b>	<b>2Q24</b>	<b>Recovery (%)</b>	<b>Recovery</b>	<b>Total Recovery</b>	<b>1,706,598</b>
Current Assets				Liquidation cost (5% Assumption)	85,330
Cash and Cash Equivalents	570,398	100%	570,398	Proceeds Available	1,621,268
Prepaid Expenses and Other Assets	33,493	0%	0	1L Secured claims	0
Restricted Cash	13,980	0%	0	Proceeds Available	1,621,268
Accounts Receivables	507,524	75%	380,643	1L recovery	100%
Inventories	784,775	50%	392,388	Senior Unsecured	1,200
<b>Total Current Assets</b>	<b>1,910,170</b>		<b>1,343,429</b>	<b>Sr. Unsecured recovery</b>	<b>100%</b>
Non-Current Assets					
Operating Lease Right-of-use Assets	188,506	0%	0		
Plant, Property and Equipment, Net	384,373	50%	192,187		
Goodwill	546,436	0%	0		
Other Intangible Asset, Net	472,854	25%	118,214		
Other Assets	105,539	50%	52,770		
<b>Total Non-Current Assets</b>	<b>1,697,708</b>		<b>363,170</b>		
<b>Total Assets</b>	<b>3,607,878</b>		<b>1,706,598</b>		

## Risks and Mitigants

Risks	Mitigants
<p>The company has seen a shift in key leadership, including both the CEO and CIO.</p>	<p>Both the new CEO and the new CIO have a proven track record with the firm. The transition will likely stabilize the firm as the company had an interim CEO the year prior.</p>
<p>Major weather events, particularly cold/adverse weather, can negatively affect garden revenues.</p>	<p>Central Garden &amp; Pet is monitoring this risk and can and has made appropriate divestitures if necessary, such as closing facilities. CGP has also been able to manage historical fluctuations in demand and seasons while maintaining cash flow, which we expect to continue.</p>
<p>Approximately 51% of the company's revenue comes from its top 5 customers.</p>	<p>Central Garden &amp; Pet provides specialized services for these large retailers. The company has also invested in e-commerce to 1) accommodate consumer shifts to omnichannel / pureplay e-commerce and 2) better serve and increase convenience for vendor partners.</p>
<p>The company has intensive working capital needs due to high inventory levels, especially because of Garden segment seasonality.</p>	<p>Central Garden &amp; Pet carries a large cash balance and has a revolving credit facility to ensure it has cash on hand to pay liabilities.</p>
<p>The company faces commodity risk for some inputs, such as bird seed.</p>	<p>Central Garden &amp; Pet will purchase and hold additional inventory in anticipation of a price increase.</p>
<p>Longer maturity bonds have both secured debt issuance and refinancing risk.</p>	<p>The recovery value is 1.5x of total debt and even in our bear scenario in 2027, the recovery value is 100%.</p>

# Appendix

# Modeled Income Statement

Currency USD  
Units Thousands  
Fiscal Year Sep- Sep

Legend Text Formula Non-Relevant Item  
Projection Constant Ratio

Income Statement	2020	2021	2022	2023	2024	2025	2026E	2027E	2028E	2029E	2030E	2031E
Revenues	2,695,509	3,303,684	3,338,588	3,310,083	3,296,970	3,329,940	3,329,940	3,329,940	3,329,940	3,329,940	3,329,940	3,329,940
Cost of Goods Sold	-1,898,951	-2,332,783	-2,346,283	-2,363,241	-2,307,040	-2,349,614	-2,330,958	-2,330,958	-2,330,958	-2,330,958	-2,330,958	-2,330,958
<b>Gross Profit</b>	796,558	970,901	992,305	946,842	989,930	980,326	998,982	998,982	998,982	998,982	998,982	998,982
SG&A	-598,581	-716,405	-732,269	-736,196	-756,633	-738,723	-739,247	-739,247	-739,247	-739,247	-739,247	-739,247
<b>EBIT</b>	197,977	254,496	260,036	210,646	233,297	241,603	259,735	259,735	259,735	259,735	259,735	259,735
Interest Expense	-44,016	-58,597	-58,255	-57,025	-58,134	-58,890	-55,177	-47,752	-44,040	-36,699	-28,449	-9,886
Interest Income	4,027	415	721	7,362	17,866	23,235	25,515	27,200	31,902	36,285	46,259	37,450
Other Income/expense												
<b>Earnings before Taxes</b>	157,988	196,314	202,502	160,983	193,028	205,948	230,074	239,184	247,597	259,322	277,546	287,299
Provision for Income Tax	-32,218	-42,035	-46,234	-36,348	-45,211	-45,926	-51,306	-53,338	-55,214	-57,829	-61,893	-64,068
Minority Interest (After Tax)												
<b>Net Income (Loss)</b>	125,770	154,279	156,268	124,635	147,817	160,021	178,767	185,846	192,383	201,493	215,653	223,231
<b>EBITDA</b>	253,336	329,223	340,984	320,905	345,523	352,224	369,767	369,050	368,248	367,592	367,017	366,473
<b>P&amp;L Ratios</b>												
Gross Margin	29.55%	29.39%	29.72%	28.60%	30.03%	29.44%	30.00%	30.00%	30.00%	30.00%	30.00%	30.00%
EBIT Margin	7.34%	7.70%	7.79%	6.36%	7.08%	7.26%	7.80%	7.80%	7.80%	7.80%	7.80%	7.80%
EBITDA Margin	9.40%	9.97%	10.21%	9.69%	10.48%	10.58%	11.10%	11.08%	11.06%	11.04%	11.02%	11.01%
Net Income Margin	4.67%	4.67%	4.68%	3.77%	4.48%	4.81%	5.37%	5.58%	5.78%	6.05%	6.48%	6.70%
SG&A	22.21%	21.69%	21.93%	22.24%	22.95%	22.18%	22.20%	22.20%	22.20%	22.20%	22.20%	22.20%
Rev growth		22.56%	1.06%	-0.85%	-0.40%	1.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Efective Interest Expense rate		6.23%	4.91%	4.80%	4.89%	4.95%	4.95%	4.95%	4.13%	4.13%	4.13%	4.13%
Efective Interes Income rate		0.08%	0.23%	2.12%	3.11%	3.25%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
Dep & Amort Rate		17.74%	11.54%	9.59%	10.38%	10.52%	10.50%	10.50%	10.50%	10.50%	10.50%	10.50%
Effective Tax rate	-20.39%	-21.41%	-22.83%	-22.58%	-23.42%	-22.30%	-22.30%	-22.30%	-22.30%	-22.30%	-22.30%	-22.30%



# Modeled Balance Sheet

Currency USD  
Units Thousands  
Fiscal Year Sep- Sep

Legend Text Formula Non-Relevant Item  
Projection *Constant Ratio*

	2020	2021	2022	2023	2024	2025	2026E	2027E	2028E	2029E	2030E	2031E
Cash and Cash Equivalents	652,712	426,422	177,442	488,730	645,140	785,580	777,152	911,473	1,036,721	1,321,693	1,070,008	860,236
Prepaid Expenses and Other Assets	27,498	33,514	46,883	33,172	42,045	38,716	38,866	39,936	38,547	39,622	39,138	39,222
Restricted Cash	13,685	13,100	14,742	14,143	0	0						
Accounts Receivables	391,773	385,384	376,787	332,890	393,646	412,616	370,196	412,616	370,066	394,279	371,098	408,203
Inventories	439,615	685,237	938,000	838,188	860,312	904,163	873,018	873,018	873,018	873,018	873,018	873,018
<b>Total Current Assets</b>	<b>1,525,283</b>	<b>1,543,657</b>	<b>1,553,854</b>	<b>1,707,123</b>	<b>1,941,143</b>	<b>2,141,075</b>	<b>2,059,232</b>	<b>2,237,043</b>	<b>2,318,352</b>	<b>2,628,612</b>	<b>2,353,261</b>	<b>2,180,678</b>
Operating Lease Right-of-use Assets	115,882	165,602	186,344	173,540	188,506	188,506	188,506	188,506	188,506	188,506	188,506	188,506
Plant, Property and Equipment, Net	244,667	328,571	396,979	391,768	383,290	374,789	347,591	313,485	283,810	253,388	224,030	194,976
Goodwill	289,955	369,391	546,436	546,436	546,436	546,436	546,436	546,436	546,436	546,436	546,436	546,436
Other Intangible Asset, Net	134,924	134,431	543,210	497,228	472,597	472,369	492,739	519,210	542,631	567,576	591,760	616,324
Other Assets	28,653	575,028	55,179	62,553	105,539	105,539	105,539	105,539	105,539	105,539	105,539	105,539
<b>Total Non Current Assets</b>	<b>814,081</b>	<b>1,573,023</b>	<b>1,728,148</b>	<b>1,671,525</b>	<b>1,696,368</b>	<b>1,687,638</b>	<b>1,680,811</b>	<b>1,673,176</b>	<b>1,666,921</b>	<b>1,661,446</b>	<b>1,656,271</b>	<b>1,651,781</b>
<b>Total Assets</b>	<b>2,339,364</b>	<b>3,116,680</b>	<b>3,282,002</b>	<b>3,378,648</b>	<b>3,637,511</b>	<b>3,828,714</b>	<b>3,740,043</b>	<b>3,910,219</b>	<b>3,985,273</b>	<b>4,290,058</b>	<b>4,009,532</b>	<b>3,832,460</b>
Accounts Payable	205,234	245,542	215,681	190,902	265,218	282,628	178,667	306,954	187,526	292,523	194,122	292,865
Accrued Expenses	201,436	234,965	201,783	216,241	227,637	241,118	228,332	232,362	233,937	231,544	232,615	232,699
Current Portion of Long-term Debt	97	1,081	317	247	308	320	292	307	306	301	305	304
Current Lease Liabilities	33,495	40,731	48,111	50,597	53,363	53,363	53,363	53,363	53,363	53,363	53,363	53,363
<b>Total Current Liabilities</b>	<b>440,262</b>	<b>522,319</b>	<b>465,892</b>	<b>457,987</b>	<b>546,526</b>	<b>577,429</b>	<b>460,653</b>	<b>592,986</b>	<b>475,133</b>	<b>577,731</b>	<b>480,404</b>	<b>579,231</b>
Long-term Debt	693,956	1,184,683	1,186,245	1,187,956	1,189,366	1,189,366	1,039,366	889,366	889,366	889,366	489,366	-10,634
Long-term Lease Liabilities	86,516	130,125	147,724	135,621	151,276	152,266	153,037	153,842	154,684	155,563	156,482	157,442
Minority Interest	871	1,292	1,006	1,460	1,249	1,369	1,359	1,326	1,352	1,346	1,341	1,346
Deferred Income Taxes and Other	40,956	56,012	147,429	144,271	150,184	149,146	147,867	149,066	148,693	148,542	148,767	148,667
<b>Total Non Current Liabilities</b>	<b>822,299</b>	<b>1,372,112</b>	<b>1,482,404</b>	<b>1,469,308</b>	<b>1,492,076</b>	<b>1,492,148</b>	<b>1,341,630</b>	<b>1,193,600</b>	<b>1,194,094</b>	<b>1,194,817</b>	<b>795,956</b>	<b>296,822</b>
<b>Total Liabilities</b>	<b>1,262,561</b>	<b>1,894,431</b>	<b>1,948,296</b>	<b>1,927,295</b>	<b>2,038,602</b>	<b>2,069,577</b>	<b>1,802,283</b>	<b>1,786,586</b>	<b>1,669,227</b>	<b>1,772,548</b>	<b>1,276,360</b>	<b>876,053</b>
Additional Paid in Capital	566,883	576,446	582,056	594,416	595,646	595,646	595,646	595,646	595,646	595,646	595,646	595,646
Retained Earnings (Accumulated Deficit)	510,781	646,082	755,253	859,370	1,005,678	1,165,699	1,344,466	1,530,312	1,722,695	1,924,188	2,139,841	2,363,072
Other - Common stock + other accumulated	-861	-279	-3,603	-2,433	-2,415	-2,208	-2,352	-2,325	-2,295	-2,324	-2,315	-2,311
<b>Total Shareholders Equity</b>	<b>1,076,803</b>	<b>1,222,249</b>	<b>1,333,706</b>	<b>1,451,353</b>	<b>1,598,909</b>	<b>1,759,137</b>	<b>1,937,760</b>	<b>2,123,633</b>	<b>2,316,046</b>	<b>2,517,510</b>	<b>2,733,172</b>	<b>2,956,407</b>
<b>Total Liabilities &amp; Shareholders Equity</b>	<b>2,339,364</b>	<b>3,116,680</b>	<b>3,282,002</b>	<b>3,378,648</b>	<b>3,637,511</b>	<b>3,828,714</b>	<b>3,740,043</b>	<b>3,910,219</b>	<b>3,985,273</b>	<b>4,290,058</b>	<b>4,009,532</b>	<b>3,832,460</b>

## Modeled Cash Flow

Currency  
Units  
Fiscal Year

USD  
Thousands  
Sep- Sep

Legend

Text  
Formula  
Projection

Ratio  
Non-Relevant Item  
*Constant Ratio*

	2020	2021	2022	2023	2024	2025	2026E	2027E	2028E	2029E	2030E	2031E
<b>Net Income</b>	120,677	151,747	152,153	125,644	147,292	160,021	178,767	185,846	192,383	201,493	215,653	223,231
Depreciation & Amort.	55,359	74,727	80,948	87,700	90,571	89,541	88,952	88,235	87,433	86,776	86,201	85,658
Other Assets related	6,619	4,581	2,741	-2,179								
Stock-Based Compensation	18,982	23,127	25,817	27,990	it is considered in the variation of accrued expenses							
Other Operating Activities	33,959	40,608	76,735	54,923								
Change in Acc. Receivable	-91,457	69,096	6,958	43,987	-56,081	-18,971	42,420	-42,420	42,550	-24,213	23,181	-37,105
Change In Inventories	27,377	-132,147	-256,464	86,969	-16,824	-43,851	31,145	0	0	0	0	0
Change in Acc. Payable	52,025	24,614	-31,205	-19,972	71,252	17,410	-103,962	128,288	-119,428	104,996	-98,401	98,744
Change in Other Net Operating Assets	40,825	-5,431	-91,808	-23,527	-43,119	17,799	-12,165	3,765	3,806	-2,589	2,474	960
<b>Cash from Ops.</b>	264,331	250,820	-34,049	381,606	274,550	221,950	225,158	363,713	206,745	366,463	229,108	371,488
Capital Expenditure	-43,100	-80,400	-115,200	-53,900	-46,063	-48,011	-49,325	-47,799	-48,378	-48,501	-48,226	-48,368
Cash Acquisitions	0	-820,422	0	0	-68,000	-32,800	-32,800	-32,800	-32,800	-32,800	-32,800	-32,800
Divestitures	0	2,400	0	20,000								
Invest. in Marketable & Equity Secur.	-4,400	-500	-27,800	-600								
Other Investing Activities	-700	-540	0	-100								
<b>Cash from Investing</b>	-48,200	-899,462	-143,000	-34,600	-115,763	-80,811	-82,125	-80,599	-81,178	-81,301	-81,026	-81,168
Short Term Debt Issued	200,000	1,258,000	0	48,000								
Short Term Debt Repaid	-200,000	-888,300	-300	-48,200								
Total Use of Revolving line of Credit	0	369,700	-300	-200								
Long-Term Debt Issued	0	500,000	0	0								
Long-Term Debt Repaid	0	-400,000	-800	-100	0	0	-150,000	-150,000		0	-400,000	-500,000
Total LT Debt	0	100,000	-800	-100	0	0	-150,000	-150,000	0	0	-400,000	-500,000
Repurchase of Common Stock	-59,200	-28,000	-62,400	-37,100	-15,619	-699	-1,461	1,207	-318	-191	233	-92
Total Dividends Paid	0	0	0	0								
Special Dividend Paid	0	0	0	0								
Other Financing Activities	-1,300	-21,200	-3,300	0								
<b>Cash from Financing</b>	-60,500	420,500	-66,800	-37,400	-16,819	-699	-151,461	-148,793	-318	-191	-399,767	-500,092
Foreign Exchange Rate Adj.	180	1,207	-3,500	1,146								
<b>Net Change in Cash</b>	155,811	-226,935	-247,349	310,752	142,258	140,439	-8,428	134,320	125,248	284,972	-251,685	-209,772

## Modeled Key Ratios

Currency  
Units  
Fiscal Year

USD  
Thousands  
Sep-Sep

Legend

Text  
Formula  
Projection

Ratio  
Non-Relevant Item  
Constant Ratio

	2020	2021	2022	2023	2024	2025	2026E	2027E	2028E	2029E	2030E	2031E
<b>Profitability</b>												
ROA	5.38%	4.95%	4.76%	3.69%	4.06%	4.18%	4.78%	4.75%	4.83%	4.70%	5.38%	5.82%
ROE	11.68%	12.62%	11.72%	8.59%	9.24%	9.10%	9.23%	8.75%	8.31%	8.00%	7.89%	7.55%
<b>Asset Turnover</b>												
Total Asset Turnover		1.21x	1.04x	0.99x	0.94x	0.89x	0.88x	0.87x	0.84x	0.80x	0.80x	0.85x
Fixed Asset Turnover		11.53x	9.20x	8.39x	8.51x	8.79x	9.22x	10.07x	11.15x	12.40x	13.95x	15.89x
Accounts Receivable Turnover		8.50x	8.76x	9.33x	9.08x	8.26x	8.51x	8.51x	8.51x	8.71x	8.70x	8.55x
Inventory Turnover		4.15x	2.89x	2.66x	2.72x	2.66x	2.67x	2.67x	2.67x	2.67x	2.67x	2.67x
Accounts Payable Turnover		10.35x	10.17x	11.62x	10.12x	8.58x	10.11x	9.60x	9.43x	9.71x	9.58x	9.57x
<b>Cash conversion cycle</b>												
Days of inventory		86.79	124.53	135.29	132.52	135.17	134.83	134.83	134.83	134.83	134.83	134.83
Days of Sales outstanding		42.34	41.09	38.59	39.67	43.58	42.31	42.31	42.31	41.32	41.37	42.13
Days Payable		34.78	35.38	30.97	35.59	41.97	35.62	37.50	38.18	37.07	37.58	37.61
<b>Short Term Liquidity</b>												
Current Ratio	3.46x	2.96x	3.34x	3.73x	3.55x	3.71x	4.47x	3.77x	4.88x	4.55x	4.90x	3.76x
Quick Ratio	2.47x	1.64x	1.32x	1.90x	1.98x	2.14x	2.58x	2.30x	3.04x	3.04x	3.08x	2.26x
<b>Long Term Solvency</b>												
Total Debt/Equity	0.64x	0.97x	0.89x	0.82x	0.74x	0.68x	0.54x	0.42x	0.38x	0.35x	0.18x	0.00x
Total Debt/Capital	1.22x	2.06x	2.04x	2.00x	2.00x	2.00x	1.75x	1.49x	1.49x	1.49x	0.82x	-0.02x
LT Debt/Equity	0.64x	0.97x	0.89x	0.82x	0.74x	0.68x	0.54x	0.42x	0.38x	0.35x	0.18x	0.00x
LT Debt/Capital	1.22x	2.06x	2.04x	2.00x	2.00x	2.00x	1.74x	1.49x	1.49x	1.49x	0.82x	-0.02x
Total Liabilities/Total Assets	0.54x	0.61x	0.59x	0.57x	0.56x	0.54x	0.48x	0.46x	0.42x	0.41x	0.32x	0.23x
<b>Credit Ratios</b>												
EBIT / Interest Exp.	4.50x	4.34x	4.46x	3.69x	4.01x	4.10x	4.71x	5.44x	5.90x	7.08x	9.13x	26.27x
EBITDA / Interest Exp.	5.76x	5.62x	5.85x	5.63x	5.94x	5.98x	6.70x	7.73x	8.36x	10.02x	12.90x	37.07x
(EBITDA-CAPEX) / Interest Exp.	4.78x	4.25x	3.88x	4.68x	5.15x	5.17x	5.81x	6.73x	7.26x	8.69x	11.21x	32.18x
Total Debt/EBITDA	2.74x	3.60x	3.48x	3.70x	3.44x	3.38x	2.81x	2.41x	2.42x	2.42x	1.33x	-0.03x
Net Debt/EBITDA	0.11x	2.27x	2.92x	2.14x	1.58x	1.15x	0.71x	-0.06x	-0.40x	-1.18x	-1.58x	-2.38x
Total Debt/(EBITDA-CAPEX)	3.30x	4.77x	5.26x	4.45x	3.97x	3.91x	3.24x	2.77x	2.78x	2.79x	1.54x	-0.03x
Net Debt/(EBITDA-CAPEX)	0.13x	3.00x	4.40x	2.57x	1.82x	1.33x	0.82x	-0.07x	-0.46x	-1.35x	-1.82x	-2.74x

## Yields compared vs Average Rating

### CGP debt yield curve

- Considering strong financial position, we consider that it should be trading significantly lower than the BB consumer staples.
- There is 115 bps of compression if CGP gets into investment grade rating. That is higher than our bull case return expectation.



## Leadership



### **Niko Lahanas, CEO and member of the Board of Directors**

- Assumed role as CEO on 9/29/2024
- CFO of Central from May 2017 – CEO appointment
- Prior experience in private equity and investment banking
- MBA from George Washington University

















### **Brad Smith, CFO**

- Assumed role as CFO on 9/29/2024
- Former CFO, Pet segment
- Joined Central in May of 2017
- Prior experience in finance including a role as CFO of European Operations at the Delhaize Group (now Ahold Delhaize)

## Key Milestones & Proven Track Record of M&A

60+ acquisitions over the last 30 years

1980	1992	1993	1997	1998	2004	2006	2015	2021	2023
Company founded	Company incorporated	Company goes Public	<p>Acquires:</p>    	<p>Acquires:</p> 	<p>Expands operations into Europe with acquisition</p> 	<p>Acquires:</p>  	<p>Acquires</p>  <p>\$23.2MM for IMS Dog Chews</p>	<p>Acquires:</p>  <p>\$81MM</p>  <p>\$81MM</p>  <p>\$571MM (\$180MM credit facility)</p>  <p>\$88MM Cash + \$30MM LT Debt</p>	<p>Acquires:</p>  <p>\$60MM</p> <p>Sells:</p> <p>Independent garden center distribution business</p> <p>\$20MM</p>

### Notable Convents and Ratios:

- Bond covenants allow the issuer to redeem some or all the bonds at any point at a price equal to 100% of the bond amount plus a “make-whole” premium. All bonds are callable in the last 5 years at decreasing premiums.
  - Call dates for the 4/30/31 bond: 4/30/26 @ 102.063, 4/30/27 @ 101.375, 4/30/28 at 100.688 and 4/30/29 @ 100, plus accrued and unpaid interest.
- Guidance from Management on dividends (Central Garden and Pet 2023 10-K):
  - “We do not expect to pay dividends in the foreseeable future. We have never paid any cash dividends on our common stock or Class A common stock and currently do not intend to do so. Provisions of our credit facility and the indenture governing our senior subordinated notes restrict our ability to pay cash dividends. Any future determination to pay cash dividends will be at the discretion of our Board of Directors, subject to limitations under applicable law and contractual restrictions, and will depend upon our results of operations, financial condition and other factors deemed relevant by our Board of Directors.”

# Central Garden & Pet Management Guidance & Priorities



## Capital Allocation Priorities

### Targeted M&A

- Build scale, fill white spaces and enter priority adjacencies
- Enhance key capabilities and pursue portfolio optimization

### Share repurchases

- Opportunistic and programmatic share repurchases

### Invest for Growth

- Expand capacity
- Selectively invest in brand building, ecommerce, digital marketing, consumer insights

### Debt Repayment

- Maintain flexibility for opportunistic M&A
- Reach investment grade rating



# Central Garden & Pet brand innovation

**CONSUMER**

## Innovating for Growth

- Curated gift box collection with best selling durable chew toys and natural chew treats
- Offered for puppies, small and large dogs
- Initial launch outpaced forecast by 30%

- Ready to use combination of mulch, grass seed & fertilizer
- Uses 30% less water than ordinary grass seed
- Proprietary tackifier

**CONSUMER**

## Innovation Expands our Industry Leadership

**Nylabone**

**Gourmet**  
Long-lasting dog chews

Finalist 2022 Pet Product News Editor Choice Awards

"Chew Toy of the Year" 2022 Pet Independent Innovation Award

**KAYLE**

**NutriSoft**  
Bird feed with unique soft texture

"Bird food product of the Year" 2022 Pet Independent Innovation Award

**CONSUMER**

## Investing Behind Winning Innovation

**Brand Extension**

**HSD**

POS \$ growth vs. prior year\*

Launching full season Lawn Fertilizer & liquid Plant Food

**Brand Redesign**

**HSD**

POS \$ growth vs. prior year\*\*  
Reversing years of POS losses

**CENTRAL** 2024 Introduction to Central \*excluding Wild Bird, 1H FY24 \*\* 1H FY24 56

# Central Garden & Pet Competitors

**Broad Portfolio across Garden & Pet**

**Garden**

**# 2**

**Lawn & Garden Consumables**

**Pet**

**# 2**

**Pet Supplies**  
(ex- Dog & Cat Food, Cat Litter)

- Major Participant
- Meaningful Participant
- Minor Participant

Controls	Major Participant	Major Participant	Major Participant	Major Participant
Grass Seed	Major Participant	Major Participant	Major Participant	Major Participant
Packet Seed	Major Participant	Major Participant	Major Participant	Major Participant
Wild Bird	Major Participant	Major Participant	Major Participant	Major Participant
Fertilizer	Major Participant	Major Participant	Major Participant	Major Participant
Live Plants	Major Participant	Minor Participant	Major Participant	Major Participant
Growing Media & Mulch	Major Participant	Major Participant	Major Participant	Major Participant

Dog & Cat Supplies	Major Participant	Major Participant	Minor Participant	Major Participant
Dog Treats & Chews	Major Participant	Major Participant	Major Participant	Major Participant
Aquatics Supplies	Major Participant	Major Participant	Major Participant	Major Participant
Small Animal Supplies	Major Participant	Major Participant	Major Participant	Major Participant
Pet Bird Supplies	Major Participant	Major Participant	Major Participant	Major Participant
Reptile Supplies	Major Participant	Minor Participant	Major Participant	Major Participant
Equine Supplies	Major Participant	Major Participant	Major Participant	Major Participant
Professional	Major Participant	Major Participant	Major Participant	Major Participant
Live Fish & Small Animals	Major Participant	Major Participant	Major Participant	Major Participant
Dog & Cat Food	Major Participant	Major Participant	Major Participant	Major Participant *
Cat Treats	Major Participant	Major Participant	Minor Participant	Major Participant
Cat Litter	Major Participant	Minor Participant	Major Participant	Major Participant
Services (Vet/ non-medical)	Major Participant	Major Participant	Major Participant	Major Participant

\* Cat food only

# Central Garden & Pet Manufacturing & Distribution Network

Large national footprint with sales, logistics, and manufacturing sites

Strong distributor capabilities in Pet & Garden

Low-cost producer in several categories

**CUSTOMER**

## Pet Distribution Generates Competitive Advantage

**~20%** of Pet revenue

**Largest**  
Assortment of supplies in Pet distribution with over 23,000 SKU's

**Our Portfolio**  
Third-Party Brands  
**~80%**

**Who We Serve**  
9,800+ Retailers  
6,400+ Vet clinics

**Competitive Advantages**

- Insight into leading consumer trends
- Channel leadership in Pet Specialty
- Strengthened category management with top customers
- Access to emerging brands for M&A

## Garden Distribution Generates Competitive Advantage

**~17%** of Garden revenue

**#2 Largest**  
U.S. National Distributor in Lawn & Garden

**+40K** Store Doors Served

**Competitive Advantages**

- Preferred partner for largest retailers in the United States
- Strengthened customer partnerships, category management
- Insight into leading consumer trends
- Access to emerging brands for M&A



# Build a Leading eCommerce Platform

## Developing Winning Capabilities

Activation



Assortment



Content



Availability



eCommerce Flywheel



Search

**\$594MM**

2023 eCommerce  
Net Sales

**+5%**

2023 eCommerce  
Net Sales growth

**~24%**

business in Pet,  
**~6%** in Garden

**amazon**  
**chewy**

**Top 10**  
Customers for  
Central

## Multi-year Journey to Reduce Cost and Simplify our Business

### PRINCIPLES

Simplify our business, focus our portfolio and supply chain

Improve our efficiency across everything we do

Execute in market with excellence

Take a disciplined and phased approach, avoid a “big bang”

### FOCUS AREAS

 **Procurement**

 **Manufacturing**

 **Logistics**

 **Portfolio**

 **Administration**

### OUTCOMES

Significantly reduced complexity: fewer SKUs, fewer plants, fewer distribution centers

Lower COGS through lower logistics costs, better procurement

Greater focus on higher margin consumer product Pet and Garden businesses

Lower administrative costs through scale leverage and efficiency

# Central Garden & Pet Market Trends

### Pet is an Attractive Growing Industry

- Large Market**: \$145B Industry
- Growing & Resilient**: LSD Growth Rate
- Broad Consumer Base**: Over 90% Household Penetration
- Strong Tailwinds**: Aligned with Consumer Trends

CENTRAL | 2024 Introduction to Central

### Garden is an Attractive Industry

- Large Market**: \$32B Industry
- Resilient Industry**: LSD Growth Rate
- Broad Consumer Base**: Over 70% Household Penetration
- High Consumer Engagement**: Strong Retention & Loyalty

CENTRAL | 2024 Introduction to Central

### Favorable Pet Industry Trends

- Humanization**: 95% of pet owners see pets as family
- Premiumization**: Shift to higher-end nutrition drives growth
- eCommerce**: More than 80% of the U.S. population shops online
- Demographics**: More than half of the U.S. population born after 1981
- Health & Wellness**: 70% of dog/cat owners look for products to improve pet health\*

CENTRAL | 2024 Introduction to Central | \*Packaged Facts

### Strong Garden Industry Trends

- Sustainability**: 82% of Gardeners believe they have a responsibility to be environmentally friendly
- Hybrid Work**: More than half of employees are set up to work from home
- Demographics**: More than half of the U.S. population was born after 1981
- eCommerce**: Emerging Home & Garden eCommerce growing faster than category
- Rural Migration**: A larger portion of the population lives outside of cities

### Large Pet Household Penetration

Long-term growth is fueled by positive consumer trends

#### Households Buying Pet Supplies (in millions)

Year	Value
Mar-19	93.8
Mar-20	96.0
Mar-21	99.7
Mar-22	100.7
Mar-23	101.3
Mar-24	101.5

#### Number of Pet Owning Households (in percent of all households)

Pet Type	2019	2023
Any Pets	54%	51%
Dogs	40%	38%
Cats	23%	24%
Other Pets	11%	15%

CENTRAL | 2024 Introduction to Central

### Significant Growth in Lawn & Garden Household Penetration and Spend

- 4.6MM**: New households entered category since 2019
- +71%**: Average spend per household vs 2019
- +1.5 points**: Household Penetration Growth\* (90.5% in 2019, 92.0% in 2024)

CENTRAL | 2024 Introduction to Central | \*Numerator Data through 3/24



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

**December 5<sup>th</sup>, 2024**

**Team Number: 9**

**Students: Maggie Kochevar, Nishant Patel,  
Xiaojun Zhu**

### Investment recommendations:

**Buy** Gap Inc. GAP 3.875% 2031 senior unsecured bond (BB/B1) trading at 282 bps\* (as of 09/19/2024).

**Target spreads: 210 bps**, and base case total return ~6.64%.



**Thesis #1: Brand reinvigoration strategy driving top-line and market share growth especially from growing Gen-Z consumption**

**Thesis #2: Investments in inventory support margin expansion and start to pay off**

**Thesis #3: Improving balance sheet and credit metrics enable upgrade potential to BB+**



# Capital Structure and Bond Selection

We recommend the GAP 3.875 10/01/2031 bond due to the attractive yields and longer duration.

Credit Facility	Out. (MM)	Currency	Is Guaranteed	Is Secured	Price	Coupon	Bid YTW	Z-Spread	S&P Rating	Leverage
Revolver due 07/13/2027	-	USD	-	Y	-	5.938	-	-	-	-
<b>Secured Loan Outstanding</b>										
3.625% senior note due 10/01/2029	750	USD	Y	N	90.485	3.625	5.861	269	BB	
3.875% senior note due 10/01/2031	750	USD	Y	N	87.969	3.875	6.153	275	BB	
<b>Unsecured Debt Outstanding</b>	<b>1500</b>									<b>1.3x</b>

Base case return on one year horizon	
Current price	87.582
Spread compression	72 bps
Implied price	89.610
Settle date	9/17/2025
Total return	6.64%

# Overview

**Gap Inc is an American clothing retailer leader that operates four brands and targets a variety of consumers**

## Overview and History

- Gap Inc. designs and sells apparel and accessories for women, men, and children under four brands,
- Gap was founded in 1969 with the basic goal to sell jeans that fit and is headquartered in San Francisco
- The company founded Old Navy in 1994,
- They acquired Banana republic in 1983 and Athleta in 2008

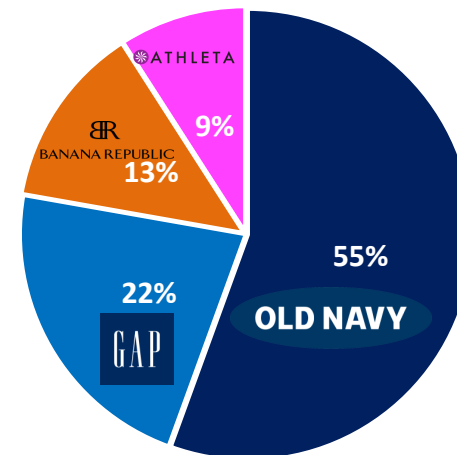
## Geography Mix

- 88% of their sales come from the US, 8% from Canada, and 4% from other regions
- They source apparel from 250+ vendors in 30 countries, top two suppliers are 7% and 9% of sales, 29% Vietnam and 18% Indonesia

## Channel Mix

- 67% percent of revenue comes from in-store sales while the rest comes from online sales
- Out of the 3560 stores across the brands, 72% are company operated
- The vast majority of stores they operate are leased

## Brands



# Investment Thesis 1 – Revitalized Revenue Stream

**Brand reinvigoration strategy is driving top-line and market share growth especially from growing Gen-Z consumption**

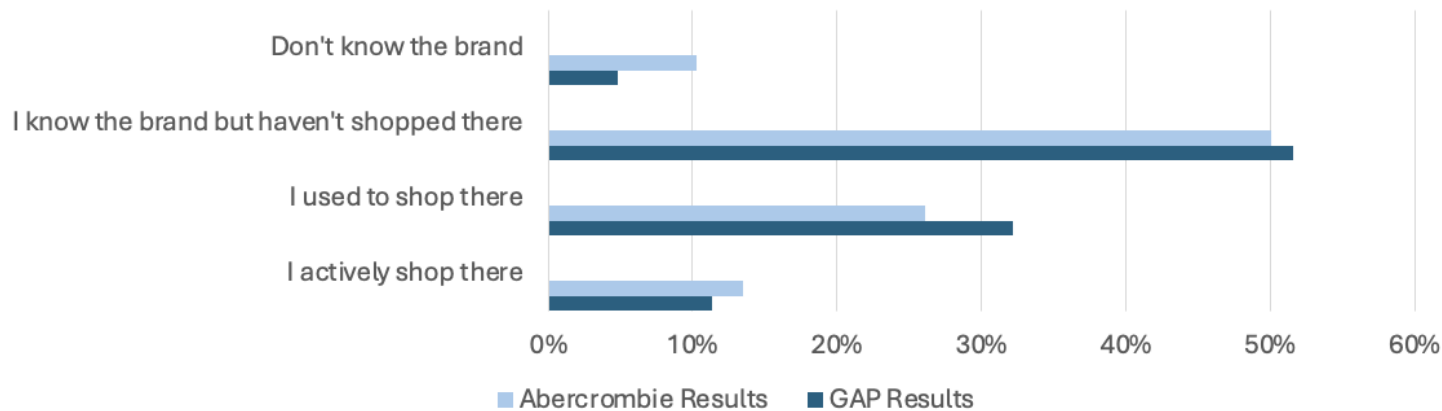
## Industry Trends

- 4.6% Sales Growth in US Adult retail in 2024 with **2.6% annual growth** expected 2025-2029<sup>1</sup>
- Gen Z's global spending power is expected to **increase ~30% by 2030**<sup>2</sup>
- 68% of Gen Z and Millennials agree that **social media is an essential resource** for styling inspiration<sup>1</sup>

## Gap Inc Trends

- Gap Inc's net sales were up **5% YoY** showcasing its increase in market share with fewer price discounts
- Gap and Old Navy have run **marketing campaigns** with celebrities and choreographed dancing that has seen **high engagement with Gen Z**
- From Q4 2022 to Q2 2024, Gap saw a **1500+% increase in engagement** from Gen Z which was noted as the **highest amongst any brand**<sup>3</sup>

**Primary Research conducted shows us that when compared to A&F, which has recently undergone a strong turn around, Gap has similar brand recognition amongst Gen Z consumers<sup>4</sup>**



Sources: 1. Mintel –Market Research Agency, 2. NielsenIQ – Global GenZ Spending Report , 3. dcdx – Marketing and Brand Strategy agency specializing in Gen Z consumers, 4. Anonymous surveys conducted at a local university

## Investment Thesis 1 – Revitalized Revenue Stream

Brand reinvigoration strategy driving top-line and market share growth especially from growing Gen-Z consumption

### OLD NAVY

- **Reassert** Old Navy and deliver consistent results
- Defend position as **#2 apparel brand**<sup>1</sup> in the US and **#1 kids and baby brand**<sup>1</sup> in US
- Most recent earnings: **+1% sales, 5** consecutive quarters of non-negative comps as operational rigor drives consistency in results



- **Reignite** Gap by returning to brand roots of on-trend basics that drive cultural conversation
- Recent successful campaigns: “Get Loose” Fall 2024 denim campaign with Troye Sivan, “Linen Moves” Spring 2024 campaign
- Most recent earnings: **+1% sales, +3%** comparable sales, **4** consecutive quarters of positive comp sales



### BANANA REPUBLIC

- **Reestablish** Banana Republic with creative rebrand that began in 2021 focused on returning to heritage, travel, and adventure roots
- Management acknowledges improving fundamentals takes time



- **Reset** Athleta by correcting previous product and marketing mistakes and bringing in new leadership (previous President of Alo Yoga)
- **#3 women’s active brand**<sup>1</sup> in US
- Management expects Athleta to return to positive comparable sales growth in remainder of FY24

<sup>1</sup>Source: Circana, U.S. Apparel Market, R3M ending July 2024. Circana is an analytics provider that collects in store and online POS data from retailers.

# Investment Thesis 2 – Inventory and Margin Improvement

Investments in inventory control support margin expansion and start to pay off

## Gap Inc's inventory control efforts:

- Vendor-managed inventory system
- Pack and hold strategies

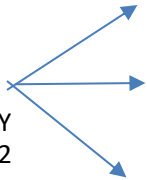


	FY20	FY21	FY22	FY23	LTM
Change in inventory	14%	23%	-21%	-16%	-5%
Days inventory	92	99	96	88	88
Inventory to sales	17.76	18.1	15.3	13.4	15.3
Promo level*			Elevated	Normal	Control

## Inventory change driver

**-30%**

Inventory YOY  
From 2023 Q2

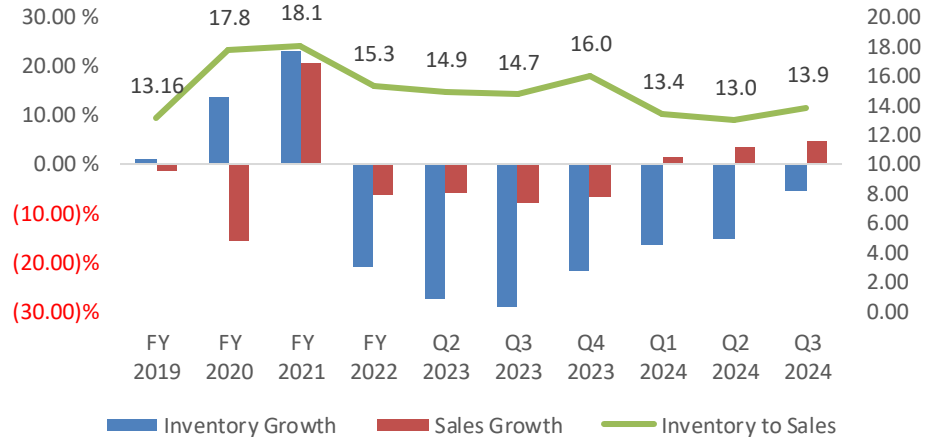


**-9%** from COVID related inventory normalization

**-6%** from “pack and hold”

**-15%** from new inventory system

## Inventory to sales driver



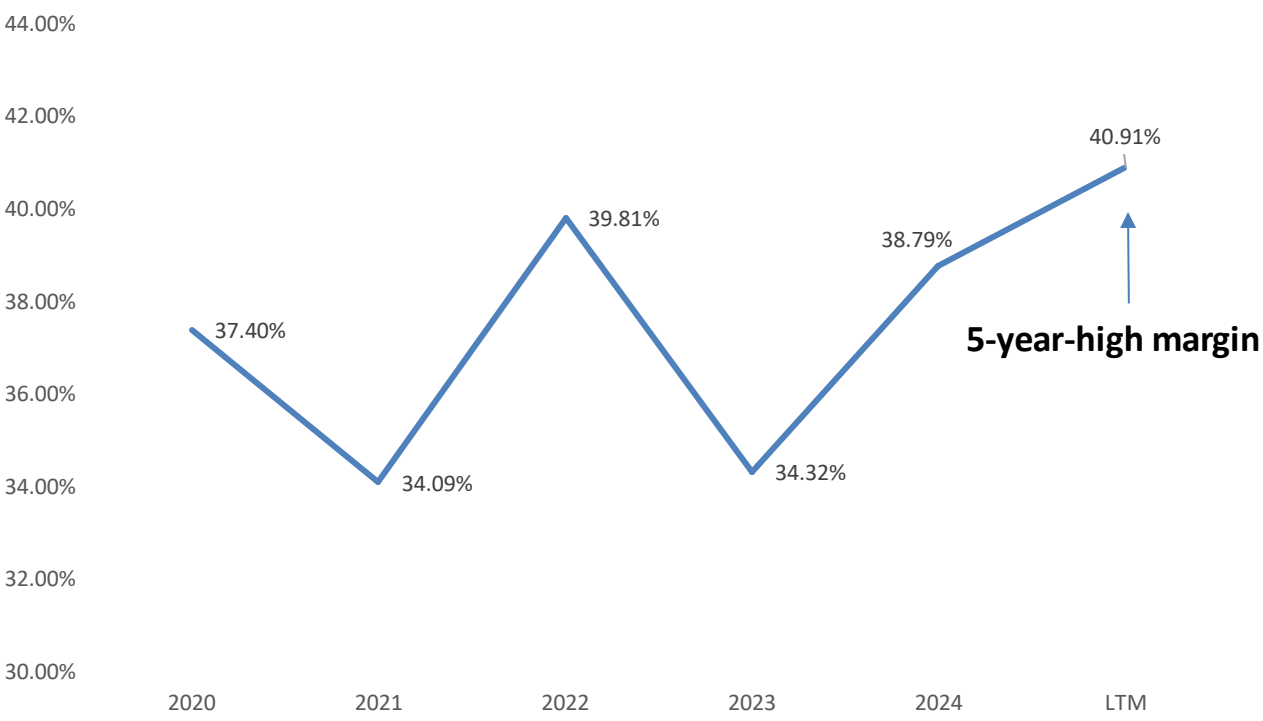
### Key takeaways:

1. Gap Inc's leaner inventory operation is mostly driven by internal operational initiatives. Industry-wide inventory normalization contributed a lower percentage
2. Inventory control was not affected by elevated stimulus promotions. Given management guidance on normalized discount activities, **inventory is likely to stabilize at a current level in the foreseeable future**

# Investment Thesis 2 – Margin Improvement

**Investments in inventory & supply chain support margin expansion and start to pay off**

## Gap Inc Gross Margin



**Key takeaways:**

1. Gap Inc's control on its inventory supported margin expansion to 5 year high
2. Gap Inc's inventory growth is significantly lower than competitors e.g. A&F, showcasing its ability to be rigorous especially during holiday seasons

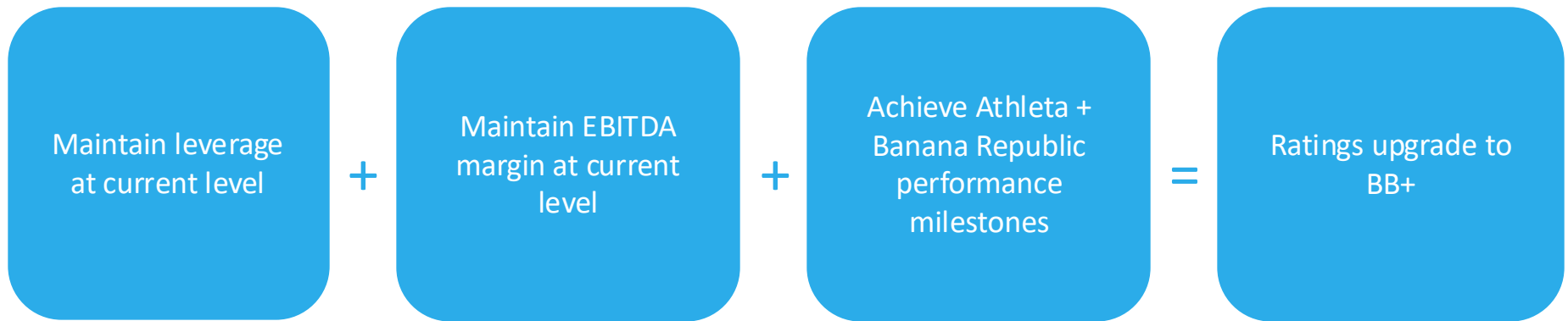
## Inventory growth YOY

Retail comps	FY 2019	FY 2020	FY 2021	FY 2022	FY2023	LTM
Gap Inc	1.17	13.68	23.13	(20.84)%	(16.49)%	(1.94)%
Abercrombie & Fitch	-0.81	(6.97)%	30.15 %	(3.85)%	(7.15)%	9.38 %
Crocs Inc	-4.49	38.19 %	1.80 %	21.93 %	120.85 %	(18.34)%

## Investment Thesis 3 – Upgrade Opportunity

Gap Inc’s topline growth, margin expansion, and healthier balance sheet enable potential upgrade opportunity

### S&P upgrade trigger



### Met in valuation cases?

#### Base + Bull

2.4x net or below  
 (= 1.9x S&P adjusted)

#### Base + Bull

10% or below  
 (= 14% S&P adjusted)

#### Bull

2.5% Athleta revenue growth  
 1% Banana Republic revenue growth  
 (S&P does not define performance milestones)

#### Bull

# Investment Thesis 3 – Upgrade Opportunity

## Gap Inc's turnaround strategy demonstrating results in FY23 and LTM

	FY19	FY20	FY21	FY22	FY23	LTM
<b>Income statement metrics</b>						
Revenue	\$16,383	\$16,383	\$13,800	\$16,670	\$15,616	\$14,889
Revenue growth			-16%	21%	-6%	-5%
EBITDA	\$ 1,131	\$ (355)	\$ 1,314	\$ 471	\$ 1,082	\$ 1,464
EBITDA growth			NM	-64%	130%	35%
EBITDA margin	7%	-2%	10%	3%	7%	10%
<b>Cash flow metrics</b>						
EBITDA	\$1,131	(\$355)	\$1,314	\$471	\$1,082	\$1,464
Capex	\$ (1,045)	\$ (392)	\$ (694)	\$ (685)	\$ (420)	\$ (403)
Interest	\$ (76)	\$ 145	\$ (180)	\$ (76)	\$ (74)	\$ (65)
Taxes	\$ (176)	\$ 20	\$ (215)	\$ 388	\$ (49)	\$ (166)
Dividends	\$ (364)	\$ -	\$ (226)	\$ (220)	\$ (222)	\$ (223)
Free cash flow	\$ (530)	\$ (912)	\$ (1)	\$ (122)	\$ 317	\$ 607
<b>Balance sheet metrics</b>						
Cash	\$1,364	\$1,364	\$1,988	\$877	\$1,215	\$1,873
Total debt (including operating leases)	\$7,677	\$7,677	\$7,664	\$6,251	\$6,020	\$5,441
<b>Credit metrics</b>						
Interest coverage	12.5	12.5	-4.7	4.9	6.2	9.9
Leverage (total debt including operating leases/EBITDA + cost of leases)	3.3	11.2	3.4	4.8	3.2	2.4
Net leverage (total debt including operating leases/EBITDA + cost of leases)	2.7	9.2	2.5	4.1	2.5	1.6

- **Thesis 1 and 2 results:** Demonstrated in return to topline growth and EBITDA margin expansion
- **Liquidity:** Strong, including \$1.9bn in cash on hand and no borrowings under its \$2.2bn ABL facility due 2027
- **Leverage:** Declining due to stronger EBITDA and lower debt, no leverage target
- **Free cash flow and interest coverage:** Up due to topline and margin gains
- **Financial policy:** Committed to maintaining at least \$1.2bn in cash on hand
- **Capital allocation priorities:** 1. Invest in the business 2. Shareholder returns



# Investment Thesis 3 – Upgrade Opportunity

## Gap Inc outperforming BB rated retail average on key credit metrics

	LTM Gap Inc	LTM BB- to BB+ Retail average	LTM Victoria's Secret	LTM Abercrombie & Fitch	LTM Bath & Body Works	LTM Foot Locker
<b>Income statement metrics</b>						
Revenue	\$ 15,173	\$ 12,500	\$ 6,123	\$ 4,664	\$ 7,384	\$ 8,152
<i>Revenue growth</i>	2%	2%	-1%	21%	-2%	2%
EBITDA	\$ 1,464	\$ 978	\$ 532	\$ 1,062	\$ 1,569	\$ 289
<i>EBITDA growth</i>	35%	4%				
<i>EBITDA margin</i>	10%	10%	9%	25%	17%	2%
<b>Cash flow metrics</b>						
EBITDA	\$ 1,464	\$ 978	\$ 532	\$ 1,062	\$ 1,569	\$ 289
Capex	\$ (403)	\$ (289)	\$ (211)	\$ (150)	\$ (221)	\$ (269)
Interest	\$ (65)	\$ (121)	\$ (96)	\$ (26)	\$ (329)	\$ (24)
Taxes	\$ (166)	\$ (106)	\$ (44)	\$ (171)	\$ (115)	\$ 113
Dividends	\$ (223)	\$ (78)	\$ -	\$ -	\$ (180)	\$ (38)
Free cash flow	\$ 607	\$ 383	\$ 182	\$ 714	\$ 724	\$ 71
<b>Balance sheet metrics</b>						
Cash	\$ 1,900	\$ 377	\$ 169	\$ 738	\$ 514	\$ 291
Total debt (including operating leases)	\$ 5,459	\$ 3,940	\$ 2,808	\$ 891	\$ 5,364	\$ 2,919
<b>Credit metrics</b>						
Interest coverage	9.9	8.6	3.0	33.8	2.4	-1.8
Leverage (including operating leases)	3.7	4.1	5.3	0.8	3.4	10.1
Net leverage (including operating leases)	2.4	3.7	5.0	0.1	3.1	9.1

Gap Inc is outperforming the BB- to BB+ retail average on several key credit metrics including:

- Free cash flow generation
- Liquidity
- Interest coverage
- Leverage

## Thesis 3 – Upgrade Opportunity

We anticipate that Gap Inc's turnaround strategy will continue to drive financial metric improvement

	Base			Bear			Bull		
	FY24	FY25	FY26	FY24	FY25	FY26	FY24	FY25	FY26
<b>Income statement metrics</b>									
Revenue	\$14,889	\$15,246	\$15,622	\$14,889	\$15,081	\$15,285	\$14,889	\$15,401	\$15,935
<i>Revenue growth</i>		2%	2%		1%	1%		3%	3%
EBITDA	\$1,082	\$1,445	\$1,480	\$1,082	\$837	\$849	\$1,082	\$1,829	\$1,893
<i>EBITDA growth</i>	130%	0%	2%	130%	1%	1%	130%	3%	4%
<i>EBITDA margin</i>	-7%	-9%	-9%	-7%	-5%	-5%	-7%	-11%	-11%
<b>Cash flow metrics</b>									
EBITDA	\$1,082	\$1,445	\$1,480	\$1,082	\$826	\$837	\$1,082	\$1,767	\$1,829
Capex	-\$420	-\$578	-\$592	-\$420	-\$572	-\$579	-\$420	-\$584	-\$604
Interest	-\$90	-\$113	-\$113	-\$90	-\$113	-\$113	-\$90	-\$113	-\$113
Taxes	-\$54	-\$266	-\$255	-\$54	-\$83	-\$65	-\$54	-\$362	-\$356
Dividends	-\$56	-\$223	-\$223	-\$56	-\$223	-\$223	-\$56	-\$223	-\$223
Free cash flow	\$462	\$265	\$298	\$462	-\$164	-\$143	\$462	\$486	\$533
<b>Balance sheet metrics</b>									
Cash	\$1,873	\$2,395	\$2,765	\$1,873	\$2,016	\$1,997	\$1,873	\$2,687	\$3,266
Total debt	\$5,441	\$5,152	\$5,136	\$5,441	\$5,135	\$5,102	\$5,441	\$5,171	\$5,169
<b>Credit metrics</b>									
Interest coverage	6.2x	7.9x	7.5x	6.2x	2.4x	1.9x	6.2x	10.7x	10.5x
Leverage (total debt including operating leases/EBITDA + cost of leases)	2.9x	2.3x	2.2x	2.9x	3.1x	3.1x	2.9x	2.0x	1.9x
Net leverage (total debt including operating leases/EBITDA + cost of leases)	1.9x	1.2x	1.0x	1.9x	1.9x	1.9x	1.9x	1.0x	0.7x

### Key assumptions:

#### Base case:

- Revenue growth at ~2.5% (separately projected by business segments)
- EBITDA and free cash flow continued to grow
- Interest coverage ratio improved while leverage ratio dropped

#### Bear case:

- Revenue growth at ~1.4% (separately projected by business segments)
- EBITDA and free cash flow grow at a lower rate
- Interest coverage and leverage ratio improved less

#### Bull case:

- Revenue growth at ~5% (separately projected by business segments)
- EBITDA and free cash flow significantly grow
- Interest coverage ratio and leverage ratio significantly improved

# Valuation Summary

**Relative value:** We anticipate that Gap Inc's continued financial metric improvement will tighten spreads to BB average curve

Gap issuer curve vs USD US Retail Curve



**Takeaways:**

Gap Inc spreads have already tightened meaningfully since bond universe released due to strong Q3 earnings

- **Base case:** Spread tightens 10 bps further below BB curve; target spread 210 bps
- **Bear case:** Spread widens 25 bps to BB retail curve; spread 245 bps
- **Bull case:** Spread tightens 50 bps to halfway between BB and BBB retail curves; target spread 170 bps

## Thesis Risks and Mitigants

### There are risks to the future Gap Inc

#### Risks

- **Brand image and product** may not continue to resonate with customers
- **Reinvestment** in the brand may be **costly**
- Company may become **increasingly shareholder-friendly** or adopt a more **aggressive financial policy**

#### Mitigants

- The **new CEO** has done a successful brand turnaround in the past with Barbie. In addition, other brands like Abercrombie have shown that with the right strategy a **turnaround is possible**
- Gap Inc's **SG&A is higher than industry** average which shows an opportunity for more efficient cost management which will free up capital to reinvest
- Reinvesting in the business is **#1 capital allocation priority**
- Combination of topline growth and expense management will **increase EBITDA and decrease leverage**
- Management is committed to **maintaining a cash balance of at least \$1.2bn**

# Appendix

# Bond Covenants

94 Notes 95 Buy 96 Sell

25 Bond Description	26 Issuer Description	
<b>Covenants</b>		
51) <a href="#">Negative Pledge</a>		Yes
52) <a href="#">Change of Control</a>		Yes @ 101.00
	<a href="#">Fundamental Change</a>	No
	<a href="#">Limit of Indebtedness</a>	No
53) <a href="#">Cross Default</a>		Yes
	<a href="#">Negative Covenant</a>	Yes
54) <a href="#">Certain Sales of Assets</a>		Yes
	<a href="#">Restriction on Activities</a>	Yes
	<a href="#">Debt Service Coverage Ratio</a>	No
	<a href="#">Free Cash Flow To Debt Service Ratio</a>	No
	<a href="#">Restrictive Covenant</a>	Yes
55) <a href="#">Merger Restrictions</a>		Yes
56) <a href="#">Limitation on Sale-and-Leaseback</a>		Yes
	<a href="#">Limitation on Subsidiary Debt</a>	No
	<a href="#">Restricted Payments</a>	No
57) <a href="#">Ratings Trigger</a>		Yes
	<a href="#">Collective Action Clause</a>	No
	<a href="#">Material Adverse Change Clause</a>	No
	<a href="#">Force Majeure</a>	No

94 Notes 95 Buy 96 Sell

25 Bond Description	26 Issuer Description	
<b>Schedules</b>		
<b>Call Schedule</b>		
Callable on and anytime after date(s) shown		
	<b>Date</b>	<b>Price</b>
	10/01/2026	101.938
	10/01/2027	101.292
	10/01/2028	100.646
	10/01/2029	100.000

## Comparable Sales

	Third Quarter	
	2024	2023
Old Navy	— %	1 %
Gap	3 %	(1)%
Banana Republic	(1)%	(8)%
Athleta	5 %	(19)%
Gap Inc.	1 %	(2)%

## Full Year Fiscal 2024

	Current FY24 Outlook	Prior FY24 Outlook	FY23 Results
Net sales	Up 1.5% to 2.0% on a 52-week basis	Up slightly on a 52-week basis	\$14.9 billion <sup>1</sup>
Gross margin	Approximately 220 bps expansion	Approximately 200 bps expansion	38.8%
Operating expense	Approximately \$5.1 billion	Approximately \$5.1 billion	\$5.17 billion (adjusted) <sup>2</sup>
Operating income	Mid to High 60% growth range	Mid to High 50% growth range	\$606 million (adjusted) <sup>3</sup>
Effective tax rate	Approximately 26.5%	Approximately 28%	9.7%
Capital expenditures	Approximately \$500 million	Approximately \$500 million	\$420 million

<sup>1</sup> Fiscal year 2023 consisted of 53 weeks and the extra week drove approximately \$160 million of incremental sales.

<sup>2</sup> Fiscal year 2023 adjusted operating expense of \$5.17 billion excludes \$89 million in restructuring costs and a \$47 million gain on sale.

<sup>3</sup> Fiscal year 2023 adjusted operating income of \$606 million excludes \$93 million in restructuring costs and a \$47 million gain on sale.

## Highlights:

- Net Sales grew for the 4th consecutive quarter
- Gross margin continues to expand
- Highest Q3 operating profits in 7 years
- Market share gains for the 7th consecutive quarter
- Significant gain in performance for Athleta due to new marketing and products

# Valuation Assumptions

Same Store Sales		2020A	2021A	2022A	2023A	2024A	2025E	2026E	2027E
Gap Inc Global	Bull						4.0%	4.0%	4.0%
	Base			8.0%	(\$4.0%)	1.0%	3.0%	3.0%	3.0%
	Bear						2.0%	2.0%	2.0%
Old Navy	Bull						4.0%	4.0%	4.0%
	Base			-	(\$12.0%)	(\$1.0%)	3.0%	3.0%	3.0%
	Bear						2.0%	2.0%	2.0%
Banana Republic	Bull						1.0%	1.0%	1.0%
	Base			24.0%	9.0%	(\$7.0%)	0.5%	0.5%	0.5%
	Bear						(\$1.0%)	(\$1.0%)	(\$1.0%)
Athleta	Bull						2.5%	2.5%	2.5%
	Base			—	(\$5.0%)	(\$12.0%)	1.5%	1.5%	1.5%
	Bear						1.0%	1.0%	1.0%



# Valuation Assumptions

Cost Assumption		2020A	2021A	2022A	2023A	2024A	2025E	2026E	2027E	Note
Inventory % Sales	Bull						11.0%	11.0%	11.0%	
	Base	13%	18%	18%	15%	13%	13.0%	13.0%	13.0%	
	Bear						13.0%	13.0%	13.0%	
OpEx % Sales	Bull						35.0%	35.0%	35.0%	
	Base	34%	40%	35%	35%	35%	35.0%	35.0%	35.0%	
	Bear						35.0%	35.0%	35.0%	
COGS & Occupancy % Sales	Bull						57.0%	57.0%	57.0%	
	Base	63%	66%	60%	66%	61%	59.0%	59.0%	59.0%	
	Bear						63.0%	63.0%	63.0%	

CAPEX & Lease assumption	2020A	2021A	2022A	2023A	2024A	2025E	2026E	2027E	Note
Capex	\$1,045	\$392	\$694	\$685	\$420	578	607	623	
Capex New Building	343	0	0	0	0	\$0	\$0	\$0	Based on company guidance
Capex PP&E	702	392.00	694.00	685.00	420.00	578	607	623	Based on avg of past 3 years of Capex % sales
Depreciation	\$557	\$507	\$504	\$540	\$522	530	557	571	
Depreciation % Capex	53%	129%	73%	79%	124%	91.7%	91.7%	91.7%	Based on avg of past 3 years of dep % Capex
Cost of Ccapitalized Operating Lease	1224	1039	948	824	823	824	824	824	Average last two years since new turnaround efforts
Rental Expense	1845	1455	1376	1271	1266	1268.5	1268.5	1268.5	
Variable Lease Cost	621	416	428	447	443	445	445	445	

## Operating Comps

**Gap Inc is pursuing a similar strategy to other competitors doing brand turnarounds but with some key advantages**

**A&F:**

- Reduce occupancy cost
- More variable digital fulfillment and marketing
- Shift to digital
- Normalization of freight cost and raw materials
- Inventory cost control
- Prioritize customer facing spend and reduce non-customer facing expenses “strategically increasing tickets and reducing the depth and breadth of promotions to drive AUR growth”

“So what we are focused on is number one, looking at expenses, anything that is non-customer facing, those discretionary expenses and pausing some of those, but we are not going to step back from some of the key expenses (digital, technology, marketing) we need to drive the topline as that is marketing.” - CEO

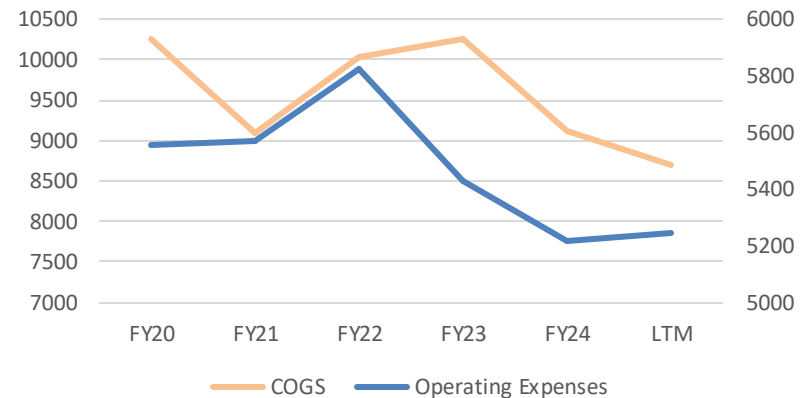
	Reduce Inventory	Improve Supply Chain	Operating Cost Control	Leaderships Change	Reshape Marketing
Gap Inc	√	√	√	√	√
A&F	√	√	√		

## Supply Chain Improvement

- **Technology** – utilize tech partners e.g. Optoro to optimize restocking efforts
- **Digital product designs** – results in **40% reduction** in development time
- **Diversification** – diversify the sourcing country portfolio and port exposure

## Cost Reduction

- Tech-enabled marketing and media campaign
- Workforce adjustment with more disciplined culture



**2020**

- 1 CapEx with ROIC Focus**  
Invest in profitable growth: brands and customer facing capabilities
- 2 Restructure Fixed Cost Base**  
Aggressive store closure plan and strategic review of Europe
- 3 Return to Efficient Capital Structure**  
Reduce debt leverage over time
- 4 Return Cash to Shareholders**  
Through dividend and share repurchases

**2024**

## Capital Allocation Priorities

### INVEST IN BUSINESS:

Targeting FY 2024 Capital Expenditures of ~\$500 million

### RETURN CASH TO SHAREHOLDERS:

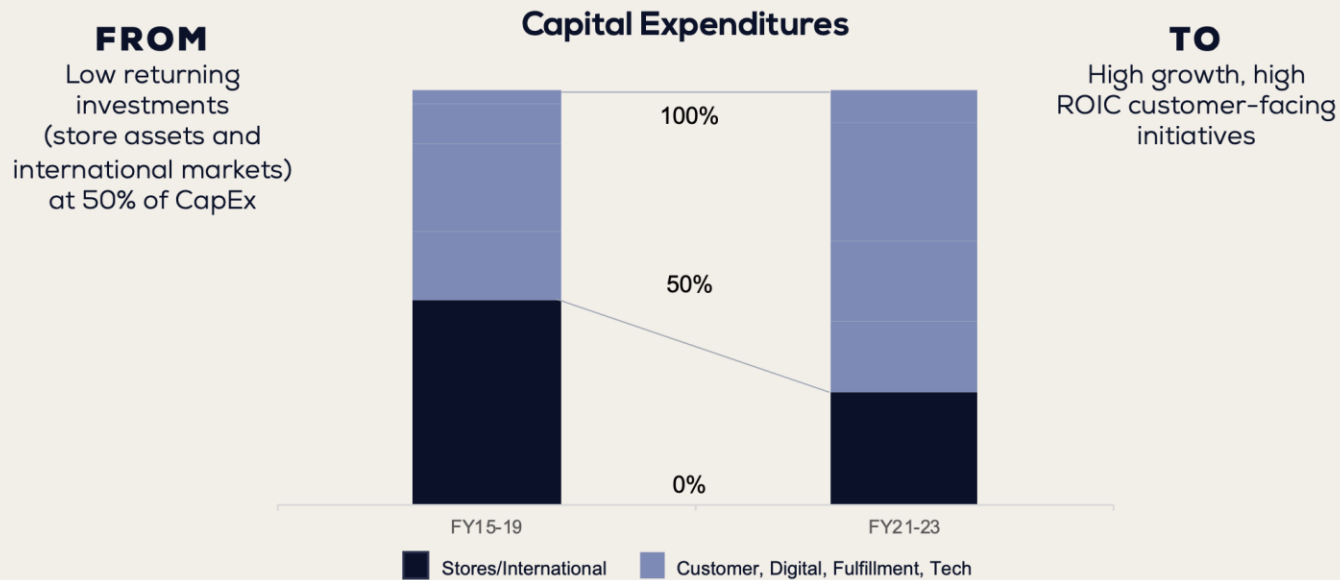
Returned \$169 million to shareholders in the form of dividends YTD

Board of Directors approved Q4 2024 dividend of \$0.15 per share

2020

## Capital Investments Focused on Improving ROIC

EXPECT AVERAGE ANNUAL CAPITAL EXPENDITURES AT ~4-5% OF NET SALES



Gap Inc.



**Chemours™**

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

**December 5th, 2024**

**Team Number: 3**

**Students: Joe Kinney, Vivian Lam and  
Mario Stefanidis**

**Recommendation: SHORT Chemours 4.625% 2029 bonds**

CUSIP: 163851AH1

Current Price = \$88.60 (as of 11/24/2024)

Yield to Worst = 7.33%

1-Year Price Target = \$79.20

Total Spread Expansion = 250bps

Annualized Total Return (Base Case) = 9.2%

Chemours was spun off from DuPont in 2015 taking on the primary responsibility of managing the perfluoroalkyl and polyfluoroalkyl substances (PFAS) related liabilities. It has three business segments across Titanium Technologies, Thermal & Specialized Solutions and Advanced Performance Materials.

## Titanium Technologies

- One of the largest global producers of Titanium Dioxide (TiO<sub>2</sub>) pigment used in coatings, plastics and papers



## Thermal & Specialized Solutions

- Provider of refrigerants, thermal management solutions, propellants, foam blowing agents, and specialty solvents



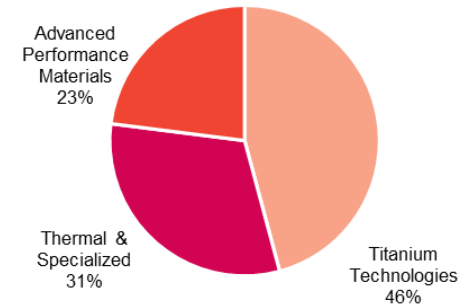
## Advanced Performance Materials

- Producers of high-end polymers and specialty materials solutions across telecommunications, industrials, oil & gas and medical end markets

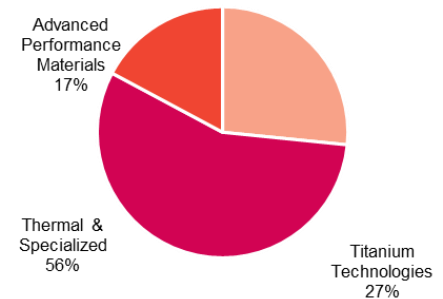


### PFAS Liability Exposure

Revenue breakdown



EBITDA breakdown



## Competitive Rivalry

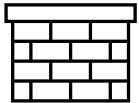


- Chemours competes with other chemical giants like 3M, BASF, Arkema, and DuPont, which it spun out from in 2015.
- The market for PFAS-related compounds is mature and saturated, leading to intense price-based competition (Adj. EBITDA margins ~13% in latest quarter).
- Products like Teflon and other fluoropolymers are differentiated based on quality and performance, but innovation is required to maintain share.



High

## Barriers to Entry



*Note: meaningful existential risk to PFAs due to water contamination liabilities*

- Production of fluoropolymers and PFAS-related products requires significant capital investment in manufacturing facilities and R&D.
- Stringent environmental regulations related to PFAS creates barriers for smaller players.
- Chemours holds patents and has proprietary processes that deter new competitors.



Moderate to High

## Supplier Power



- Chemours relies on specialized raw materials controlled by a few suppliers (details are proprietary).
- TiO<sub>2</sub> suppliers are global, in Australia, Africa, and Eastern Europe, giving Chemours some optionality in its supply chain.
- Contracts span two to ten years and Chemours highlights "competitive, flexible, and diversified" sourcing power.



Moderate



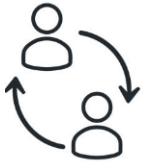
## Buyer Power



- Chemours primarily serves the automotive, construction, and electronics industries, where customers have significant bargaining power due to large purchase volumes.
- Buyers have numerous suppliers to choose from as it relates to Chemours' Titanium Technologies and Thermal segments.
- Buyers in cost-competitive industries are sensitive to price fluctuations and have leverage in pricing during downturns.



## Threat of Substitutes



- Both TiO<sub>2</sub> and PFAS are politically fraught with liability, and industries are seeking substitutes for these products.
- Governments and NGOs advocating for PFAS alternatives amplify this threat.
- Rivals like BASF and Arkema are investing in bio-based polymers, which could impact Chemours' market share.



**Chemours operates in a competitive industry with moderate to high barriers to entry, moderate supplier power, high buyer power and strong threat from substitutes.**

# Chemours Understates the Fair Value of Current and Future Liabilities attributable to PFA Settlements; Senior Unsecured Debt Levered 10.5x PF Max Settlement Obligations and ex. APM

In 2021, Chemours entered a binding memorandum obligating the company to share potential future legacy PFAS liabilities and is **responsible for up to 50% of potential liability over the following 15 years up to a cap of \$4bn.**

Furthermore, in 2023, Chemours **agreed to contribute \$592mm (accounting for ~25% of the total \$4bn split liability) to a settlement fund** held in escrow to address a public water system settlement and in expectation of further settlement requirements.

Not only does Chemours fail to adequately account for the escrow pledge liability, but there is also a **high likelihood of further litigation** from a combination of **(i) personal injury lawsuits** and additional scrutiny and **(ii) penalties led by the new Administration, Lee Zeldin and RFK.**

Facility	Out (\$MM)	Guaranteed?	Secured?	Price	Market (\$)	YTW	Coupon	Spread	S&P Rating	Gross Debt / EBITDA		
										Consolidated	ex. Advanced Perf Mat.	
Tranche B-3 U.S. dollar term loan due August 2028	1,059.0	Y	Y	100.4	1,063.0	7.89%	floating	n.m.				
Tranche B-3 euro term loan due August 2028	462.0	Y	Y	100.3	463.2	7.27%	floating	n.m.				
<b>Total Secured Debt</b>	<b>1,521.0</b>				<b>1,526.2</b>						<b>1.9x</b> <b>2.4x</b>	
4.000% Senior Unsecured Notes due May 2026	491.0	Y	N	99.9	490.7	5.46%	4.00%	250.48	BB-			
5.375% Senior Unsecured Notes due May 2027	495.0	Y	N	97.8	484.1	6.35%	5.38%	224.79	BB-			
5.750% Senior Unsecured Notes due November 2028	783.0	Y	N	93.7	734.0	7.60%	4.75%	359.13	BB-			
4.625% Senior Unsecured Notes due November 2029	620.0	Y	N	88.6	549.4	7.40%	4.63%	343.05	BB-			
8.000% Senior Unsecured Notes due January 2033	600.0	Y	N	100.0	600.1	7.99%	8.00%	402.25	BB-			
Finance Lease, Financing and Other Obligations	168.0			100.0	168.0							
<b>PFOA Legal Accrual (Only \$55mm Recognized)</b>	<b>2000.0</b>			<b>100.0</b>	<b>2,000.0</b>						<b>Excludes \$567mm of Off-Balance Sheet PFA Remediation</b>	
<b>Total Debt</b>	<b>6,678.0</b>			<b>210.39</b>	<b>6,552.4</b>						<b>8.5x</b> <b>10.5x</b>	
- Cash & Cash Equivalents	596.0			100.0	596.0							
- Restricted Cash	20.0			100.0	20.0							
+ Market Capitalization	3,216.8			100.0	3,216.8							
<b>Enterprise Value</b>	<b>10,510.8</b>				<b>10,385.2</b>						<b>13.4x</b> <b>16.6x</b>	
										LTM Adj. EBITDA	786.0	633.0
										LTM Int. Coverage	3.0x	2.4x

**EBITDA from  
APM 42.7% YoY  
in Q4 2024**

# Investment Recommendation and Return Sensitivities: SHORT CC 4.625% 2029 Bonds over the Next Year

There is Asymmetric Risk to the Downside with respect to the Chemours Senior Bonds due 2029; in addition, to substantial existing regulatory, cash settlement and business headwinds to Chemours Advanced Performance Materials segment, there is substantial unpriced risk related to the new Administration and the President-Elects appointments to the EPA and HHS.

### CC 4.675% Due November 15, 2029

#### Assumptions

Coupon (cost of shorting) 4.63%

EFFR 4.58%

(Less): 25bps haircut -0.25%

**Net Annual Cost to Short -0.30%**

#### Return Sensitivities

Change in Spread (bps) 250

OAS Modified Duration 4.274

Change in Price -10.7%

Price in 1Yr 79.2

**Gain / (Loss) from Price Change 9.47%**

**Net Gain over 1Yr 9.17%**

Base Case Downside Case

5Yr Treasury Rate	Change in Spread from Today						
	400.0	300.0	200.0	100.0	0.0	-10.0	-20.0
4.25%	13.4%	9.7%	5.9%	2.1%	-1.7%	-2.1%	-2.5%
4.30%	13.7%	9.9%	6.1%	2.3%	-1.5%	-1.9%	-2.2%
4.35%	13.9%	10.1%	6.3%	2.5%	-1.3%	-1.7%	-2.0%
4.40%	14.1%	10.3%	6.5%	2.7%	-1.1%	-1.4%	-1.8%
4.45%	14.3%	10.5%	6.7%	2.9%	-0.9%	-1.2%	-1.6%
4.50%	14.5%	10.7%	6.9%	3.2%	-0.6%	-1.0%	-1.4%

↑  
 Downside is limited in the case where  
 the bonds do not trade down/upon  
 no catalyst

### Investment Recommendation:

- ✓ **SHORT** Chemours 4.625% 2029 Senior Unsecured Notes (B+/B2/BB-) trading at **\$88.6** – 4.63% Coupon vs. 4.33% Net Offset (EFFR – 25bps) as of 11/24/2024
- ✓ **Target Return: 9.2% over 1Yr**, based on midpoint sensitivity of **4.37% 5Yr** and **250bps spread expansion** on the heels of **existing and future PFA settlement liability**

- **Macro Headwinds:** Since winning the election a few weeks ago, the President-Elect has nominated Lee Zeldin and RFK to head the EPA and the HHS, respectively. Both have spoken publicly against PFAs. Water quality is a headline issue for these individuals and likely target of continued scrutiny, while other areas of business experience deregulation.
- **Understated PFA Liability:** Chemours materially understates the future PFA settlement-related liabilities. The market is not pricing in the cost of this settlement liability and the senior unsecured notes will trade down upon the realization of future liabilities that we deem likely.
- **Existential Risk to APM:** Chemours is an American Chemical company that was created through a 2015 spin-off from Dupont, intended in part to ring fence PFA liabilities related to the creation of forever chemicals, and their proliferation through various water sources across the continental United States. Advanced Performance Materials segment (historically \$300mm+ segment EBITDA) profitability has collapsed (42.5% EBITDA contraction over the last year) and will cease to exist as substitutes are found and suffers existential risk due to manufacturing practices.

## Thesis #1: Lee Zeldin and RFK will penalize Chemours in 2025



CBS News (11/12/24): “Four years ago, **Zeldin was calling on the EPA to protect water. Now, he's leading the agency.**” Politico (11/19/24): “President-elect Donald Trump’s pick to lead EPA **has a history of siding with Democrats on toxic chemicals issues**, giving advocates some hope “forever chemicals” rules may be spared from the incoming administration’s deregulatory agenda.”



In a similar vein to Zeldin, RFK Jr. has made water quality a hot button issue for the Department of Health and Human Services expressing the view that Fluoride in water is s ‘an industrial waste’ linked to cancer, diseases and disorders. **Given the growing body of scientific evidence linking PFAs to adverse outcomes, it is highly likely that RFK will side with and support initiatives Zeldin takes to address PFAs.**

**Lawyer at a Full-Service Law Firm speaking about 3M**

Expert network call on March 28, 2024: “Obviously, when you have a company as large as 3M, and I think I indicated that this particular product, these forever chemicals, **PFAS is only about 4% of their overall picture at this point anyway, but there's always a concern that they're going to file for bankruptcy just in contemplation of the additional claims that may be coming.**”

**Former Senior Vice President at AECOM**

Expert network call on January 8, 2024: “**You're starting to see new regulatory drivers coming out from US EPA, defining criteria around them. So to date, they've been really segmented in certain states or like the federal government has been looking at their sites. And that's where the majority of the evaluation and assessment has gone. Now that's going to be wider spread.**”

**With a Republican majority in Congress and Zeldin promising to “deregulate” the EPA, the new Trump administration will prioritize fossil fuel interests over environmental protection. We believe that the target will fall squarely and aggressively on other industries that Lee Zeldin has campaigned against in the past – specifically PFAs and forever chemicals.**

## Thesis #2: Chemours Liable for up to \$1.4bn in additional settlement, further remedies possible

### MOU signed in January 2021

Chemours, DuPont, Corteva, and El du Pont de Nemours & Co. (EID), a subsidiary of Corteva, entered into a binding memorandum of understanding, reflecting the parties' agreement to share potential future legacy PFAS liabilities arising out of pre-July 2015 conduct

- Chemours is responsible for 50% of potential liabilities until December 31, 2040 or \$4 billion, whichever is sooner
- The agreement sets the target balance of the escrow account to \$700 million by 2028, with Chemours making 50% of the deposits and DuPont and Corteva together making 50% of the deposits

### Major payment in June 2023

A total of \$1.185 billion was paid based on this MOU for the settlement of PFAS liabilities with the US public water system

- Chemours paid \$592 million (50% of total), funded using proceeds from the issuance of term loans, cash and funds under the escrow account

“Management believes that it is reasonable that the Company could incur losses related to POA and/or PFAS matters in excess of amounts accrued, but any such losses, which could be material to results of operations, financial position, or cash flows are not estimable at this time”

3Q2024 Quarterly Report

“Active litigation cases are likely to be ~1,000 cases beyond the number reported in system”

Primary Research from  
Institutional Specialty  
Research Advisor

**With multiple PFAS-related lawsuits underway, Chemours faced substantial risks for further remedies beyond current estimate**

# Thesis #3: APM Manufacturing concentrated in U.S., already subject to \$567mm Off-Balance Sheet Remediation

Letter from the UN to Chemours dated February 21, 2024 (post all announced and agreed settlements to date):

- American chemical companies DuPont and Chemours have discharged toxic per- and polyfluoroalkyl substances (PFAS) into the local environment, completely disregarding the rights and wellbeing of residents along the lower Cape Fear River in North Carolina, UN experts\* said today.
- “DuPont and Chemours appear to have impermissibly captured the U.S. Environmental Protection Agency and delayed its efforts to properly regulate PFAS chemicals,” the experts said.**
- “Health and environmental regulators in the United States have fallen short in their duty to protect against business-related human rights abuses, including providing the public, particularly affected communities in North Carolina, with the type and amount of information necessary to prevent harm and seek reparation,” the experts said. “Where legal action has been taken against the two companies, enforcement and remediation measures have been inadequate,” they said.



## *APM manufacturing primarily U.S. based*

### **Advanced Performance Materials**

Deepwater, New Jersey  
 Elkton, Maryland (1)  
 Fayetteville, North Carolina  
 Louisville, Kentucky  
 Parlin, New Jersey (1)  
 Washington, West Virginia  
 Mechelen, Belgium  
 Villers St. Paul, France (1)

Shimizu, Japan (2)  
 Sichuan, China (2)

**Despite receiving scrutiny at the highest level (i.e., the letter from the UN in late 2023 citing Human Rights Violations related to PFA manufacturing in alleged human rights violations and abuses against residents along the lower Cape Fear River in North Carolina excerpted above), Chemours continued to move forward with expansion of the Fayetteville other facilities over the last year**

## Thesis #3: Chemours Liable for up to \$1.4bn in additional settlement, further remedies possible

Current S&P rating: BB- (Negative outlook)

Upgrade (Revise outlook to Stable)	Downgrade (B+)
<ul style="list-style-type: none"> <li>No further credit risks from its financial reporting issue</li> <li>FFO to total debt to remain above 30%, adjusted EBITDA margin &gt;20% on a sustainable basis</li> <li><b>Consideration on potential for any credit risks related to new environmental issues or an increase in risk related to current issues</b></li> </ul>	<ul style="list-style-type: none"> <li>Continued/ new issue on internal controls over financial reporting leading to credit deterioration, or adverse actions from company's lenders or customers</li> <li>Weighted average FFO to debt to drop below 20% without near-term remedy</li> <li><b>Current provisions and contingent liabilities are insufficient and Chemours will likely need to increase them substantially</b></li> </ul>

Chemours currently faces multiple litigations beyond PFAs Claims. Liabilities in relation to environmental claims are central to any upgrade consideration, and any incremental claims may lead to a downgrade.

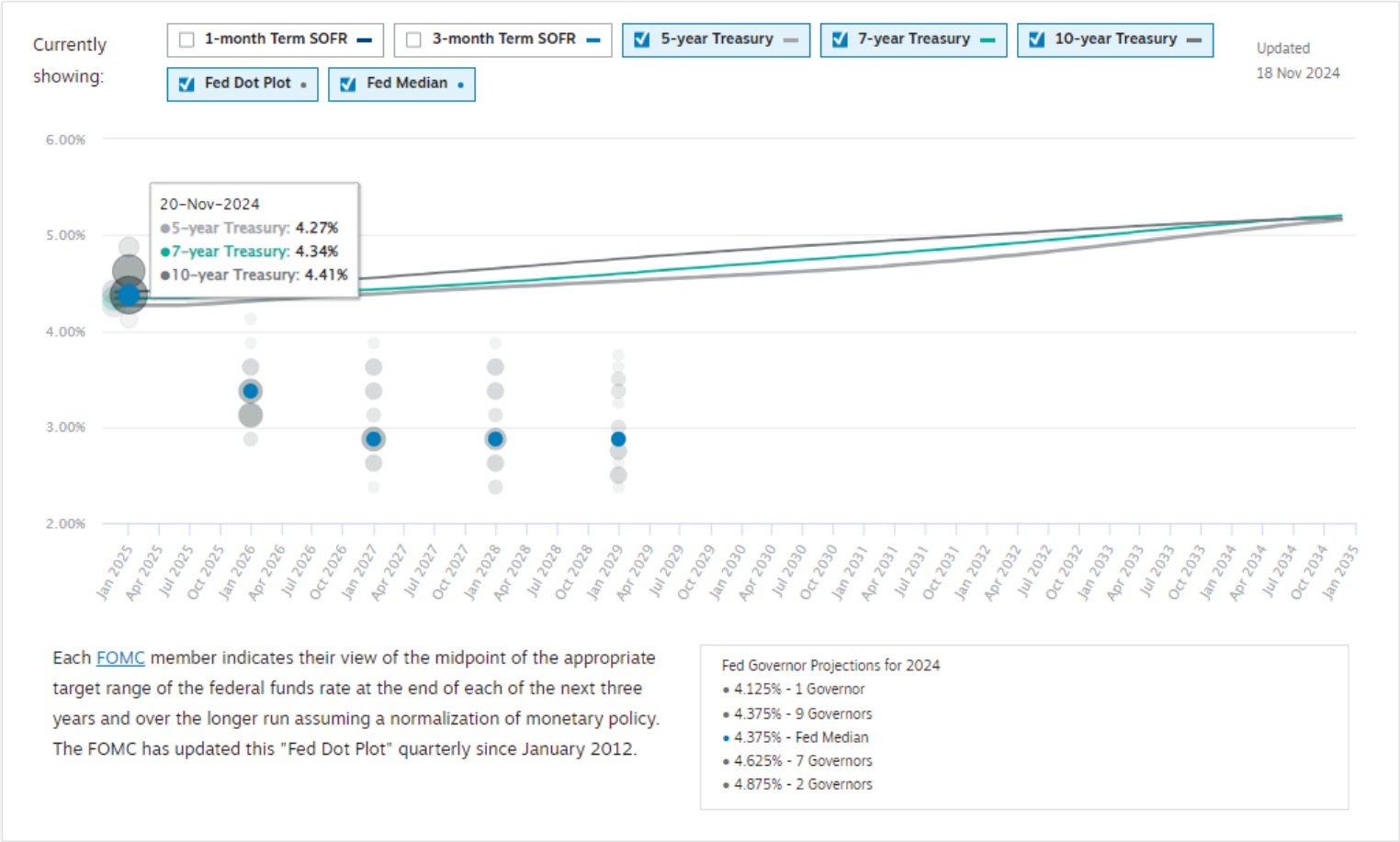


# APPENDIX

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

# The 5Yr Treasury Spread (base rate for the CC 2029 bonds) has widened 83bps since Sept '24 lows

The 5Yr Treasury Spread (base rate for the CC 2029 bonds) has widened 83bps since Sept '24 lows; this is expected to continue for the foreseeable future and especially in the context of the new Administration



# Bond Holders

		All		All			
1. + Allianz SE		ULT-AGG	14.11		87,500	0	10/31/24
2. + Blackrock Inc		ULT-AGG	9.39		58,274	6,224	11/22/24
3. + Vanguard Group Inc/The		ULT-AGG	7.63		47,306	0	11/21/24
4. + JPMorgan Chase & Co		ULT-AGG	5.06		31,417	-934	11/22/24
5. + KKR Financial CLO Ltd	Multiple Portfolios	MF-AGG	4.03		24,990	0	11/01/24
6. + FMR LLC		ULT-AGG	3.78		23,436	-1,800	11/21/24
7. + Goldman Sachs Group Inc/The		ULT-AGG	2.72		16,854	-91	11/22/24
8. + Massachusetts Financial Services Co	Multiple Portfolios	MF-AGG	2.38		14,787	55	10/31/24
9. + State Street Corp		ULT-AGG	2.13		13,231	-14	11/22/24
10. + ARES MANAGEMENT CORP		ULT-AGG	1.44		8,922	0	09/30/24
11. + Kohlberg Kravis Roberts & Co LP	Multiple Portfolios	MF-AGG	1.12		6,917	2,452	07/31/24
12. + Wellington Management Group LLP	Multiple Portfolios	Sch-D [De...	0.99		6,124	-159	06/30/24
13. + Northeast Investors Trust	Multiple Portfolios	MF-AGG	0.81		5,000	0	06/30/24
14. + T Rowe Price Group Inc		ULT-AGG	0.75		4,642	0	06/30/24
15. + Franklin Resources Inc		ULT-AGG	0.73		4,523	0	06/30/24
16. + New York Life Insurance Co		ULT-AGG	0.71		4,375	0	06/30/24
17. + Calamos Partners LLC		ULT-AGG	0.64		4,000	0	09/30/24
18. + Thrivent Financial for Lutherans	Multiple Portfolios	Sch-D	0.64		4,000	0	06/30/24
19. + Victory Capital Management Inc	Multiple Portfolios	MF-AGG	0.64		4,000	1,000	07/31/24
20. + SEI Investments Co		ULT-AGG	0.63		3,894	5	10/31/24
21. + NYL Investors LLC	Multiple Portfolios	Sch-D [De...	0.61		3,760	0	06/30/24
22. + Deutsche Bank AG		ULT-AGG	0.57		3,563	0	11/24/24
23. + IndexIQ Advisors LLC	Multiple Portfolios	Sch-D [De...	0.54		3,372	0	06/30/24
24. + Apogem Capital LLC	Multiple Portfolios	Sch-D [De...	0.54		3,372	0	06/30/24
25. State of Wisconsin Investment Board		Research	0.49		3,040	550	09/30/22
26. + American Century Cos Inc	Multiple Portfolios	MF-AGG	0.48		3,003	-200	11/22/24
27. + Timothy Partners Ltd	Multiple Portfolios	MF-AGG	0.48		3,000	0	06/30/24
28. + Mackay Shields UK LLP	Multiple Portfolios	Sch-D [De...	0.44		2,757	0	06/30/24
29. + PERPETUAL US SERVICES LLC	Multiple Portfolios	MF-AGG	0.43		2,685	0	07/31/24
30. + Apollo Global Management Inc		ULT-AGG	0.43		2,667	0	06/30/24
31. + Provident Investment Management LLC	Multiple Portfolios	Sch-D [De...	0.43		2,667	0	06/30/24

# Equity Holders

Holder Name	Portfolio Name	Source	% Out	Opt	Position	Latest Chg	File Dt
		All		All			
1. FMR LLC		ULT-AGG	12.14		18,142,202	618,361	09/30/24
2. Blackrock Inc		ULT-AGG	10.93		16,329,150	69,625	09/30/24
3. Vanguard Group Inc/The		ULT-AGG	10.13		15,129,076	-33,870	09/30/24
4. MARSHALL WACE		ULT-AGG	4.76		7,116,954	107,086	09/30/24
5. State Street Corp		ULT-AGG	3.04		4,548,019	-109,125	09/30/24
6. Ameriprise Financial Inc		ULT-AGG	2.36		3,533,323	675,215	09/30/24
7. Khrom Capital Management LLC	Khrom Capital Management LLC	13F	2.24		3,342,682	-113,944	09/30/24
8. JPMorgan Chase & Co	JPMorgan Chase & Co	13F	2.11	Y	3,157,461	-660,951	09/30/24
9. Geode Capital Management LLC	Geode Capital Management LLC	13F	1.67		2,491,748	28,803	09/30/24
10. Vaughan Nelson Investment Management LP	Vaughan Nelson Investment Management LP	13F	1.45		2,166,741	-657,560	09/30/24
11. LSV Asset Management	LSV Asset Management	13F	1.25		1,872,000	-211,900	09/30/24
12. Millennium Management LLC/NY	Millennium Management LLC/NY	13F	1.16		1,733,725	1,189,593	09/30/24
13. Norges Bank	Norges Bank	13F	1.13		1,684,233	442,289	06/30/24
14. Appian Way Asset Management LP	Appian Way Asset Management LP	13F	1.12		1,680,673	1,680,673	09/30/24
15. Luminus Management LLC	Luminus Management LLC	13F	1.08	Y	1,616,202	227,048	09/30/24
16. Massachusetts Financial Services Co	Massachusetts Financial Services Co	13F	1.02		1,526,108	-967,691	09/30/24
17. Morgan Stanley		ULT-AGG	1.01		1,514,481	430,357	09/30/24
18. American Century Cos Inc	American Century Cos Inc	13F	1.01		1,509,583	-302,374	09/30/24
19. Bank of New York Mellon Corp/The		ULT-AGG	1.00		1,488,916	-117,537	09/30/24
20. Dimensional Fund Advisors LP	Dimensional Fund Advisors LP	13F	0.97		1,451,288	-886,549	09/30/24
21. Two Sigma Investments LP		ULT-AGG	0.97		1,446,896	23,026	09/30/24
22. Power Corp of Canada		ULT-AGG	0.97		1,445,868	-39,535	09/30/24
23. Vision One Management Partners LP	Vision One Management Partners LP	13F	0.93		1,390,350	1,390,350	09/30/24
24. Charles Schwab Corp/The		ULT-AGG	0.82		1,229,052	32,590	09/30/24
25. Moore Capital Management LP	Moore Capital Management LP	13F	0.70		1,050,673	533,863	09/30/24
26. Northern Trust Corp	Northern Trust Corp	13F	0.70		1,040,799	-12,744	09/30/24
27. Legal & General Group PLC	Legal & General Group PLC	13F	0.66		987,236	-639	09/30/24
28. SIR Capital Management LP	SIR Capital Management LP	13F	0.61		913,564	318,129	09/30/24
29. Sessa Capital IM LP		13G	0.55		818,717	-7,374,719	12/31/22
30. Private Management Group Inc	Private Management Group Inc	13F	0.53		785,809	329,037	09/30/24
31. Equitable Holdings Inc	Multiple Portfolios	MF-AGG	0.51		755,491	-34,852	06/30/24
32. DE Shaw & Co LP		ULT-AGG	0.47		708,156	419,389	09/30/24
33. Goldman Sachs Group Inc/The		ULT-AGG	0.46		694,446	87,817	09/30/24

# USD US Corporate Bond Yield Curves



## Investigation on Internal Control Failure in 2023

On February 29, 2024, Chemours disclosed that the filing of its annual report for 2023 was delayed, that it “is evaluating one or more potential material weaknesses in its internal control over financial reporting as of December 31, 2023 with respect to maintaining effective controls related to the control environment, including the effectiveness of the ‘tone at the top’ set by certain members of senior management.” and that its President/CEO, Senior VP/CFO, and Vice President, Controller and Principal Accounting Officer had been placed on administrative leave “pending the completion of an internal review being overseen by the Audit Committee of the Board of Directors with the assistance of independent outside counsel.”

Thereafter, the Company and certain of its executives were sued in a securities class action lawsuit, charging them with failing to disclose material information during the Class Period, violating federal securities laws, which remains ongoing.

Kahn Swick & Foti, LLC’s investigation is focusing on whether Chemours’ officers and/or directors breached their fiduciary duties to its shareholders or otherwise violated state or federal laws.

## Management Overview

Name	Title	Board	Age	Tenure	Start	End
1) Denise M Dignam	President/CEO	✓	58 *	0.7	03/22/2024	
2) David A Will	Chief Accounting Officer/Controller		40 *	0.3	08/12/2024	
3) Shane W Hostetter	Senior VP/CFO		43 *	0.3	07/01/2024	
4) Brian Shay	Interim Chief Human Resources Officer			0.2	09/06/2024	
5) Calderon Gerardo Familiar	Pres:Advanced Performance Mat		48 *	1.6	04/01/2023	
6) Joseph T Martinko	Pres:Thermal & Specialized Solutions		56 *	1.4	06/01/2023	
7) Diane Iuliano Picho	Interim Pres:Titanium Technologies		63 *	0.7	03/22/2024	
8) Matthew S Abbott "Matt"	Senior VP/Chief Enterprise Transformation Officer		48 *	1.4	06/06/2023	
9) Kristine Wellman	Senior VP/Secy/Gen Cnsl		54 *	2.1	10/01/2022	
10) Alvenia Scarborough	Senior VP:Corp Communications/Chief Brand Ofcr		50 *	4.1	10/01/2020	
11) Brandon Ontjes	VP:Financial Planning & IR			1.1	10/01/2023	

# VAIL RESORTS®

EXPERIENCE OF A LIFETIME™



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

**December 5, 2024**

**Team Number: 4**

**Students: Caden Kalinowski, Emma Paine, Mathian Vali**



## Investment Summary

Proposal

### Investment Recommendation

- **Buy** Vail Resorts, Inc. - MTN 6.50% 2032 Senior Unsecured Notes (Ba3/BB) trading at **\$102.02** – 6.16% yield to maturity and ~162bps OAS (as of 11/19/2024)
- **Target spread: 150bps**, and base-case target total return: **~ 6.0% p.a**

Rationale

### Continued and Proven Pricing Power

- After resetting pass prices 20% lower in FY22, Vail has increased pass prices by 8% per year and we expect this to continue to outpace inflation going forward as Vail leverages their position as the market leader

### Upside opportunity in ancillary sales

- Ancillary sales have lagged Vail's lift pass sales due partially to the behavioral impacts of COVID, a strong recovery in ancillary sales will be aided by initiatives like My Epic Gear

### Two-Year Transformation Plan

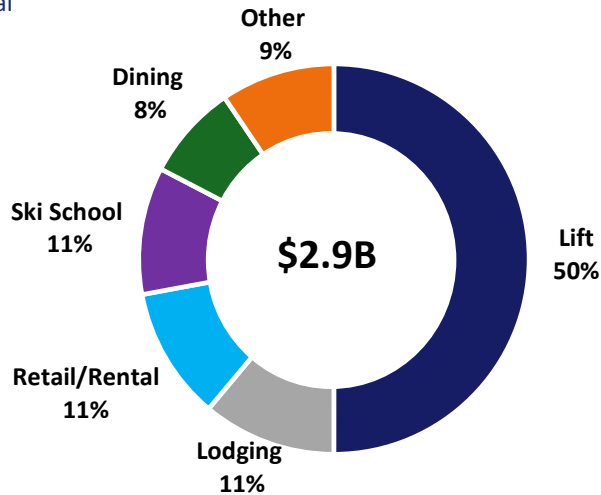
- Ancillary sales have lagged Vail's lift pass sales due partially to the behavioral impacts of COVID, a strong recovery in ancillary sales will be aided by initiatives like My Epic Gear

# 1. Company Overview

# Vail Resorts, Inc. is the premier mountain resort company in the world operating across three segments: Mountain, Lodging, and Real Estate.

## FY 2024 Revenue Breakdown

% of total



## Leading Destination Resorts

Resort	North America Skier Visits	Brand Awareness
<b>VAIL</b> <i>Beaver Creek</i>	#1	#1
<b>WHISTLER BLACKCOMB</b>	#2	#6
<b>BRECKENRIDGE</b>	#3	#2
<b>PARK CITY</b>	#4	#4
<b>KEYSTONE</b>	#5	#5

## Resort Locations

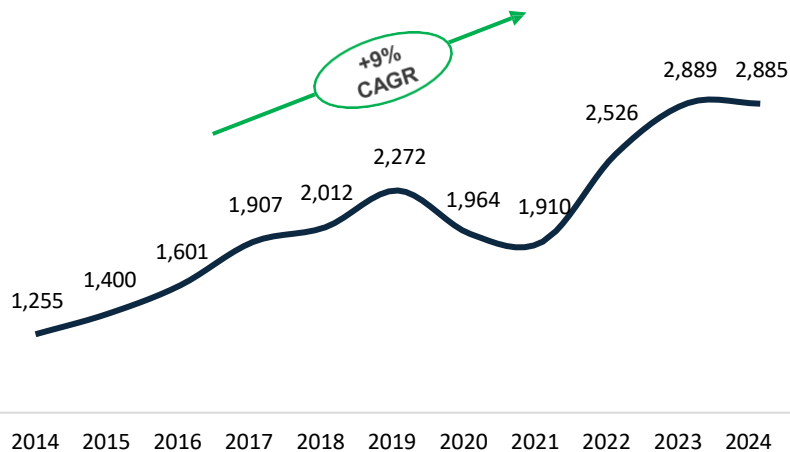


\*Pending closure of acquisition

# Vail has risen to become the world's largest mountain resort operator, with 42 resorts today

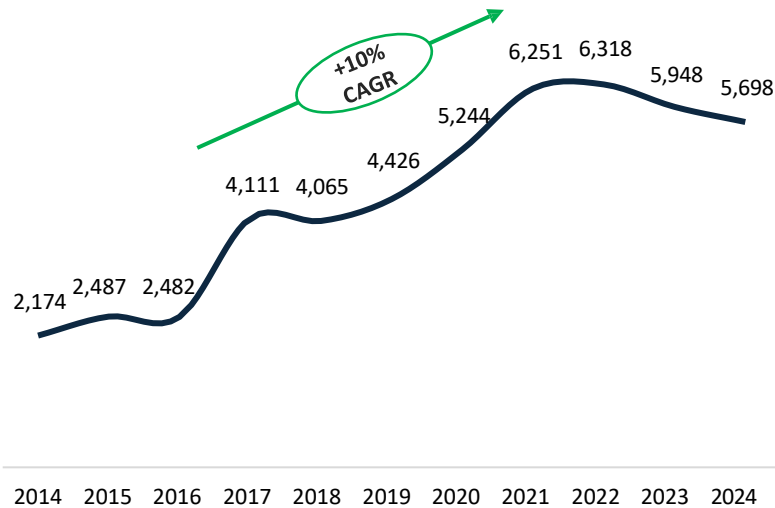
## Total Revenue Growth

\$M

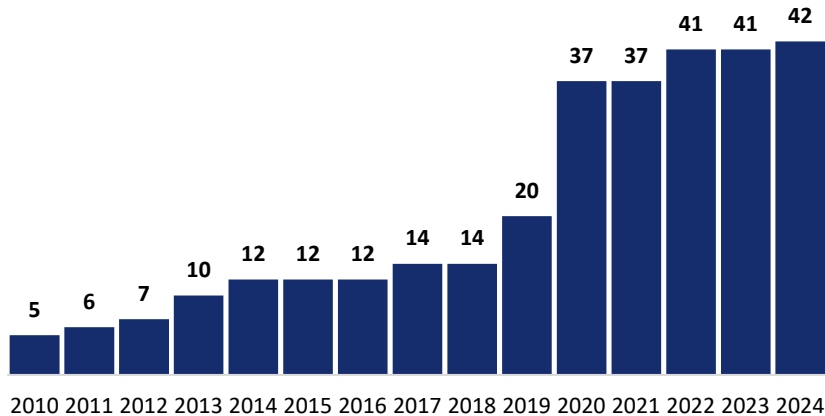


## Total Assets Growth

\$M

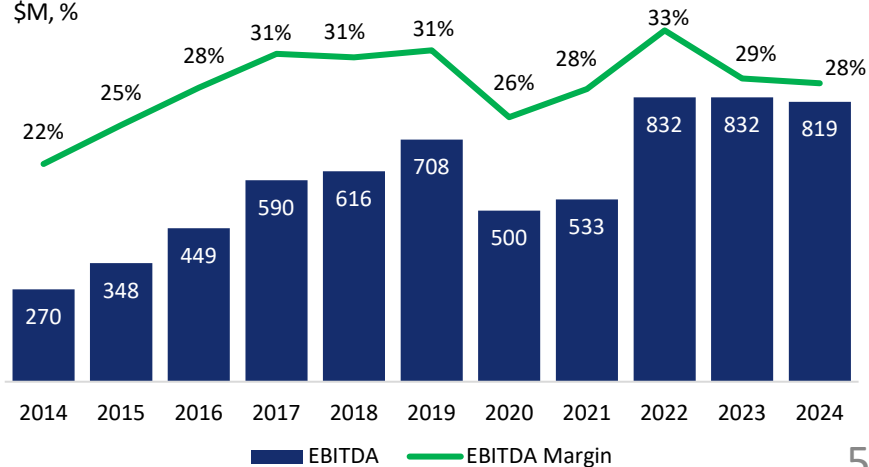


## Resort Properties Owned & Operated By Vail



## EBITDA and EBITDA Margin

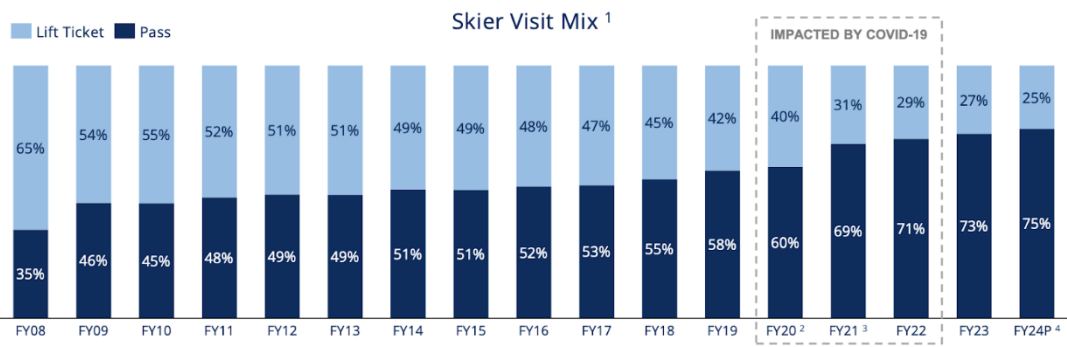
\$M, %



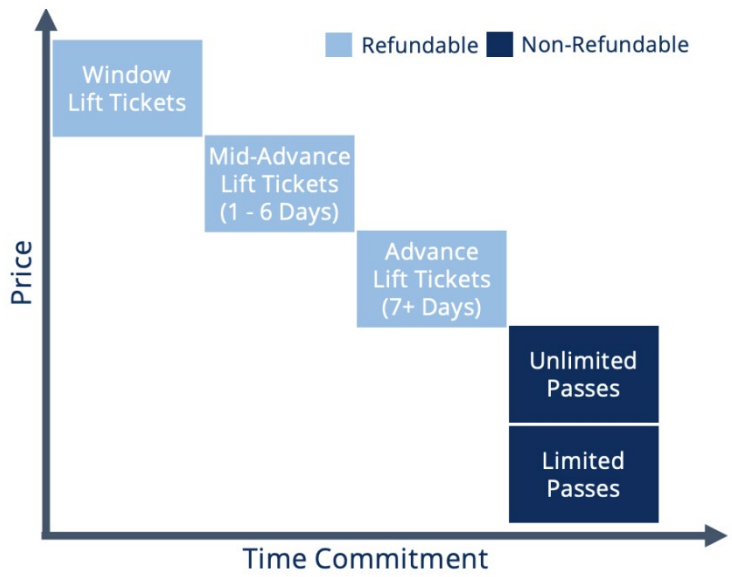
# Epic Pass pricing model functions as a lever to drive advanced commitment and value creation

- **Multi-Resort Access:** Unlimited or restricted access to over 40 resorts worldwide
- **Flexible Options:** Various pass levels (full, local, day passes) to suit different skier needs and budgets
- **Cost Efficiency:** Offers significant savings compared to daily lift tickets, encouraging early season purchases
- **Loyalty & Revenue:** Drives customer retention, recurring revenue, and increased on-mountain spending

75% OF OUR VISITS ARE PRE-COMMITTED IN ADVANCE



1. Represents Lift Ticket and Season Pass Skier Visits for Vail Resorts owned mountains; excludes employee and complimentary visits  
 2. FY20 reflects shortened season due to early resort closures  
 3. FY21 reflects impact of reservation system and lift ticket inventory pushing higher portion of Skier Visits into Pass products  
 4. FY24 reflects total fiscal year forecast as of March 11, 2024



epic PASS™	epic LOCAL PASS™	epic 4-DAY PASS™
ULTIMATE ALL-RESORTS ACCESS	ALL RESORTS WITH RESTRICTIONS	VISIT THROUGHOUT THE SEASON
<b>\$929</b>	<b>\$689</b>	<b>\$383</b>
ADULT (AGES 13+) MORE AGES AVAILABLE	ADULT (AGES 19+) MORE AGES AVAILABLE	ADULT (AGES 13+) MORE AGES AVAILABLE
SKI AND RIDE VAIL, WHISTLER BLACKCOMB AND MORE	SKI AND RIDE VAIL, BRECKENRIDGE AND MORE	BUILD YOUR OWN 4-DAY PASS
ACCESS ALL SEASON LONG	EXCLUDES PEAK DATES	OPTION TO CHOOSE PEAK DATES
EPIC MOUNTAIN REWARDS	EPIC MOUNTAIN REWARDS	EPIC MOUNTAIN REWARDS
<a href="#">Learn More</a>	<a href="#">Learn More</a>	<a href="#">Learn More</a>

# Vail Resorts operates a balanced and moderately leveraged capital structure that supports its aggressive expansion strategy

**Demonstrable Access to Capital Markets**

- Vail has demonstrated market access through the issuance of the \$600mm 6.50% senior unsecured bond and renewal of their secured term loan in 2024
- Their recent ability to utilize debt markets shows that they will be able to refinance the 2026 convertible bond by maturity

Facility	Out (\$M)	Coupon	Maturity	Price	YTM	Ratings	Leverage as a Multiple of EBITDA	Loan-to-Value
\$500mm Revolver	-	S + 125			100%			
\$2.75Bn Secured Term Loan	960	S + 135			100%			
Employee Housing Bonds	53	S + 20			100%			
EPR Secured Note	114	11.80%			100%			
NRP Loan	37	0.63%			100%			
Capital Leases	397	NA	NA					
<b>Total Secured Debt</b>	<b>1,561</b>						<b>1.9x</b>	<b>17.1%</b>
6.50% Senior Unsecured Bonds	600	6.50%	5/15/2032	102.018	6.16%	Ba3/BB		
Operating Leases	266	NA	NA					
Other Debt	52							
<b>Total Senior Debt</b>	<b>2,479</b>						<b>3.0x</b>	<b>27.1%</b>
Subordinated Convertible Bond	575	0.0%	1/1/2026	94.050	5.63%			
<b>Total Debt</b>	<b>3,054</b>						<b>3.7x</b>	<b>33.4%</b>
Less: Cash	(323)							
<b>Net Debt</b>	<b>2,731</b>						<b>3.3x</b>	<b>29.8%</b>
Equity Market Cap	6,419							
<b>Total Enterprise Value</b>	<b>9,150</b>						<b>11.2x</b>	<b>100.0%</b>

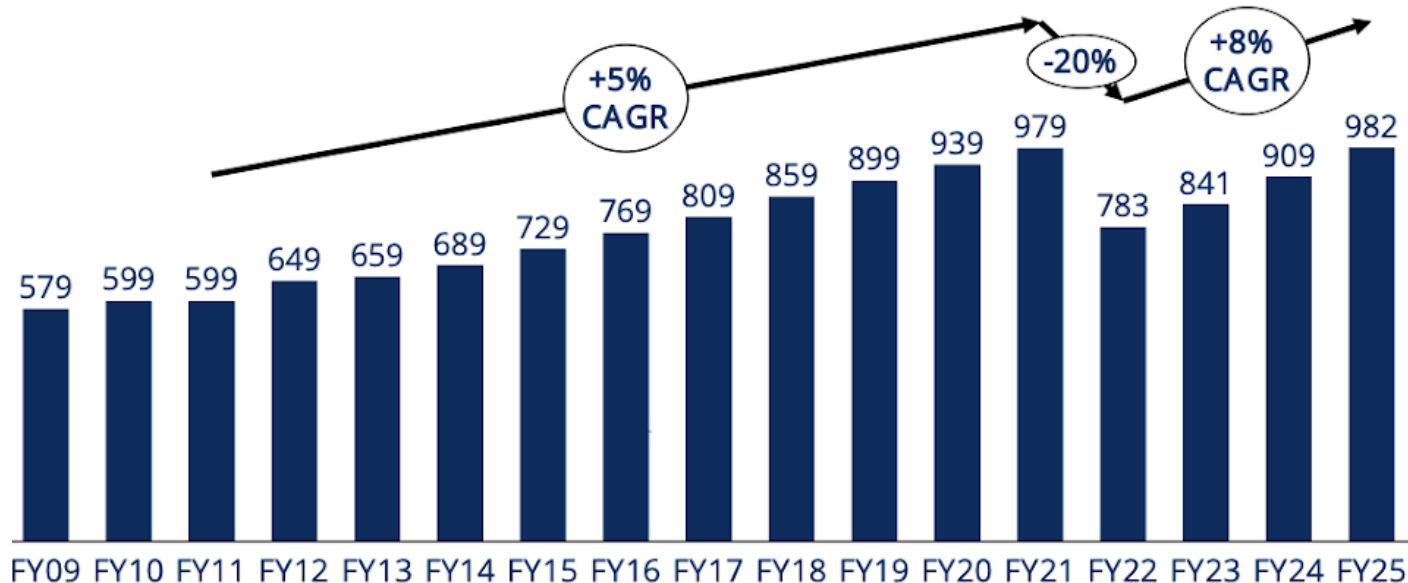
## 2. Investment Thesis

# Thesis #1: Vail has consistent pricing power and should be able to price above inflation

**Continued and Proven Pricing Power**

- After a strategic 20% pass price reset in 2022 following COVID-19, Vail can continue to look to aggressive price growth
- 2025 pass prices reached parity with 2019 pass prices meaning that there is sufficient room to increase prices to catch up with inflation
- 7.3% annual growth through 2028 would bring pass prices in line with inflation in food services, accommodation, and recreation
- Additionally, we expect this to continue because Epic Pass is already priced significantly below lift tickets

**Epic Pass Launch Price <sup>1</sup>**  
 \$USD

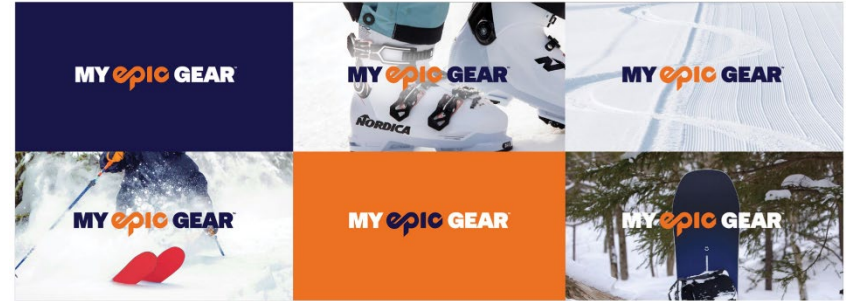




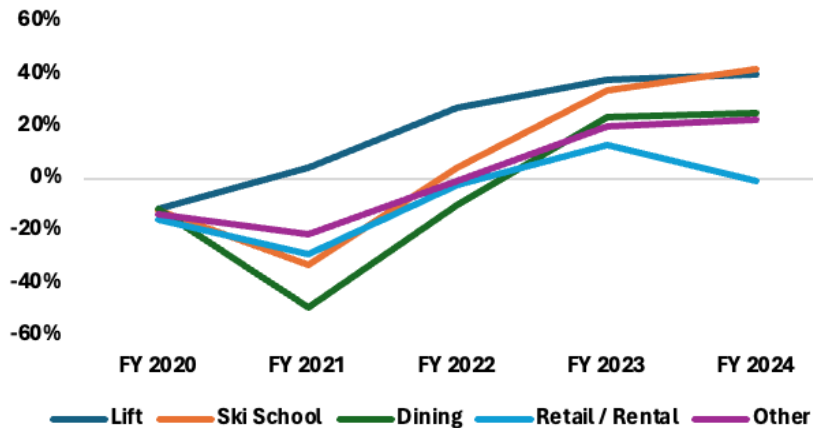
# Thesis #2: Vail has built the foundation for strong ancillary revenue growth

## Key Takeaways:

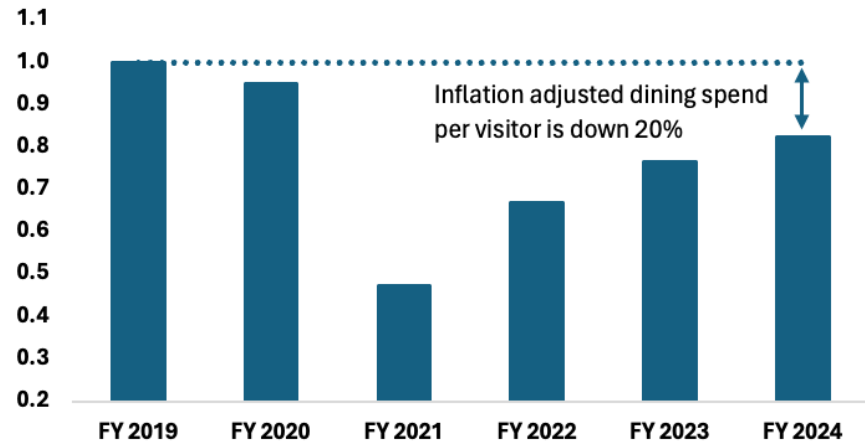
- While lift revenue is up ~40% since FY 2019, other areas, such as Dining and Retail / Rental sales have lagged significantly
- A return to pre-COVID behavior should drive a bounce back in Dining sales
- The company launched My Epic Gear, a new gear rental membership program in March 2024, and is rolling this out to 12 resorts this year



**Growth since FY 2019**



**Inflation Indexed Dining Spend Per Visitor**



# Thesis #3: Vail’s Cost Transformation Plan will result in \$100mm of annualized cost efficiencies, increasing margins and allowing for deleveraging

## Key Assumptions

<b>Base</b> <ul style="list-style-type: none"> <li>➤ Revenue growth at ~8% CAGR</li> <li>➤ Skier volume growth at ~1% CAGR</li> <li>➤ EBITDA margin grows to 36% in 2028</li> </ul>	<b>Bear</b> <ul style="list-style-type: none"> <li>➤ Revenue growth at ~1% CAGR</li> <li>➤ Skier volume growth at ~-1% CAGR</li> <li>➤ EBITDA margin remains ~30%</li> <li>➤ \$500mm debt funded M&amp;A</li> </ul>	<b>Bull</b> <ul style="list-style-type: none"> <li>➤ Revenue growth at ~10% CAGR</li> <li>➤ Skier volume growth at ~3% CAGR</li> <li>➤ EBITDA margin grows to 37% in 2028</li> </ul>
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## Financial Projections

\$M	2024A	2025E	2026E	2027E	2028E	2028 Bear	2028 Bull
Revenue	2,885	3,070	3,351	3,597	3,862	3,035	4,165
EBITDA	819	946	1,143	1,268	1,390	927	1,541
FCF	292	430	614	641	777	393	909
Cash	323	368	586	822	1,182	196	1,481

## Leverage Ratios

\$M	2024A	2025E	2026E	2027E	2028E	2028 Bear	2028 Bull
Debt	3,045	3,035	3,015	2,992	2,969	3,413	2,988
Debt / EBITDA through Secured Debt	1.9x	1.6x	1.3x	1.1x	1.0x	1.5x	0.9x
Debt / EBITDA through Senior Unsecured Debt	3.0x	2.6x	2.1x	1.9x	1.7x	3.1x	1.6x
Debt / EBITDA through Total Debt	3.7x	3.2x	2.6x	2.4x	2.1x	3.7x	1.9x
EBITDA/ Interest	5.1x	5.9x	6.8x	6.9x	7.5x	4.2x	8.2x
(EBITDA - Capex)/ Interest	3.8x	4.7x	5.6x	5.8x	6.4x	3.2x	7.1x

# 3. Valuation

# Our base case valuation calls for 150bps target spread over three years, for a total annualized return of 6.0%

**Bear** – Trades wider to +300 bps for **4.8% total return p.a.**

**Base** –Tightens to ~150 bps for **6.0% return p.a.**

**Bull** – Tightens to ‘BB+’ low level of 135 bps for **6.1% return p.a.**

	Moody's	S&P	Base	Bear	Bull
<b>Upgrade Trigger</b>	<ul style="list-style-type: none"> <li>➤ Sustains strong EBITDA margin</li> <li>➤ Reduces cyclical volatility</li> <li>➤ Total Debt/EBITDA falls below 3.0x</li> </ul>	<ul style="list-style-type: none"> <li>➤ Generates sufficient revenue, EBITDA, and cash flow to sustain Debt/EBITDA below 3.25x</li> </ul>	Met	Not Met	Met
<b>Downgrade Trigger</b>	<ul style="list-style-type: none"> <li>➤ Large debt-funded acquisition</li> <li>➤ Total Debt/EBITDA rises above 4.0x</li> <li>➤ Material decline in visitation</li> <li>➤ Significant margin deterioration</li> </ul>	<ul style="list-style-type: none"> <li>➤ Significant leveraging acquisition</li> <li>➤ Depressed skier visitation impairs EBITDA and cash flow</li> </ul>	Not Met	Near trigger	Not Met

### Vail Resorts Relative Value Analysis

	Bond	Coupon	Maturity	YTM	OAS	Leverage	Ratings
<b>MTN 6.5% Senior Unsecured Bond due 2032 (recommend buy)</b>	MTN 6 ½ 05/32	6.50%	May 2032	6.16%	162	3.0x	Ba3/BB
<b>Ski Resort Operators (Private Companies)</b>							
Boyne USA (BIGSKY)	BIGSKY 4 ¾ 05/29	4.75%	May 2029	5.89%	174	NA	B1/B
Alterra Mountain Company		S + 300	May 2030	7.46%	S + 300	NA	B1/B+
<b>Travel &amp; Leisure Comparables</b>							
Hilton	HLT 5 ¾ 04/29	5.88%	Apr 2029	5.57%	130	4.1x	Ba2/BB+
Royal Caribbean Cruises	RCL 6 ¼ 03/32	6.25%	Mar 2032	5.74%	135	4.9x	Ba2/BB+
Live Nation	LYV 3 ¾ 01/28	3.75%	Jan 2028	5.53%	148	4.6x	Ba2/BB
<b>Fixed-income indices:</b>							
Bloomberg BB Index		5.75%	5 years	6.27%	162	NA	BB
Bloomberg HY Leisure Index		6.57%	4 years	5.95%	157	NA	Ba3/B1

## We estimate that Vail Resorts' Senior Unsecured Bonds have a recovery value of ~55%.

53% of Vail Resorts' debt is secured. The 2032 Senior Unsecured Bonds benefit from contractual seniority over the convertible bonds. Cash, receivables, property, equipment, and land rights drive the partial recovery from the company's liquidation value.

### Liquidation Analysis

\$M	FY 2024	Recovery %	Recovery (\$)
Balance Sheet as of:			
<b>Assets</b>	Book Value		
Cash	323	100%	323
<b>Total Cash and &amp; St Investments</b>	<b>323</b>		<b>323</b>
Accounts Receivable	376	90%	338
<b>Total Receivables</b>	<b>376</b>		<b>338</b>
Inventory	119	65%	77
Restricted Cash	14	100%	14
Other Current Assets	80	10%	8
<b>Total Current Assets</b>	<b>911</b>		<b>761</b>
Net Property, Plant & Equipment	2,423	39%	943
Goodwill	1,678	5%	84
Other Intangibles	303	35%	106
Real Estate Held for Sale and Investment	87	70%	61
Other Long-Term Assets	41	0%	-
<b>Total Liquidation Value</b>	<b>5,442</b>	<b>36%</b>	<b>1,954</b>

### Waterfall Analysis

\$M	Estimated \$ Recovery
Total Liquidation Value	1,954
Less: Secured Debt	(1,561)
<b>Distributable Value to Unsecured Claims</b>	<b>393</b>
Senior Unsecured Bonds	620
Operating Lease Rejection Claims	40
Other Unsecured Claims	52
<b>Total General Unsecured Claims</b>	<b>711</b>
<b>Recovery to Unsecured Claims (%)</b>	<b>55%</b>

Declining supply of ski resorts supports a favorable liquidation price for the rights to use the resort, the real estate, and equipment

### Key Covenants and Financial Strategy Details

- Debt incurrence test is subject to 3.5x EBITDA max leverage ratio and 2x minimum interest coverage ratio on the senior secured term loan
- Standard covenant on negative pledge, sales of assets, restricted payment, etc.
- Vail Resorts pays \$330M+ in dividends annually. Dividends are the primary method of returning cash to shareholders

## Risks & Mitigants

Risks	Mitigants
<b>Reduction in Snowfall</b>	Vail has acquired <b>large, high elevation resorts</b> with <b>extensive snowmaking capabilities</b> to ensure a long season with quality snow despite large fluctuations in natural snowfall. Additionally, <b>75% of ski visits are pre-committed in advance</b> and <b>nonrefundable</b> , locking in revenue early.
<b>Weakened consumer demand</b> and macro environment	Despite being a discretionary/recreational concept, it <b>skews towards higher income consumers</b> which will offer <b>increased resiliency</b> . In 2009, Vail's total skier visits declined only 5%. Additionally, there is a mix of high frequency local guests and high-end vacation travelers.
<b>Overly aggressive acquisition strategy</b>	We believe management will remain consistent with the recently announced <b>Two-Year Transformation Plan</b> , which focuses on <b>capturing operational synergies</b> following more than 30 acquisitions over the past 10 years. We expect this to plan to be a turning point for management to a new focus on <b>cost reduction and technological centralization</b> .

# Appendix

## Tenured management team has the expertise to deliver on the next phase of Vail Resorts' growth



**Kristen Lynch (CEO)**

- CEO since 2021
- Prior to this served as CMO from 2011 to 2021, where she led the growth of the Epic pass
- Prior to Vail, she held leadership roles at PepsiCo, Kraft Foods, and Ford



**Robert Katz (Exec. Chair)**

- Former CEO of Vail Resorts (2006-2021)
- Served on Board of Directors of Vail Resorts since 1996
- Prior to becoming CEO of Vail in 2006, he worked for Apollo since its founding in 1990 and led Apollo's investment in Vail Resorts



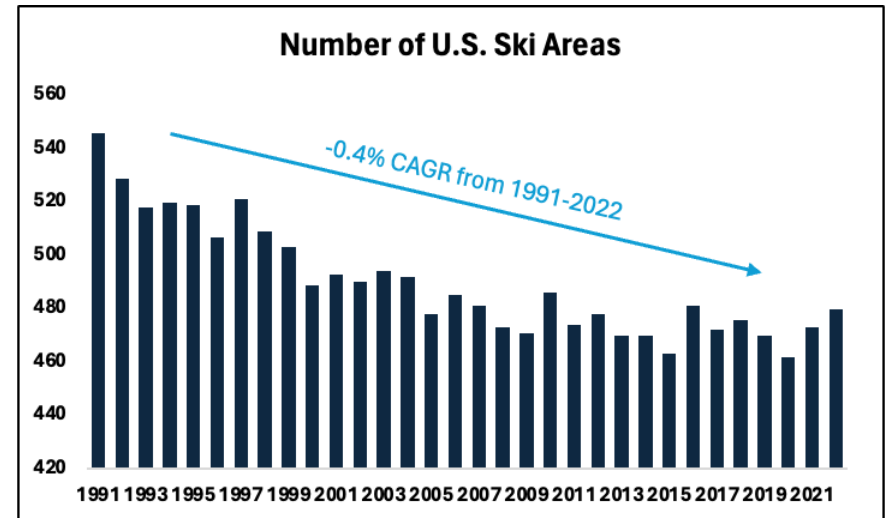
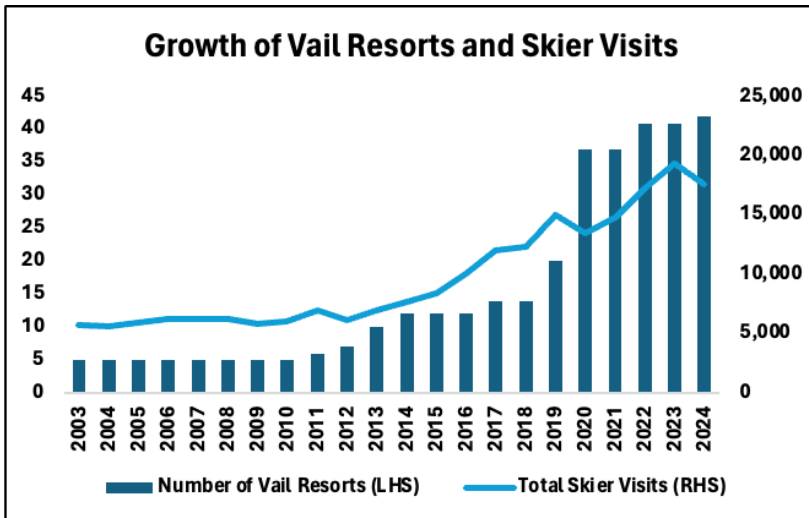
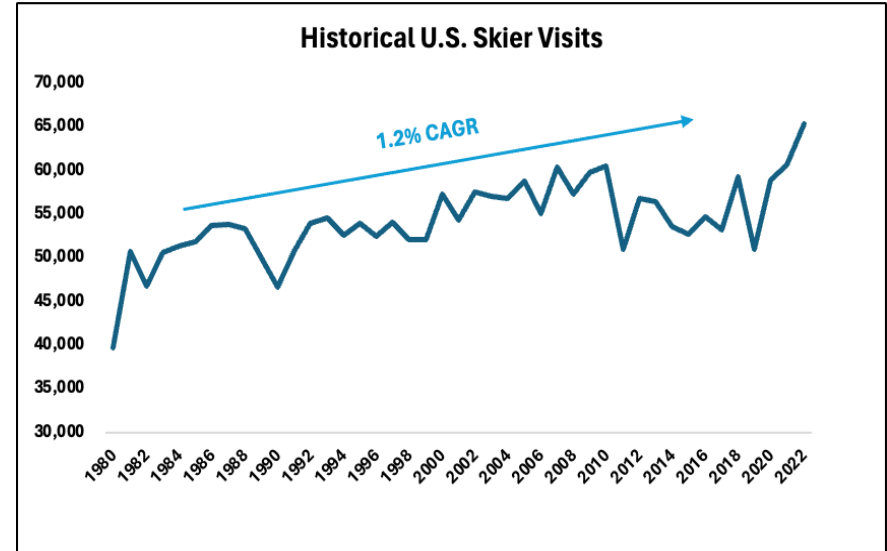
**Bill Rock (President of the Mountain Division)**

- President since May 2023
- Nearly 30 years of experience in the ski and ride industry
- Most recently was EVP of Mountain Operations and COO for the Rocky Mountain Region



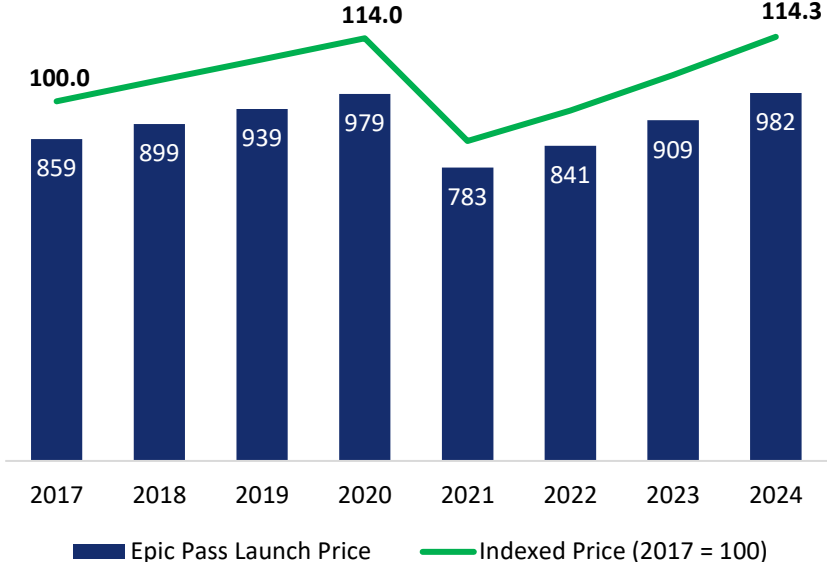
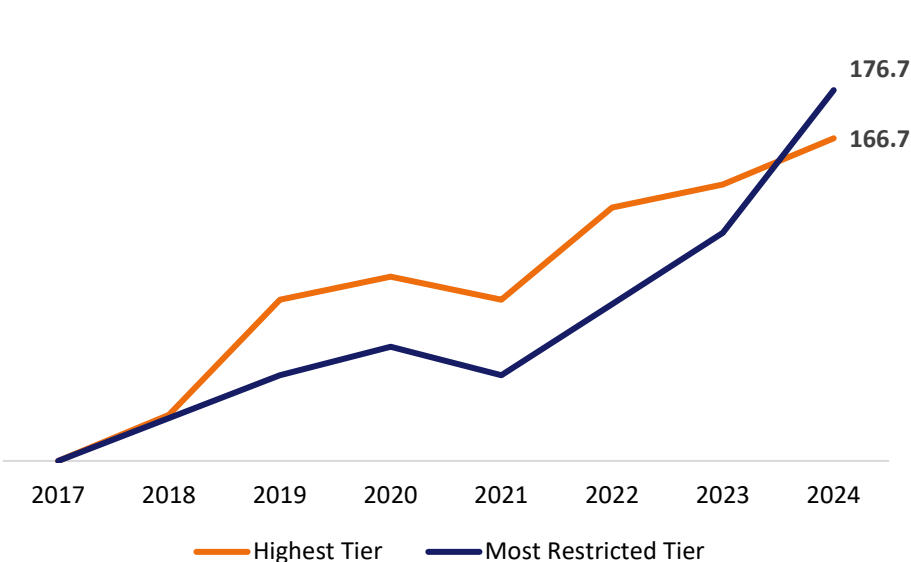
## Thesis #1 : Pricing Power

- The number of U.S. ski areas has been in decline for over 30 years (-0.4% CAGR), while skier visits have continued to grow
- There have been **no new mountain resorts of scale in over 40 years**
- The competition is going away, while Vail continues to gain scale
- Vail's total Skier visits have grown at a 5.5% CAGR since 2003.



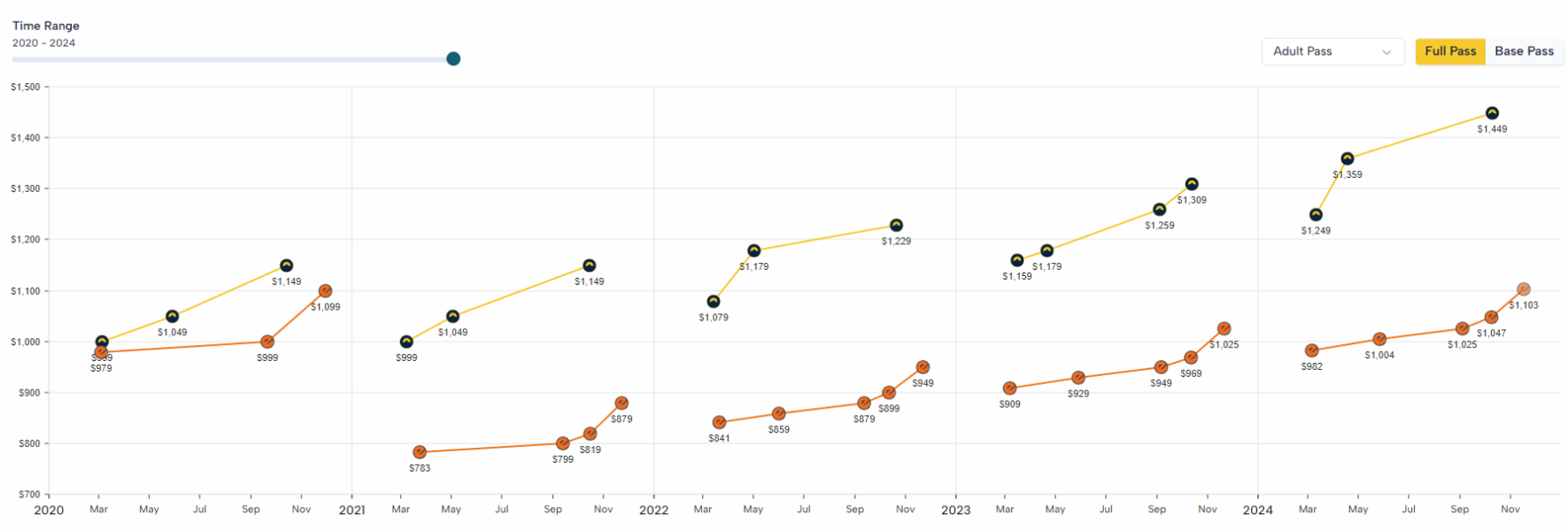
# Thesis #1 : Pricing Power

Disneyland Annual Pass price increased 66%-76% since 2017 ...while Epic Pass Launch Prices increased only 14%.



## Thesis #1 : Pricing Power

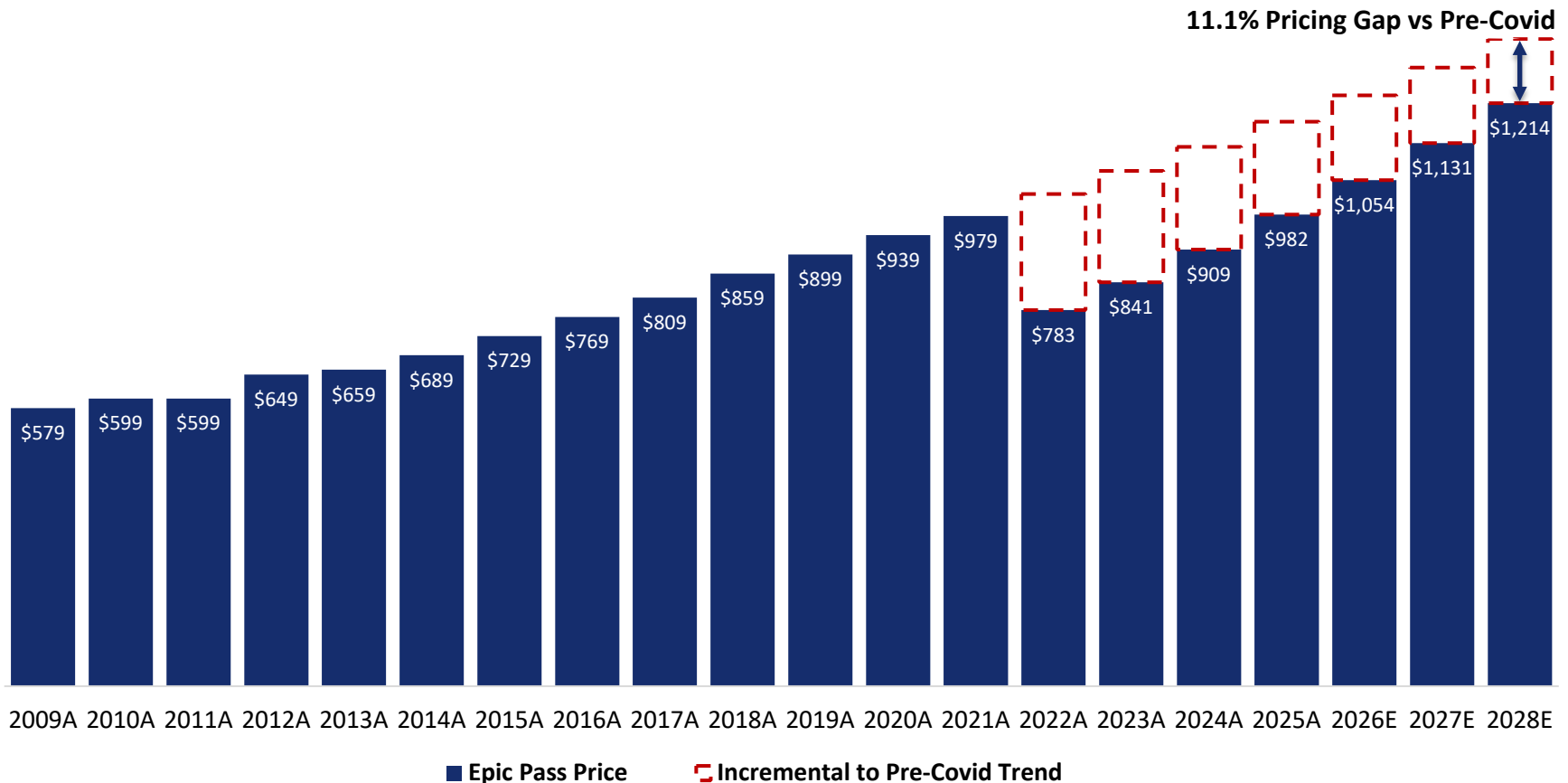
**Growing gap in pricing between Epic and Ikon Pass provides flexibility to increase Epic Pass prices**



➤ **Following the 20% price cut, Epic passes are priced at a 27% discount to the Ikon Pass**

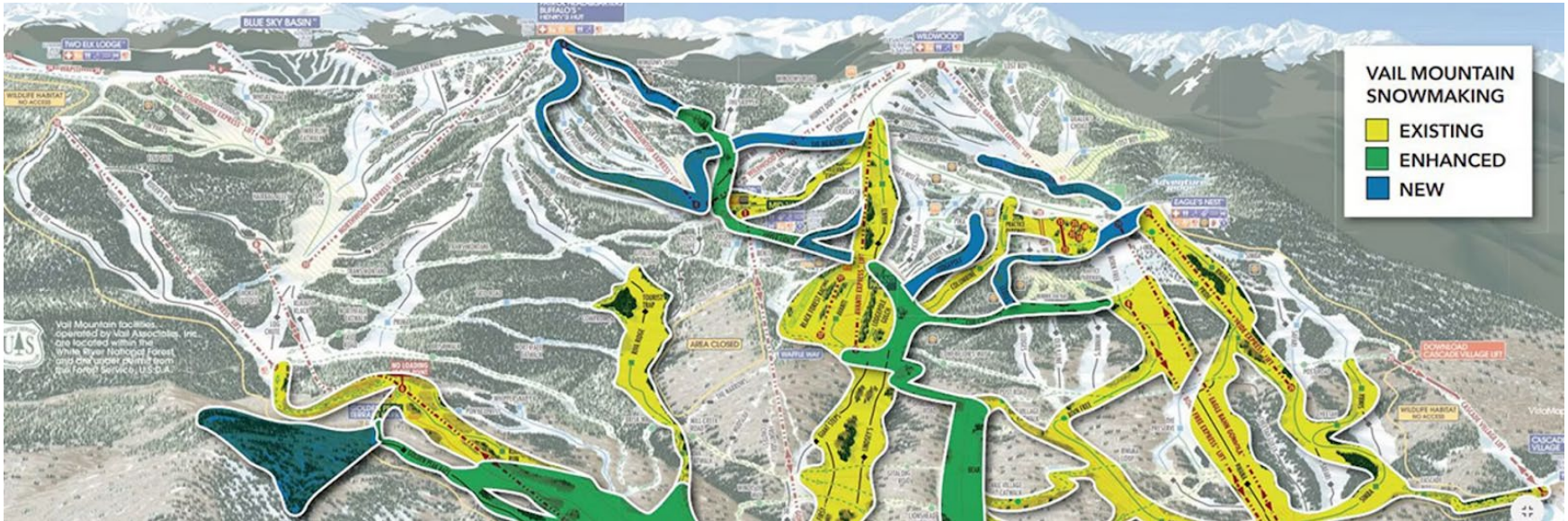
## Thesis #1 : Pricing Power

Following the Epic Pass price reset, MTN has significant room to increase prices before returning to the pre-Covid trend



## Snowmaking

Vail Ski Resort has installed snowmaking machines to produce snow to cover trails from peak to base.



- Vail Resorts is able to produce sufficient machine-made snow to ensure that its mountains open on their regularly scheduled dates. Opening on-time is key to attracting winter holiday traffic.
- Machine-made snow is comprised of individual ice flakes. This type of snow is more dense than natural snow, and thus stays much colder and is more durable against warmer temperatures.

## Model Output: Income Statement and FCF

Fiscal Year	2022A	2023A	2024A	2025E	2026E	2027E	2028E
<b>Revenue</b>	2,526	2,889	2,885	3,070	3,351	3,597	3,862
Mountain	2,213	2,541	2,544	2,741	2,994	3,228	3,479
Lift	1,310	1,421	1,443	1,559	1,706	1,858	2,024
Ski School	224	287	305	332	367	403	443
Dining	164	225	228	251	282	299	317
Retail / Rental	312	361	317	345	383	408	432
Lodging	300	323	320	339	356	370	383
<b>Operating Expense</b>	(1,697)	(2,058)	(2,066)	(2,124)	(2,208)	(2,329)	(2,472)
Mountain	(1,405)	(1,719)	(1,743)	(1,815)	(1,897)	(2,020)	(2,152)
Lodging	(275)	(311)	(297)	(294)	(298)	(309)	(319)
<b>EBITDA</b>	829	832	819	946	1,143	1,268	1,390
EBITDA Margin	32.8%	28.8%	28.4%	30.8%	34.1%	35.3%	36.0%
Less: Capex	(193)	(315)	(211)	(195)	(199)	(203)	(207)
EBITDAX	636	517	608	751	943	1,065	1,183
Less: Interest Expense	(148)	(153)	(162)	(159)	(167)	(183)	(185)
Less: Cash taxes paid	(20)	(94)	(129)	(145)	(201)	(235)	(271)
FCF b/f change in NWC	468	269	317	447	575	647	726
Less: Net Changes in Net Working Capital	94	(18)	(25)	(17)	40	(5)	52
<b>FCF - Levered</b>	563	252	292	430	615	642	778
EBITDA Conversion	67.9%	30.3%	35.7%	45.5%	53.8%	50.6%	55.9%
<b>Forecast Assumptions</b>							
Fiscal Year	2022A	2023A	2024A	2025E	2026E	2027E	2028E
Revenue Growth	32.3%	14.4%	(0.1)%	6.4%	9.1%	7.4%	7.3%
Lift Revenue Growth	21.7%	8.4%	1.5%	8.0%	9.5%	8.9%	8.9%
Skier Volume Growth	16.5%	12.2%	(9.5)%	0.0%	2.0%	1.5%	1.5%
Pass Price Growth	4.5%	(3.4)%	12.2%	8.0%	7.3%	7.3%	7.3%

## Model Output: Credit Metrics

### Credit Metrics

Fiscal Year	2022A	2023A	2024A	2025E	2026E	2027E	2028E
<b>Leverage</b>							
Debt	2,943	3,025	3,045	3,035	3,015	2,992	2,969
Less: Cash	(1,107)	(563)	(323)	(368)	(587)	(824)	(1,185)
Net Debt	1,835	2,462	2,722	2,668	2,428	2,168	1,784
EBITDA	829	832	819	946	1,143	1,268	1,390
<b>Debt/EBITDA</b>	3.5x	3.6x	3.7x	3.2x	2.6x	2.4x	2.1x
Net Debt/EBITDA	2.2x	3.0x	3.3x	2.8x	2.1x	1.7x	1.3x
FCF/Debt	19.1%	8.3%	9.6%	14.2%	20.4%	21.5%	26.2%
<b>Interest Coverage</b>							
Interest Expense	148	153	162	159	167	183	185
EBITDAX	636	517	608	751	943	1,065	1,183
<b>EBITDAX Interest Coverage</b>	4.29x	3.38x	3.76x	4.71x	5.64x	5.82x	6.39x
EBITDAR	890	903	891	1,023	1,226	1,358	1,486
EBITDAR Less Capex	698	588	680	829	1,027	1,155	1,279
<b>Lease-adj Interest Coverage</b>	3.33x	2.62x	2.91x	3.50x	4.09x	4.23x	4.54x



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

**Dec 6, 2024**

**Team Number: 5**

**Students: Eric Zhu, Wanlin Huang, Szu Han Chen**



# Executive Summary

## Security Detail

<b>Bond</b>	<b>VSCO 4.625 7/15/29 CORP</b> (US926400AA00)
<b>Recommendation</b>	<b>Buy</b>
<b>Rank</b>	Sr Unsecured
<b>Coupon</b>	4.62500%
<b>Type</b>	Fixed
<b>Bond Ratings</b>	Moody's <b>B1</b>   S&P <b>BB-</b>
<b>Aggregated Amount Issued/Out</b>	USD 600,000,000
<b>Price</b>	\$90.19   Spread 288.9 bps   Yield to Maturity: 7.15%
<b>Target</b>	\$96.02   Spread 230 bps   3 Year Expected Return: 7.64% p.a.

## Company Overview

Victoria's Secret & Co. (VSCO), founded in 1977 by Roy Raymond, is a global leader in lingerie and beauty products, primarily operating in North America.

## Investment Thesis

<b>Topline</b>	Positive consumer spending trend will boost rebound of women's intimate market, and holiday shopping will add a nice momentum.
<b>Margin</b>	VSCO is on par with the industry on margin, and we saw recent company strategic shifts to boost ROIC and margin discipline.
<b>Capital</b>	Through our valuations, we found the company to have the potential of being upgraded by S&P, as leverage ratio under base case lowers to less than 3x.

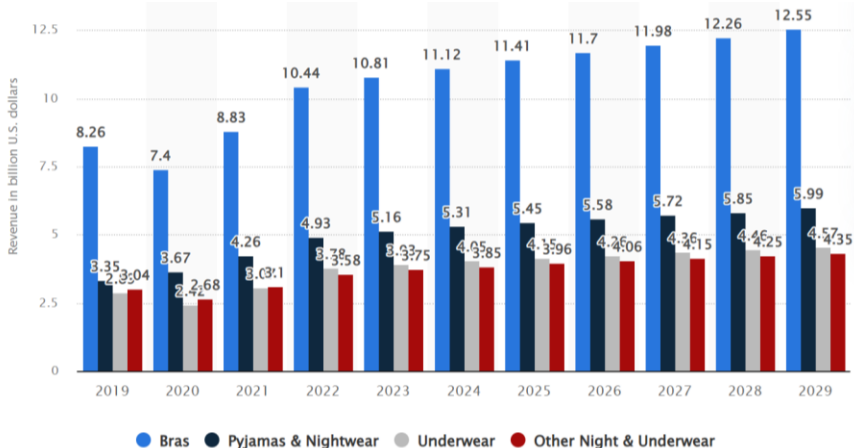
# Business Overview

Victoria's Secret is still the world's largest intimates specialty retailer, and more diversified

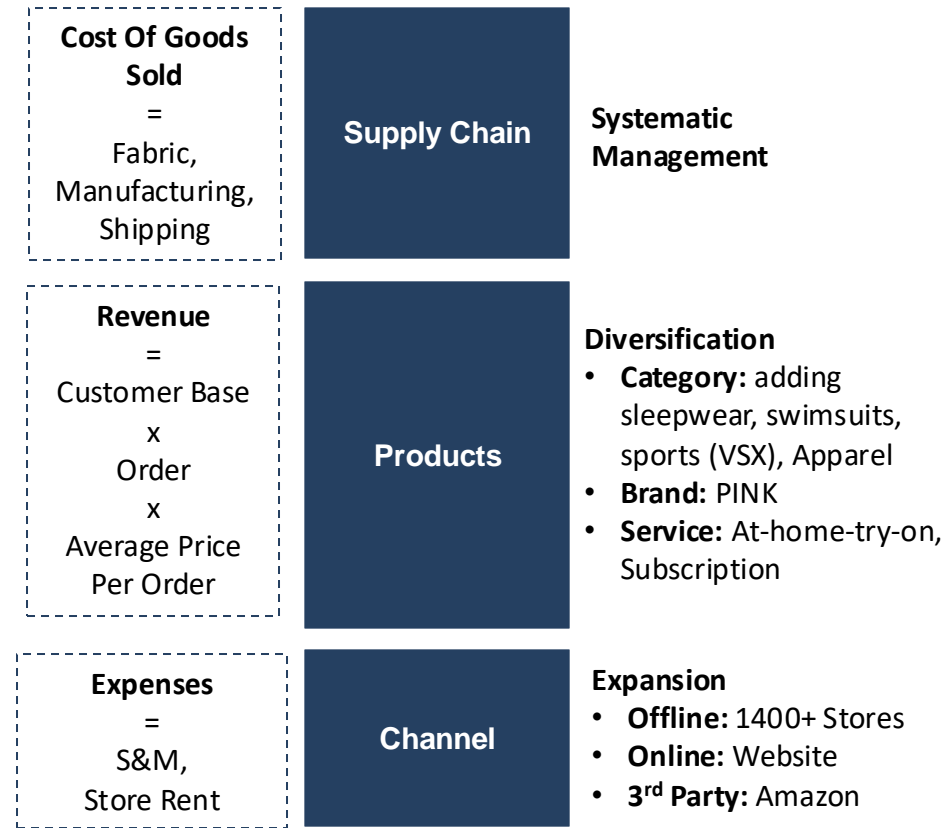
## The Market Of Women Intimates Is Evolving, Especially Bras



Women's Intimates Market Growth (By Category), 2019-2029



## So is Victoria's Secret's Business Model



~33% market share in bras  
22% in panties  
16% in beauty

Significant awareness in the NA intimates space

# Competitor Landscape

## Victoria's Secret Is Unique

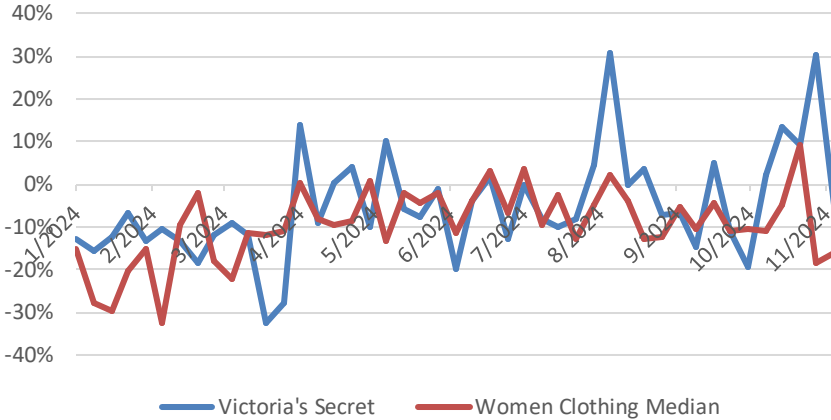
In USD (MM) Numbers are rounded	VICTORIA'S SECRET	AMERICAN EAGLE OUTFITTERS	GAP	SAVAGE FENTY LINGERIE BY RIHANNA	SKIMS
<b>Categories</b>	Women Intimates	General Apparel with sub-brand Aerie in intimates	General Apparel	Intimates	Shapewear
<b>Positioning</b>	Stylish Solutions	Apparel One-stop Shop	Family Clothing	Stylish Solutions With Subscription Model	Inclusive, Stylish Solutions
<b>Key Products</b>	Bras, Lingerie, Nightwear	Clothing, Bras	Clothing	Bras, Underwear	Bras, Shapewear, Clothes
<b>Geographic Distribution</b>	90% North America, 10% International	90%+ North America, 5% Mexico, Hong Kong	95% North America, 5% International	Primarily North America	Primarily North America
<b>Bond Spread OAS</b>	287.8	Not in universe	179.9	Not in universe	Not in universe
<b>Debt Rating</b>	B1 / BB-	N.A.	B1 / BB	/	/
<b>Market Cap</b>	2,912	3,382	9,359	Est 3,000 (2022)	Est 4,000 (2022)
<b>Revenue</b>	6,300	5,000	15,600	"Compounding Growth"	750
<b>Revenue Growth (FY23)</b>	-6%	0%	-6%	/	50%
<b>Gross Margin (FY23)</b>	35.6%	35%	34.3%	/	/
<b>Net Income Margin (FY23)</b>	6.6%	3.9%	-1.4%	/	/

# Investment Thesis #1 – Revenue Turnaround

Driven by customer base stabilization and product diversification

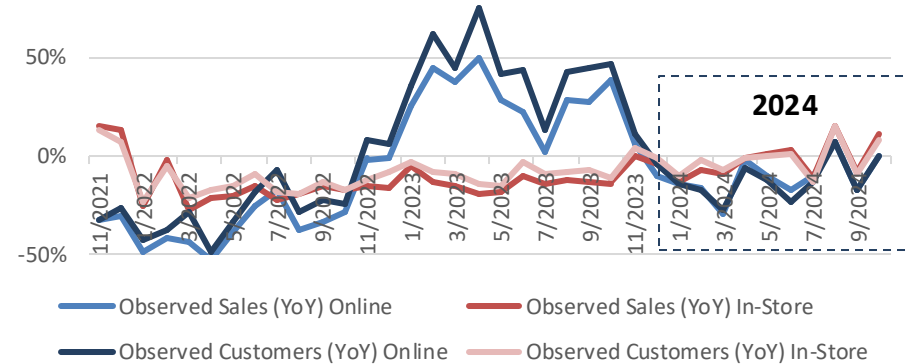
## Observed Sales Outpace Peers in 3 Consecutive Quarters

Weekly Observed Sales YoY, 2024



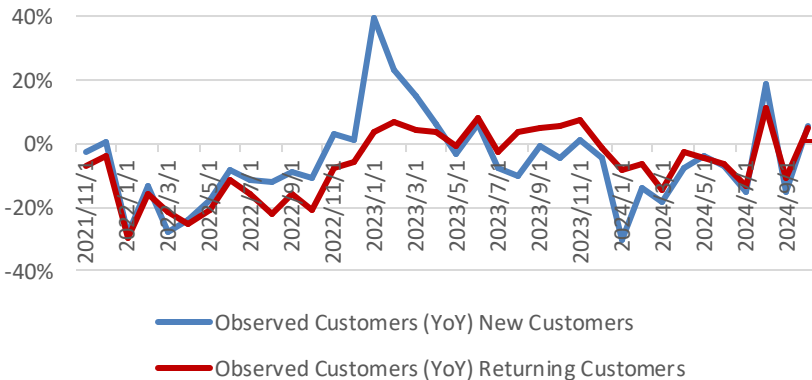
## Both Online And Offline See Stabilization & Improved Conversion

Observed Sales And Customers YoY Growth By Channel, 2021-2024



## Existing Customer's Bleeding Is Over With Added New Interests

Observed Customers, New/Returning, 2021-2024



## Cross selling And Service Added Provides Revenue Gains

**18 million registered loyalty members:**

- ~ 75% of sales
- Double transactions vs peer
- Cross category basket

### Four Groups of Primary Customer

1. Trend-seeking
2. Stylish but value driven
3. Modern minimalist for basics
4. detail-seeking

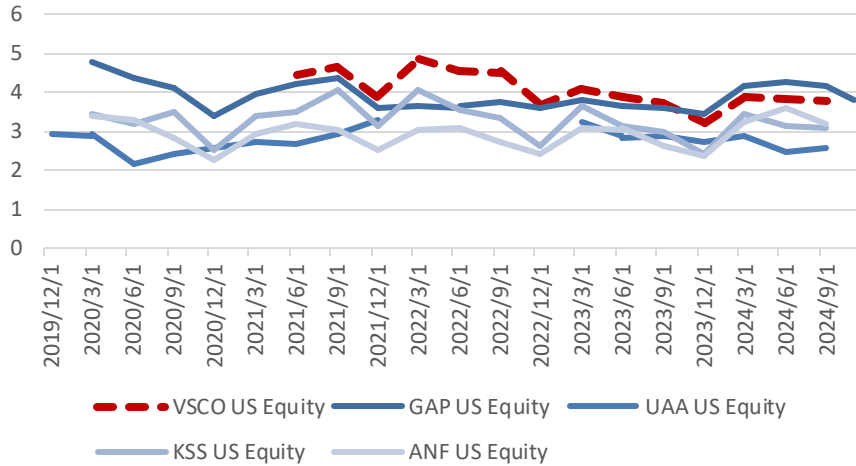
Swimwear | Sports (VSX) | Beauty

**Subscription**  
 (400 pts in revenue growth, used by Savage X Fenty as well)

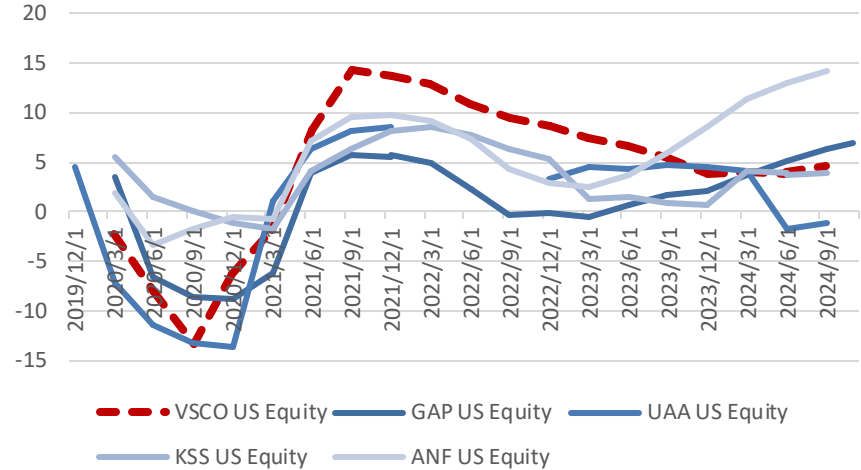
# Investment Thesis #2 – Same Beta, Better Alpha Ahead

Margins and Operational Efficiencies Improving.

## Inventory Turnover Among the Higher End of the Pack



## EBIT Margin Slightly Trails Peers, Trend In-line with Industry



## CEO Having Solid Background in Merchandising

**Before being professional CEO, Hilliary Supers has served as:**

- Chief Merchandising Officer at Maris Collective (formerly Seaside Luxe) - 2 years
- Senior VP (Buying, Planning, Allocation, Visual Merchandising), Guess NA – 1 year 2 months
- VP (General Merchandising Manager), American Eagle Outfitters – 5 years 6 months
- Divisional Merchandise Manager, Gap – 4 years 11 months

**Alignment with VSCO's current strategies:**

- The company is targeting major 'launches' 4+ times per year, buzzworthy 'drops' 10 to 12+ times per year, and co-branded collaborations 2 to 4+ times per year.

Super's entry into VSCO was a time when the company is shifting to introducing more products per year and promoting cross-channel / cross-brand sales. Her experience in merchandising will help the company to operate more efficiently.

## Cost Cutting Initiatives

On track to beat \$250m cost savings target from Oct 2023 to 2025. More than 1/3 to be realized in 2024 to 2025.

**Guidance:** A path to 10-12% operating margins by FY26 (& longer-term goal of 15% EBIT margins)

**Driven by:**

- ~200-300bps of SG&A leverage.
- ~300-400bps of GPM expansion.

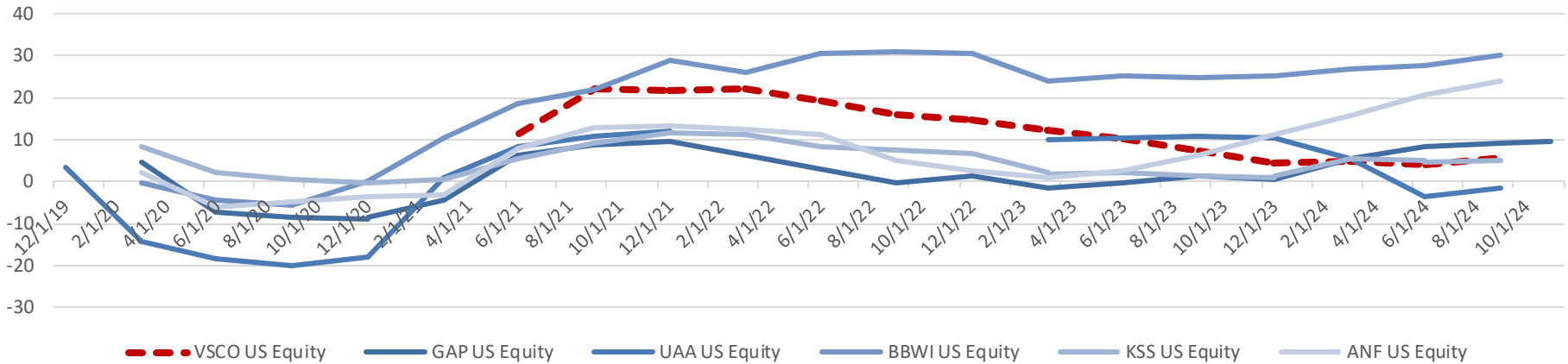
Specifically, management expects merchandise margins to grow above sales (w/ GPM +HSD% vs. sales +MSD%) as the company benefits from lower sourcing costs and B&O leverage.

- **GPM benefit:** lower cost in raw materials, factory/production efficiencies, streamlined merchandising structure.
- **Building an efficient operating model:** modernizing the business across the stores, distribution, people, and process, and non-merchandise procurement.

# Investment Thesis #2 – Same Beta, Better Alpha Ahead

CAPEX should receive more ROI.

## ROIC Below Major Apparel Peers – New Leadership Focused on Unlocking Value



## Looking for the Right Investment in All the Right Places

### Current Spend:

Having invested \$400MM in upgrading the VS platform, highly efficient DC's, omni-channel technology, and AI over the past five years, in addition to expanding their collaboration with Amazon, the brand can focus on elevating the experience further and make additional progress on key KPIs.

### Guidance from New CEO:

Focused on reinvesting cost savings back into the business to support growth on high returning core business activity first.

### Strategic Actions Backed by CAPEX:

LT CAPEX of 4.0-4.5% of sales a “reasonable” expectation (vs. ~4% of sales guided in 2023) consisting of ~70% of CAPEX on real estate to support NA fleet evolution, ~20% on technology (investment in core & new capabilities), and ~10% on logistics/other (modernizing supply chain).

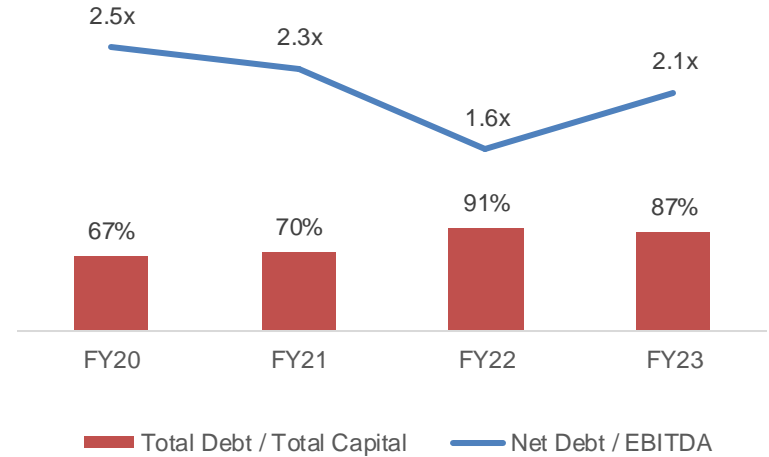
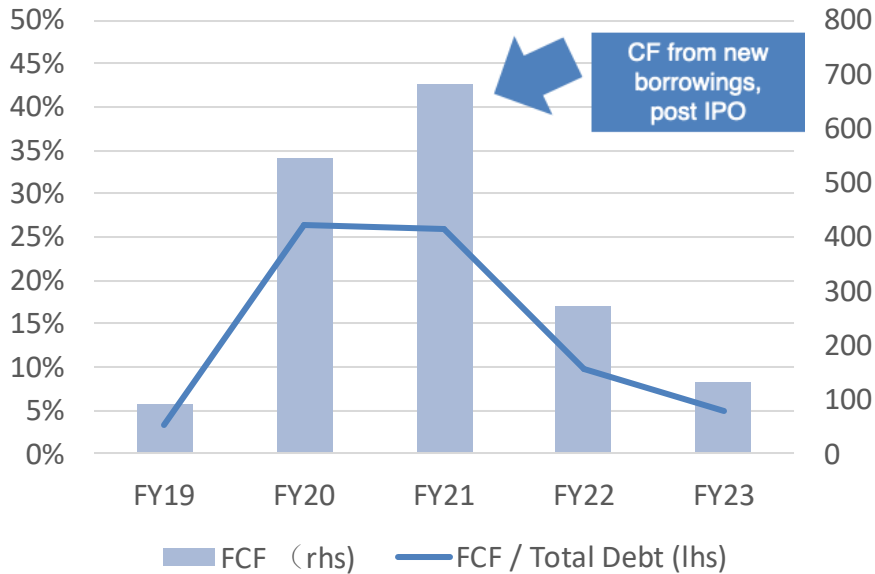
Headwinds	Solutions
E-Commerce + Peer Competition Getting Fiercer	Spending on technologies to increase in-store experience (e.g., through purchase of Adore Me)
	Investing in supply chain management and sourcing to enhance delivery efficiency
Brand Perception & Product Offering	Actively trim underperforming stores and locations.
	Increasing push of PINK, more styles as well as more categories (fragrant, makeup), to capture changing consumer profile.

Source: Company Report, CapIQ, BBG

# Investment Thesis #3 – Disciplined Capital Structure

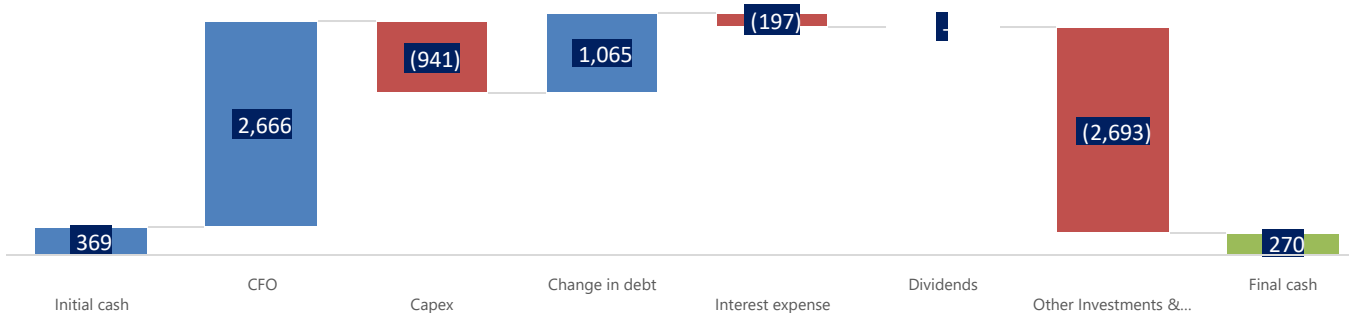
Disciplined capital deployment framework has kept business thrive.

## Cash Generation and Credit Metrics



## Historical Capital Allocation

### Cash Bridge FY 2019-2023



For the past 5 years (incl. pre 2021 IPO), VSCO was able to generate stable cash flows that fund CAPEX, interest, and payoff to pre-IPO investors (as other financing activities).

At the same time period, VSCO has bought back ~\$625m shares, roughly half of long-term debt.

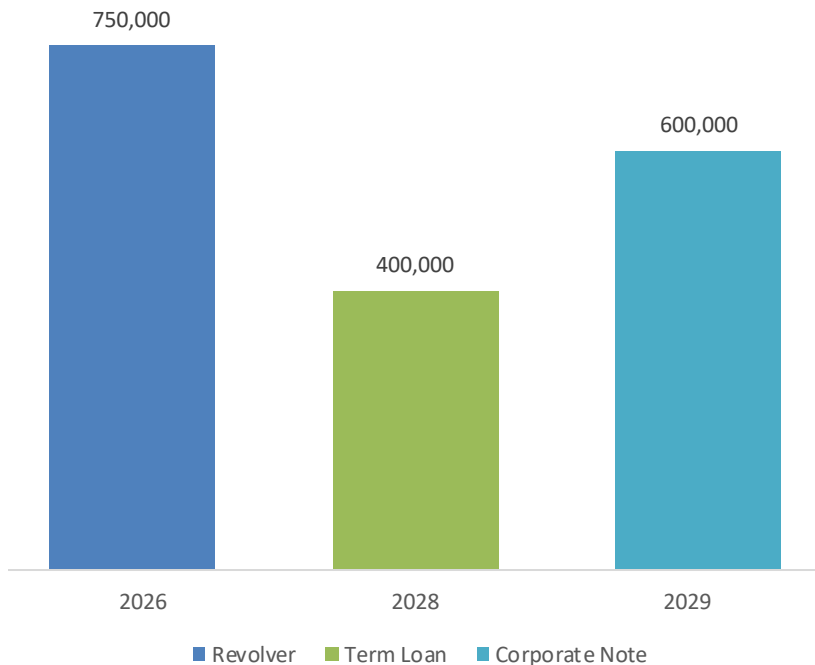
# Investment Thesis #3 – Debt Outstanding and Credit Profile

Disciplined capital deployment framework has kept business thrive.

## Debt Outstanding

Issuer	CUSIP	Maturity Date	Seniority	Security Type	Coupon Rate (%)	Original Issue Date	Issue Currency	Amount Out (\$000)	S&P Global Ratings	Price (%)
Victoria's Secret & Co.	92639MAD9	6/30/2026	First Lien	Revolving Credit	SOFR + 1.60%~2.10%	6/30/2021	USD	750,000	BB+	-
Victoria's Secret & Co.	92639MAB3	8/2/2028	First Lien	Term Loan	SOFR + 3.36%~3.68%	8/2/2021	USD	400,000	BB+	99.75
Victoria's Secret & Co.	926400AA0	7/15/2029	Senior Unsecured	Corporate Note	4.625%	7/15/2021	USD	600,000	BB-	89.973

## Upcoming Maturities



## S&P Current Rating: BB- / Negative

### S&P Downside Scenario



We could lower our rating on VS if:

- The company's competitive standing further weakens due to accelerated competition, merchandising missteps, or a lack of success in repositioning its brand, which leads to sustained declines in its overall sales and an inability to improve its profitability; or
- It adopts a more-aggressive financial policy before fully addressing **its performance issues such that it sustains leverage of about 3x or higher.**



### S&P Upside Scenario



We could revise our outlook on VS to stable **if it restores its leverage below 3x**. This could occur if:

- The company stabilizes its top-line revenue and improves its profitability by sustaining tight inventory management, successfully resetting its merchandise offerings at PINK, leveraging Adore Me's technology across its main brands, and realizing certain cost improvements; and
- It maintains a conservative approach to leverage.





# Scenario Test – Assumptions

We assumed 3 scenarios to test the company's limits.

## Assumptions Summary

Assumptions	Base	Realistic Bear	Stress Test
Revenue CAGR (6Y)	2.1%	0.5%	-12.9%
Gross Margin	36.9%-37.8%	36.8%-37.8%	36.4%-37.1%
SG&A Margin	31.8%-32.2%	32.4%-32.7%	20.5%-22.4%
Net Income Margin	2.5%-3.8%	2.2%-3.0%	1.5%-2.3%
<hr/>			
Effective Interest Rate	7.3%	7.3%	7.3%
Beta (Levered)	1.25	1.25	1.25
<hr/>			
Terminal EV/EBIT	5x	5x	5x
Terminal Growth Rate	2%	2%	2%
Equity Price	\$19.84 (-45.3%)	\$10.76 (-70.3%)	\$0.89 (-97.5%)
Equity Consensus Price	\$28.27 (-23.8%)	\$28.27 (-23.8%)	\$28.27 (-23.8%)

Note: Current as of Nov 20, 2024

Source: Company Report, CapIQ, BBG

## Methodology

We used a DCF analysis to forecast the company's future performances, so that we can gauge:

- If the company is in breach of any covenants, giving its current operational and financing trends.
- If the market underperform, how can we make sure the company will be able to pay us back? (Realistic Bear)
- If the VSCO is under severe competition, what will happen? (Stress Test)

Base	<ul style="list-style-type: none"> <li>• We assume the company's fundamental does not change (i.e. maintain stable revenue growth at ~2% p.a., maintain its margins).</li> <li>• Our valuation proves to align well with market consensus.</li> </ul>
Realistic Bear	<ul style="list-style-type: none"> <li>• This is to assume VSCO was not successful in its turnaround strategy, and keeps losing market share to competitors. We assumed the Sales pre Sq Feet in North America to be only 80% of base case.</li> <li>• Based on this, we have also assumed the company are under more margin pressure, having to offer more discounts.</li> </ul>
Stress Test	<ul style="list-style-type: none"> <li>• We assumed the <u>absolute worse</u> in this case, effectively suggesting a total collapse of VSCO with Store sales per Sq Feet in North America decline to 66% of the value assumed in base case.</li> <li>• The goal of the stress test is to effectively wipe out 97.5% of equity value and assess the company's performances.</li> <li>• We have also assumed more store closures in North America, as well as more severe margin compression (50bps more) due to more discounts and worse inventory management.</li> <li>• We have also assumed an increase in company's effective interest rate by 100bps.</li> </ul>

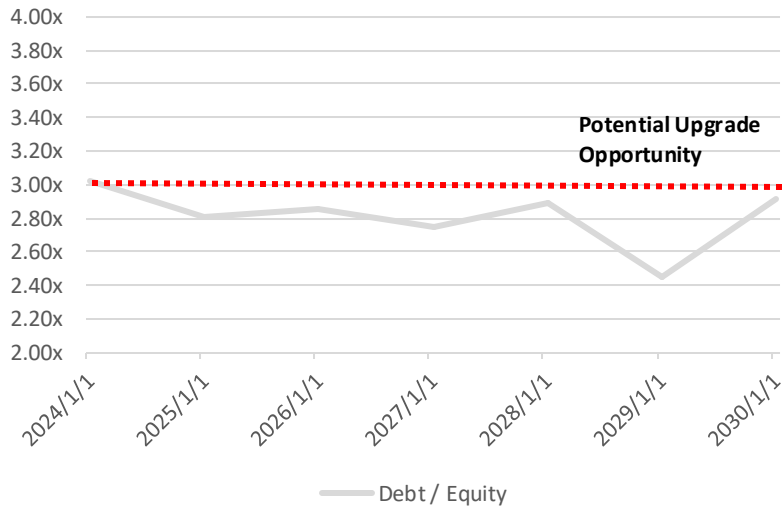
# Scenario Test – Base Case Results

We assumed 3 scenarios to test the company's limits.

## Result Snapshot

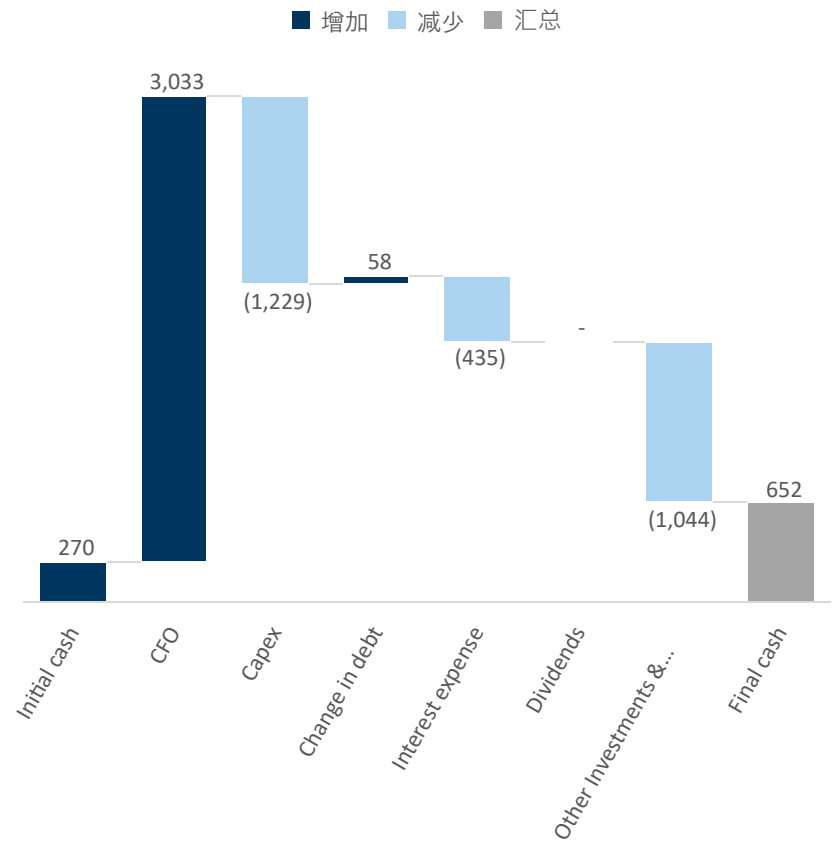
FY		2024E	2025E	2026E	2027E	2028E	2029E
Revenue		6,043	6,084	6,208	6,397	6,626	6,843
Revenue Growth		-2%	1%	2%	3%	0%	0%
Gross Profit		2,231	2,267	2,329	2,416	2,503	2,584
GP Margin		36.9%	37.3%	37.5%	37.8%	37.8%	37.8%
SG&A		(1,944)	(1,957)	(1,991)	(2,045)	(2,112)	(2,174)
SG&A Margin		32.2%	32.2%	32.1%	32.0%	31.9%	31.8%
EBIT		288	310	338	371	391	410
EBIT Margin		4.8%	5.1%	5.4%	5.8%	5.9%	6.0%
Net Income		152	181	205	230	245	260
NIM		2.5%	3.0%	3.3%	3.6%	3.7%	3.8%
FCFF		199	261	278	334	352	380
<b>Leverage</b>							
Debt / EBITDA		2.46x	2.41x	2.33x	1.93x	1.87x	1.78x
Net Debt / EBITDA		1.74x	1.87x	1.75x	1.24x	1.44x	0.80x
PVOL (PV of Op. Lease)		3,931	3,805	3,658	3,517	3,452	3,447
Adj. Net Debt / EBITDAR		4.73x	4.72x	4.54x	4.07x	4.10x	3.63x
Net Debt incl. Leases		2,621	2,710	2,683	2,448	2,596	2,216
Adjusted Net Debt/EBITDAR (Lease)		2.55x	2.65x	2.62x	2.33x	2.44x	2.02x
Fixed charge cover (EBITDA / interest + rent)		1.80x	1.87x	1.94x	2.06x	2.12x	2.19x

## Debt / Equity (Base)



## Cash Bridge

### Cash Bridge FY 2024E - 2029E (Base)



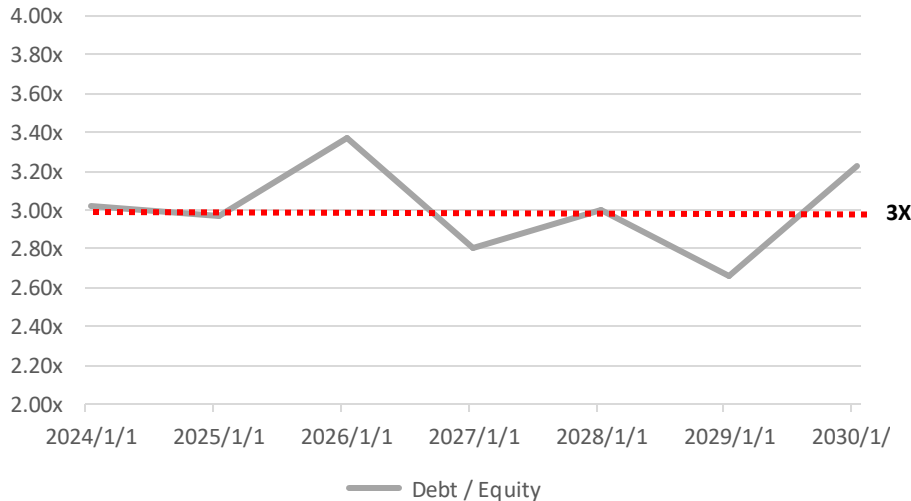
# Scenario Test – Realistic Bear Case Results

We assumed 3 scenarios to test the company's limits.

## Result Snapshot

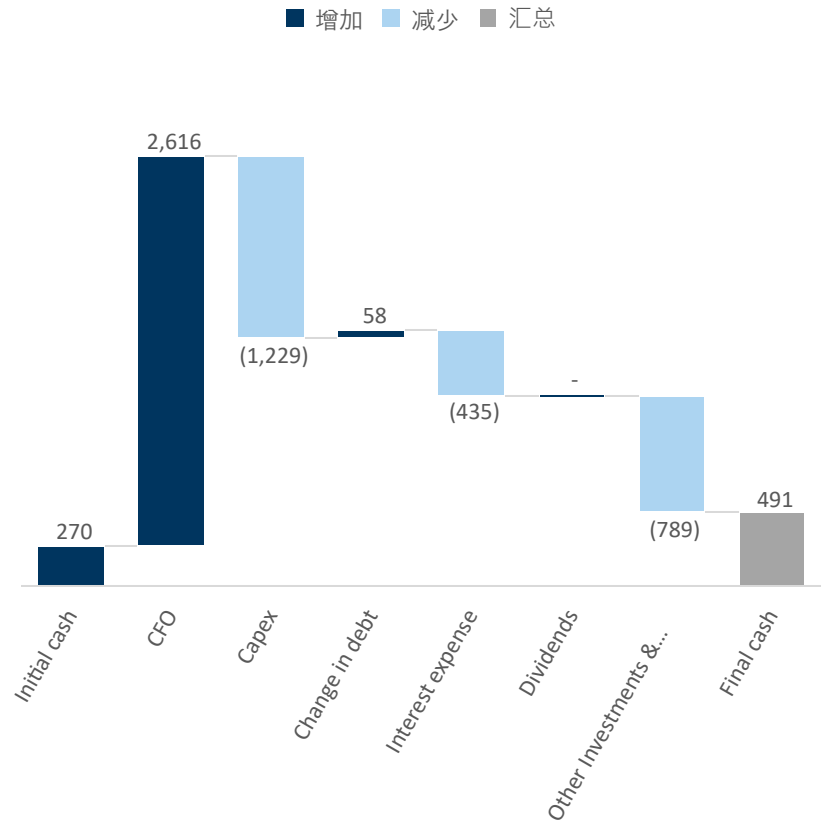
FY	2024E	2025E	2026E	2027E	2028E	2029E
Revenue	5,737	5,379	5,465	5,597	5,753	5,894
Revenue Growth	-7%	-6%	2%	2%	0%	0%
Gross Profit	2111	1999	2048	2114	2173	2,226
GP Margin	36.8%	37.2%	37.5%	37.8%	37.8%	37.8%
SG&A	(1,856)	(1,747)	(1,780)	(1,829)	(1,880)	(1,926)
SG&A Margin	32.4%	32.5%	32.6%	32.7%	32.7%	32.7%
EBIT	255	252	267	285	293	300
EBIT Margin	4.4%	4.7%	4.9%	5.1%	5.1%	5.1%
Net Income	127	137	150	164	170	175
NIM	2.2%	2.5%	2.7%	2.9%	3.0%	3.0%
FCFF	162	199	217	259	267	284
<b>Leverage</b>						
Debt / EBITDA	2.62x	2.70x	2.66x	2.24x	2.21x	2.13x
Net Debt / EBITDA	1.92x	2.29x	2.06x	1.60x	1.82x	1.25x
PVOL (PV of Op. Lease)	3,650	3,078	2,961	2,848	2,796	2,792
Adj. Net Debt / EBITDAR	4.81x	4.80x	4.60x	4.18x	4.26x	3.86x
Net Debt incl. Leases	2,658	2,809	2,712	2,528	2,661	2,377
Adjusted Net Debt/EBITDAR (Lease)	2.76x	3.21x	3.13x	2.86x	3.01x	2.63x
Fixed charge cover (EBITDA / interest + rent)	1.79x	1.91x	1.97x	2.07x	2.11x	2.16x

## Debt / Equity (Realistic Bear)



## Cash Bridge

### Cash Bridge FY 2024E - 2029E (Realistic Bear)



# Scenario Test – Stress Test Case Results

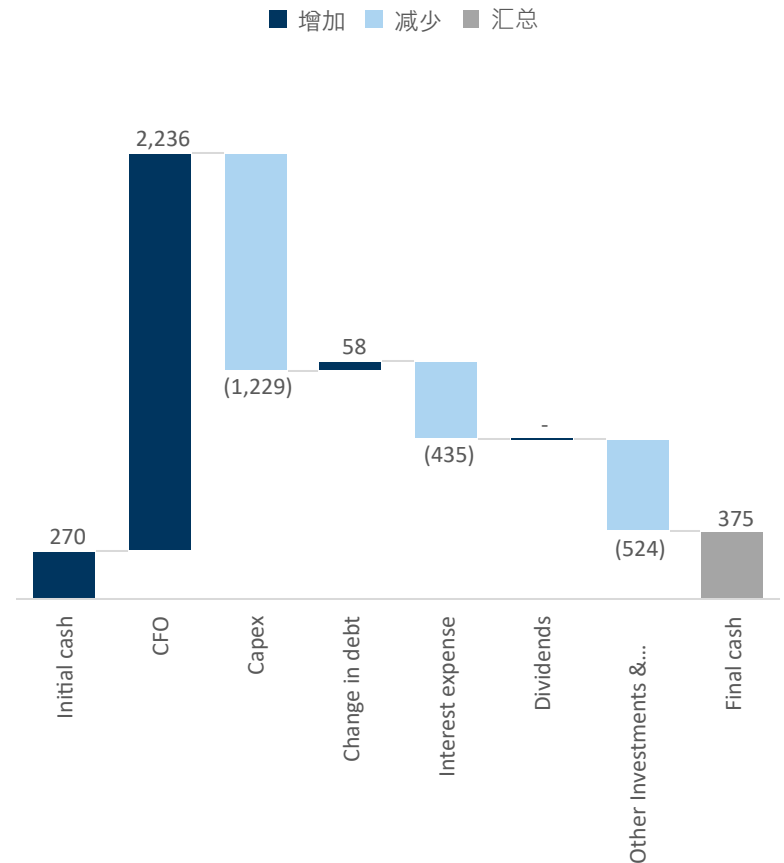
We assumed 3 scenarios to test the company's limits.

## Result Snapshot

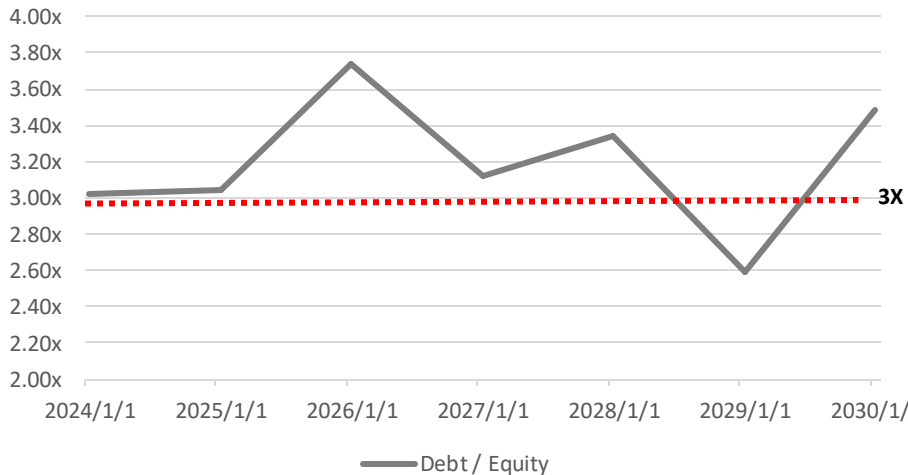
## Cash Bridge

FY		2024E	2025E	2026E	2027E	2028E	2029E
Revenue		5,515	4,837	4,836	4,854	4,902	4,933
Revenue Growth		-11%	-12%	0%	0%	0%	0%
Gross Profit		2024	1788	1790	1799	1792	1,794
GP Margin		36.7%	37.0%	37.0%	37.1%	36.6%	36.4%
SG&A		(1,783)	(1,568)	(1,579)	(1,590)	(1,610)	(1,625)
SG&A Margin		32.3%	32.4%	32.6%	32.7%	32.8%	32.9%
EBIT		241	220	211	209	182	168
EBIT Margin		4.4%	4.6%	4.4%	4.3%	3.7%	3.4%
Net Income		116	112	107	106	85	74
NIM		2.1%	2.3%	2.2%	2.2%	1.7%	1.5%
FCFF		143	161	168	192	173	171
<b>Leverage</b>							
Debt / EBITDA		2.69x	2.89x	3.00x	2.61x	2.78x	2.80x
Net Debt / EBITDA		2.02x	2.57x	2.48x	2.11x	2.31x	1.91x
PVOL (PV of Op. Lease)		3,448	2,524	2,379	2,239	2,168	2,153
Adj. Net Debt / EBITDAR		4.81x	4.78x	4.70x	4.36x	4.52x	4.28x
Net Debt incl. Leases		2,677	2,866	2,778	2,636	2,664	2,493
Adjusted Net Debt/EBITDAR (Lease)		2.90x	3.70x	3.76x	3.60x	3.83x	3.60x
Fixed charge cover (EBITDA / interest + rent)		1.80x	1.99x	2.01x	2.09x	2.04x	2.04x

## Cash Bridge FY 2024E - 2029E (Stress Test)

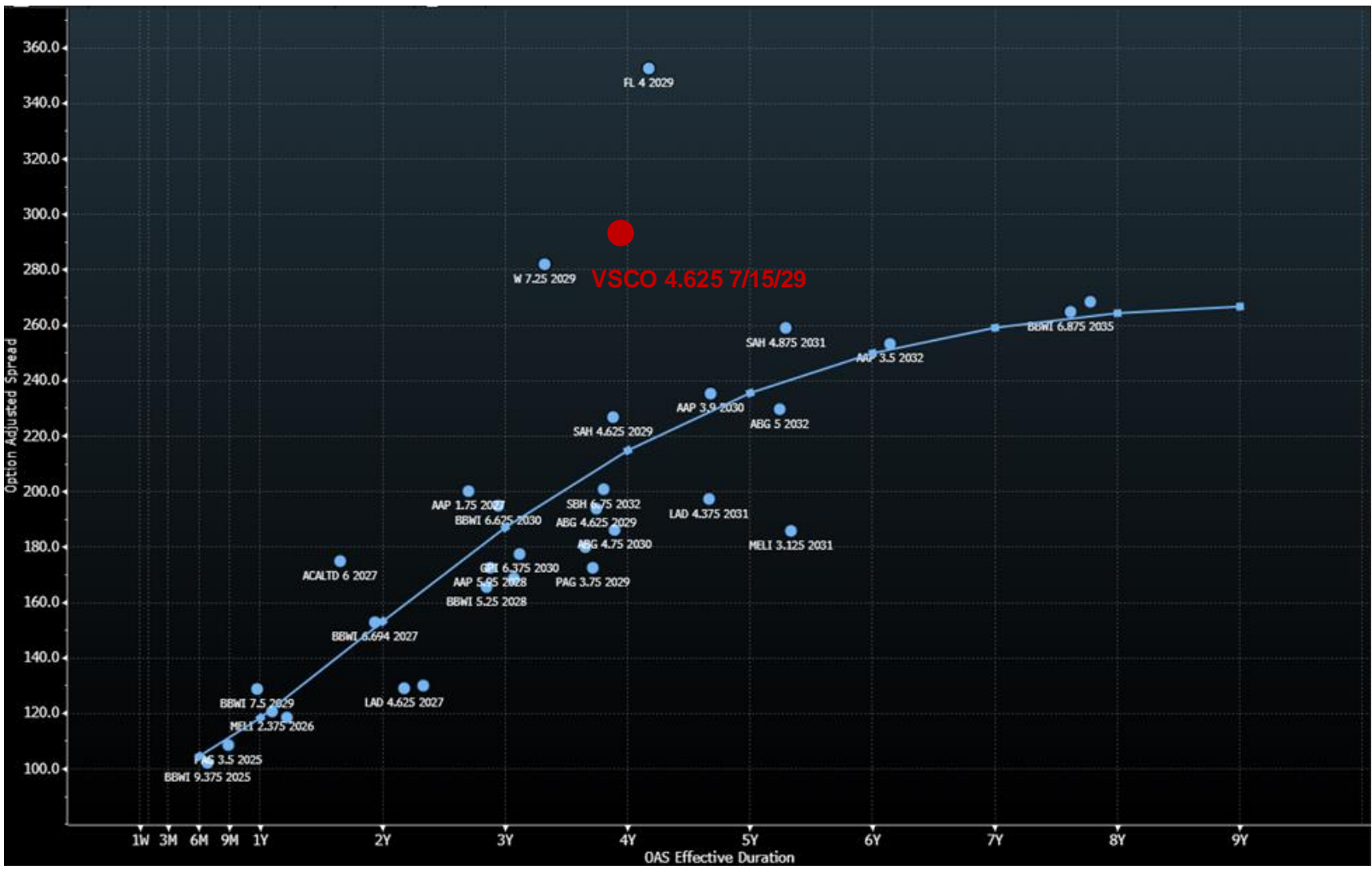


## Debt / Equity (Stress Test)



# OAS Spread In Favor For Tightening

We observed this bond to be well above the curve in credit universe.



Source: Company Report, CapIQ, BBG

# Spread tightening throughout the year and will keep going

Positive sentiment toward new CEO and successful launch of Victoria's secret fashion show

Analyst are now more positive toward VSCO

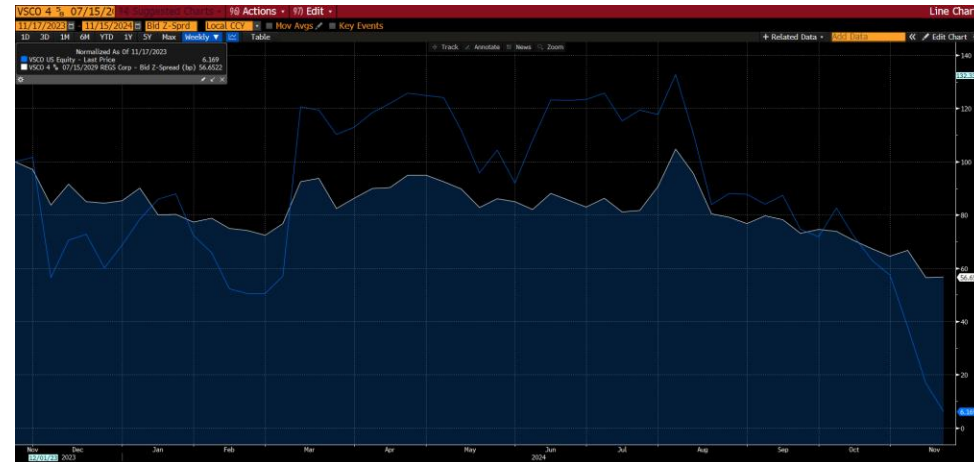
Historical spread show that the market is regaining trust

	Judgement	Target Price	Date
Jefferies	Buy	\$ 40	11/12
Wells Fargo	Buy	\$ 30	10/21
BMO	Buy	\$ 33	10/17
Barclays	Neutral	\$ 25	9/18
TD Cowen	Neutral	\$ 35	8/30
Goldman Sachs	Sell	\$ 19	8/30
Morgan Stanley	Sell	\$ 29	8/30
BofA Securities	Sell	\$ 21	8/30



130 bps spread over GAP

Equity reacted faster than Credit



\* Stock price inverted for comparison

# Better Return, Lower Risk

Better performance than peers and better than VSCO stock.

## Current Spread Provides Decent Protection

	VSCO
Current Spread	330 bps
1Y breakeven threshold	+230 bps
1Y SD	100 bp

### VSCO has decent yield that can protect it from price volatility

Over the past year, VSCO has narrowed its credit spread from the 500 basis points range to 330 basis points, driven by its successful strategic pivot. The revitalization of its PINK brand and the redefinition of its flagship Victoria's Secret brand have increased investor confidence, demonstrating its ability to reshape market perceptions and reestablish its presence.

## Bond Is Yielding More Than Stock

### VSCO 4.625 29 offer greater protection than stock while delivering higher yields.

Currently, bonds yield 7.17%, which is 2.28% higher than the yield of VSCO's stock, likely due to the slower price reaction typically observed in the bond market. We attribute the stock's higher valuation to the market's expectation of increased EPS in the upcoming quarters, reflecting the positive sentiment investors currently hold toward VSCO.

	Return
Stock Earning yield	4.85%
VSCO 4.625 29	7.17%

## Lower Leverage Compared To Peers

Company	Issuer Rating Moody's / S&P / Fitch	Outlook			Leverage (ST+LT Debt/ BEst)	Adj. Leverage (Adj Debt/ BEst)
		Moody's / S&P / Fitch	Moody's / S&P / Fitch	Moody's / S&P / Fitch		
NORDSTROM INC	Ba2 / BB+ / BB	●	●	●	2.3x	3.0x
KOHL'S CORP	Ba2 / BB / BB	●	●	●	3.4x	4.6x
MACY'S INC	Ba1 / BB+ / BBB-	●	●	●	1.5x	2.5x
CARTER'S INC	Ba1 / BB+ / N.A.	●	●	●	1.6x	1.9x
LEVI STRAUSS-A	Ba1 / BB+ / BB+	●	●	●	1.2x	1.7x
SALLY BEAUTY HOL	Ba1 / BB- / N.A.	●	●	●	2.3x	2.4x
ALBERTSONS COS-A	Ba1 / BB+ ** / N.A.	●	●	●	1.9x	2.6x
BATH & BODY WORK	Ba2 / BB / WD	●	●	●	2.7x	2.8x
UNDER ARMOUR-A	Ba2 / BB- / N.A.	●	●	●	2.1x	2.6x
GAP INC/THE	Ba3 / BB / WD	●	●	●	1.0x	2.0x
CROCS INC	Ba3 / BB / N.A.	●	●	●	1.4x	1.5x
VICTORIA'S SECRE	Ba3 / BB- / N.A.	●	●	●	2.1x	2.7x
VF CORP	Ba1 / BBB- / N.A.	●	●	●	8.2x	5.3x

Note: Using Issuer LT rating unless otherwise noted. Adj. leverage includes leases and underfunded pension obligations. \*N.A. when Ebitda negative/no estimates.

Outlook Key: ● Negative ● Stable ● Positive ● Not Applicable

Bloomberg Intelligence BI

## Better Risk Return Than Peers

### VSCO offers better risk return

Based on historical data, VSCO has demonstrated a generous spread and decent volatility, outperforming similar clothing companies in terms of potential returns. With the ongoing repositioning efforts, VSCO is likely to strengthen its financial position, creating a favorable outlook for potential upgrades in the future.

	VSCO	GAP	VFC
Yield	7.17%	6.00%	5.99%
Benchmark	4.35%	4.35%	4.35%
SD	3.67%	5.65%	0.77%
Sharpe	0.8	0.29	2.13

# Valuation – Scenario Test

The bond thrive in both soft-landing and recession scenarios.

## Scenario Assumptions

## Scenario Results

### Base Case: Moderate recovery

- By relaunching Victoria's Secret Fashion Show, VSCO successfully maintained market share while have decent profit margin of 2-3%
- VSCO also benefited from no landing scenario, which helped industry wide rebound of clothing sales

	1Y	3Y
Total return	7.75%	7.64%
Yield	7.17%	7.17%
Roll down	0.29%	0.45%
Spread return	0.29%	0.02%
Benchmark return	0%	0%

### Scenario Case: Repositioning Failure

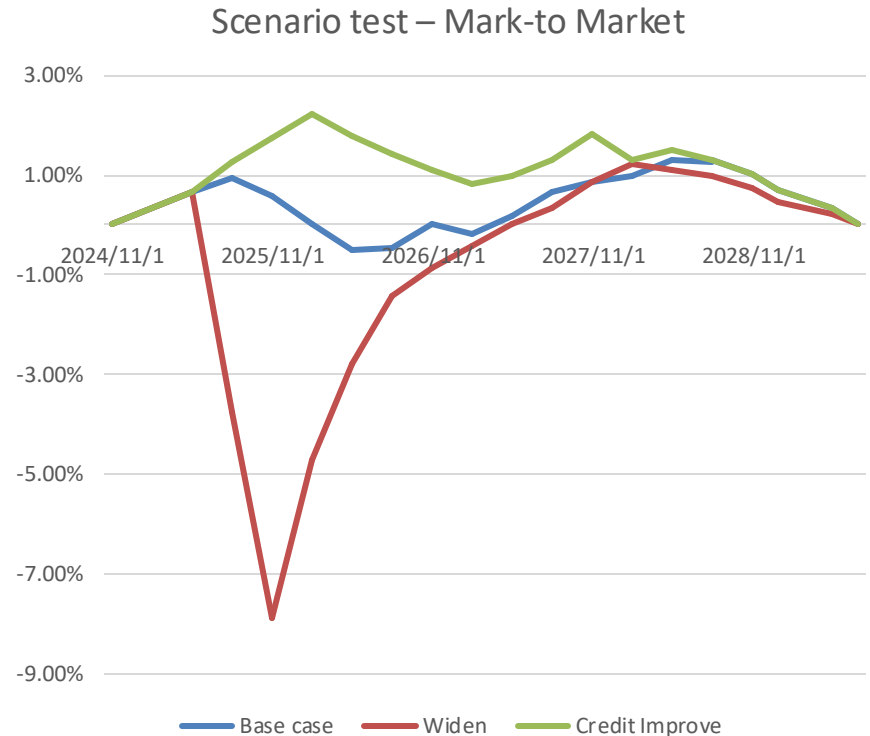
- In this scenario, VSCO failed to find its market position. With several failed attempts, VSCO was deeply in debt and triggered a sell-off
- VSCO will react by closing several stores to lower rent expense and dedicate more on PINK which has a lower margin

	1Y	3Y
Total return	-0.71%	7.41%
Yield	7.17%	7.17%
Roll down	0.29%	0.45%
Spread return	-8.17%	-0.21%
Benchmark return	0%	0%

### Scenario Case: Credit improve

- By relaunching Victoria's Secret Fashion Show, VSCO successfully grew market share while improving profit margin of 3-4%
- New CEO repositioned VSCO toward younger and more diverse generation, gaining popularity and sales from other celebrity brands

	1Y	3Y
Total return	8.92%	7.78%
Yield	7.17%	7.17%
Roll down	0.29%	0.45%
Spread return	1.46%	0.16%
Benchmark return	0%	0%



Low call risk: call on 12/23/2024 @ 102.31 (current: \$90.11)



# Risk Evaluation

There are 4 potential risks to this investment.

## In-store purchase might be replaced by online sales

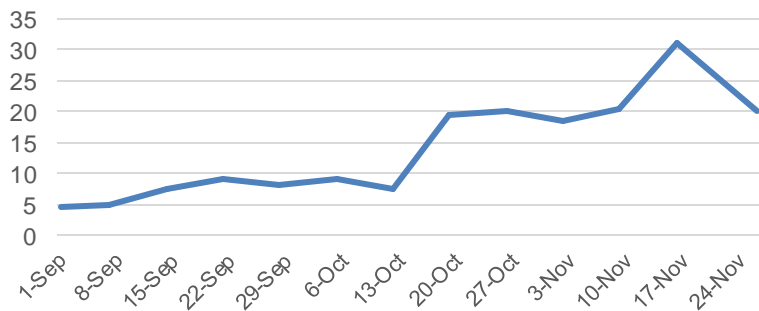
**Issue** VSCO mainly focus on providing great in-store experience. When customers turn to online shopping, this can put an extra blow on VSCO. Specifically, we are watching for competition from SHEIN and Temu.

**Mitigants**  
**For Lingerie, fit matters:** Unlike other clothing, Lingerie has a lower tolerance on poor-fitness. People likes to try it on in-stores. Ordering online might hurt their purchase experience as they might have to navigate the lengthy return experience.  
**Great in-store experience:** VSCO provide luxury experience with wide range of size for customer to choose from. VSCO will track service customer experience by feed back system.  
**Online to in-store:** VSCO launches promotional campaigns, such as annual sales and bundle deals, to draw customers into their stores.

## Low Liquidity of the Note

**Issue** The bond we have selected might face liquidity related issues, making it harder to enter and exit, as well as widen the spread. This could undermine the thesis.

**Mitigants** Expected daily volume (in millions) seemed healthy. We expect 20 bps of slippage.



Source: Company Report, CapIQ, BBG

## Supply Chain Disruption

**Issue** After the election, Trump might start a wave of tariff war against China. The cost of tariff will affect the price for product.

**Mitigants**  
**Inventory management:** VSCO employs advanced inventory management systems that provide visibility across their supply chain. This allows them to anticipate potential disruptions and respond proactively, such as by prioritizing key product lines.  
**Strong brand recognition:** VSCO's strong brand recognition allows it to command greater influence over the final product price. In contrast, budget brands, which rely primarily on price as their competitive advantage, are more vulnerable to market pressures.  
**Close Supplier Relationships:** Long-standing partnerships ensure cost efficiency without compromising quality, while maintaining the ability to provide a diverse and innovative product range.

## CEO Change

**Issue** VSCO replaced its CEO with Hillary Super, CEO of Savage X Fenty on September 8, 2024. Execution of the transition under a challenging macro condition can become a risk.

**Mitigants**  
**Positive Market Reaction:** Several analyst upgraded VSCO's target price following the announcement, suggesting confidence in the leadership change. Other analysts have followed up with notes stating their support / neutral stance over the change.  
Barclays: "Her deep knowledge of the sector and her focus on understanding Victoria's Secret's core consumer are seen as critical assets that will help the company execute its turnaround plan."

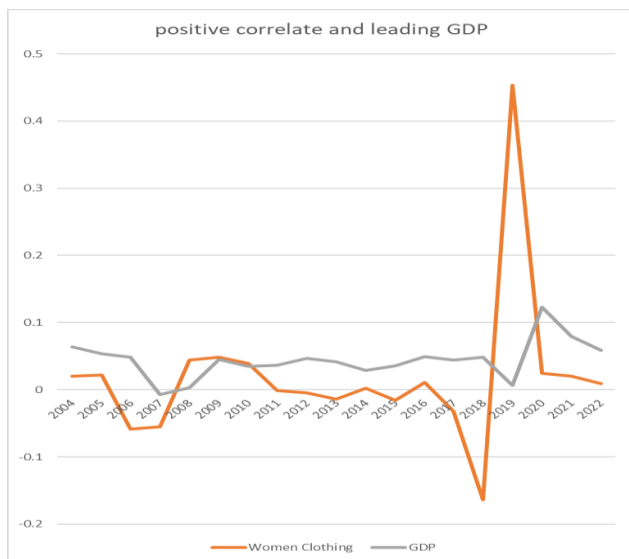
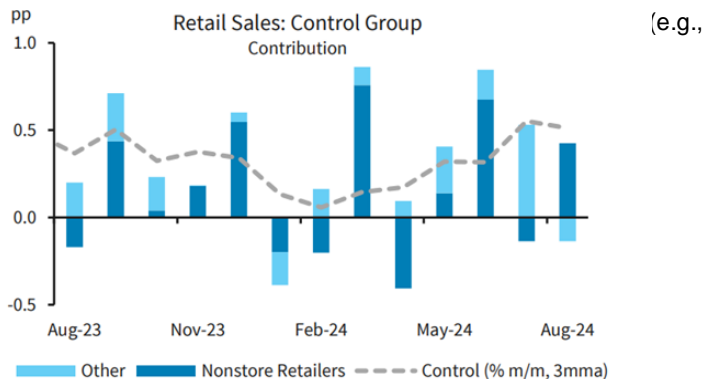
**Three decade of industry experience:** The new CEO served in GAP, AEO, Guess, Savage X Fenty. These experiences equip her with precise market sense and the differentiate strategy VSCO needed.

# What if consumer sentiment doesn't bounce back?

The bond thrive in both soft-landing and recession scenarios.

## Unlike Women Clothing, Lingerie follow different pattern

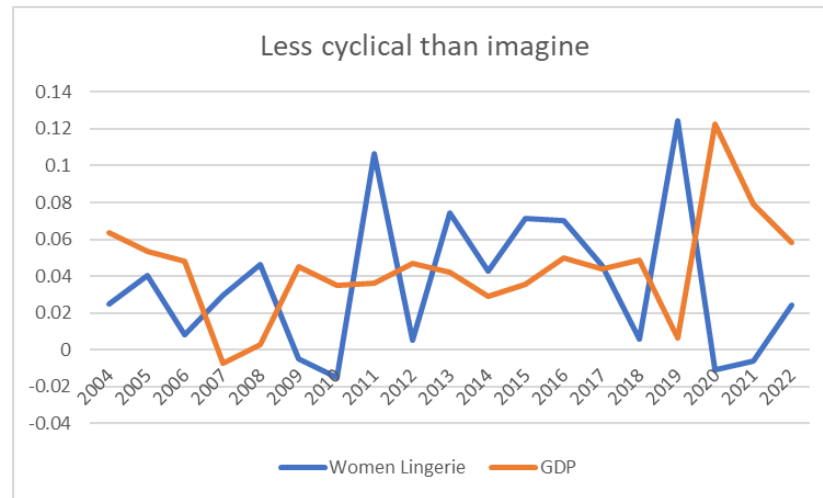
Women's clothing is significantly affected by fashion trends, with consumers often purchasing new items in response to seasonal changes or the latest styles, showing a degree of cyclicity.



## Lipstick effect for Lingerie?

### Lipstick

For the most part, lipstick is a relatively inexpensive accessory, with a typical tube costing anywhere from \$5 to \$20. History has shown that women will cut back on more expensive beauty goods like makeup and perfume when times are tight. But lipstick? Don't even go there. When lipstick sales increase as luxury beauty item accessories decrease, that's another potential sign of economic headwinds.



Furthermore, essentials like underwear and sleepwear are often replenished as needed rather than following a fixed purchasing cycle.

# Executive Summary

## Security Detail

<b>Bond</b>	<b>VSCO 4.625 7/15/29 CORP</b> (US926400AA00)
<b>Recommendation</b>	<b>Buy</b>
<b>Rank</b>	Sr Unsecured
<b>Coupon</b>	4.62500%
<b>Type</b>	Fixed
<b>Bond Ratings</b>	Moody's <b>B1</b>   S&P <b>BB-</b>
<b>Aggregated Amount Issued/Out</b>	USD 600,000,000
<b>Price</b>	\$90.19   Spread 288.9 bps   Yield to Maturity: 7.15%
<b>Target</b>	\$96.02   Spread 230 bps   3 Year Expected Return: 7.64% p.a.

## Company Overview

Victoria's Secret & Co. (VSCO), founded in 1977 by Roy Raymond, is a global leader in lingerie and beauty products, primarily operating in North America.

## Investment Thesis

- Topline** Positive consumer spending trend will boost rebound of women's intimate market, and holiday shopping will add a nice momentum.
- Margin** VSCO is on par with the industry on margin, and we saw recent company strategic shifts to boost ROIC and margin discipline.
- Capital** Through our valuations, we found the company to have the potential of being upgraded by S&P, as leverage ratio under base case lowers to less than 3x.

# Appendix I – New CEO Profile

Hillary Super brings 3 decades of retail experience to VSCO.

## Past Roles

Hillary Super is a seasoned retail executive with nearly three decades of experience leading prominent fashion brands. Her career trajectory and the impacts she has made at each firm are as follows:

**Leadership Role in:** American Eagle Outfitters, Ann Inc., New York & Company, Guess, Gap Inc., and Old Navy.

**Anthropologie Group (owned by Urban Outfitters) (2019–2021):**

As Global CEO, Super led a turnaround of the Women's Apparel and Accessories business, revitalizing the brand's market presence and driving growth.

**Savage X Fenty (2023–2024):**

Serving as CEO and board member, Super oversaw the lingerie brand co-founded by Rihanna, appealing to younger consumers and enhancing the company's cultural relevance.



## Track Record in Past Roles

**key focus on “understanding & listening to the customer”, which CEO Super described as the enabler of her prior execution at Anthropologie, where she served as Global CEO from 2018-21, added \$100M revenues to the brand in her first year as Global CEO, increased focus on omnichannel, and led the launch of Plus sizes at Anthropologie.**

1. Super is a genuine advocate for size inclusivity because it broadens the company's reputation and addressable market.
2. One source said she “speaks Gen Z very fluently”
3. A female CEO will represent a welcome change and a female perspective to the company's products and offerings.

## Entry into VSCO

Super has reportedly signed on for a base salary of \$1.2 million and a \$1 million signing bonus.

She's also set to receive an annual cash bonus reportedly between \$2.1 million to \$2.4 million and equity in the brand.

**This includes a one-time stock award valued at \$5.75 million, fully vesting in three years. In 2025, she will also receive an annual equity grant valued at \$7.7 million.**

In total, Super was offered \$18m to join VSCO, ~\$13.45 (74%) in equity.  
**Showing strong alignment of interest with company performance.**

# Appendix I – Commentaries from Sellside / Mgmt. Meeting

## Positive outlook from the Sellside.

### UBS

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#### **Our time with VSCO's new CEO highlighted some key turnaround initiatives:**

Some areas of focus in the near-term will include:

- 1.Understanding Victoria's Secret (VS) and PINK customers' needs;
- 2.Growth outside intimates; and
- 3.Supply chain agility.

Management acknowledged VS has lost share in intimates to Off-Price and other value players. To address this issue, VSCO intends to deepen its connection with consumers and provide a better customer experience. **Management noted VS is farther along the journey of understanding its customers' needs than PINK and will therefore spend more time learning about the collegiate consumer.**

On category growth, VSCO's CEO sees potential in sportswear and swim while highlighting the VSX product as a well-executed launch.

Super noted apparel as an opportunity to increase basket size with its current customers. **VSCO's CEO also considers the company can become faster on how it brings product to market by working with different lead times by category instead of relying on bras' lead times, which tend to be longer.**

### Barclays

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#### **Experience that complements what VSCO needs:**

We believe Hillary Super's experience as the Global CEO of Anthropologie Group (URBN) as well as CEO of Savage x Fenty (private) are well suited to VSCO's needs today. **From Anthropologie, the notion of creating a more agile organization is something that is necessary for VSCO**, where merchant teams across the organization are currently anchored in longer lead-time bras and intimates. In our view, while this makes it easier to do the merchandise planning on a quarterly basis as it's anchored to the longer lead-time bra production, it was likely inefficient and didn't allow the company to read and react as quickly in categories like apparel.

**Additionally, utilizing omnichannel to engage with consumers is an area of opportunity for VSCO, and should drive increased customer engagement.**

Further, there are white-space opportunities in category adjacencies beyond just sport and swim that could potentially drive value for current customers. **From Savage x Fenty, we believe Hillary Super brings not only the competitive view of VSCO's positioning in the category, but a knowledge of how to effectively identify and connect with its target customer.**

#### **Re-focusing on understanding and engaging the customer:**

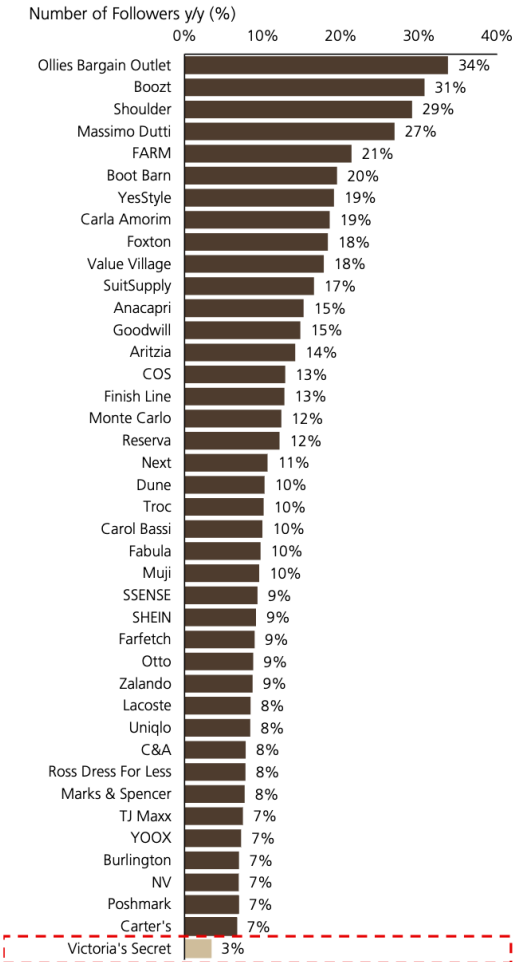
**Management believes there was a loss of focus at Pink on understanding who the target customer is and there is more work to be done on product and messaging before it can ultimately shift to a less promotionally driven value offering.** With Victoria's Secret, the brand's positioning won't completely change from where it is today, but there are important aspects that management is thinking through on how to organically capitalize on current trends, create excitement, increase customer frequency, and improve storytelling in the stores.

While the return of the Fashion Show on 10/15/24 was a proud moment for the company and by external measures well received, management did not commit to its annual return, and is evaluating the best go-forward strategy and ROI on reaching its target customer, which in our view may mean spreading some of the marketing budget to drive excitement throughout the year versus the once-a-year show.

# Appendix I – Social Media Growth

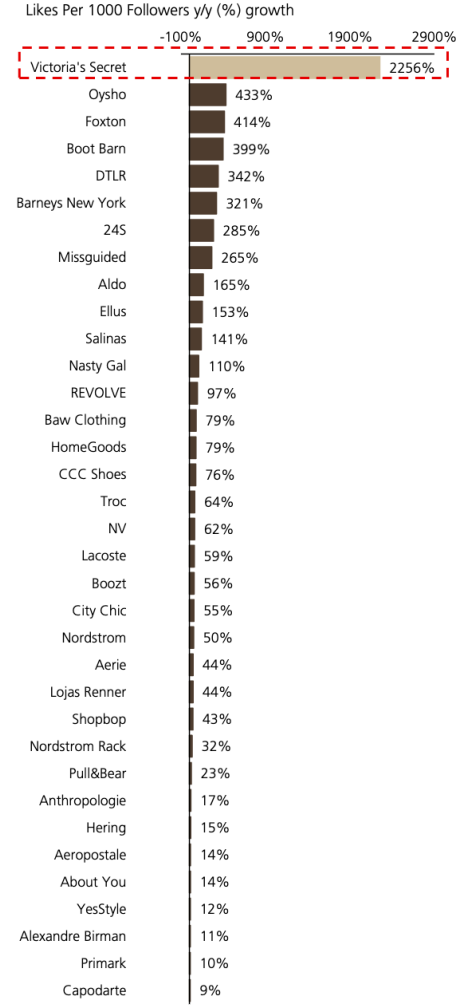
The VS Fashion Show has immediate impact on social media likes, while follower impacts are more delayed.

**Figure 24: Victoria's Secret followers growth vs. peers, October 2024**



Source: UBS Evidence Lab (> [Access Dataset](#)), Instagram

**Figure 25: Victoria's Secret likes per 1,000 followers y/y growth vs. peers, October 2024**



Source: UBS Evidence Lab (> [Access Dataset](#)), Instagram

# Appendix I – The Revived Fashion Show

VSCO’s first VS Fashion Show received positive feedbacks after a 6 year hiatus.

## Early Comments from Mgmt.

**Pleased with early results from VS Fashion Show:** Management struck a constructive tone regarding early indicators of the recently relaunched VS Fashion Show event that took place on October 15th. While it will take time for the company to fully measure ROI and the event’s halo effect, **VSCO noted it delivered 98% positive sentiment with ~21mn people livestreaming the show.** The company noted the event served as a strong top-of-funnel brand heat mechanism overall, citing strong Y/Y performance and sell-outs of product. That said, the company will carefully evaluate this alongside other marketing investments.

## Change in Trends

**We note that VSCO is putting more focus on inclusivity in their show and marketing.** VS 2024 was the first to include two transgender models to walk on the show (Valentina Sampaio and Alex Consani).

Note: Super is a part of the LGBTQ community.

## Reason for Discontinuation

**Viewership Decline:** fallen from 9.2 million viewers in 2014 to 3.2 million in 2018.

**Little Material Impact to Sales:** On November 21, 2019, L Brands CFO Stuart Burgdoerfer officially confirmed that the 2019 fashion show had been canceled, citing its declining viewership and lack of immediate "material impact" on Victoria's Secret sales post-broadcast.

**Controversies and Criticisms:** a retail analyst described as encouraging women to objectify themselves to "impress men".

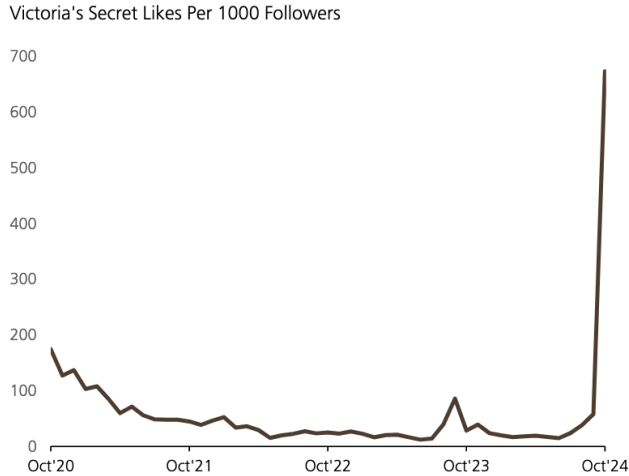
**Attempt to Revive:** in 2023, VSCO produced a documentary *The Victoria's Secret World Tour*, which streamed on Amazon Prime. (~11.5m views)

Figure 22: Victoria's Secret followers and m/m growth



Source: UBS Evidence Lab (> [Access Dataset](#)), Instagram

Figure 23: Victoria's Secret likes per 1,000 followers



Source: UBS Evidence Lab (> [Access Dataset](#)), Instagram

## Appendix II – Store Count Guidance

Forecasting flat - 2% increase in store counts.

# Store Count & Selling Sq Ft – 2024 Forecast

	Beginning of Year	New Stores	Closures	Total Reconstructions and Change in SSF	End of Year	Increase / (Decrease)	
<b>Company-Operated</b>							
<b>U.S.</b>							
Store Count	808	14 to 16	(42 to 44)	48	778 to 782	(30 to 26)	(4% to 3%)
Selling Sq Ft 000's	5,542	78 to 79	(182 to 197)	(38)	5,385 to 5,401	(157 to 141)	(3%)
<b>Canada</b>							
Store Count	23	1	-	2	24	1	4%
Selling Sq Ft 000's	212	4	-	(6)	210	(2)	(1%)
<b>Subtotal Company-Operated</b>							
Store Count	831	15 to 17	(42 to 44)	50	802 to 806	(29 to 25)	(3%)
Selling Sq Ft 000's	5,754	82 to 83	(182 to 197)	(44)	5,595 to 5,611	(159 to 143)	(3% to 2%)
<b>China Joint Venture</b>							
Beauty & Accessories Store Count	34	2	(2 to 3)	-	33 to 34	(1) to 0	(3%) to 0%
Full Assortment Store Count	36	3 to 5	(1 to 2)	-	37 to 40	1 to 4	3% to 11%
<b>Subtotal China Joint Venture Store Count</b>	<b>70</b>	<b>5 to 7</b>	<b>(3 to 5)</b>	<b>-</b>	<b>70 to 74</b>	<b>0 to 4</b>	<b>0% to 6%</b>
<b>Partner-Operated</b>							
Beauty & Accessories Store Count	307	34 to 40	(19 to 24)	-	317 to 328	10 to 21	3% to 7%
Full Assortment Store Count	156	31 to 35	(6 to 7)	-	180 to 185	24 to 29	15% to 19%
<b>Subtotal Partner-Operated Store Count</b>	<b>463</b>	<b>65 to 75</b>	<b>(25 to 31)</b>	<b>-</b>	<b>497 to 513</b>	<b>34 to 50</b>	<b>7% to 11%</b>
<b>Adore Me</b>							
Store Count	6	-	-	-	6	-	-
Selling Sq Ft 000's	23	-	-	-	23	-	-
<b>Total Store Count</b>	<b>1,370</b>	<b>85 to 99</b>	<b>(70 to 80)</b>	<b>-</b>	<b>1,375 to 1,399</b>	<b>5 to 29</b>	<b>0% to 2%</b>



## Appendix II – FY Guidance

Outlook on revenue stabilized. ~1%YOY decline excl. 1 extra selling week.

# 2024 Outlook

(As of August 28, 2024)

	Third Quarter	Full Year
Net Sales	Increase low-single digits compared to \$1.265 billion in 2023	Decrease approximately 1% compared to 2023 excluding the extra week
Adjusted Gross Margin Rate	Approximately 34.3% to 35.0%, compared to 2023 rate of 34.3%	-
Adjusted SG&A Expense Rate	Approximately 38.0% to 39.0%, leveraging compared to 2023 rate of 39.1%	-
Adjusted Operating Income (Loss)	Approximately (\$40) million to (\$60) million	Approximately \$275 million to \$300 million
Adjusted Net Non-Operating Expense	Approximately \$20 million	-
Adjusted Tax Rate (before discrete items)	Approximately 22% to 23%	-
Weighted Average Diluted Shares Outstanding <sup>1</sup>	Approximately 79 million	-
Adjusted Net Income (Loss) Per Diluted Share Attributable to VS&Co	Approximately (\$0.60) to (\$0.80)	-
Capital Expenditures	-	Approximately \$200 million
Adjusted Free Cash Flow <sup>2</sup>	-	Approximately \$200 million to \$225 million

<sup>1</sup> Weighted Average Shares Outstanding in the third quarter reflects basic shares due to the Net Loss.

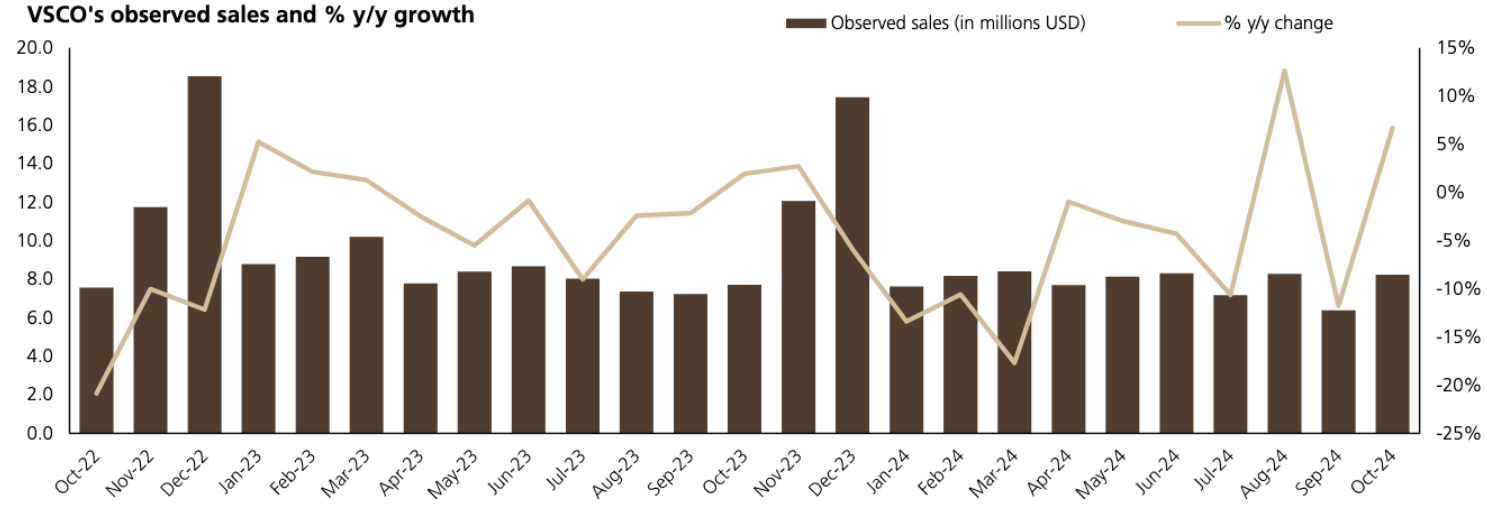
<sup>2</sup> Refer to Non-GAAP Financial Information table in the Appendix for additional information including a reconciliation to the most directly comparable GAAP financial measure.



# Appendix II – Observed Sales

Increased 12.6% in August, fell 11.8% in September, and grew 6.7% in October on a YoY basis.

**Figure 45: By month, VSCO's observed sales increased 12.6% in August, fell 11.8% in September, and grew 6.7% in October on a y/y basis**



Source: Bloomberg Finance LP

# Appendix III – ESG

Leading the pack in ESG performance, and addressing reputation concerns.

## ESG Score is well above median

Ticker	Short Name	Country	ESG Percentile	Governance Percentile	Board Comp Score	Executive Comp Score	Auditing Score
VSCO US	VICTORIA'S SE US		79.60	91.90	8.26	7.75	9.74
TJX US	TJX COS INC US		81.30	91.00	6.66	8.49	8.10
NKE US	NIKE INC -CL B US		98.10	92.80	7.13	8.76	8.16
ROST US	ROSS STORES I US		64.50	93.80	7.11	7.97	7.85
LULU US	LULULEMON / US		93.80	83.80	8.01	8.01	9.33
DECK US	DECKERS OUTI US		84.90	93.50	7.53	8.06	8.63
BURL US	BURLINGTON US		50.80	90.00	7.94	7.66	8.29
TPR US	TAPESTRY INC US		90.00	98.10	8.10	8.51	7.79
RL US	RALPH LAURE US		98.40	80.10	6.27	7.45	8.50
SKX US	SKECHERS US/ US		69.90	39.90	5.11	6.74	7.00
GAP US	GAP INC/THE US		100.00	96.60	8.05	7.39	7.04
ANF US	ABERCROMBII US		82.10	97.50	8.90	7.22	8.82
VFC US	VF CORP US		85.40	88.50	7.29	7.53	8.39
LEVI US	LEVI STRAUSS- US		88.50	84.40	7.36	7.72	9.62
CROX US	CROCS INC US		88.80	78.20	6.46	7.90	9.08
PVH US	PVH CORP US		97.00	97.20	8.41	7.28	7.78
KTB US	KONTOOR BR/ US		74.50	91.30	6.72	7.86	9.90
COLM US	COLUMBIA SP US		82.60	87.20	6.66	7.27	9.35
BOOT US	BOOT BARN H US		50.20	89.70	7.49	7.82	8.19
UAA US	UNDER ARMO US		74.10	83.50	6.74	8.17	7.60
URBN US	URBAN OUTFI US		65.90	85.70	5.73	6.57	9.65
AEO US	AMER EAGLE C US		77.30	63.60	5.05	7.14	8.13
1910 HK	SAMSONITE IN US		89.70	70.10	5.81	7.48	6.09
SHOO US	STEVEN MADC US		71.80	90.70	6.21	7.62	9.09
HBI US	HANESBRAND US		84.10	95.60	7.63	6.96	9.11
BKE US	THE BUCKLE I/ US		42.10	74.80	4.68	5.83	9.15
CPRI US	CAPRI HOLDI US		95.30	78.80	7.38	5.97	9.34
CRI US	CARTER'S INC US		83.80	95.00	6.82	7.40	8.63
WWW US	WOLVERINE V US		65.00	86.90	7.77	6.98	7.66
WINA US	WINMARK CO US		40.70	98.80	8.66	7.22	9.64
OKM US	OXFORD INDS US		31.00	79.10	5.47	8.30	9.15
GES US	GUESS? INC US		94.40	81.60	7.01	6.53	9.38
ZUMZ US	ZUMIEZ INC US		43.30	76.60	5.86	7.34	9.41
MOV US	MOVADO GRC US		94.70	69.50	4.99	7.07	9.32
JILL US	J. JILL INC US		29.90	73.20	8.55	6.61	7.18
WEYS US	WEYCO GROU US		32.90	29.60	2.98	4.88	9.47
SGC US	SUPERIOR GRI US		49.10	85.00	7.86	6.36	9.71
PLCE US	CHILDREN'S P/ US		91.40	82.20	6.67	5.00	9.93
BRLT US	BRILLIANT EAF US		42.70	75.40	7.44	4.20	9.79
CTRN US	CITI TRENDS II US		39.90	97.80	7.66	8.52	9.84
RCKY US	ROCKY BRANC US		49.10	84.70	7.38	7.79	8.74
LAKE US	LAKELAND INI US		67.80	96.30	7.54	9.08	9.78
VRA US	VERA BRADLE' US		70.90	85.40	7.26	7.81	9.04
DLTH US	DULUTH HLDK US		36.40	88.20	7.33	7.79	9.76
DXLG US	DESTINATION US		43.30	92.50	8.68	5.68	8.61
TLYS US	TILLY'S INC-CL US		46.10	83.20	7.20	8.28	9.77
PLBY US	PLBY GROUP I US		29.90	73.50	7.14	7.62	6.65
CATO US	CATO CORP-A US		31.90	51.40	5.04	5.92	9.50
CULP US	CULP INC US		37.50	94.40	8.23	8.90	9.56
FOSL US	FOSSIL GROUF US		86.60	94.10	7.54	6.43	9.01
TLF US	TANDY LEATHI US		53.70	96.00	8.39	6.83	8.84
VNCE US	VINCE HOLDI US		58.60	86.30	7.84	7.90	9.29

Source: Company Report, CapIQ, BBG

## Clearing out the past bad reputation

Controversies	Solutions
Lack of Diversity and Inclusivity	In 2021, Victoria's Secret launched the "VS Collective," replacing its "Angels" with a diverse group of women, including athletes, activists, and actors, to promote a more inclusive brand image.
Cultural Appropriation	Victoria's Secret has made efforts to avoid cultural appropriation by collaborating with cultural consultants and ensuring respectful representation in its marketing and product designs.
Corporate Misconduct Allegations	<p><b>Leadership Changes:</b> The company underwent significant leadership restructuring, appointing new executives committed to fostering a more inclusive and respectful corporate culture.</p> <p><b>Corporate Culture Overhaul:</b> The company has implemented new policies and training programs aimed at creating a safe and inclusive workplace, addressing past allegations of misconduct.</p>

## Appendix III – Revenue Mix

By Channel

	Jan 2/2/19 2018	Jan 2/1/20 2019	Jan 1/30/21 2020	Jan 1/29/22 2021	Jan 1/28/23 2022	Jan 1/27/24 2023
<b>Store Sales - North America</b>	<b>5,627.8</b>	<b>5,111.5</b>	<b>2,795.0</b>	<b>4,194.1</b>	<b>3,909.5</b>	<b>3,480.2</b>
<i>% chg. y/y</i>		-9.2%	-45.3%	50.1%	-6.8%	-11.0%
<i>2-yr stack (geometric)</i>			-50.3%	-17.9%	39.9%	-17.0%
<i>non-comp sales / mix</i>		3.3%	-26.2%	46.0%	2.4%	0.7%
<b>Direct Sales</b>	<b>1,747.0</b>	<b>1,693.0</b>	<b>2,222.6</b>	<b>2,114.3</b>	<b>1,843.0</b>	<b>2,014.9</b>
<i>% chg. y/y</i>		-3.1%	31.3%	-4.9%	-12.8%	9.3%
<i>2-yr stack (geometric)</i>			27.2%	24.9%	-17.1%	-4.7%
<i>Assumed direct comp acq / 53rd week</i>					0.0%	16.2%
<b>International Sales</b>	<b>728.0</b>	<b>704.3</b>	<b>395.1</b>	<b>476.0</b>	<b>591.8</b>	<b>686.8</b>
<i>% chg. y/y</i>		-3.3%	-43.9%	20.5%	24.3%	16.1%
<i>2-yr stack (geometric)</i>			-45.7%	-32.4%	49.8%	44.3%
<i>E-commerce penetration</i>	22%	23%	41%	31%	29%	33%
<b>Sales outside of the U.S.</b>		1,000.0	643.0	736.0	830.0	910.0
<i>% of total</i>		13%	12%	11%	13%	15%

# Appendix III – VSCO Store Summary

## Regional Stores Breakdown

	Jan 2/2/19 2018	Jan 2/1/20 2019	Jan 1/30/21 2020	Jan 1/29/22 2021	Jan 1/28/23 2022	Jan 1/27/24 2023
<b>VSCO Store Summary</b>						
US Stores	1,098	1,053	846	808	812	808
CA Stores	45	25	25	26	25	23
<b>Total NA Stores</b>	<b>1,143</b>	<b>1,078</b>	<b>871</b>	<b>834</b>	<b>837</b>	<b>831</b>
Beauty & Accessories JV Stores	38	41	36	35	39	34
Full Assortment JV Stores	15	23	26	30	33	36
<b>Total JV Stores</b>	<b>53</b>	<b>64</b>	<b>62</b>	<b>65</b>	<b>72</b>	<b>70</b>
Adore Me Stores	0	0	0	0	6	6
<b>Total Company Operated / JV Stores</b>	<b>1,196</b>	<b>1,142</b>	<b>933</b>	<b>899</b>	<b>915</b>	<b>907</b>
% chg. y/y	--	-4.5%	-18.3%	-3.6%	1.8%	-0.9%
<b>Average Company Operated / JV Stores</b>	<b>1,202</b>	<b>1,149</b>	<b>988</b>	<b>918</b>	<b>907</b>	<b>910</b>
% chg. y/y	--	-4.4%	-14.1%	-7.0%	-1.3%	0.4%
Beauty & Accessories Franchise Stores	383	360	338	335	308	307
Full Assortment Franchise Stores	56	84	120	128	135	156
<b>Total Franchise / License Stores</b>	<b>439</b>	<b>444</b>	<b>458</b>	<b>463</b>	<b>443</b>	<b>463</b>
% chg. y/y	--	1.1%	3.2%	1.1%	-4.3%	4.5%
<b>Average Franchise / License Stores</b>	<b>446</b>	<b>442</b>	<b>448</b>	<b>461</b>	<b>445</b>	<b>447</b>
% chg. y/y	--	-0.9%	1.4%	2.8%	-3.4%	0.4%
<b>Period-end Company-Operated Stores</b>	<b>1,143</b>	<b>1,078</b>	<b>871</b>	<b>834</b>	<b>837</b>	<b>831</b>
Net additions/closures	-27	-65	-207	-37	3	-6
Avg Stores	1,159	1,090	924	855	834	833
% chg. y/y	--	-6.0%	-15.2%	-7.5%	-2.5%	-0.1%
<b>Period-end Company-Operated Sq Ft</b>	<b>7,521</b>	<b>7,239</b>	<b>6,111</b>	<b>5,862</b>	<b>5,863</b>	<b>5,754</b>
Avg Sq Ft	7,589	7,335	6,395	5,977	5,852	5,811
% chg. y/y	--	-3.4%	-12.8%	-6.5%	-2.1%	-0.7%
<b>Period-end Company-Operated Sq Ft / Store (000s)</b>	<b>6,580</b>	<b>6,715</b>	<b>7,016</b>	<b>7,029</b>	<b>7,005</b>	<b>6,924</b>
Avg Sq Ft / Store (000s)	6,548	6,729	6,933	6,989	7,019	6,974
% chg. y/y	--	2.8%	3.0%	0.8%	0.4%	-0.6%

# Appendix III – China JV, Adore Me and Franchise Stores

## Regional Stores Breakdown

	Jan 2/2/19 2018	Jan 2/1/20 2019	Jan 1/30/21 2020	Jan 1/29/22 2021	Jan 1/28/23 2022	Jan 1/27/24 2023
<b>Beauty &amp; Accessories (China JV)</b>						
Period-beginning stores	--	38	41	36	35	39
Net additions/closures	--	3	-5	-1	4	-5
Period-end VSCO B&A Stores	38	41	36	35	39	34
<b>Average VSCO B&amp;A Stores</b>	<b>31</b>	<b>40</b>	<b>38</b>	<b>36</b>	<b>40</b>	<b>36</b>
% chg. y/y	--	28.0%	-4.4%	-6.5%	11.9%	-9.4%
Total VSCO B&A Sq Ft	0.036	0.036	0.031	0.030	0.033	0.029
Average VSCO B&A Sq Ft / Store	0.95	0.878	0.861	0.857	0.857	0.857
<b>Full Assortment (China JV)</b>						
Period-beginning stores	--	15	23	26	30	33
Net additions/closures	--	8	3	4	3	3
Period-end VSCO FA Stores	15	23	26	30	33	36
<b>Average VSCO FA Stores</b>	<b>12</b>	<b>19</b>	<b>25</b>	<b>27</b>	<b>31</b>	<b>34</b>
% chg. y/y	--	67.4%	29.9%	9.0%	14.7%	9.6%
Total VS FA Sq Ft	0.165	0.186	0.171	0.181	0.199	0.217
Average VS FA Sq Ft / Store	11.00	8.087	6.577	6.033	6.033	6.033
<b>Adore Me Store Build</b>						
Period-beginning stores						6
Net additions/closures					6	0
Period-end Adore Me Stores					6	6
<b>Average Adore Me Stores</b>					--	<b>6</b>
% chg. y/y					--	--
Total Adore Me Selling Sq Ft (mn)					0.023	0.023
Adore Me Sq Ft / Store (000s)					3.833	3.833
<b>Franchise Stores (Partner-Operated)</b>						
VS Beauty & Accessories	383	360	338	335	308	307
Net additions/closures	--	-23	-22	-3	-27	-1
Avg Stores	397	372	345	337	312	302
% chg Y/Y	--	-6.2%	-7.4%	-2.4%	-7.2%	-3.2%
VS Full Assortment	56	84	120	128	135	156
Net additions/closures	--	28	36	8	7	21
Avg Stores	49	69	103	124	133	145
% chg Y/Y	--	42.8%	48.7%	20.4%	7.1%	9.0%
<b>Period-end Franchise Stores</b>	<b>439</b>	<b>444</b>	<b>458</b>	<b>463</b>	<b>443</b>	<b>463</b>
Net additions/closures	439	5	14	5	-20	20
Avg Stores	446	442	448	461	445	447
% chg Y/Y	--	-0.9%	1.4%	2.8%	-3.4%	0.4%

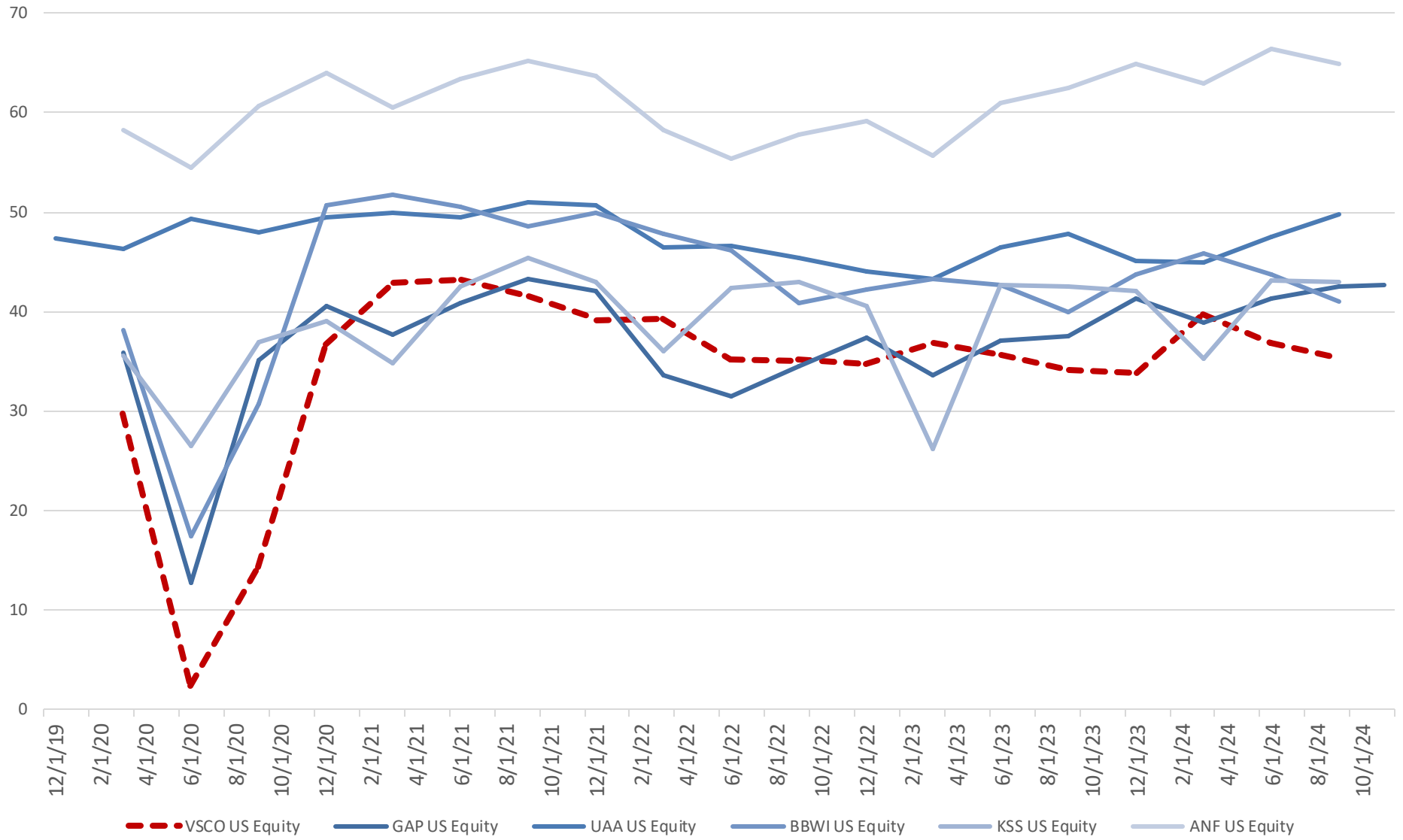
# Appendix III – Store Forecast

## Base Case

	Jan 2019/2/2 2018	Jan 2020/2/1 2019	Jan 2021/1/30 2020	Jan 2022/1/29 2021	Jan 2023/1/28 2022	Jan 2024/1/27 2023	Jan 2025/1/25 2024E	Jan 2026/1/24 2025E	Jan 2027/1/23 2026E	Jan 2028/1/22 2027E	Jan 2029/1/20 2028E	Jan 2030/1/19 2029E
<b>VSCO Store Summary</b>												
US Stores	1,098	1,053	846	808	812	808	780	752	724	724	724	724
CA Stores	45	25	25	26	25	23	24	24	24	24	24	24
<b>Total NA Stores</b>	<b>1,143</b>	<b>1,078</b>	<b>871</b>	<b>834</b>	<b>837</b>	<b>831</b>	<b>804</b>	<b>776</b>	<b>748</b>	<b>748</b>	<b>748</b>	<b>748</b>
Beauty & Accessories JV Stores	38	41	36	35	39	34	34	35	36	36	36	36
Full Assortment JV Stores	15	23	26	30	33	36	38	38	38	38	38	38
<b>Total JV Stores</b>	<b>53</b>	<b>64</b>	<b>62</b>	<b>65</b>	<b>72</b>	<b>70</b>	<b>72</b>	<b>73</b>	<b>74</b>	<b>74</b>	<b>74</b>	<b>74</b>
Adore Me Stores	0	0	0	0	6	6	6	6	6	6	6	6
<b>Total Company Operated / JV Stores</b>	<b>1,196</b>	<b>1,142</b>	<b>933</b>	<b>899</b>	<b>915</b>	<b>907</b>	<b>882</b>	<b>855</b>	<b>828</b>	<b>828</b>	<b>828</b>	<b>828</b>
% chg. y/y	--	-4.5%	-18.3%	-3.6%	1.8%	-0.9%	-2.8%	-3.1%	-3.2%	-2.9%	-1.5%	-1.5%
<b>Average Company Operated / JV Stores</b>	<b>1,202</b>	<b>1,149</b>	<b>988</b>	<b>918</b>	<b>907</b>	<b>910</b>	<b>893</b>	<b>868</b>	<b>841</b>	<b>828</b>	<b>828</b>	<b>828</b>
% chg. y/y	--	-4.4%	-14.1%	-7.0%	-1.3%	0.4%	-1.8%	-2.9%	-3.1%	-1.5%	0.0%	0.0%
Beauty & Accessories Franchise Stores	383	360	338	335	308	307	323	336	343	343	343	343
Full Assortment Franchise Stores	56	84	120	128	135	156	183	210	237	244	251	258
<b>Total Franchise / License Stores</b>	<b>439</b>	<b>444</b>	<b>458</b>	<b>463</b>	<b>443</b>	<b>463</b>	<b>506</b>	<b>546</b>	<b>580</b>	<b>587</b>	<b>594</b>	<b>601</b>
% chg. y/y	--	1.1%	3.2%	1.1%	-4.3%	4.5%	9.3%	7.9%	6.2%	1.2%	1.2%	1.2%
<b>Average Franchise / License Stores</b>	<b>446</b>	<b>442</b>	<b>448</b>	<b>461</b>	<b>445</b>	<b>447</b>	<b>488</b>	<b>528</b>	<b>566</b>	<b>584</b>	<b>591</b>	<b>598</b>
% chg. y/y	--	-0.9%	1.4%	2.8%	-3.4%	0.4%	9.1%	8.2%	7.2%	3.1%	1.2%	1.2%
<b>Period-end Company-Operated Stores</b>	<b>1,143</b>	<b>1,078</b>	<b>871</b>	<b>834</b>	<b>837</b>	<b>831</b>	<b>804</b>	<b>776</b>	<b>748</b>	<b>748</b>	<b>748</b>	<b>748</b>
Net additions/closures	-27	-65	-207	-37	3	-6	-27	-28	-28	0	0	0
Avg Stores	1,159	1,090	924	855	834	833	816	789	761	748	748	748
% chg. y/y	--	-6.0%	-15.2%	-7.5%	-2.5%	-0.1%	-2.0%	-3.4%	-3.5%	-1.7%	0.0%	0.0%
<b>Period-end Company-Operated Sq Ft</b>	<b>7,521</b>	<b>7,239</b>	<b>6,111</b>	<b>5,862</b>	<b>5,863</b>	<b>5,754</b>	<b>4,491</b>	<b>4,312</b>	<b>4,134</b>	<b>4,129</b>	<b>4,123</b>	<b>4,117</b>
Avg Sq Ft	7,589	7,335	6,395	5,977	5,852	5,811	5,135	4,391	4,213	4,131	4,126	4,120
% chg. y/y	--	-3.4%	-12.8%	-6.5%	-2.1%	-0.7%	-11.6%	-14.5%	-4.1%	-1.9%	-0.1%	-0.1%
<b>Period-end Company-Operated Sq Ft / Store (000s)</b>	<b>6,580</b>	<b>6,715</b>	<b>7,016</b>	<b>7,029</b>	<b>7,005</b>	<b>6,924</b>	<b>5,586</b>	<b>5,556</b>	<b>5,527</b>	<b>5,519</b>	<b>5,512</b>	<b>5,504</b>
Avg Sq Ft / Store (000s)	6,548	6,729	6,933	6,989	7,019	6,974	6,286	5,567	5,538	5,523	5,516	5,508
% chg. y/y	--	2.8%	3.0%	0.8%	0.4%	-0.6%	-9.9%	-11.4%	-0.5%	-0.3%	-0.1%	-0.1%

# Appendix IV – Compared to Peers

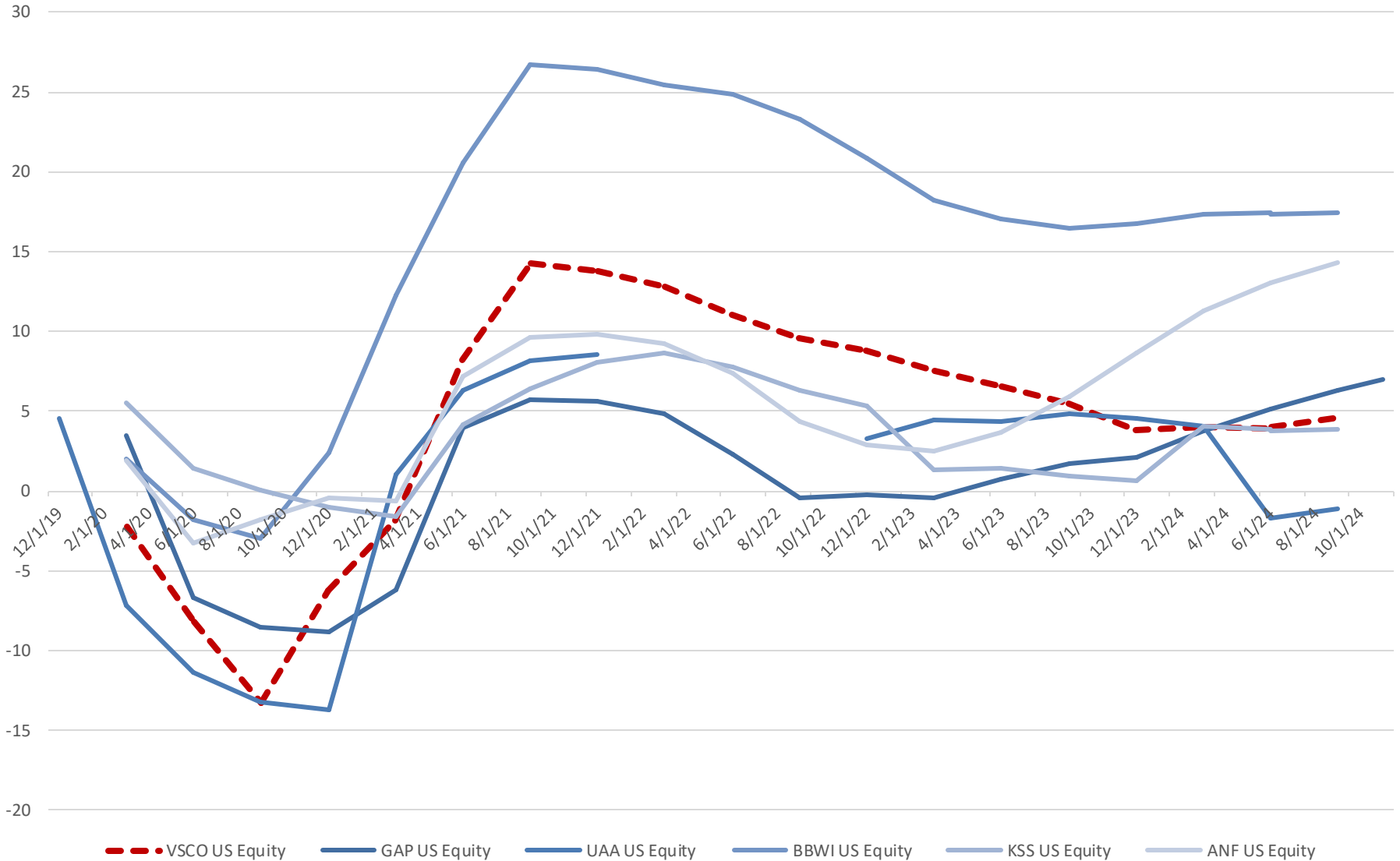
Gross Margin for the past 5Y.





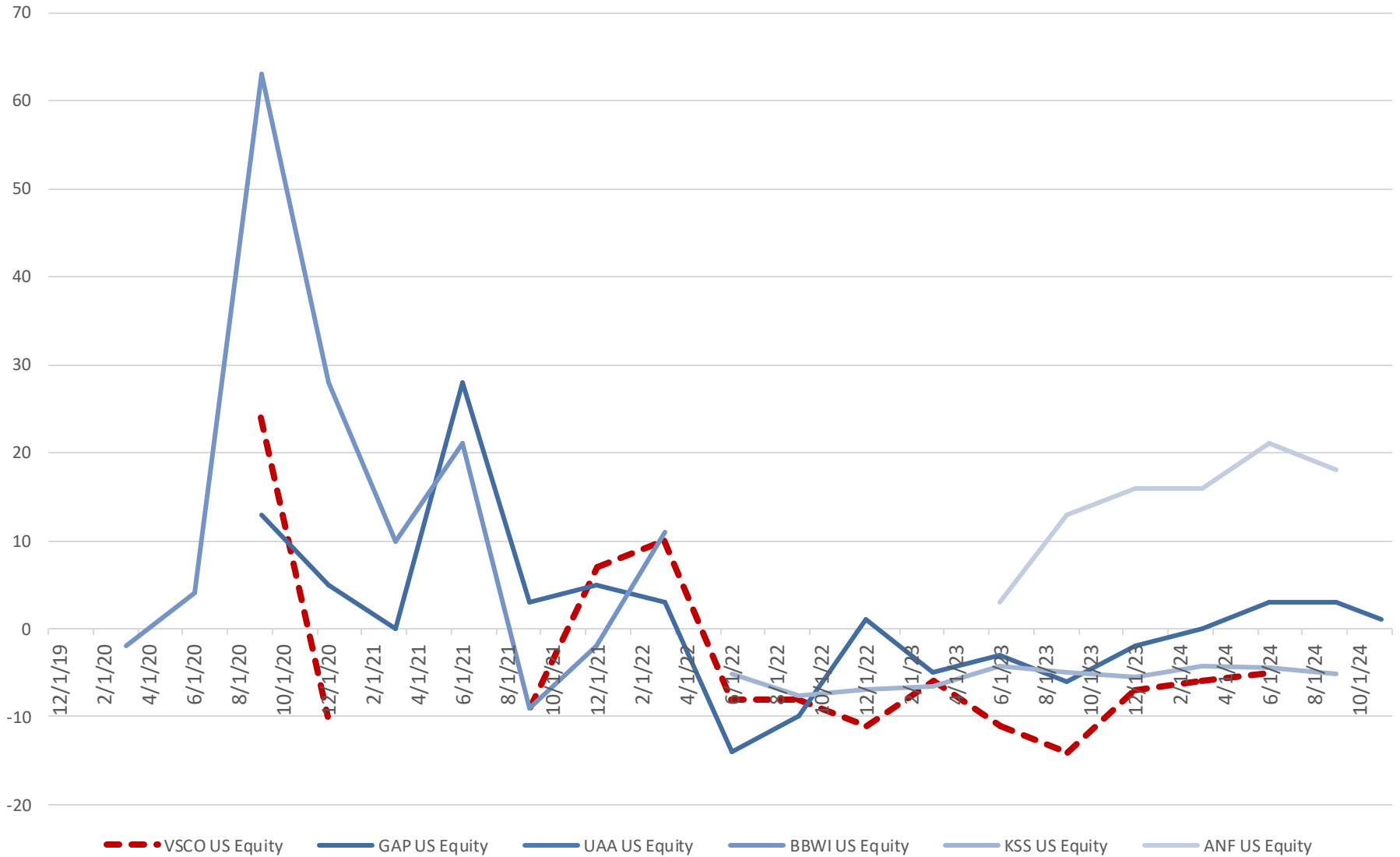
# Appendix IV – Compared to Peers

EBIT Margin for the past 5Y.



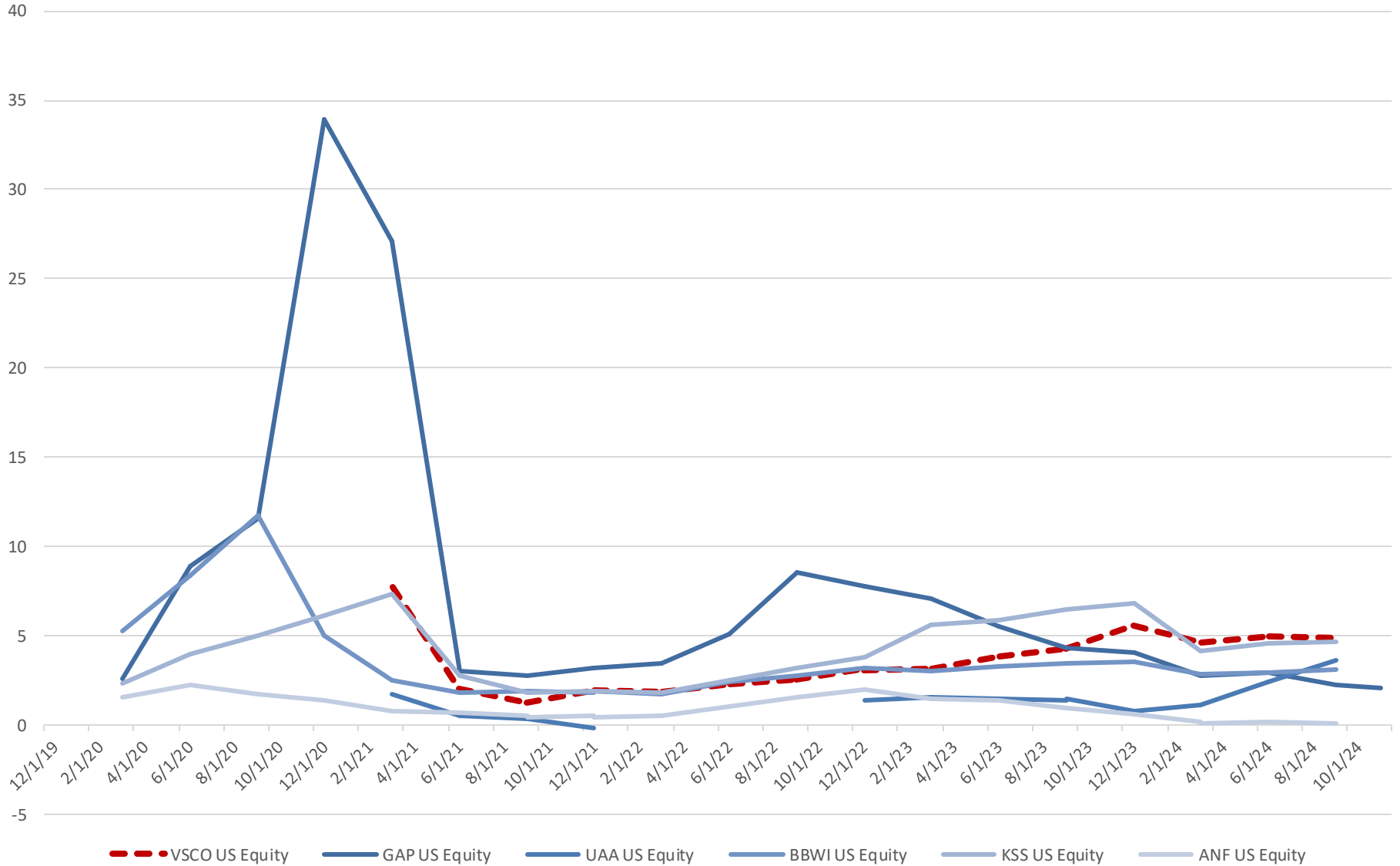
# Appendix IV – Compared to Peers

Same Store Sales for the past 5Y.



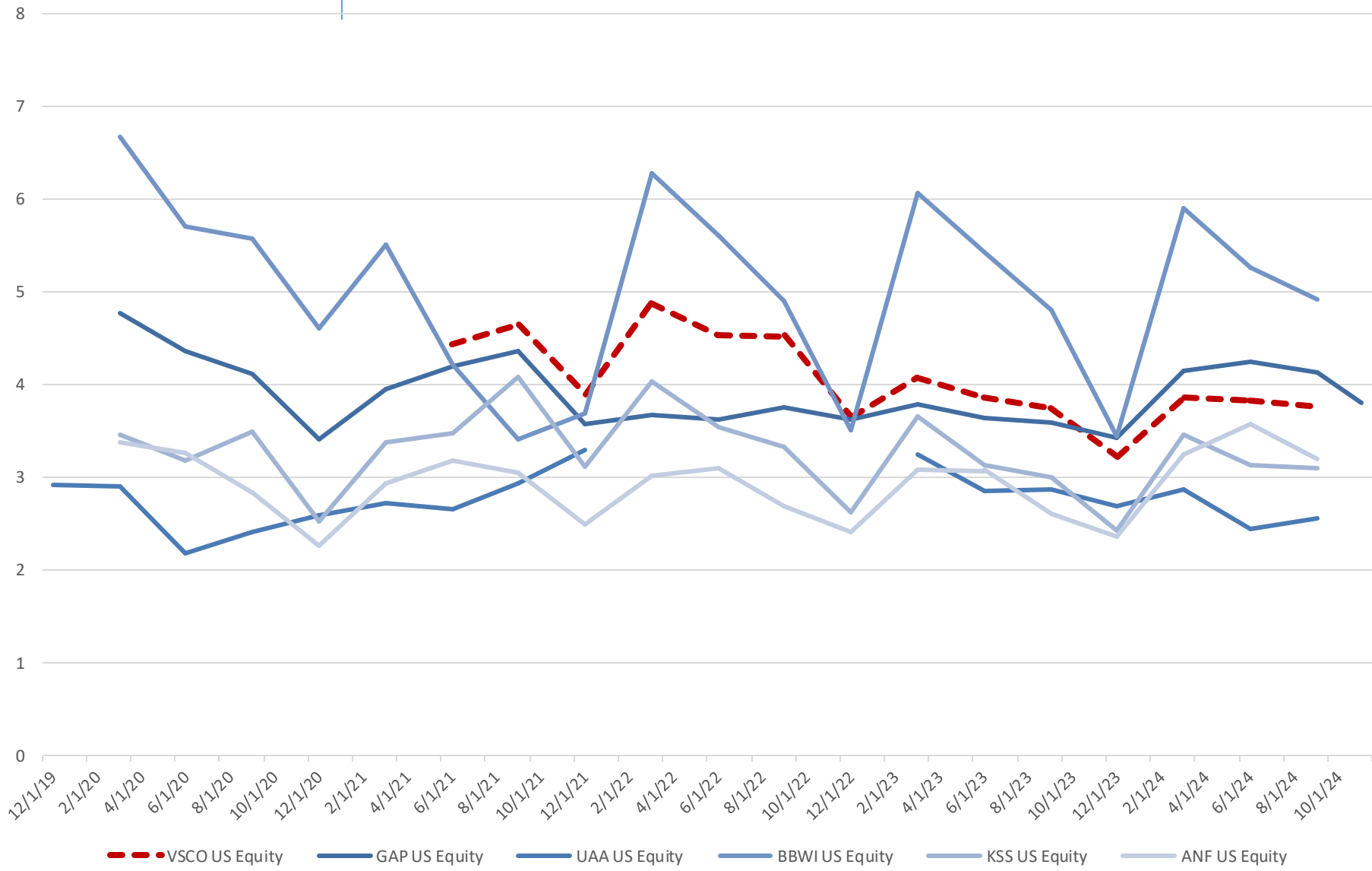
# Appendix IV – Compared to Peers

Net Debt / EBITDA for the past 5Y.



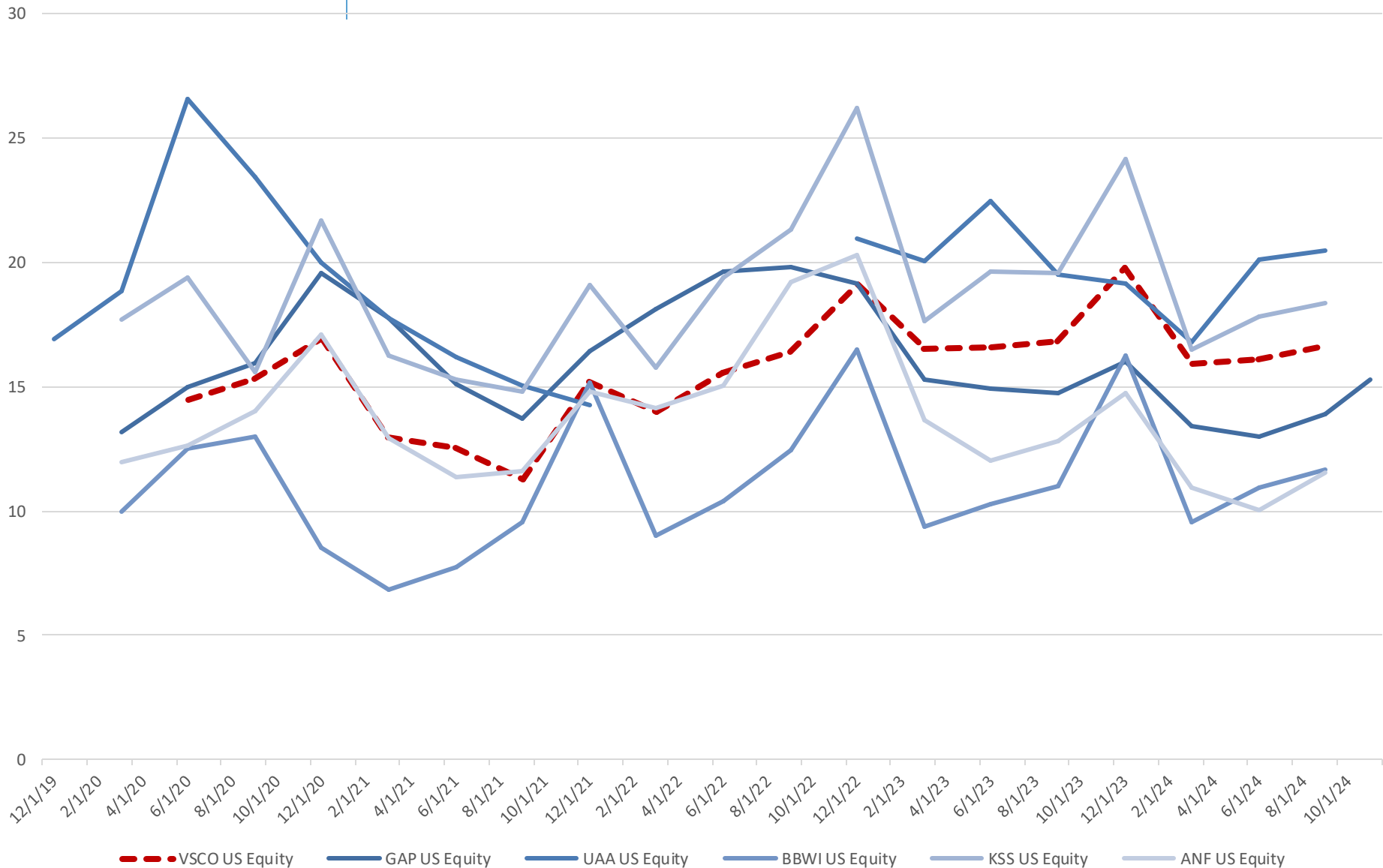
# Appendix IV – Compared to Peers

## Inventory Turnover for the past 5Y.



# Appendix IV – Compared to Peers

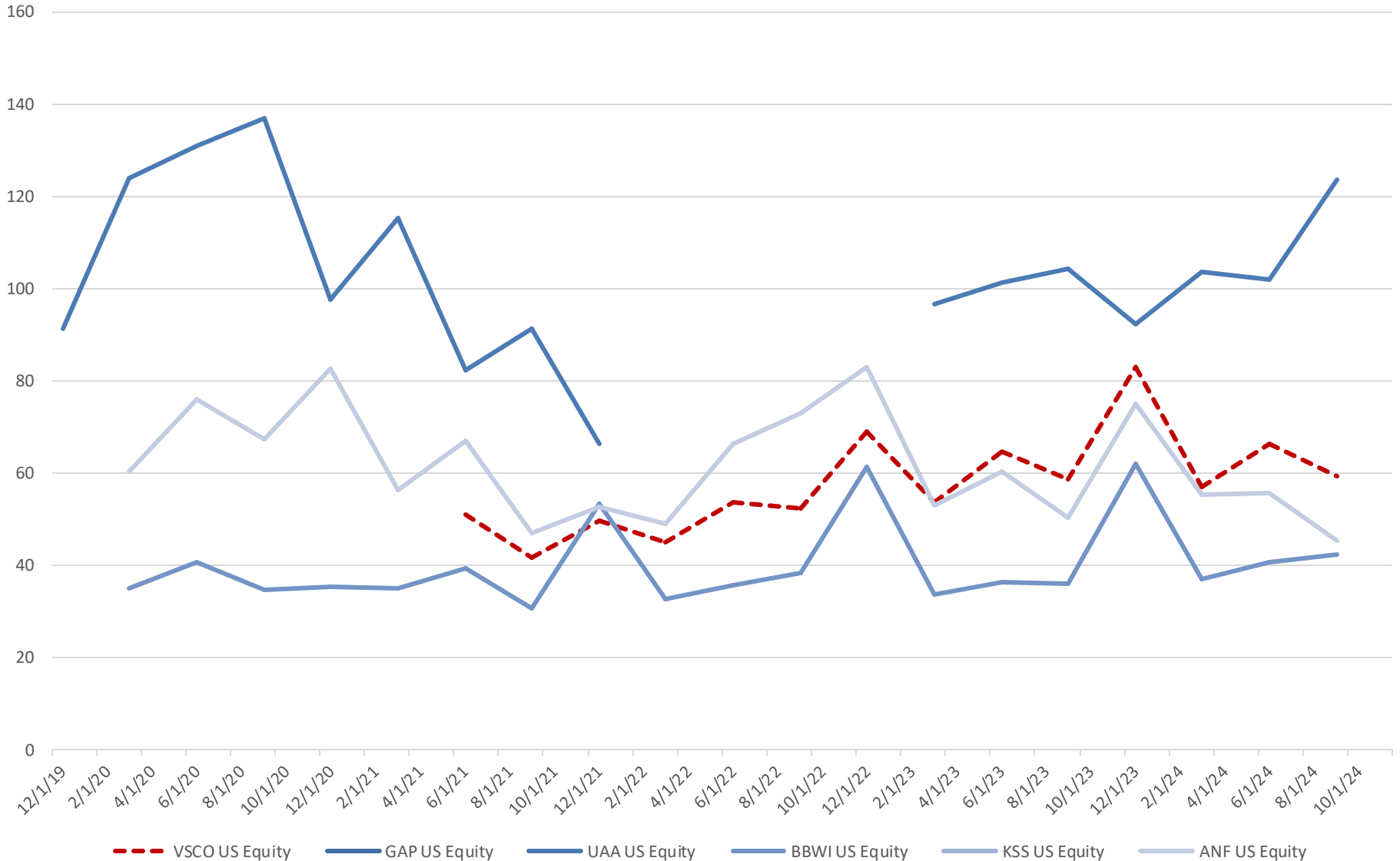
Inventory / Sales for the past 5Y.



Source: Company Report, CapIQ, BBG

# Appendix IV – Compared to Peers

Cash Conversion Cycle for the past 5Y.



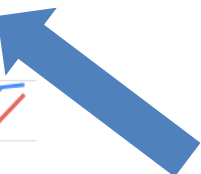
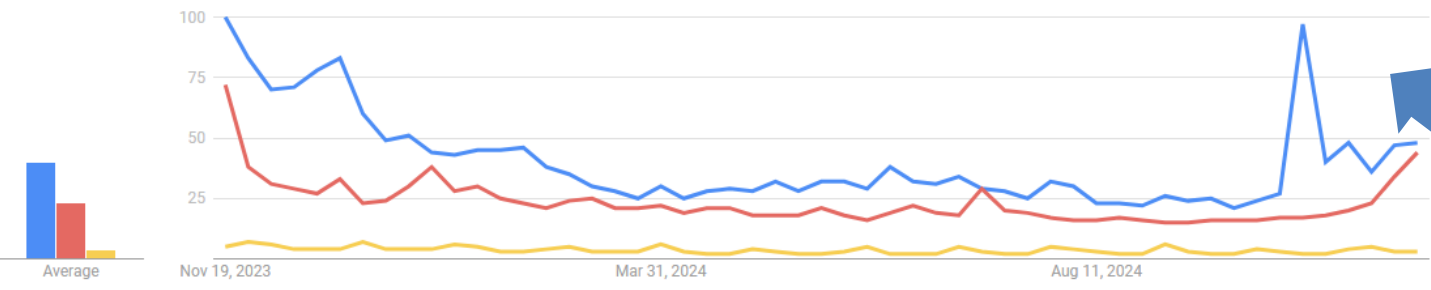
# Appendix IV – Compared to Peers

Google Search Comparison with Savage X Fenty (Red), and SKIMS (Yellow)  
 For the past 12 months.

## US

Interest over time ?

Download Compare Share

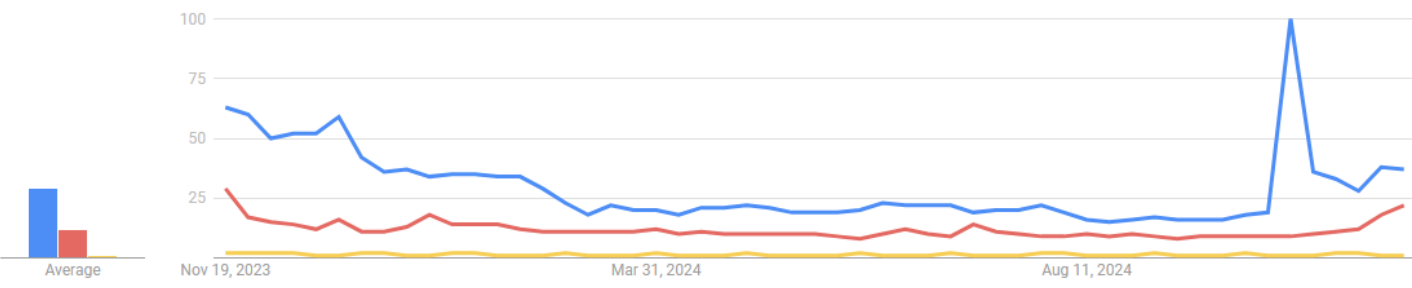


VS Fashion Show

## Worldwide

Interest over time ?

Download Compare Share



# Appendix VI – Base Case

## Base Case Results

### Victoria's Secret & Co.

#### Summary Model

\$ millions except per share data, FY ending Jan

Victoria's Secret & Co.	Jan 2018	Jan 2019	Jan 2020	Jan 2021	Jan 2022	Jan 2023	Jan 2024E	Jan 2025E	Jan 2026E	Jan 2027E	Jan 2028E	Jan 2029E
<b>Income Statement</b>												
Retail revenue	7,916	7,315	5,278	6,653	6,221	6,087	5,962	6,003	6,125	6,312	6,538	6,752
Credit card revenue	187	194	135	132	123	95	81	81	83	85	88	91
<b>Net Sales</b>	<b>8,103</b>	<b>7,509</b>	<b>5,413</b>	<b>6,785</b>	<b>6,344</b>	<b>6,182</b>	<b>6,043</b>	<b>6,084</b>	<b>6,208</b>	<b>6,397</b>	<b>6,626</b>	<b>6,843</b>
% chg Y/Y		-7%	-28%	25%	-6%	-3%	-2%	1%	2%	3%	0%	0%
<b>Gross Profit</b>	<b>2,770.0</b>	<b>2,315.6</b>	<b>1,748.4</b>	<b>2,760.0</b>	<b>2,309.2</b>	<b>2,274.4</b>	<b>2,231.2</b>	<b>2,267.4</b>	<b>2,329.0</b>	<b>2,416.0</b>	<b>2,502.5</b>	<b>2,584.5</b>
% margin	34%	31%	32.3%	40.7%	36.4%	36.8%	36.9%	37.3%	37.5%	37.8%	37.8%	37.8%
margin chg. Y/Y bps		-335bp	146bp	838bp	-428bp	39bp	13bp	35bp	25bp	25bp	0bp	0bp
<b>Total SG&amp;A</b>	<b>-2,289.0</b>	<b>-2,234.9</b>	<b>-1,650.9</b>	<b>-1,890.5</b>	<b>-1,743.5</b>	<b>-1,947.5</b>	<b>-1,943.6</b>	<b>-1,957.2</b>	<b>-1,991.1</b>	<b>-2,045.4</b>	<b>-2,112.0</b>	<b>-2,174.3</b>
% chg Y/Y	0.0%	-2.4%	-26.1%	14.5%	-7.8%	11.7%	-0.2%	0.7%	1.7%	2.7%	3.3%	3.0%
% of sales	28.2%	29.8%	30.5%	27.9%	27.5%	31.5%	32.2%	32.2%	32.1%	32.0%	31.9%	31.8%
<b>EBIT</b>	<b>481.0</b>	<b>80.7</b>	<b>97.5</b>	<b>869.5</b>	<b>565.7</b>	<b>326.9</b>	<b>287.6</b>	<b>310.3</b>	<b>337.9</b>	<b>370.6</b>	<b>390.5</b>	<b>410.2</b>
% chg Y/Y		-83.2%	20.9%	791.8%	-34.9%	-42.2%	-12.0%	7.9%	8.9%	9.7%	5.4%	5.0%
% margin	5.9%	1.1%	1.8%	12.8%	8.9%	5.3%	4.8%	5.1%	5.4%	5.8%	5.9%	6.0%
margin chg. Y/Y bps		-486bp	73bp	1101bp	-390bp	-363bp	-53bp	34bp	34bp	35bp	10bp	10bp
Net Interest	-2	-8	-6	-27	-60	-95	-81	-73	-70	-70	-70	-70
Other	-7	1	1	1	0	1	1	0	0	0	0	0
<b>Pre-Tax Income</b>	<b>472.0</b>	<b>73.2</b>	<b>93.0</b>	<b>843.1</b>	<b>504.9</b>	<b>233.1</b>	<b>207.9</b>	<b>237.3</b>	<b>267.7</b>	<b>300.4</b>	<b>320.3</b>	<b>339.9</b>
Income Taxes	-153	-24	-50	-197	-99	-48	-54	-55	-62	-69	-74	-78
Tax Rate	32.4%	32.8%	53.7%	23.3%	19.6%	20.8%	25.8%	23.0%	23.0%	23.0%	23.0%	23.0%
Non-controlling interest	0	0	0	0	-10	7	2	1	1	1	1	1
<b>Net Income</b>	<b>319.0</b>	<b>49.2</b>	<b>43.0</b>	<b>646.4</b>	<b>416.4</b>	<b>178.1</b>	<b>152.0</b>	<b>181.4</b>	<b>204.8</b>	<b>229.9</b>	<b>245.2</b>	<b>260.3</b>
Diluted Average Shares	88	88	88	90	84	79	78	70	58	49	36	25
<b>EPS - Comparable</b>	<b>\$3.61</b>	<b>\$0.56</b>	<b>\$0.49</b>	<b>\$7.18</b>	<b>\$4.95</b>	<b>\$2.27</b>	<b>\$1.95</b>	<b>\$2.59</b>	<b>\$3.51</b>	<b>\$4.72</b>	<b>\$6.83</b>	<b>\$10.30</b>
% chg Y/Y	0.0%	0.0%		1373.2%	-31.0%	-54.2%	-14.1%	33.3%	35.3%	34.4%	44.7%	50.9%
<b>GAAP EPS</b>	<b>\$2.84</b>	<b>-\$10.17</b>	<b>-\$0.82</b>	<b>\$7.18</b>	<b>\$4.14</b>	<b>\$1.39</b>	<b>\$1.79</b>	<b>\$2.59</b>	<b>\$3.51</b>	<b>\$4.72</b>	<b>\$6.83</b>	<b>\$10.30</b>
<b>Select Other Items</b>												
VS Comparable sales	-2.0%	-8.0%	1.0%	3.0%	-8.0%	-9.0%	-1.6%	1.1%	2.8%	2.8%	2.8%	2.8%
Period-end Total Stores	1,222	1,168	933	899	915	901	876	849	822	822	822	822
Period-end Owned Square Feet (000)	7,953	7,692	6,313	6,073	6,096	6,000	5,872	5,649	5,428	5,421	5,414	5,406
Period-end Franchise Stores	439	444	458	463	443	463	506	546	580	587	594	601
Cash From Operations	698	315	674	851	437	389	398	463	482	540	560	590
Capex	-341	-225	-127	-169	-164	-256	-200	-202	-204	-206	-208	-210
Buybacks (\$mn)	0	0	0	-250	-250	-125	-100	-250	-250	-100	-500	0
Free Cash Flow	778	778	547	682	273	133	199	261	278	334	352	380
Adjusted ROIC: PVOL method	na	7.3%	4.5%	23.9%	17.3%	12.2%	10.7%	11.1%	11.5%	12.3%	12.7%	13.1%
Cash and Equivalents	369	245	335	490	427	270	387	299	328	418	271	652
Net Debt (Cash)	na	-92	-238	492	849	854	936	1,025	997	763	911	531
Net Debt to EBITDA	na	-0.2x	-0.6x	0.4x	1.0x	1.4x	1.7x	1.9x	1.8x	1.2x	1.4x	0.8x
Adj. Net Debt to EBITDAR: PVOL	na	4.4x	3.7x	2.6x	3.5x	4.4x	4.7x	4.7x	4.5x	4.1x	4.1x	3.6x
Inventory Turnover	na	6.1x	4.3x	4.7x	3.8x	3.7x	3.7x	3.7x	3.7x	3.7x	3.8x	3.9x
Inventory Growth	na	na	-18.0%	35.3%	10.9%	-6.4%	1.4%	0.1%	1.6%	2.8%	2.4%	-9.4%



# Appendix VI – Realistic Bear Case

## Realistic Bear Case Results

### Victoria's Secret & Co.

#### Summary Model

\$ millions except per share data, FY ending Jan

Victoria's Secret & Co.	Jan 2018	Jan 2019	Jan 2020	Jan 2021	Jan 2022	Jan 2023	Jan 2024E	Jan 2025E	Jan 2026E	Jan 2027E	Jan 2028E	Jan 2029E
<b>Income Statement</b>												
Retail revenue	7,916	7,315	5,278	6,653	6,221	6,087	5,656	5,303	5,388	5,518	5,672	5,811
Credit card revenue	187	194	135	132	123	95	81	76	77	79	81	83
<b>Net Sales</b>	<b>8,103</b>	<b>7,509</b>	<b>5,413</b>	<b>6,785</b>	<b>6,344</b>	<b>6,182</b>	<b>5,737</b>	<b>5,379</b>	<b>5,465</b>	<b>5,597</b>	<b>5,753</b>	<b>5,894</b>
% chg Y/Y		-7%	-28%	25%	-6%	-3%	-7%	-6%	2%	2%	0%	0%
<b>Gross Profit</b>	<b>2,770.0</b>	<b>2,315.6</b>	<b>1,748.4</b>	<b>2,760.0</b>	<b>2,309.2</b>	<b>2,274.4</b>	<b>2,111.2</b>	<b>1,999.2</b>	<b>2,047.5</b>	<b>2,113.7</b>	<b>2,172.7</b>	<b>2,226.0</b>
% margin	34%	31%	32.3%	40.7%	36.4%	36.8%	36.8%	37.2%	37.5%	37.8%	37.8%	37.8%
margin chg. Y/Y bps		-335bp	146bp	838bp	-428bp	39bp	1bp	37bp	30bp	30bp	0bp	0bp
<b>Total SG&amp;A</b>	<b>-2,289.0</b>	<b>-2,234.9</b>	<b>-1,650.9</b>	<b>-1,890.5</b>	<b>-1,743.5</b>	<b>-1,947.5</b>	<b>-1,856.2</b>	<b>-1,746.8</b>	<b>-1,780.4</b>	<b>-1,828.9</b>	<b>-1,880.0</b>	<b>-1,926.1</b>
% chg Y/Y	0.0%	-2.4%	-26.1%	14.5%	-7.8%	11.7%	-4.7%	-5.9%	1.9%	2.7%	2.8%	2.5%
% of sales	28.2%	29.8%	30.5%	27.9%	27.5%	31.5%	32.4%	32.5%	32.6%	32.7%	32.7%	32.7%
<b>EBIT</b>	<b>481.0</b>	<b>80.7</b>	<b>97.5</b>	<b>869.5</b>	<b>565.7</b>	<b>326.9</b>	<b>255.0</b>	<b>252.4</b>	<b>267.1</b>	<b>284.8</b>	<b>292.7</b>	<b>299.9</b>
% chg Y/Y		-83.2%	20.9%	791.8%	-34.9%	-42.2%	-22.0%	-1.0%	5.8%	6.6%	2.8%	2.5%
% margin	5.9%	1.1%	1.8%	12.8%	8.9%	5.3%	4.4%	4.7%	4.9%	5.1%	5.1%	5.1%
margin chg. Y/Y bps		-486bp	73bp	1101bp	-390bp	-363bp	-84bp	25bp	20bp	20bp	0bp	0bp
Net Interest	-2	-8	-6	-27	-60	-95	-81	-73	-70	-70	-70	-70
Other	-7	1	1	1	0	1	1	0	0	0	0	0
<b>Pre-Tax Income</b>	<b>472.0</b>	<b>73.2</b>	<b>93.0</b>	<b>843.1</b>	<b>504.9</b>	<b>233.1</b>	<b>175.3</b>	<b>179.5</b>	<b>196.9</b>	<b>214.5</b>	<b>222.5</b>	<b>229.7</b>
Income Taxes	-153	-24	-50	-197	-99	-48	-46	-41	-45	-49	-51	-53
Tax Rate	32.4%	32.8%	53.7%	23.3%	19.6%	20.8%	26.3%	23.0%	23.0%	23.0%	23.0%	23.0%
Non-controlling interest	0	0	0	0	-10	7	2	1	1	1	1	1
<b>Net Income</b>	<b>319.0</b>	<b>49.2</b>	<b>43.0</b>	<b>646.4</b>	<b>416.4</b>	<b>178.1</b>	<b>126.9</b>	<b>136.8</b>	<b>150.2</b>	<b>163.8</b>	<b>169.9</b>	<b>175.4</b>
Diluted Average Shares	88	88	88	90	84	79	78	70	61	55	45	36
<b>EPS - Comparable</b>	<b>\$3.61</b>	<b>\$0.56</b>	<b>\$0.49</b>	<b>\$7.18</b>	<b>\$4.95</b>	<b>\$2.27</b>	<b>\$1.63</b>	<b>\$1.96</b>	<b>\$2.47</b>	<b>\$2.98</b>	<b>\$3.79</b>	<b>\$4.83</b>
% chg Y/Y	0.0%	0.0%		1373.2%	-31.0%	-54.2%	-28.3%	20.4%	26.0%	20.8%	27.2%	27.4%
<b>GAAP EPS</b>	<b>\$2.84</b>	<b>-\$10.17</b>	<b>-\$0.82</b>	<b>\$7.18</b>	<b>\$4.14</b>	<b>\$1.39</b>	<b>\$1.47</b>	<b>\$1.96</b>	<b>\$2.47</b>	<b>\$2.98</b>	<b>\$3.79</b>	<b>\$4.83</b>
<b>Select Other Items</b>												
VS Comparable sales	-2.0%	-8.0%	1.0%	3.0%	-8.0%	-9.0%	-1.8%	0.8%	2.4%	2.5%	2.5%	2.5%
Period-end Total Stores	1,222	1,168	933	899	915	901	876	849	822	822	822	822
Period-end Owned Square Feet (000)	7,953	7,692	6,313	6,073	6,096	6,000	4,749	4,571	4,394	4,389	4,383	4,377
Period-end Franchise Stores	439	444	458	463	443	463	506	546	580	587	594	601
Cash From Operations	698	315	674	851	437	389	362	401	421	465	475	494
Capex	-341	-225	-127	-169	-164	-256	-200	-202	-204	-206	-208	-210
Buybacks (\$mn)	0	0	0	-250	-250	-125	-100	-250	-120	-75	-400	0
Free Cash Flow	778	778	547	682	273	133	162	199	217	259	267	284
Adjusted ROIC: PVOL method	na	7.3%	4.5%	23.9%	17.3%	12.2%	9.9%	9.9%	10.5%	11.1%	11.4%	11.6%
Cash and Equivalents	369	245	335	490	427	270	350	200	298	338	206	491
Net Debt (Cash)	na	-92	-238	492	849	854	973	1,124	1,027	843	976	692
Net Debt to EBITDA	na	-0.2x	-0.6x	0.4x	1.0x	1.4x	1.9x	2.3x	2.1x	1.6x	1.8x	1.2x
Adj. Net Debt to EBITDAR: PVOL	na	4.4x	3.7x	2.6x	3.5x	4.4x	4.8x	4.8x	4.6x	4.2x	4.3x	3.9x
Inventory Turnover	na	6.1x	4.3x	4.7x	3.8x	3.7x	3.6x	3.6x	3.7x	3.7x	3.8x	3.9x
Inventory Growth	na	na	-18.0%	35.3%	10.9%	-6.4%	-3.5%	-6.8%	1.1%	1.7%	0.6%	-11.5%

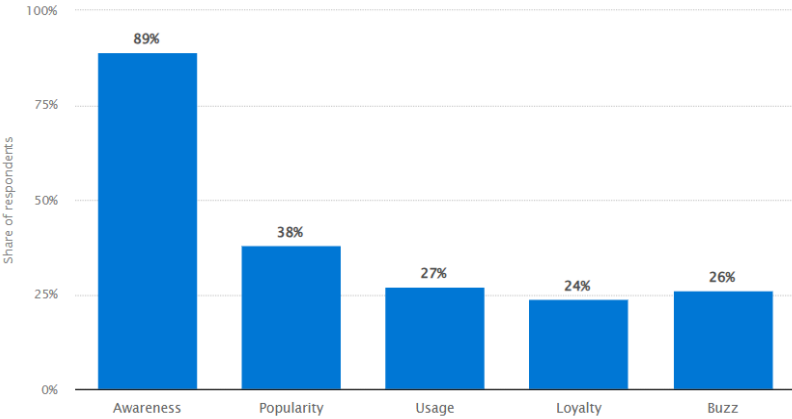
# Appendix VI – Stress Test Case

## Stress Test Case Results

Victoria's Secret & Co.												
Summary Model												
\$ millions except per share data, FY ending Jan												
Victoria's Secret & Co.	Jan 2018	Jan 2019	Jan 2020	Jan 2021	Jan 2022	Jan 2023	Jan 2024E	Jan 2025E	Jan 2026E	Jan 2027E	Jan 2028E	Jan 2029E
<b>Income Statement</b>												
Retail revenue	7,916	7,315	5,278	6,653	6,221	6,087	5,434	4,766	4,765	4,783	4,830	4,860
Credit card revenue	187	194	135	132	123	95	81	72	72	72	73	73
<b>Net Sales</b>	<b>8,103</b>	<b>7,509</b>	<b>5,413</b>	<b>6,785</b>	<b>6,344</b>	<b>6,182</b>	<b>5,515</b>	<b>4,837</b>	<b>4,836</b>	<b>4,854</b>	<b>4,902</b>	<b>4,933</b>
% chg Y/Y		-7%	-28%	25%	-6%	-3%	-11%	-12%	0%	0%	0%	0%
<b>Gross Profit</b>	<b>2,770.0</b>	<b>2,315.6</b>	<b>1,748.4</b>	<b>2,760.0</b>	<b>2,309.2</b>	<b>2,274.4</b>	<b>2,023.7</b>	<b>1,788.0</b>	<b>1,789.9</b>	<b>1,798.9</b>	<b>1,792.2</b>	<b>1,793.5</b>
% margin	34%	31%	32.3%	40.7%	36.4%	36.8%	36.7%	37.0%	37.0%	37.1%	36.6%	36.4%
margin chg. Y/Y bps		-335bp	146bp	838bp	-428bp	39bp	-10bp	27bp	5bp	5bp	-50bp	-20bp
<b>Total SG&amp;A</b>	<b>-2,289.0</b>	<b>-2,234.9</b>	<b>-1,650.9</b>	<b>-1,890.5</b>	<b>-1,743.5</b>	<b>-1,947.5</b>	<b>-1,782.5</b>	<b>-1,567.6</b>	<b>-1,579.0</b>	<b>-1,589.7</b>	<b>-1,610.3</b>	<b>-1,625.4</b>
% chg Y/Y	0.0%	-2.4%	-26.1%	14.5%	-7.8%	11.7%	-8.5%	-12.1%	0.7%	0.7%	1.3%	0.9%
% of sales	28.2%	29.8%	30.5%	27.9%	27.5%	31.5%	32.3%	32.4%	32.6%	32.7%	32.8%	32.9%
<b>EBIT</b>	<b>481.0</b>	<b>80.7</b>	<b>97.5</b>	<b>869.5</b>	<b>565.7</b>	<b>326.9</b>	<b>241.2</b>	<b>220.4</b>	<b>210.8</b>	<b>209.2</b>	<b>181.8</b>	<b>168.2</b>
% chg Y/Y		-83.2%	20.9%	791.8%	-34.9%	-42.2%	-26.2%	-8.6%	-4.3%	-0.8%	-13.1%	-7.5%
% margin	5.9%	1.1%	1.8%	12.8%	8.9%	5.3%	4.4%	4.6%	4.4%	4.3%	3.7%	3.4%
margin chg. Y/Y bps		-486bp	73bp	1101bp	-390bp	-363bp	-91bp	18bp	-20bp	-5bp	-60bp	-30bp
Net Interest	-2	-8	-6	-27	-60	-95	-81	-73	-70	-70	-70	-70
Other	-7	1	1	1	0	1	1	0	0	0	0	0
<b>Pre-Tax Income</b>	<b>472.0</b>	<b>73.2</b>	<b>93.0</b>	<b>843.1</b>	<b>504.9</b>	<b>233.1</b>	<b>161.5</b>	<b>147.4</b>	<b>140.6</b>	<b>138.9</b>	<b>111.6</b>	<b>97.9</b>
Income Taxes	-153	-24	-50	-197	-99	-48	-43	-34	-32	-32	-26	-23
Tax Rate	32.4%	32.8%	53.7%	23.3%	19.6%	20.8%	26.6%	23.0%	23.0%	23.0%	23.0%	23.0%
Non-controlling interest	0	0	0	0	-10	7	2	1	1	1	1	1
<b>Net Income</b>	<b>319.0</b>	<b>49.2</b>	<b>43.0</b>	<b>646.4</b>	<b>416.4</b>	<b>178.1</b>	<b>116.3</b>	<b>112.2</b>	<b>106.9</b>	<b>105.6</b>	<b>84.5</b>	<b>74.0</b>
Diluted Average Shares	88	88	88	90	84	79	78	70	62	57	52	48
<b>EPS - Comparable</b>	<b>\$3.61</b>	<b>\$0.56</b>	<b>\$0.49</b>	<b>\$7.18</b>	<b>\$4.95</b>	<b>\$2.27</b>	<b>\$1.49</b>	<b>\$1.60</b>	<b>\$1.73</b>	<b>\$1.84</b>	<b>\$1.63</b>	<b>\$1.55</b>
% chg Y/Y	0.0%	0.0%		1373.2%	-31.0%	-54.2%	-34.3%	7.7%	7.8%	6.6%	-11.7%	-4.6%
<b>GAAP EPS</b>	<b>\$2.84</b>	<b>-\$10.17</b>	<b>-\$0.82</b>	<b>\$7.18</b>	<b>\$4.14</b>	<b>\$1.39</b>	<b>\$1.33</b>	<b>\$1.60</b>	<b>\$1.73</b>	<b>\$1.84</b>	<b>\$1.63</b>	<b>\$1.55</b>
<b>Select Other Items</b>												
VS Comparable sales	-2.0%	-8.0%	1.0%	3.0%	-8.0%	-9.0%	-2.1%	0.4%	1.7%	1.0%	1.0%	1.0%
Period-end Total Stores	1,222	1,168	933	899	915	901	868	827	782	778	774	770
Period-end Owned Square Feet (000)	7,953	7,692	6,313	6,073	6,096	6,000	3,922	3,712	3,480	3,456	3,433	3,409
Period-end Franchise Stores	439	444	458	463	443	463	506	546	580	587	594	601
Cash From Operations	698	315	674	851	437	389	343	362	372	398	380	381
Capex	-341	-225	-127	-169	-164	-256	-200	-202	-204	-206	-208	-210
Buybacks (\$mn)	0	0	0	-250	-250	-125	-100	-250	-80	-50	-200	0
Free Cash Flow	778	778	547	682	273	133	143	161	168	192	173	171
Adjusted ROIC: PVOL method	na	7.3%	4.5%	23.9%	17.3%	12.2%	9.5%	9.0%	9.5%	9.8%	9.3%	9.2%
Cash and Equivalents	369	245	335	490	427	270	331	143	232	230	203	375
Net Debt (Cash)	na	-92	-238	492	849	854	992	1,181	1,093	951	979	808
Net Debt to EBITDA	na	-0.2x	-0.6x	0.4x	1.0x	1.4x	2.0x	2.6x	2.5x	2.1x	2.3x	1.9x
Adj. Net Debt to EBITDAR: PVOL	na	4.4x	3.7x	2.6x	3.5x	4.4x	4.8x	4.8x	4.7x	4.4x	4.5x	4.3x
Inventory Turnover	na	6.1x	4.3x	4.7x	3.8x	3.7x	3.5x	3.5x	3.6x	3.7x	3.7x	3.8x
Inventory Growth	na	na	-18.0%	35.3%	10.9%	-6.4%	-7.1%	-12.7%	-0.1%	-0.9%	-2.7%	-15.5%

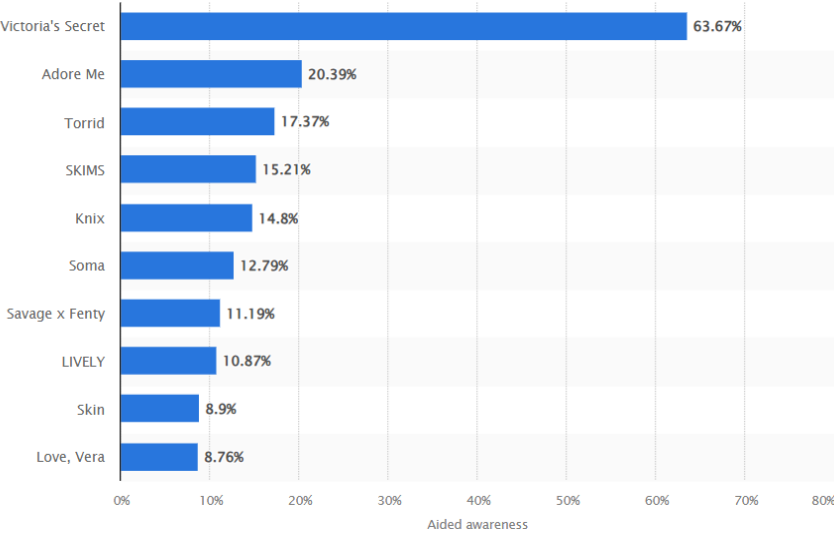
# Appendix VI – Consumer recognition

Victoria's Secret brand KPI profile in the U.S.



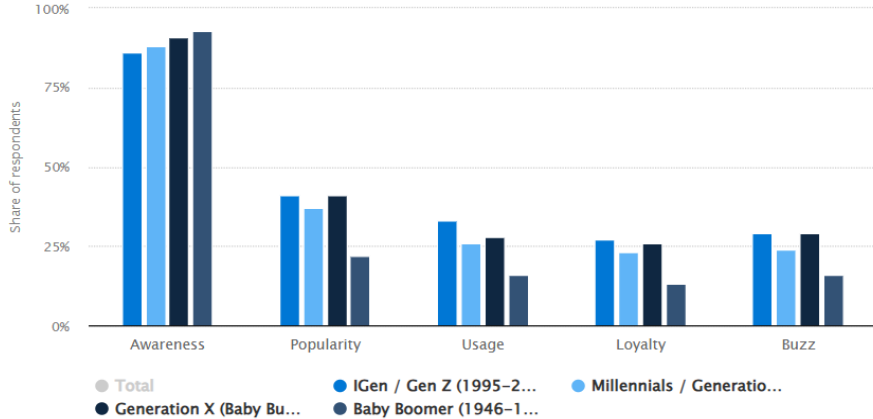
Details: United States; March 2024; online survey; 1,026 respondents who use fashion online shops; 18 to 64 years; Consumer Insights Brand KPIs

## Most awarded brand among lingerie brands



## VSCO is making a comeback in GenZ, through PINK

Victoria's Secret audience by generations in the U.S.



Details: United States; March 2024; online survey; 1,026 respondents who use fashion online shops; 18 to 64 years; Consumer Insights Brand KPIs

# Appendix VI – Scenario Assumptions

	2.27	0.12	0.40	-0.68	2.13	1.95	2.59	3.51	4.72	6.83	10.30
	Jan	Apr	Jul	Oct	Jan	Jan	Jan	Jan	Jan	Jan	Jan
	1/27/24	4/27/24	7/27/24	10/26/24	1/25/25	1/25/25	1/24/26	1/23/27	1/22/28	1/20/29	1/19/30
	2023	1Q	2Q	3QE	4QE	2024E	2025E	2026E	2027E	2028E	2029E
<b>Scenario Selection</b>	<b>1</b>					←1: Base, 2: Realistic Bear, 3: Stress Test					
<b>VSCO Company-Operated Store Build (NA)</b>											
<b>VSCO US</b>											
Period-beginning stores	812	808	805	793	793	808	780	752	724	724	724
Net additions/closures	-4	-3	-12	0	-13	-28	-28	-28	0	0	0
Base				0	-13				0	0	0
Realistic Bear				0	-13	0	0	0	0	0	0
Bear - Stress Test				0	-20				-3	-3	-3
<b>Period-end VSCO US Stores</b>	<b>808</b>	<b>805</b>	<b>793</b>	<b>793</b>	<b>780</b>	<b>780</b>	<b>752</b>	<b>724</b>	<b>724</b>	<b>724</b>	<b>724</b>
Average VSCO US Stores	810	807	799	793	787	793	765	737	724	724	724
% chg. y/y	0	0	0	0	0	0	0	0	0	0	0
Total US Selling Sq Ft	5.542	5.555	5.507	5.501	5.403	5.403	5.179	4.958	4.950	4.943	4.936
Average US Selling Sq Ft	5.586	5.549	5.531	5.504	5.452	5.492	5.279	5.056	4.954	4.947	4.940
% chg. y/y	-0.26%	-1.07%	-1.17%	-1.74%	-2.22%	-1.69%	-3.88%	-4.22%	-2.02%	-0.15%	-0.15%
US Selling Sq Ft / Store	6.859	6.901	6.945	6.938	6.928	6.928	6.888	6.848	6.838	6.828	6.818
Base				6.938	6.928				6.838	6.828	6.818
Realistic Bear				5.550	5.542				5.470	5.462	5.454
Bear - Stress Test				4.579	4.572				4.513	4.506	4.500
<b>VSCO Canada</b>											
Period-beginning stores	25	23	23	23	24	23	24	24	24	24	24
Net additions/closures	-2	0	0	1	0	1	0	0	0	0	0
Base				1	0				0	0	0
Realistic Bear				1	0				0	0	0
Bear - Stress Test				0	-1				-1	-1	-1
<b>Period-end VSCO Canada Stores</b>	<b>23</b>	<b>23</b>	<b>23</b>	<b>24</b>	<b>24</b>	<b>24</b>	<b>24</b>	<b>24</b>	<b>24</b>	<b>24</b>	<b>24</b>
Average VSCO Canada Stores	24	23	23	24	24	24	24	24	24	24	24
% chg. y/y	-8%	-6%	-4%	-2%	2%	-1%	2%	0%	0%	0%	0%
Total Canada Selling Sq Ft	0.212	0.209	0.206	0.212	0.210	0.210	0.210	0.210	0.210	0.210	0.210
Average Canada Selling Sq Ft	0.225	0.210	0.207	0.209	0.211	0.209	0.210	0.210	0.210	0.210	0.210
% chg. y/y	-11%	-12%	-10%	-8%	-3%	-7%	0%	0%	0%	0%	0%
Canada Selling Sq Ft / Store	9.217	9.079	8.943	8.853	8.763	8.763	8.763	8.763	8.763	8.763	8.763
Base				8.853	8.763				8.763	8.763	8.763
Realistic Bear				7.082	7.010	-	-	-	7.010	7.010	7.010
Bear - Stress Test				5.843	5.784				5.784	5.784	5.784

# Appendix VI – Scenario Assumptions

	Jan 1/27/24 2023	Apr 4/27/24 1Q	Jul 7/27/24 2Q	Oct 10/26/24 3QE	Jan 1/25/25 4QE	Jan 1/25/25 2024E	Jan 1/24/26 2025E	Jan 1/23/27 2026E	Jan 1/22/28 2027E	Jan 1/20/29 2028E	Jan 1/19/30 2029E
<b>Direct Sales</b>	<b>2,015</b>	<b>449</b>	<b>430</b>	<b>394</b>	<b>713</b>	<b>1,986</b>	<b>2,045</b>	<b>2,127</b>	<b>2,212</b>	<b>2,301</b>	<b>2,393</b>
% chg. y/y	9%	-3%	-1%	3%	1%	-1%	3%	4%	4%	4%	4%
Base				3%	1%				4%	4%	4%
Realistic Bear				2%	0%				3%	3%	3%
Bear - Stress Test				1%	-1%				0%	0%	0%
2-yr stack (geometric)	-5%	7%	4%	15%	11%	8%	2%	7%	8%	8%	8%
Assumed direct comp acq / 53rd week	-6%	-3%	-1%	3%	5%	1%	3%	4%	4%	4%	4%
	16%	0%	0%	0%	-4%	-1%	0%	0%	0%	0%	0%
<b>International Sales</b>	<b>687</b>	<b>182</b>	<b>187</b>	<b>179</b>	<b>202</b>	<b>750</b>	<b>840</b>	<b>940</b>	<b>1,034</b>	<b>1,107</b>	<b>1,162</b>
% chg. y/y	16%	16%	6%	12%	4%	9%	12%	12%	10%	7%	5%
Base				12%	4%				10%	7%	5%
Realistic Bear				9%	1%				7%	4%	2%
Bear - Stress Test				7%	-1%				5%	2%	0%
2-yr stack (geometric)	44%	37%	35%	9%	29%	27%	22%	25%	23%	18%	12%
<b>Gross Margin</b>	<b>36.8%</b>	<b>36.9%</b>	<b>35.4%</b>	<b>34.7%</b>	<b>39.5%</b>	<b>36.9%</b>	<b>37.3%</b>	<b>37.5%</b>	<b>37.8%</b>	<b>37.8%</b>	<b>37.8%</b>
Margin chg. Y/Y bps	39bp	33bp	81bp	40bp	-50bp	13bp	35bp	25bp	25bp	0bp	0bp
Base				40bp	-50bp				25bp	0bp	0bp
Realistic Bear				30bp	-60bp				30bp	0bp	0bp
Bear - Stress Test				20bp	-70bp				5bp	-50bp	-20bp
<b>SG&amp;A</b>	<b>31.5%</b>	<b>34.0%</b>	<b>31.0%</b>	<b>38.5%</b>	<b>27.7%</b>	<b>32.2%</b>	<b>32.2%</b>	<b>32.1%</b>	<b>32.0%</b>	<b>31.9%</b>	<b>31.8%</b>
Margin chg. Y/Y bps	402bp	133bp	-17bp	-60bp	130bp	66bp	1bp	-10bp	-10bp	-10bp	-10bp
Base				-60bp	130bp				-10bp	-10bp	-10bp
Realistic Bear				-40bp	150bp				10bp	0bp	0bp
Bear - Stress Test				50bp	50bp				10bp	10bp	10bp
<b>Buybacks</b>	<b>-125bp</b>	<b>0</b>	<b>0</b>	<b>-50bp</b>	<b>-50bp</b>	<b>-100bp</b>	<b>-250bp</b>	<b>-250bp</b>	<b>-100bp</b>	<b>-500bp</b>	<b>0bp</b>
Base				-50bp	-50bp				-100bp	-500bp	0bp
Realistic Bear				-50bp	-50bp				-75bp	-400bp	0bp
Bear - Stress Test				-50bp	-50bp				-50bp	-200bp	0bp

**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** RingCentral 8.5% 15/08/2030 Senior Unsecured Notes trading at **106.00** with **6.65% yield to maturity** and **~184bps** spread (as of 24/11/2024).
- **Target Spread:** **142 bps** and base-case target total return of **~9.1% p.a.**
- **Key Factors:**
  - **Leadership in the Unified Communications as a Service (UCaaS) market, differentiated go-to-market**
  - **AI-powered products expansion**
  - **Strengthening financial profile**

RNG 8.5% 15/08/2030 USD	
Current Price	106
Current YTM	6.65%
Current Spread	184 bps.
Target Spread	142 bps
Upside	42 bps.
1-Year Return	9.1%

# Company Overview



# Trusted Leader in AI Business Communications

As business telephony evolves from traditional on-premises private branch exchange solutions to cloud-based solutions, RingCentral provides over-the-top voice over IP services bundled with proprietary software to provide Unified Communications as a Service (UCaaS), which includes messaging, conferencing, mobile, etc., propelling digital transformation initiatives for enterprises of all sizes

## RingCentral Value Proposition

### Trust

**99.999%**

Reliability for 25 consecutive quarters

### Innovation

**#1 in UCaaS<sup>(1)</sup>**

Market Share  
(1) Unified Communications as a Service

### Partnerships

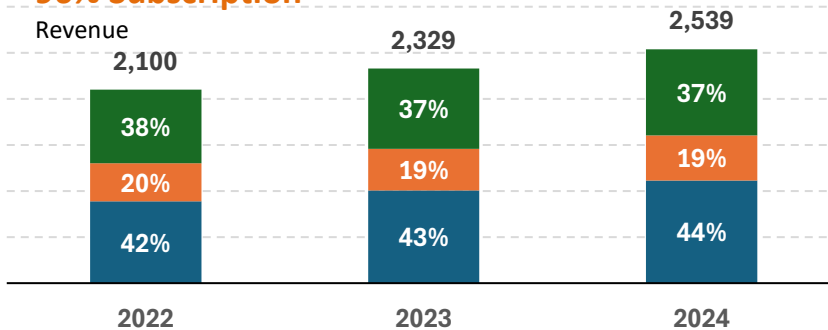
**15,000+**

Channel Partners, Strategic Partners, and Developers

## Annualized Exit Monthly Recurring Revenue

■ Enterprise ARR ■ Mid-market ARR ■ Small and Medium Business ARR

**96% Subscription**



Enterprise ARR covers ARR \$100k+, Mid-market ARR covers ARR \$25k-\$100k, with Small and Medium Business ARR covering ARR <\$25k

## Product Portfolio

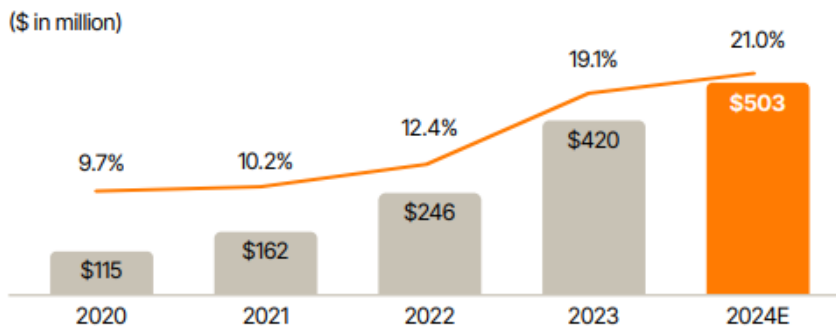
<p><b>RingEX</b></p> <p>UCaaS enterprise-grade voice, video, messaging, &amp; collaboration</p> <ul style="list-style-type: none"> <li>• Business Phone System</li> <li>• SMS, Fax</li> <li>• Push to Talk</li> <li>• Team Messaging</li> <li>• AI Assistant</li> </ul>	<p><b>RingCX</b> ★</p> <p>CCaaS AI-powered contact center solution with 500+ customers</p> <ul style="list-style-type: none"> <li>• Omnichannel</li> <li>• IVA</li> <li>• AI-Assist</li> <li>• WEM, QM</li> <li>• Conversation Intelligence</li> </ul>
<p><b>RingCentral Events</b> ★</p> <p>Virtual/hybrid events platform</p> <ul style="list-style-type: none"> <li>• Events</li> <li>• Webinars</li> <li>• Video Meetings</li> <li>• Rooms</li> </ul>	<p><b>RingSense</b> ★</p> <p>Conversation intelligence platform with 1,200+ customers</p> <ul style="list-style-type: none"> <li>• Conversation Intelligence</li> <li>• AI Coaching</li> <li>• CRM Automation</li> <li>• AI Call Scoring</li> </ul>

★ Denotes new products launched 2H 2023

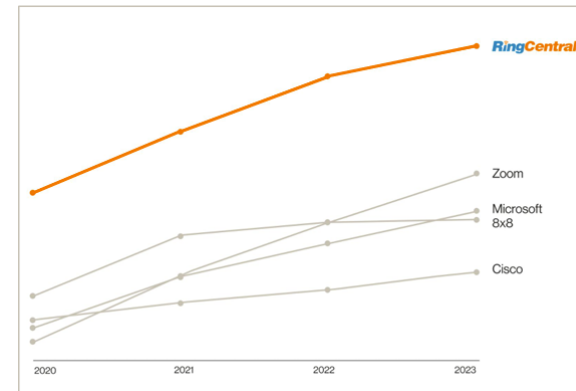
# Resetting Expectations: From Market Doubts to Proven Execution

RingCentral's Q3 outperformance was driven by continued strength in RingCentral's core UCaaS market (RingEX), combined with strong traction from new products, particularly RingCX

## Operating Profit (\$ and % of Total Rev)



## Market Share in UCaaS (Source: Synergy Research)



#1 Market Share in UCaaS

(estimated as > 20% market share based on prior research reports)

### Market Reset:

- Once trading at 20x+ sales during COVID, RNG now trades at ~2.0x EV/NTM sales amid concerns of competition and commoditization

### Proving Critics Wrong:

- Exceeding expectations with 21% operating margins, 51% YoY FCF growth, and a clear deleveraging plan

### Recent Leadership Changes:

- Return of founder Vlad Shmunis as CEO (Dec 2023)
- New CFO Abhey Lamba from AWS (Nov 2024)
- Focused on FCF generation and disciplined growth

### Resilience Core Business

- Despite intensified competition from Microsoft Teams and Zoom, maintained stable market share.

### RingCentral Key Differentiators

- Integrated UCaaS-CCaaS platforms, with over 80% of organizations prioritizing integrated UCaaS-CCaaS platforms
- Innovation in AI
- Deep global service provider relationships, including with AT&T, Vodafone, BT
- Extensive partner ecosystem, including Microsoft Teams

# Investment Thesis

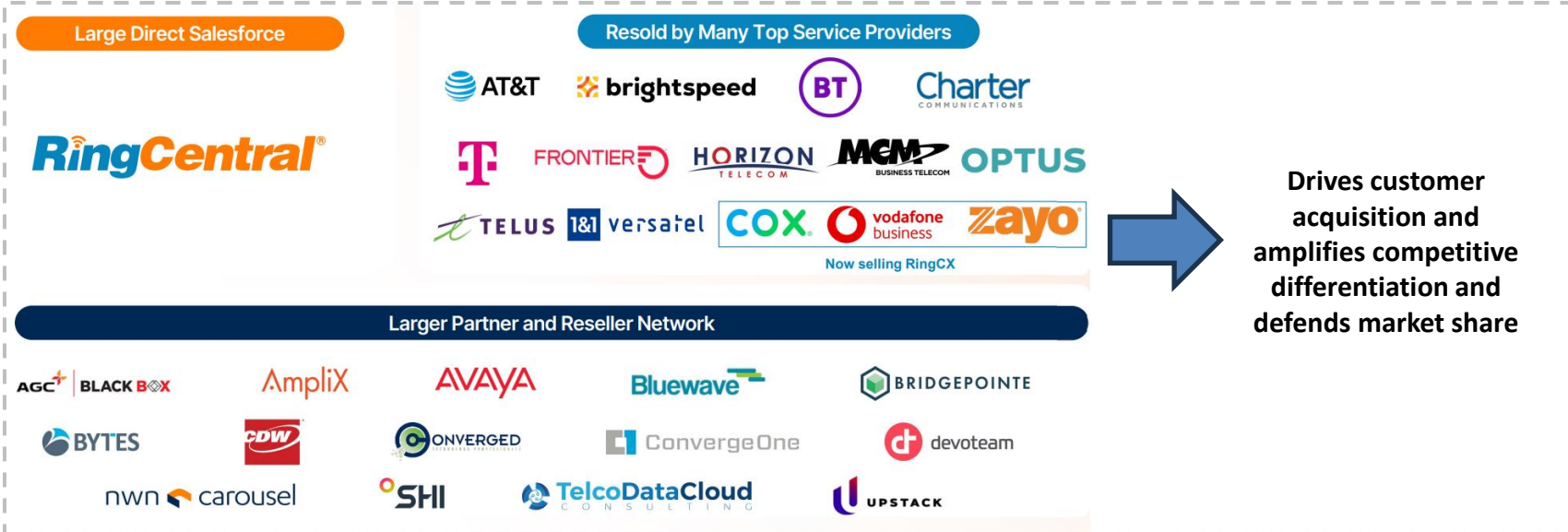
# Investment Thesis #1

## Differentiated Go-to-Market, Including Expansive Partnerships

**RingCentral Strategic Priorities include:**

- Nurturing and growing RingCentral's large and diverse partner network and expanding into new geographies

**Key:** Voice remains mission-critical, with 73% of organizations prioritizing voice over other modes of communication. 25M CCaaS lines currently exist relative to a UC install base of 400M lines, representing 6% penetration, with penetration expected to reach 15–20% in 5 years



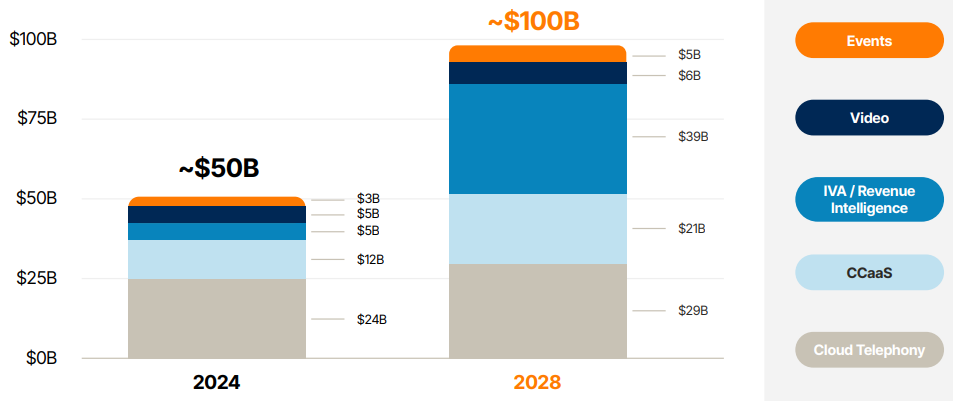
**Expanding Global Presence:** Leveraging strategic partnerships and licenses to enter underpenetrated markets:

- First pan-India UCaaS provider and ongoing growth in Europe and Australia
- Recent \$1M+ TCW wins in healthcare and automotive verticals demonstrate traction

# Investment Thesis #2

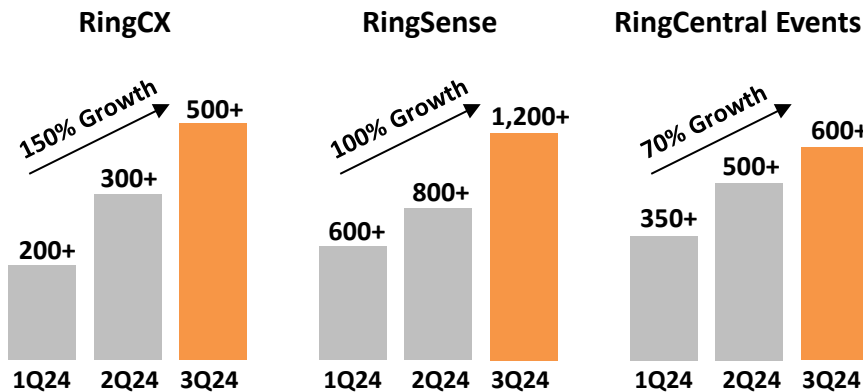
## AI-Powered Products Expand TAM, ARPU, ARR

### New products penetrate \$100B TAM opportunity and drive growth



### AI integration driving growth and higher ARPUs across portfolio

Numbers below represent customers as of end of quarter



**New Product ARR on track to achieve \$100M+ by 4Q25**

### RingCX Penetrates CCaaS Market

- 500+ customers as of 3Q24, 45% sequential growth
- AI features achieving 50% attach rate on new RingCX bookings
- Successfully deployed internally across 1,000+ AI agents
- Strategic Verint partnership expanding enterprise capabilities
- Strong GSP network providing distribution advantage for RingCX growth

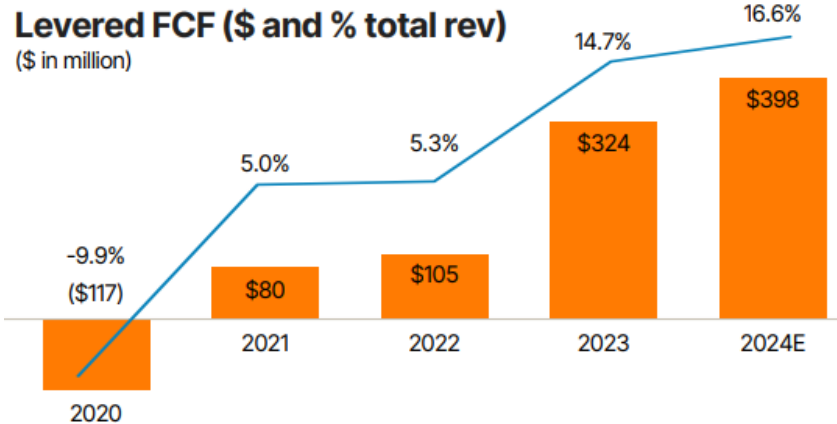
### Proprietary solutions are allowing RingCentral to move away from third-party partnerships, specifically NICE partnership

- Owner economics improving margin profile and ARPU (currently \$30 and expanding)
- Control over user experience improving customer retention
- Early traction demonstrates scalability of products and their contribution to recurring revenue growth

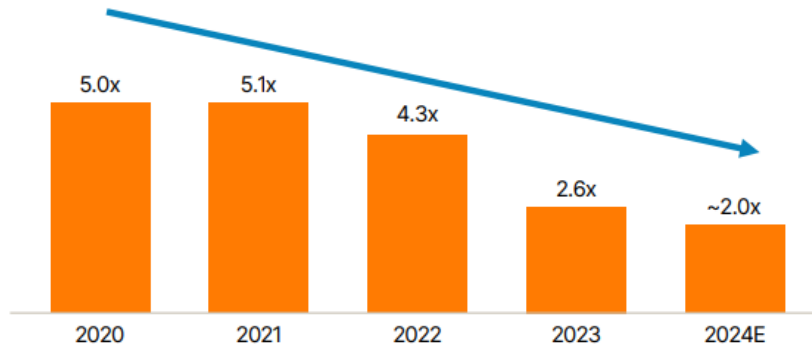
### RingCentral Strategic Priorities include:

- Solidifying RingCentral's UCaaS leadership by infusing AI across its portfolio
- Expand TAM with new AI-powered products

# Investment Thesis #3: Strengthening Financial Profile



### Net Debt to Adj. EBITDA



#### Proven Financial Discipline Enhancing Credit Profile

- **Operating Leverage and FCF Growth:** Operating margin expanded to ~20% in 2024E from ~10% in 2021, with FCF growing 51% YoY in Q3-24 and levered FCF at 16.6% of revenue.
- *Drivers:* >500 bps reduction in S&M as % of sales, >900 bps decline in SBC, workforce optimization, lower customer acquisition costs, and vendor rationalization
- **Debt Reduction:** Net debt to EBITDA has improved from 5.0x in 2020 to 2.6x in 2023 and is forecasted to reach ~2.0x by YE 2024.
- *Driver:* Strong FCF with limited capex and continued discipline in capital allocation and debt maturity management.

#### RingCentral Strategic Priorities include:

- Streamlining S&M org by focusing on enterprise customer acquisition and rationalizing vendor partnerships to lower CAC.
- Actively reducing SBC expenses and optimizing workforce management to improve profitability.

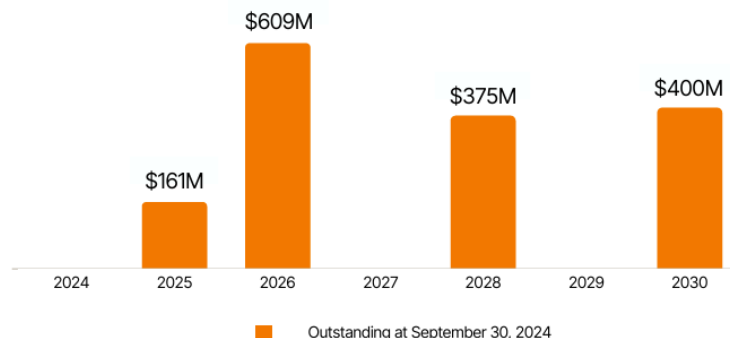
# Valuation

RingCentral total debt stands at **\$1.5 billion**, with a mix of secured debt, unsecured senior notes and two convertible notes, maturing in 2043, 2030, 2025 and 2026 respectively. Expected company's net debt for the end of 2024 is \$1.3 billion after accounting for cash and equivalents.

The company is generating enough cash to pay the upcoming convertible notes in full, having started to prepay in the recent periods.

US\$ millions	2023	2024	2025	2026	2027
<b>Outstanding debt</b>					
Term Loan	390	370	350	330	310
Projected new Loan				300	300
2030 Senior Notes	400	400	400	400	400
2025 Convertible Notes	161	161	0	0	0
2026 Convertible Notes	609	609	609	0	0
Unamortized discount and costs	-15	-12	-10	-8	-6
<b>Total</b>	<b>1,545</b>	<b>1,528</b>	<b>1,349</b>	<b>1,022</b>	<b>1,004</b>
Debt / EBITDA (forecast)	3.3x	2.9x	2.2x	1.4x	1.2x
FCFO / Debt (forecast)	21%	25%	35%	56%	64%

## Maturity Wall



### RingCentral Strategic Priorities include:

- Targeting to reduce gross debt from \$1.5B to no more than \$1B by the end of 2026
- Address \$161M 2025 convertible notes with free cash flow and refinance remaining 2026 notes

**Manageable Maturity Wall:** \$788M in liquidity supports near-term debt obligations through 2026. Driver: Strategic refinancing and efficient capital management.



# Financials forecast

## Key highlights

- **Revenue Growth:** Sustained growth driven by market leadership, underpenetrated UCaaS adoption and expansion into enterprise clients.  
**ARPU Trends:** ARPU is conservatively forecasted to decline modestly (~1%-2% annually) due to competitive pressures, partially offset by upselling new AI products (expected \$100M ARR by 2025).
- **Operating Margins:** Gradual improvements driven by continued workforce optimizations, CAC reductions (enterprise focus)
- **Deleveraging:** Net Debt/EBITDA improves from 2.9x in 2024E to 1.3x by 2027E, reflecting disciplined financial management.
- **Capital Allocation:** Conservative approach assumes all FCF (~\$500M by 2027E) goes toward share buybacks. High optionality.
- **Bear case scenario** assumes a stressed environment with accelerated ARPU decline and deteriorating margins.
- **Bull case scenario** contemplates ARPU improvement and enhanced operating margins.

US\$ millions	2021	2022	2023	2024 E	2025 E	2026 E	2027 E	2027 Bear	2027 Bull
Annualized Recurring Revenue	1,800	2,100	2,329	2,539	2,785	2,977	3,154	2,904	3,468
ARPU (monthly)	32.3	31.3	31.8	30.2	30.4	30.1	29.8	29.0	31.0
Revenues	1,595	1,988	2,202	2,398	2,613	2,820	2,994	2,803	3,224
Rev. Growth YoY%	34.7%	24.7%	10.8%	8.9%	9.0%	7.9%	6.2%	3.3%	10.2%
Adjusted EBITDA	181	267	462	521	588	662	737	459	853
Net income	(376)	(879)	(165)	(123)	(71)	9	162	(84)	244
Capex	73	86	76	80	87	99	105	98	113
Free Cash Flow	80	105	324	386	447	496	532	265	641
Cash balance	267	270	222	259	259	259	259	232	259
Long Term Debt	1,398	1,638	1,545	1,528	1,349	1,022	1,004	1,004	1,004
FCF Margin	11%	13%	21%	22%	23%	23%	25%	16%	27%
Adj EBITDA Margin	11%	13%	21%	22%	23%	23%	25%	16%	26%
Total Debt / Adj EBITDA	7.7x	6.1x	3.3x	2.9x	2.3x	1.5x	1.4x	2.2x	1.2x
Net Debt / Adj EBITDA	6.2x	5.1x	2.9x	2.4x	1.9x	1.2x	1.0x	1.7x	0.9x
Adj EBITDA / Interest Exp.	2.8x	55.5x	12.8x	8.0x	9.4x	10.8x	9.0x	5.6x	10.5x

# Our base case scenario valuation calls for 142bps target spread in one year

**Bear:** Spread widening from 184 bps to BB- technology average of **216 bps**, for **5.6%** total return p.a.

**Base:** Compress from 184 bps spread to the BB+ median of **142 bps**, for **9.1%** total return p.a.

**Bull:** Compress to the high end of comps. to **116 bps**, for **10.3%** total return p.a.

	Fitch: BB (Outlook Positive)	S&P: BB (Outlook Stable)	Bear	Base	Bull
Upgrade trigger	<ul style="list-style-type: none"> <li>EBITDA leverage below 3.0x;</li> <li>FCF/debt in the mid-teens or better;</li> <li>Consistently low-teen FCF margins or higher.</li> </ul>	<ul style="list-style-type: none"> <li>EBITDA &gt; 20% and strong free operating cash Flow</li> </ul>	No	Yes	Yes
Downgrade trigger	<ul style="list-style-type: none"> <li>Sustained EBITDA leverage above 3.75x</li> <li>Sustained FCF/debt below 7%</li> </ul>	<ul style="list-style-type: none"> <li>Execution errors around cost-reduction initiatives</li> <li>Leverage &gt; 4x and LTV below 10%</li> </ul>	No	No	No

Parent	Total EV (in mns)	Security	S&P Rating	S&P Outlook	S&P		OAS	YTW	LTV	Duration	LTM Net Leverage	LTM Net Coverage	NTM FCF / Debt
					Recovery	Price							
RINGCENTRAL INC	\$ 4,742	RNG 8 1/2 08/15/30	BB	STABLE	3(65%)	106.1	184.9	6.62%	33%	3.1%	6.3x	3.4x	30%
TWILIO INC	\$ 13,215	TWLO 3 7/8 03/15/31	BB	STABLE	3(65%)	90.0	142.2	5.78%	9%	5.4%	NM	0.0x	59%
TWILIO INC	\$ 13,215	TWLO 3 7/8 03/15/31	BB	STABLE	3(65%)	90.0	142.2	5.78%	9%	5.4%	NM	0.0x	59%
FICO	\$ 57,428	FAIRC 4 06/15/28	BB+	STABLE	3(65%)	95.3	115.6	5.48%	4%	3.2%	2.7x	7.3x	35%
ROBLOX CORP	\$ 32,912	RBLX 3 7/8 05/01/30	BB+	STABLE	3(65%)	91.2	144.7	5.78%	5%	4.8%	NM	NM	38%
INSIGHT ENTERPRS	\$ 5,769	NSIT 6 5/8 05/15/32	BB+	STABLE	3(65%)	101.7	138.9	6.20%	23%	3.8%	1.8x	10.7x	34%
KBR INC	\$ 10,128	KBR 4 3/4 09/30/28	BB+	STABLE	5(10%)	95.8	158.8	5.97%	28%	3.4%	2.9x	6.2x	12%
<b>MEDIAN BB+</b>							<b>141.8</b>	<b>5.88%</b>	<b>14%</b>	<b>3.6%</b>	<b>2.7x</b>	<b>7.3x</b>	<b>34%</b>

# Risks & Mitigants

## Risks

### Intensifying Market Competition

The UCaaS and CCaaS markets are increasingly competitive, with major players like Microsoft Teams, Zoom, Cisco, and others expanding their offerings.

### Slowing Revenue Growth:

Revenue growth decelerated from over 30% historically to around 8–10% due to macro headwinds. A further decline could pressure FCF and hinder the company's ability to meet financial obligations.

**High Debt Burden and Upcoming Maturities** RingCentral has a substantial debt load of \$1.5 billion, with significant maturities in 2025 (\$161 million) and 2026 (\$609 million). Elevated leverage poses concerns.

### Governance and Management Changes

Frequent leadership changes, including two CEOs and multiple CFOs in recent years, may lead to strategic uncertainty and could affect investor and creditor confidence.

## Mitigants

RingCentral differentiates itself with proprietary AI-driven solutions, enhancing customer value and driving premium pricing. Strong global partnerships with AT&T and Vodafone ensure broad distribution, while its integrated UCaaS + CCaaS platform addresses growing demand for unified solutions, supporting market leadership.

Expansion into new markets (e.g., India with its pan-India license, Australia through partnerships) and introduction of new AI-driven products are expected to reaccelerate growth.

Strong FCF generation supports the company's debt reduction plan to lower gross debt to below \$1 billion by 2026. Sufficient liquidity of \$788 million provides a buffer for upcoming maturities.

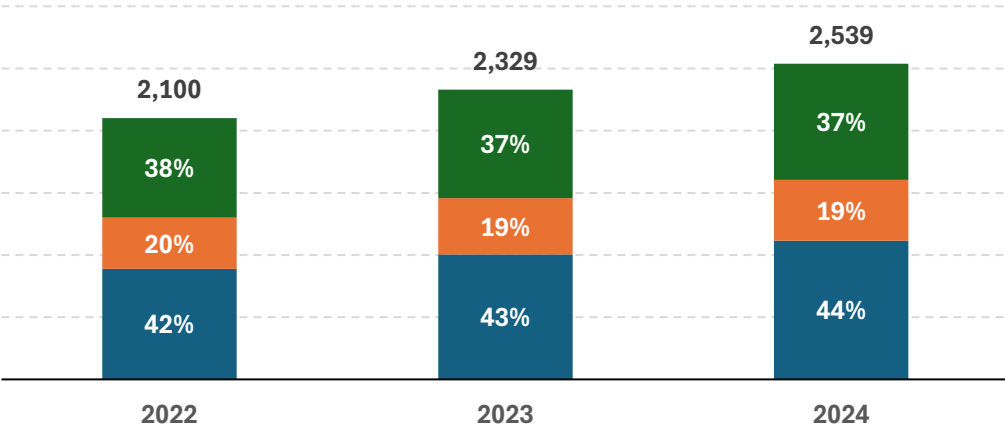
The return of founder Vlad Shmunis as CEO is intended to stabilize leadership and provide strategic continuity. The appointment of a new CFO with extensive experience in finance and technology strengthens the executive team.

# Appendix

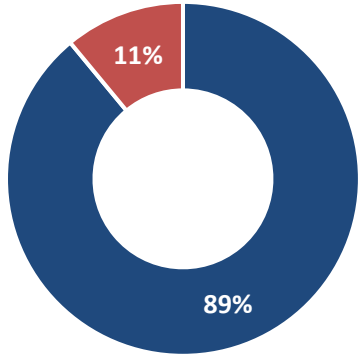
# Revenue breakdown

Annualized Exit Monthly Recurring Revenue (ARR)

■ Enterprise ARR   ■ Mid-market ARR   ■ Small and Medium Business ARR



Revenues by geography



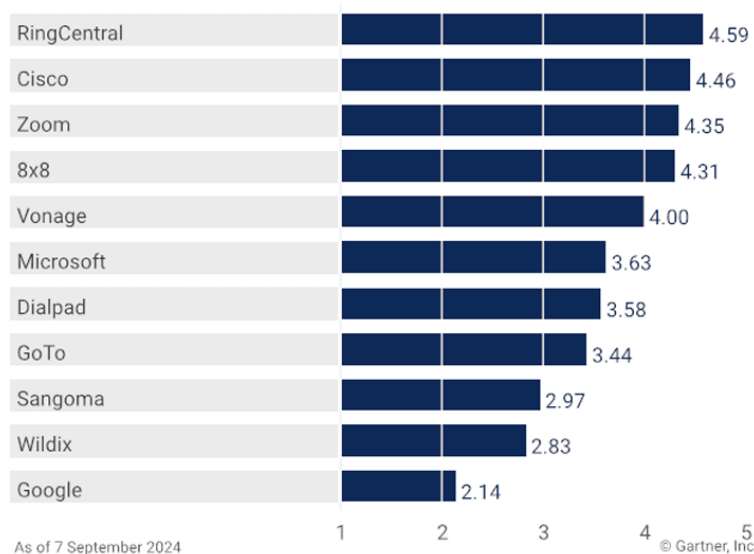
■ North America   ■ Other geographies

# Use Cases: RingCentral vs. Competitors

(Source: Gartner)

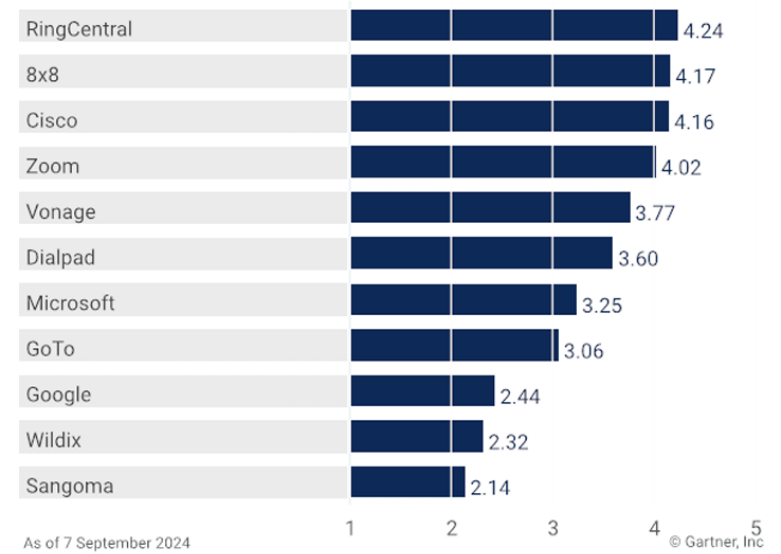
## Vendors' Product Scores for Telephony-Centric/Heavy Organizations Use Case

Product or Service Scores for Telephony-Centric/Heavy Organizations



## Vendors' Product Scores for UC With Integrated Contact Center Use Case

Product or Service Scores for UC With Integrated Contact Center



# Base Case Cash Flow Statement

US\$ millions	2021	2022	2023	2024	2025	2026	2027
Net income / loss	(376)	(879)	(165)	(123)	(71)	9	162
+ Shared-based compensation	358	386	427	346	365	380	388
+ Amortization of acquisition intangibles	66	175	151	140	139	115	-
+ Depreciation & Amortization of PP&E	59	72	83	82	81	84	90
+ Amortization of deferred sales commissions	74	115	138	134	134	133	136
+ Others	97	547	(19)	3	2	2	2
Change in deferred sales commissions	(178)	(236)	(157)	(132)	(132)	(144)	(156)
Investments in working capital	52	12	(59)	15	17	16	14
<b>Total CFO</b>	<b>152</b>	<b>191</b>	<b>400</b>	<b>466</b>	<b>534</b>	<b>595</b>	<b>637</b>
Capex PPE and software	(73)	(86)	(76)	(80)	(87)	(99)	(105)
Purchases of intangible assets	(312)	(4)	-	-	-	-	-
Others	(12)	3	(15)	-	-	-	-
<b>Total CFI</b>	<b>(397)</b>	<b>(87)</b>	<b>(90)</b>	<b>(80)</b>	<b>(87)</b>	<b>(99)</b>	<b>(105)</b>
Proceeds from stock issuance	37	16	17	-	-	-	-
Long-term debt issuance	-	-	786	-	-	300	-
Convertibles issuance	199	-	-	-	-	-	-
Repurchase of common stock	-	(100)	(311)	(330)	(266)	(167)	(512)
Repurchase of convertibles	(334)	-	(821)	-	-	-	-
Repayments on loans	(4)	(5)	(16)	(20)	(181)	(629)	(20)
Optional Repayments	-	-	-	-	-	-	-
Others	(25)	(9)	(13)	-	-	-	-
<b>Total CFF</b>	<b>(127)</b>	<b>(98)</b>	<b>(358)</b>	<b>(350)</b>	<b>(447)</b>	<b>(496)</b>	<b>(532)</b>
FX effects	(1)	(3)	1	-	-	-	-
<b>Net increase/decrease in cash</b>	<b>(373)</b>	<b>3</b>	<b>(48)</b>	<b>37</b>	<b>-</b>	<b>-</b>	<b>-</b>
Beginning of period	640	267	270	222	259	259	259
<b>End of period</b>	<b>267</b>	<b>270</b>	<b>222</b>	<b>259</b>	<b>259</b>	<b>259</b>	<b>259</b>

# Base Case Balance Sheet

US\$ millions	2021	2022	2023	2024	2025	2026	2027
Cash	267	270	222	259	259	259	259
Accounts receivable	233	311	364	397	432	467	495
Prepaid expenses	48	56	77	84	92	99	105
Deferred sales commissions	826	597	580	578	577	588	607
PP&E	167	185	184	182	188	202	217
Long-term investments	210	5	-	-	-	-	-
Acquired intangibles	717	528	394	254	115	-	-
Other assets	111	121	122	122	122	122	122
<b>Total Assets</b>	<b>2,579</b>	<b>2,074</b>	<b>1,945</b>	<b>1,876</b>	<b>1,785</b>	<b>1,737</b>	<b>1,806</b>
Accounts payable	70	63	53	58	63	68	72
Accrued liabilities	280	380	326	355	386	417	443
Deferred revenue	176	210	234	254	277	299	318
Other long-term liabilities	116	66	90	90	90	90	90
Long-term debt	1,398	1,638	1,545	1,528	1,349	1,022	1,004
<b>Total Liabilities</b>	<b>2,041</b>	<b>2,357</b>	<b>2,248</b>	<b>2,285</b>	<b>2,166</b>	<b>1,896</b>	<b>1,927</b>
Preferred stock	199	199	199	199	199	199	199
Common stock and add. paid-in capital	1,087	1,060	1,205	1,222	1,321	1,533	1,410
Accumulated OCI	1	(9)	(8)	(8)	(8)	(8)	(8)
Accumulated profit/losses	(749)	(1,534)	(1,699)	(1,822)	(1,892)	(1,884)	(1,722)
<b>Equity</b>	<b>538</b>	<b>(283)</b>	<b>(303)</b>	<b>(409)</b>	<b>(380)</b>	<b>(159)</b>	<b>(121)</b>



# Base Case Income Statement

US\$ millions	2021	2022	2023	2024	2025	2026	2027
Revenues from subscriptions	1,482	1,888	2,100	2,296	2,511	2,718	2,892
Revenues from other products	113	101	102	102	102	102	102
<b>Total revenues</b>	<b>1,595</b>	<b>1,988</b>	<b>2,202</b>	<b>2,398</b>	<b>2,613</b>	<b>2,820</b>	<b>2,994</b>
Cost of revenues	(356)	(437)	(480)	(523)	(570)	(615)	(653)
<b>Gross profit</b>	<b>1,238</b>	<b>1,552</b>	<b>1,722</b>	<b>1,875</b>	<b>2,043</b>	<b>2,205</b>	<b>2,341</b>
Adjusted Sales and marketing	(712)	(902)	(913)	(982)	(1,057)	(1,127)	(1,182)
Adjusted General and administrative	(177)	(182)	(188)	(193)	(197)	(198)	(196)
Adjusted Research and development	(227)	(273)	(242)	(261)	(282)	(301)	(317)
<b>Adjusted EBIT</b>	<b>123</b>	<b>195</b>	<b>379</b>	<b>439</b>	<b>507</b>	<b>578</b>	<b>647</b>
Stock-based compensation	(358)	(386)	(427)	(346)	(365)	(380)	(388)
Amort. of acquisition intangibles	(66)	(175)	(151)	(140)	(139)	(115)	-
<b>EBIT</b>	<b>(302)</b>	<b>(366)</b>	<b>(199)</b>	<b>(48)</b>	<b>4</b>	<b>83</b>	<b>258</b>
Asset write-down	-	(284)	-	-	-	-	-
Interest expense	(64)	(5)	(36)	(65)	(63)	(61)	(82)
Other income or expense	(8)	(220)	78	-	-	-	-
<b>EBT</b>	<b>(374)</b>	<b>(874)</b>	<b>(157)</b>	<b>(112)</b>	<b>(59)</b>	<b>22</b>	<b>177</b>
Income taxes	(3)	(5)	(8)	(10)	(12)	(13)	(15)
<b>Net profit or loss</b>	<b>(376)</b>	<b>(879)</b>	<b>(165)</b>	<b>(123)</b>	<b>(71)</b>	<b>9</b>	<b>162</b>