



**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** Bath & Body Works Inc. - BBWI 6.625% 2030 Senior Unsecured Notes (BB/Ba3) trading at **\$101.18** – 6.38% yield to maturity and ~179bps OAS (as of 11/19/2024)
- **Target spread: 165bps**, and base-case target total return: **~6.2% p.a**

### Supply Chain Flexibility

- "Beauty Park" near its Ohio headquarters cuts production time from three months to 21 days, transforming a 13,000-mile supply chain into a few local steps. This agility allows the company to launch 7,000 new scented products annually, staying ahead of consumer trends.

Rationale

### Post-Covid Business Normalization

- Candles and sanitizer categories are normalizing from a sales boom during the pandemic. Macro pressures that impacted margins are moderating. Management's cost-cutting plan to address inflationary cost pressures is outpacing expectations.

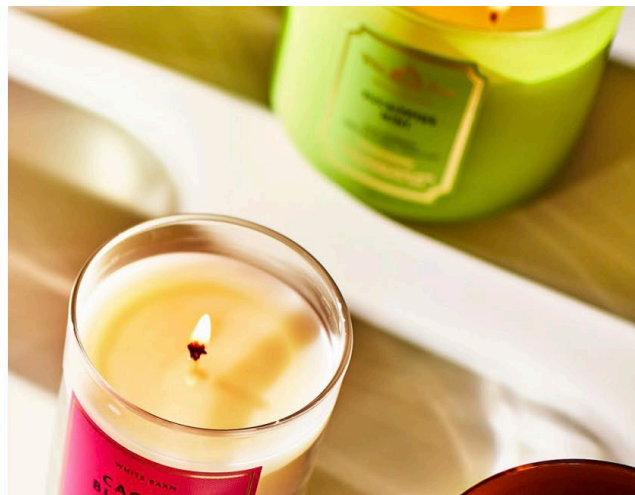
### Deleveraging from Principal Redemption

- Management has paid down \$2.8Bn of principal since 2021. It intends to retire the \$314M 2025 Senior Notes at maturity. Continued redemption of Senior Notes due over the next three years will help management achieve its targeted 2.5x leverage ratio.

# 1. Company Overview

## Bath & Body Works is a specialty retailer of home fragrance, body care, and soap and sanitizer products within the "affordable luxury" segment of the market

- BBWI was founded in Columbus, OH in 1963 and was spun-off from L Brands in 2021
- They operate 1,850 stores in North America and have 485 international partner operated stores
- They are the **#1 in market share for Home Fragrance and Soaps & Sanitizers**, and the **#2 in Body Care**
- They generate **\$7.4Bn** in revenues as of 2023, 74% comes from NA retail stores, 21% from online sales, and 5% from international franchised stores
- Q4 accounts for 40% of net sales
- The business is vertically integrated, enabling **17% operating margins**



## Bath & Body Works operates a moderately leveraged capital structure, with large debt maturities relatively far out

- We view the 2030 notes as an attractive place in the capital structure given a healthy yield and lower debt wall than longer maturity notes
- There is no secured debt senior to the 2030 notes
- 44% of outstanding unsecured notes mature after the 2030 Unsecured Notes
- Most recent capital market transactions was the issuance of the 6.625% 2030 Unsecured Notes

Facility	Out (\$MM)	Coupon	Maturity	Price	YTM	OAS	Ratings	Leverage as Multiple of EBITDA	Loan-to-Value
\$750mm Revolver	-	S + 135	8/1/26	100%					
<b>Total Secured Debt</b>	<b>-</b>								
2025 Notes	313	9.38%	7/1/25	102.51	5.13%	73	Ba2/BB		
2027 Notes	275	6.69%	1/15/27	102.24	5.56%	149	Ba2/BB		
2028 Notes	443	5.25%	2/1/28	98.99	5.60%	159	Ba2/BB		
2029 Notes	475	7.50%	6/15/29	103.32	6.63%	112	Ba2/BB		
<b>2030 Notes</b>	<b>838</b>	<b>6.63%</b>	<b>10/1/30</b>	<b>101.18</b>	<b>6.38%</b>	<b>179</b>	<b>Ba2/BB</b>		
2035 Notes	796	6.88%	11/1/35	102.61	6.54%	261	Ba2/BB		
2036 Notes	571	6.75%	7/1/36	101.90	6.51%	258	Ba2/BB		
<b>Total Senior Debt with Subsidiary Guarantee</b>	<b>3,711</b>							<b>2.0x</b>	<b>28.8%</b>
2033 Notes	283	6.95%	3/1/33	100.48	6.88%	296	B1/B+		
2037 Notes	200	7.60%	7/15/37	99.43	7.67%	373	B1/B+		
Operating Leases	2,354								
<b>Total Senior Debt</b>	<b>6,548</b>							<b>3.6x</b>	<b>50.8%</b>
<b>Total Debt</b>	<b>6,548</b>							<b>3.6x</b>	<b>50.8%</b>
Less: Cash	(514)								
<b>Net Debt</b>	<b>6,034</b>							<b>3.3x</b>	<b>46.8%</b>
Equity Market Cap	6,865								
<b>Total Enterprise Value</b>	<b>12,899</b>							<b>7.1x</b>	<b>100.0%</b>

## 2. Investment Thesis

# Thesis #1: Vertically integrated supply chain management

**Supply Chain Flexibility**

- The "Beauty Park" facility integrates production, packaging, and distribution in a single location, reducing lead times and allowing them to quickly respond to market demand
- In 2023, Beauty Park was responsible for ~55% of finished goods
- Demonstrated industry-leading speed in product development with more than 7,000 new products released each year
- By consolidating operations, it reduces dependency on external suppliers, lowers transportation costs, and improves control over quality



**CONTRACT MANUFACTURING**

**COMPONENT PRODUCTION AND PACKAGING**

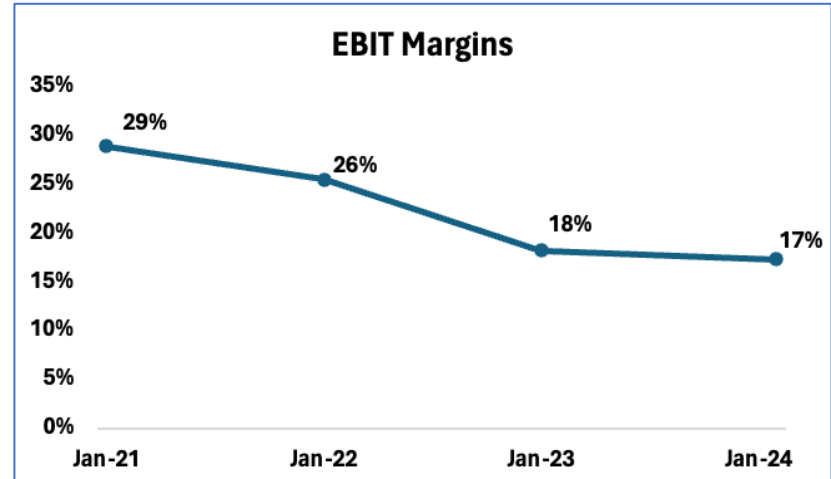
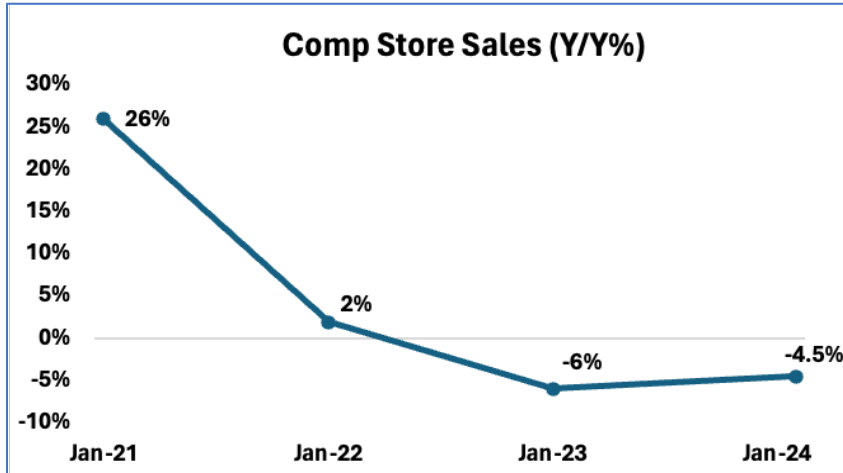
**GIFT SET ASSEMBLY**





## Thesis #2: Business is stabilizing post-COVID

- The candle and sanitizers categories experienced accelerated growth in 2020 and 2021 due to COVID and WFH trends
- Normalization as well as macro pressures have resulted in category declines, which are moderating
- BBWI has entered new markets: Men's, Lip, Laundry, Hair, Pet
- This is a replenishment category, with **37M loyalty members** (up 8%/y)
- Loyalty members drove **>80% of sales YTD**
- Cost cutting plan has exceeded expectations, and they expect to realize **\$280m** in annualized savings





## Thesis #3: Creditor-friendly capital allocation policy drives deleveraging

### History of Early Principal Redemption

- Since the spin-off from Victoria's Secret in 2021, BBWI has repaid \$2.8Bn of Senior Notes. These have been funded from a combination of proceeds from the transaction and high historical cash balances.

### Management's Targeted Leverage Ratio

- Deleveraging has been driven by management's goal to reach a 2.5x Debt/EBITDAR leverage ratio. It reported 2.7x Debt/EBITDAR on a TTM basis in Q2 2024.

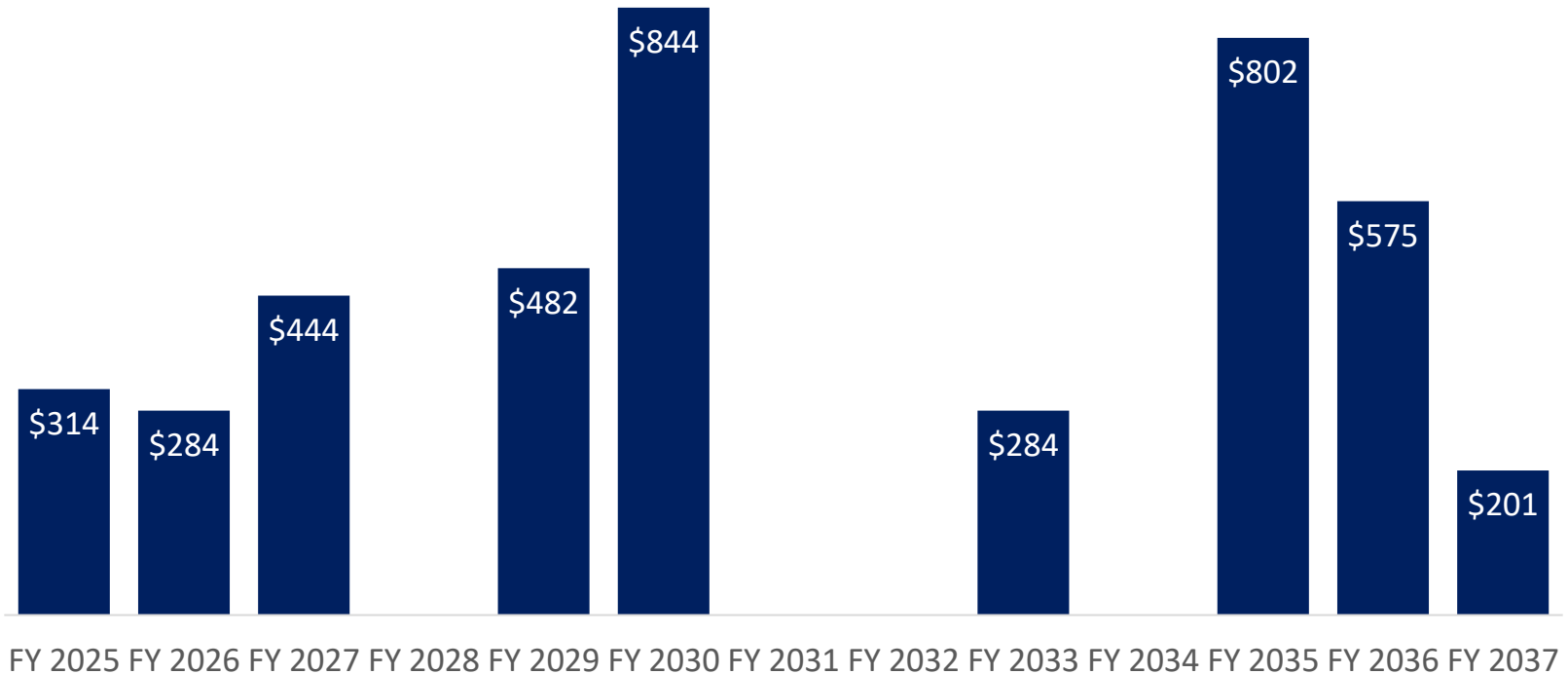
### Forecasted Principal Redemption

- Management intends to pay down the \$314M 2025 Senior Notes on the 7/1/25 maturity. Continuing this policy for the \$284M 2027 Senior Notes due 1/15/27 and \$444M 2028 Senior Notes due 2/1/28 would sustainably achieve the targeted 2.5x leverage ratio.

## Thesis #3: Creditor-friendly capital allocation policy drives deleveraging

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## Above-peer margins and favorable FCF growth permit BBWI to execute on deleveraging its capital structure

### Key Assumptions

<p><b>Base</b></p> <ul style="list-style-type: none"> <li>➤ Revenue growth at ~3% CAGR</li> <li>➤ Sales per square foot remains flat</li> <li>➤ EBITDA margin grows to 23% in 2027</li> </ul>	<p><b>Bear</b></p> <ul style="list-style-type: none"> <li>➤ Revenue growth at ~1% CAGR</li> <li>➤ Sales per square foot shrinks at -2% CAGR</li> <li>➤ EBITDA margin shrinks to 20% in 2027</li> </ul>	<p><b>Bull</b></p> <ul style="list-style-type: none"> <li>➤ Revenue growth at ~4% CAGR</li> <li>➤ Sales per square foot grows at ~1% CAGR</li> <li>➤ EBITDA margin grows to 24% in 2027</li> </ul>
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Financial Projections							
\$M	2023A	2024E	2025E	2026E	2027E	2027 Bear	2027 Bull
Revenue	7,429	7,244	7,589	7,930	8,254	7,770	8,753
EBITDA	1,554	1,500	1,611	1,739	1,867	1,560	2,117
FCF	598	740	854	968	1,089	737	1,356
Cash	1,084	1,029	1,040	1,120	1,103	670	1,661

Leverage Ratios							
\$M	2023A	2024E	2025E	2026E	2027E	2027 Bear	2027 Bull
Debt	6,757	6,556	6,324	6,105	5,723	6,205	5,717
Debt / EBITDAR	3.5x	3.4x	3.1x	2.8x	2.5x	3.1x	2.2x
Net Debt / EBITDAR	2.9x	2.9x	2.6x	2.3x	2.0x	2.8x	1.6x
FCF / Debt	8.9%	11.3%	13.5%	15.9%	19.0%	11.9%	23.7%
EBITDAR / Interest	2.6x	2.7x	2.9x	3.1x	3.4x	2.9x	3.7x
EBITDAX / Interest	3.6x	4.1x	4.5x	5.4x	6.5x	5.0x	7.5x

# 3. Valuation

# Our base case valuation calls for 165bps target spread over three years, for a total annualized return of 6.2%

**Bear** – Trades wider to 300 bps for 5.7% total return p.a.

**Base** – Tightens to 165 bps for 6.2% total return p.a.

**Bull** – Tightens to ‘BB+’ low level of 150bps for 6.3% return p.a.

	Moody's	S&P	Base	Bear	Bull
<b>Upgrade Trigger</b>	<ul style="list-style-type: none"> <li>➤ Consistent improvement in margins</li> <li>➤ Debt/EBITDA falls below 2.5x</li> <li>➤ Interest coverage sustained above 4.0x</li> </ul>	<ul style="list-style-type: none"> <li>➤ Sustained improvement in margins</li> <li>➤ Debt/EBITDA falls below 2.5x</li> </ul>	Met	Not Met	Met
<b>Downgrade Trigger</b>	<ul style="list-style-type: none"> <li>➤ Stagnant operating margins</li> <li>➤ Debt/EBITDA rises above 3.5x</li> <li>➤ Interest coverage falls below 3.0x</li> </ul>	<ul style="list-style-type: none"> <li>➤ Revenue and profitability weaken</li> <li>➤ Debt/EBITDA rises above 3x</li> </ul>	Not Met	Near trigger	Not Met

Bath & Body Works Relative Value Analysis							
	Bond	Coupon	Maturity	YTM	OAS	Leverage	Ratings
<b>BBWI 6 ½ Senior Unsecured Bond due 2030 (recommend buy)</b>	BBWI 6 ½ 10/30	6.63%	Oct 2030	6.38%	179	3.3x	Ba2/BB
Retail Comparables							
Coty Inc	COTY 6 ½ 07/30	6.63%	Jul 2030	6.17%	157	3.7x	Ba2/BBB-
Nordstrom Inc	JWN 4 03/27	4.00%	Mar 2027	5.74%	168	3.2x	Ba2/BB+
Levi Strauss & Co.	LEVI 3 ½ 03/31	3.50%	Mar 2031	5.72%	170	4.3x	Ba2/BB+
Neiman Marcus Group	NMG 8 ½ 10/28	8.50%	Oct 2028	7.88%	322	NA	Caa1/B-
Fixed-income indices:							
Bloomberg BB Index		5.75%	5 years	6.27%	162	NA	BB
Bloomberg HY Retail Index		6.56%	6 years	7.61%	310	NA	Ba3/B1

## We estimate that BBWI's Senior Unsecured Bonds with Subsidiary Guarantees have a recovery value of ~68%.

Bath & Body Works has no secured debt outstanding. The 2030 Senior Notes benefit from a guarantee from BBWI's operating subsidiaries, thus granting it contractual seniority over other unsecured debt.

Liquidation Analysis			
(\$M)			
Balance Sheet as of:	FY 2024	Recovery %	Recovery (\$)
<b>Assets</b>	Book Value		
Cash	1,084	100%	1,084
<b>Total Cash</b>	<b>1,084</b>		<b>1,084</b>
Accounts Receivable	224	90%	202
<b>Total Receivables</b>	<b>224</b>		<b>202</b>
Inventory	710	65%	462
Other Current Assets	97	10%	10
<b>Total Current Assets</b>	<b>2,115</b>		<b>1,757</b>
Net Property, Plant & Equipment	1,220	45%	553
Goodwill	628	10%	63
Trade Name	165	35%	58
Other Long-Term Assets	135	70%	95
<b>Total Liquidation Value</b>	<b>4,263</b>	<b>59%</b>	<b>2,525</b>

Waterfall Analysis	
(\$M)	Estimated \$ Recovery
Total Liquidation Value	2,525
Less: Secured Debt	-
<b>Distributable Value to Unsecured Claims</b>	<b>2,525</b>
Senior Notes with Subsidiary Guarantee	3,711
<b>Total Senior Claims</b>	<b>3,711</b>
<b>Recovery to Unsecured Claims (%)</b>	<b>68%</b>

### Financial Strategy Details

- Bath & Body Works can flex its annual share repurchases of \$300mm-\$400mm
- Dividends have been held at \$180mm per year. Management intends to increase the dividend once sustainable earnings growth has been achieved.

### Key Covenants and Callability

- A debt incurrence test requires a 2.0x Debt Service Coverage Ratio. Restricted payments are prohibited if the leverage ratio rises above 4.0x
- Standard covenant on negative pledge, sales of assets, restricted payment, etc.
- The 2030 Notes are callable starting 10/1/25 @ \$103.313. Amortizes to par call on 10/1/28.

## Risks and Mitigants

### Risks

### Mitigants

**This is a discretionary purchase that is sensitive to macro**

Though there is a degree of macro exposure, this is largely a replenishment purchase. Additionally, BBWI offers products across a wide range of price points: from a \$2 pocketbac to a \$60 perfume or \$100+ gift set.

**BBWI opens too many stores**

North American store growth has been modest at 3% per year attributable to 5% growth for new stores and 2% reduction from in-mall closures. There has been a focus on international store growth with new stores in UK and South Korea outperforming expectations. Additionally, these international stores are operated under franchises or licenses, reducing operational risk for BBWI.

**Mass retailers can compete more aggressively and capture market share**

BBWI provides a store experience that is more luxurious and personalized than competitors, uses a higher concentration of fragrance to deliver more value to customers, and benefits from a strong loyalty member base that accounts for 80% of sales. The company has legacy scents that are fan favorites and utilizes its flex model to be on trend.



# Appendix

## Dynamic management team of industry leaders and tenured executives drive BBWI's flexible business model



**CEO: Gina Boswell**

- Joined BBWI as CEO in Dec 2022
- Prior to this she served as a Senior Executive at Unilever managing a portfolio of personal care, beauty, home care, and F&B products







**CFO: Eva Boratto**

- Joined BBWI as CFO in Aug 2023
- Prior to this she served as CFO at Opentrons Labworks
- CFO at CVS Health from 2018 to 2021

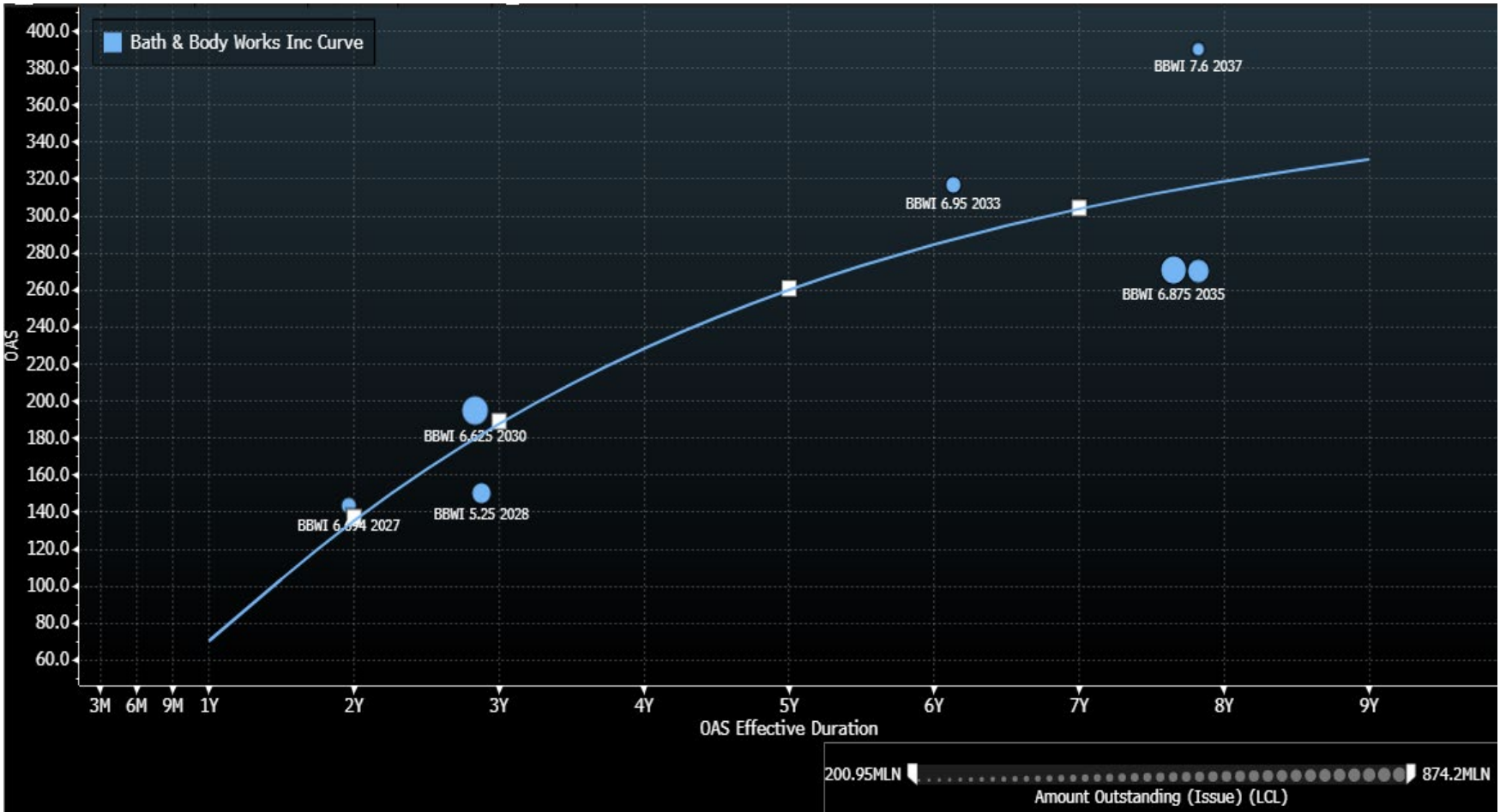


**Chief Supply Chain Officer: Tom Mazurek**

- Joined BBWI in 2000
- Appointed CSCO in May 2022
- Key contributor to Beauty Park

	Bath & Body Works	Ulta	Coty	Sally Beauty
				
<b>Issuer Ratings</b>	<b>Ba2/BB</b>	<b>N/A</b>	<b>Ba2/BB</b>	<b>Ba1/BB-</b>
<b>Revenue (\$M)</b>	\$7,403	\$11,546	\$6,134	\$3,712
<b>Ebitda</b>	1,579	1,878	1,092	434
<b>Margin (%)</b>	21.3%	16.3%	17.8%	11.7%
<b>FCF</b>	670	1,050	373	152
<b>FCF/Sales (%)</b>	9.0%	9.1%	6.1%	4.1%
<b>FCF/Debt</b>	12.3%	55.5%	8.9%	9.3%
<b>Adj. Gross Debt</b>	5,458	1,893	4,198	1,640
<b>Moody's Outlook</b>	<b>STABLE</b>	<b>N/A</b>	<b>POS</b>	<b>STABLE</b>
<b>S&amp;P Outlook</b>	<b>STABLE</b>	<b>N/A</b>	<b>POS</b>	<b>STABLE</b>

# BBWI's 2030 Senior Notes Trade Cheap within the Capital Structure



## Model Output: Income Statement and FCF

Fiscal Year	2021A	2022A	2023A	Q1	Q2	Q3E	Q4E	2024E	2025E	2026E	2027E
Fiscal year end date	01/29/22	01/28/23	02/03/24	05/04/24	08/03/24	11/02/24	02/01/25	02/01/25	01/31/26	01/31/27	01/31/28
Revenue	7,882	7,560	7,429	1,384	1,526	1,539	2,811	7,244	7,589	7,930	8,254
Stores - North America	5,709	5,476	5,507	1,065	1,140	1,167	2,139	5,496	5,755	5,986	6,228
Direct - North America	1,890	1,745	1,582	261	297	299	582	1,440	1,440	1,483	1,512
International	283	339	340	58	89	72	89	309	395	460	514
COGS	(4,027)	(4,305)	(4,193)	(778)	(900)	(869)	(1,509)	(4,057)	(4,231)	(4,401)	(4,560)
Gross Profit	3,855	3,255	3,236	606	626	669	1,302	3,187	3,358	3,529	3,694
SG&A	(1,846)	(1,879)	(1,951)	(419)	(443)	(469)	(624)	(1,956)	(2,011)	(2,062)	(2,105)
Operating Income (EBIT)	2,009	1,376	1,285	187	183	200	677	1,231	1,347	1,467	1,589
Depreciation & Amortization	363	221	269	71	71	71	71	268	264	272	278
Operating Lease Expense	216	238	254	64	64	64	64	259	264	269	276
Variable Lease Cost	108	107	107	27	27	27	27	145	152	159	165
Short-term Lease Cost	34	37	41	10	10	10	10				
EBITDAR	2,730	1,979	1,956	359	355	372	849	1,904	2,027	2,167	2,308
EBITDAR Margin	34.6%	26.2%	26.3%	25.9%	23.2%	24.1%	30.2%	26.3%	26.7%	27.3%	28.0%
Less: Capex	(270)	(328)	(298)	(46)	(55)	(75)	(75)	(250)	(300)	(300)	(300)
EBITDAX	2,460	1,651	1,658	313	300	297	774	1,654	1,727	1,867	2,008
Less: Interest Expense	(388)	(348)	(345)	(82)	(77)	(72)	(72)	(303)	(289)	(264)	(243)
Less: Lease Expense	(358)	(382)	(402)	(101)	(101)	(101)	(101)	(404)	(416)	(428)	(441)
Less: Cash taxes paid	(487)	(188)	(231)	(58)	(58)	(58)	(58)	(231)	(231)	(231)	(231)
FCF b/f change in NWC	1,227	733	680	72	64	67	544	716	792	944	1,094
Less: Net Changes in Net Working Capital	(490)	68	(82)	(95)	(140)	(240)	390	25	62	24	(5)
FCF - Levered	737	801	598	(23)	(76)	(173)	934	740	854	968	1,089
EBITDA Conversion	27.0%	40.5%	30.6%	(6.3)%	(21.4)%	(46.6)%	110.0%	38.9%	42.1%	44.7%	47.2%

## Model Forecast Assumptions

Fiscal Year	2021A	2022A	2023A	2024E	2025E	2026E	2027E
Revenue Growth	22.5%	(4.1)%	(1.7)%	(2.5)%	4.8%	4.5%	4.1%
North American Store Sales Growth	35.7%	(4.1)%	0.6%	(0.2)%	4.7%	4.0%	4.0%
Retail Square Footage Growth	3.2%	5.1%	4.3%	3.5%	3.0%	3.0%	3.0%
Sales per Square Footage Growth	33.2%	(8.2)%	(4.1)%	(3.5)%	1.3%	1.0%	1.0%
North American Online Sales Growth	(5.6)%	(7.7)%	(9.3)%	(9.0)%	-	3.0%	2.0%
International Sales Growth	26.3%	19.8%	0.3%	(9.2)%	27.9%	16.6%	11.6%
International Net New Store Growth	17.4%	26.3%	13.6%	10.3%	9.3%	8.5%	7.9%

- BBWI operated 1,850 retail stores in North America as of FY23. ~45% are located in malls (~833 stores)
- 30+ store, primarily in malls are closed annually in North America
- BBWI opens 45-50 net new stores in North America annually, resulting in ~3% of incremental retail square footage. BBWI had a North American footprint of 5.2msf
- There are 485 international stores operated under a license or franchise agreement
- 50+ net new international stores open annually. International stores comprise the majority of net new store for BBWI

## Model Output: Credit Metrics

### Credit Metrics

Fiscal Year	2021A	2022A	2023A	2024E	2025E	2026E	2027E
Fiscal year end date	01/29/22	01/28/23	02/03/24	02/01/25	01/31/26	01/31/27	01/31/28
<b>Leverage</b>							
Debt	7,149	7,205	6,757	6,556	6,324	6,105	5,723
Less: Cash	(1,979)	(1,232)	(1,084)	(1,029)	(1,040)	(1,120)	(1,103)
Net Debt	5,170	5,973	5,673	5,527	5,284	4,985	4,620
EBITDAR	2,730	1,979	1,956	1,904	2,027	2,167	2,308
Debt/EBITDAR	2.6x	3.6x	3.5x	3.4x	3.1x	2.8x	2.5x
Net Debt/EBITDAR	1.9x	3.0x	2.9x	2.9x	2.6x	2.3x	2.0x
Enterprise Value	22,191	15,507	14,028	13,706	14,596	15,603	16,620
EV/EBITDAR	8.1x	7.8x	7.2x	7.2x	7.2x	7.2x	7.2x
Net Debt/EBITDAR	1.9x	3.0x	2.9x	2.9x	2.6x	2.3x	2.0x
EV Cushion	4.3x	2.6x	2.5x	2.5x	2.8x	3.1x	3.6x
FCF/Net Debt	14.3%	13.4%	10.5%	13.4%	16.2%	19.4%	23.6%
<b>Interest Coverage</b>							
Interest Expense	388	348	345	303	289	264	243
Lease Expense	358	382	402	404	416	428	441
Total Interest Expense	746	730	747	707	704	692	684
EBITDAX	2,460	1,651	1,658	1,654	1,727	1,867	2,008
EBITDAX Interest Coverage	3.30x	2.26x	2.22x	2.34x	2.45x	2.70x	2.94x