Aritzia Inc. (ATZ:TSE)

Consumer Discretionary – Retail Apparel

A Detour from Retail Graveyard?

March 6th, 2017

Aritzia (OTC:ATZAF; TSX:ATZ) is a Canadian fashion retailer that operates through 82 retail stores and its ecommerce segment in Canada and the United States. The company designs, develops and distributes merchandise to customers directly. It designs women clothing including, but not limited to sweaters, pants, t-shirts, blouses, jackets, and accessories under its umbrella of exclusive brands and then distributes them under the Aritzia brand. The company filed for its IPO in October of 2016.

Thesis

By operating under an umbrella of mutually exclusive brands, Aritzia builds and diversifies its brand equity from multiple sources, hedging it against "fashion risk" – that is, the unpredictability of consumer preferences. We think strategic aims, like top-line growth driven by ecommerce penetration and U.S. market expansion underlying managements five-year IPO plan to grow revenues to $1.2-1.3B by fiscal year 2021 are feasible under rather conservative assumptions. While we think inorganic growth will be the most significant driver in the near-term, we are confident in their ability to grow organically through internal brand development and comparable sales growth. We reckon their strong track record of operating cash flow generation paired with a strong balance sheet, will allow them to execute on their growth initiatives with ease.

Valuation

We believe that Aritzia's current valuation is being undermined by the negative market sentiment toward retail and believe that a fair price for the stock is **$16**. As outlined by our valuation guidance, we recommend a **buy**.

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Equity Research	Canada
Price Target	**CAD$ 16.00**
Rating	Buy
Share Price (March 6th Close)	CAD$ 12.65
Total Return	26.5%

Key Statistics	
52 Week H/L	$18.35/$10.10
Market Capitalization	$1.48B
Average Daily Trading Volume	136K
Net Debt	$134M
Enterprise Value	$1.56B
Net Debt/Enterprise Value	8.6%
Diluted Shares Outstanding	116M
Free Float	50%
Dividend Yield	N/A

WestPeak's Forecast	2018E	2019E	2020E
Revenue	$755M	$862M	$958M
EBITDA	$100M	$112M	$125M
EBIT	$74M	$82M	$95M
Net Income	$40M	$47M	$55M
P/E	25.4x	25.4x	20.2x
EV/EBITDA	12.0x	11.5x	9.8x

1-Year Price Performance

All figures in CAD

Business Overview

Aritzia operates in the North American retail fashion industry. The company designs, manufactures and distributes, through its three distribution centers, a wide variety of women's clothing and accessories to its 82 brick-and-mortar locations across North America. The clothing is produced under an array of unique "in-house" brands, and then all sold under the umbrella of Aritzia. In 2000, the company began offering its products through a new channel: ecommerce. Aritzia positions itself in the retail landscape as a quality alternative to fast-fashion; that is, a product line that balances exclusivity and quality with affordability. Align with this self-described value proposition, Aritzia products are only available exclusively through its two channels: brick-and-mortar and ecommerce.

Source: Aritzia Investor Presentation

Product Line Overview

In-House Brands

As of 2017, Aritzia derived 90% of its top-line revenue from its exclusive lineup of in-house brands. The most notable of the independent labels are Wilfred, Babaton and TNA. Most recently, Aritzia is opening new stores under the banner of some of their larger brands such as Wilfred or Babaton. We see the development of new stores under assorted brands name giving their organic growth strategy more ammunition per se, and as an effective step toward diversifying their brand equity. Aritzia strives to develop and maintain each brand "individually" in an effort to address a broad range of style preferences and lifestyle requirements of its target demographic. In our view, we see Aritzia's multi-brand strategy of developing a portfolio of mutually exclusive brands not only key to differentiating itself among competitors, but also as an effective hedge against fashion risk – that is, the unpredictability of consumer preferences. As brand equity is a critical source of value that differentiates Aritzia from that of its competitors on one hand, but it can also act as a double-edged sword, posing an uncontrollable risk in the form of consumer sentiment. By simultaneously developing multiple brands under its banner, Aritzia effectively hedges itself against the risk of changing consumer preferences by having other brands it can fall back on. In our view, this multi-brand strategy acts as a hedging mechanism as it provides Aritzia flexibility to optimize its brand mix in the face of changing consumer preferences/broader market trends.

Source: Company Presentation

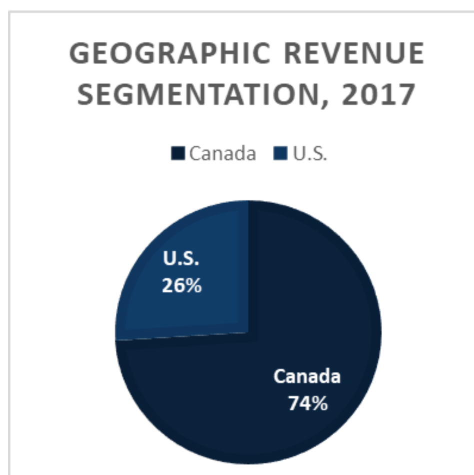
Store Economics

As many retailers in the North American retail fashion industry retreat from a predominantly brick-and-mortar oriented distribution model, herein lies a key differentiating strength of Aritzia. Underlying their expansion strategy is a disciplined real estate plan; in addition to seeking high-performing real estate in terms of foot traffic volume, the company considers how each location fits into its multi-channel strategy. The majority of Aritzia's store locations are located in class-A malls. Additionally, the company emphasizes the aspects of atmospherics, aesthetics and personalized customer service in addition to distribution with its brick-and-mortar locations. In fiscal 2016, their stores generated $1,465 in revenue per square foot. Of Aritzia's current array of 82 stores, on average each retail store setting provides approximately 5,000 square feet of selling space.

Operating Geography

These 82 locations average about 5,000 square feet. Although the greatest concentration of its retail store base is from Toronto and Vancouver, the company's five-year IPO strategy emphasizes a growth strategy focused on market development in the United States. With U.S. expansion as the centerpiece of Aritzia's strategy, key states representing growth opportunities are California, New York, and Texas. Given the company's current presence in the United States, 87% of the states are untapped markets, highlighting the potential breadth of their expansion strategy. On the distribution side, Aritzia is currently ramping up its Columbus, Ohio distribution center and is providing significant upgrades to its Vancouver distribution center. The proximity of its 3 main distribution centers to its stores suggest a strong supply chain. Although little guidance has been given regarding the precise locations of Aritzia's new stores, we estimate that regions such as the southwest, and mid-east will experience the greatest influx of new store locations given market-size potential and proximity to distributions centers.

Source: 2017 Company Report



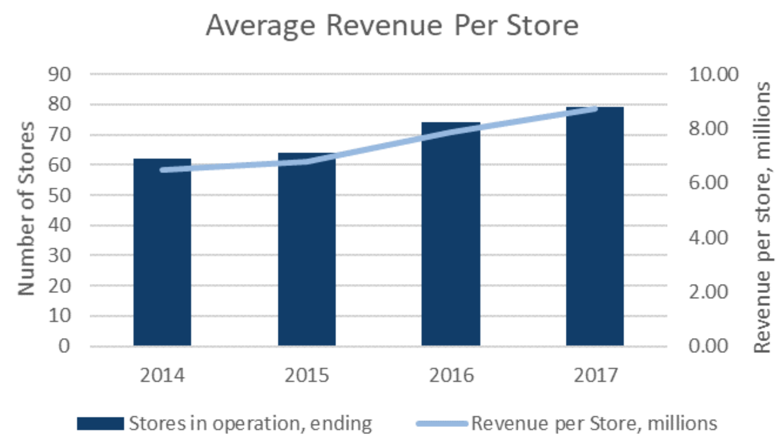
Source: 2017 Company Report

Supply Chain

Aritzia sources its raw materials primarily from Europe and Asia, while third-party offerings are obtained on a contractual basis from local wholesalers. As management has outlined that many of their suppliers and manufacturers are scalable, it will be able to limit cost increases coincidentally with its planned expansion as a result of economies of scale.

Catalysts

Brick & Mortar Expansion



Source: Annual Report

A key driver of future growth will come from their new store openings. Management has outlined that it plans to open 5-6 stores per year until 2021. With solid distribution infrastructure already built across North America and 105 viable locations indicated by third-party market research, we reckon Aritzia will be able to smoothly rollout their new store plans and maintain a double-digit comparable sales growth figure. While, in general, peers struggle to attain double digit comparable sales growth figures, based on the most previous two years, Aritzia has produced a comparable sales growth of 12% q/q. In addition to opening new locations, Aritzia has plans to increase ROIC from repositioning existing stores (layout, product assortment, footprint). While management has alluded to international growth plans, we do not see this occurring within our near-term projection horizon and have accordingly disregarded any international expansion initiatives from our projection period.

Ecommerce Development

Management has outlined its commitment toward growing its ecommerce sales to comprise 25% of revenues by 2021. Through making key investments in developing their ecommerce segment, management aims to personalize the product line by offering a greater variety of exclusive brands, whilst offering a wider selection of third party offerings. To achieve this objective, management has outlined a series of key infrastructure investments it plans to make in behaviour analytics technology. Moreover, management asserts that there exists a "synergistic relationship" between their store network and artizia.com. What we see this meaning is that, by driving brand recognition through increasing their store footprint across North America, this will in turn have the effect of channel synergy; that is, each channel will benefit from increased brand awareness. We believe management is right to emphasize the importance of developing its ecommerce segment – not only because of the economic returns, but also in the context of creating a convenient omni-channel distribution system from the perspective of consumers. A point of concern in assessing the performance of their ecommerce business segment comparatively in terms of their brick-and-mortar performance, is that management has provided a lack of visibility in revenue breakdowns, making it difficult to assess comparative segment performance. A more detailed revenue breakdown would give investors more confidence in monitoring the company's progress toward these objectives. We also see the development of Aritzia's ecommerce business segment as enhancing the reach of their supply chain. For instance, in October 2016, Aritzia introduced international shipping, giving the company its first channel to international markets.

Strong Free Cash Flow Generation and Flexible Capital Structure

By most recent measures, Aritzia's debt-to-equity ratio was .09 indicating a predominantly equity-financed capital structure, giving them more flexibility to use free cash flow to pursue their growth objectives and not being burdened by debt like many peers in the retail fashion space. Aritzia has a strong track record of generating free cash flow to finance its expansion plans. We believe management is focused on pursuing a very disciplined capital allocation strategy, in which they are using free cash flow to finance their plant expansions and deleverage their balance sheet.

2016 Initial Public Offering

In early October, Aritzia closed an initial public offering of subordinate voting shares for CAD $16/share on the Toronto Stock Exchange. 25 million shares were sold by principal shareholders, in effect raising CAD $400MM. The deal was overseen by a syndicate of underwriters, led by CIBC World Markets and Bank of America Merrill Lynch. The IPO was followed up by a $382 million secondary offering, of which the company did not receive any of the proceeds.

Five Year Plan

Underpinning management's decision to take the company public in 2016 was an articulation of key financial and operating targets. Key to management's five-year aims are inorganic growth initiatives that aim at "enhancing and expanding" their store network through new store openings and upgrades. By fiscal 2021, management aims to open at least 25-30 store in North America, two-thirds of which will be opened in the U.S. The two key drivers of Aritzia's five-year plan are expanding their North American footprint via expansions/repositions and growing their ecommerce business segment.

In terms of financial targets, management aims to grow revenues to approximately $1.1-1.2 billion by the end of fiscal 2021. In our view, this is a reasonable aim given the new store growth assumptions outlined above, and indicates technical feasibility in our model. It is worth noting that this expectation of hitting the aforementioned revenue targets rest upon the underlying assumption that management will follow through on its commitment to open roughly 6 stores per year –which is built into our model and is consistent with average revenue per store growing at roughly 5% YoY. Our skepticism regarding their financial targets arises with their EBITDA and net income targets of $195-220mm and $115-130mm respectively. These differences in expectations rest within expectations regarding cost assumptions.

Management Team

Mr. Brian Hill, Founder, CEO and Chairman

Mr. Brian Hill is the CEO and founder of Aritzia, having started the company in 1984 in Vancouver. In 2017, his total compensation totaled $5.4 million. Given that a significant proportion of his compensation is tied to stock options and that presumably has a deep-rooted connection to the company, it is safe to assume his incentives are well aligned with shareholders, and there exist no apparent principal agency issues. Reciprocally, having been with the company since its inception and has remained involved with the company's operations since, an element of the company's continuing success and morale is tied to Mr. Hill's presence in management.

Mrs. Jennifer Wong, President, COO

Mrs. Wong is the Chief Operating Officer of Aritzia - having assumed the position in 2007 - as well as the president – having assumed that title in 2015. Like Mr. Hill, Mrs. Wong's tenure with the company stretches out as many as 3 decades, as she began as a Sales Associate in 1987. During her tenure in upper-management, she has overseen key developments in facilitating Aritzia's development of a more sophisticated supply chain: the ecommerce launch in 2012; adoption of ERP in 2008 increasing supply chain visibility and coordination; and its U.S. expansion, launched in 2007. In 2017, her total compensation totaled $1.56 million. Currently, she has over $12 million of outstanding stock options, suggesting her incentives are aligned with shareholders.

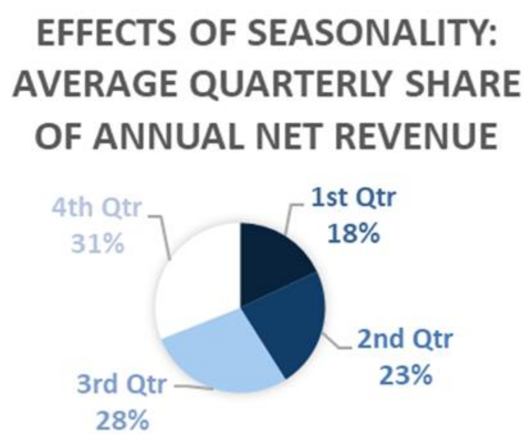
Mr. Todd Ingledew, CFO

Unlike the others holding key managerial positions, Mr. Ingledew is somewhat new to the company, having assumed the role of CFO in 2016. Prior to Aritzia, Mr. Ingledew had been involved with Steve Nash Fitness World and Intrawest ULC. In 2017 his total compensation amounted to $2.2 million.

Industry Analysis

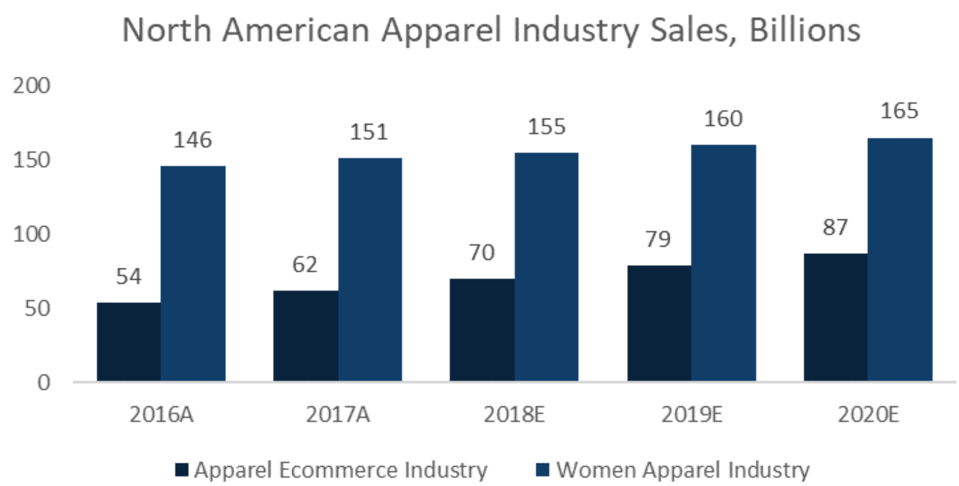
Competition and Market Structure

Aritzia operates in the North American women's apparel industry, a fragmented industry currently in the maturity/decline phase. The retail fashion sector is one that is highly competitive and is often dictated by changes in consumer preferences, often unpredictable in nature. From the consumers perspective, fashion retailers, by way of their product offerings, can be conceptualised in three main categories: fast fashion; affordable luxury; and luxury. Aritzia positions itself in between fast fashion and affordable luxury. According to a report on the Canadian retail industry by PWC, two-thirds of Canadian consumers shop at their favourite retails because "their prices are good". We believe that in the context of these consumer preferences, Aritzia's value proposition of providing an affordable product offering that still retains elements of luxury and uniqueness is fueling a differentiation advantage over competitors.

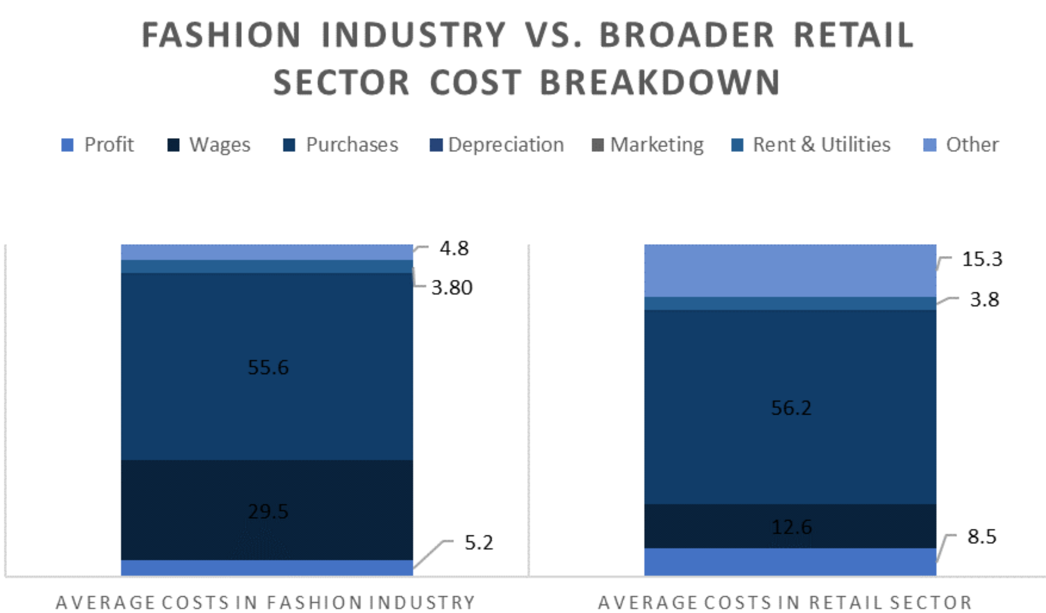


Source: Annual Report

Major players in the industry that comprise Aritzia's direct competition are Zara, Forever 21, H&M, Urban Outfitters, Nordstrom and many other boutique retailers. By many estimates, the degree of competition is high, as the industry has become saturated by many global retailers who compete on scale and lead on the basis of being a low-cost provider. In our view, barriers to entry are moderate, as brand loyalty and initial capital investment represent the two most significant barriers. A recent industry trend that has shaped the competitive landscape in the North American apparel industry has been import penetration from low wage countries. However, where many larger scale domestic retailers have been unable to weather the influx of "fast fashion" cost leaders, some retailers have been able to carve out a niche in the market by focusing explicitly on adding value in ways other than cost. In this way, we see Aritzia well positioned in a rather dire industry.



Source: Euromonitor

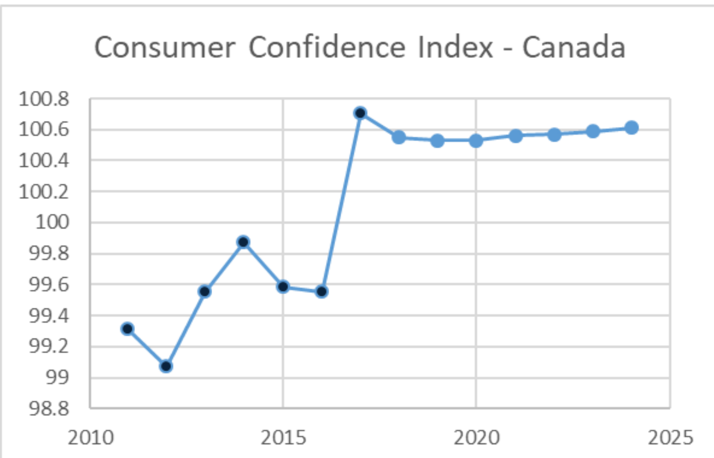


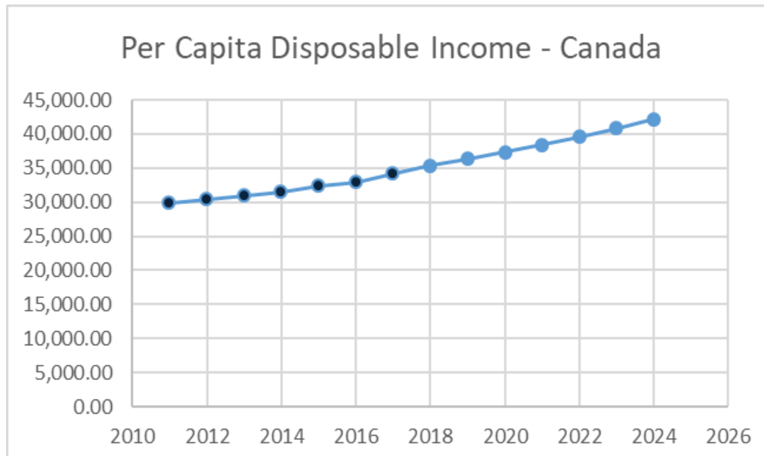
Source: IBIS World

All figures in CAD

Key Economic Drivers

Common to the discretionary nature of the retail fashion sector, consumer disposable income represents a significant driver of revenue. Per capita disposable income is expected to rise as economic growth occurs. Last year, consumer disposable income increased 3.6% and is expected to grow at 3.5% in 2018. A possible macroeconomic risk specific to Aritzia's target demographic rises in short-term interest rates that would strain disposable income.





Source: IBIS World

On the supply side, Aritzia's raw material costs are primarily driven by purchasing and manufacturing of raw materials from the textile mill industry. Industry analysis provided by IBIS world suggests that analysts expect the percentage of revenue spent on purchases to increase until 2022. In comparison to the weighted average costs of all industries, wages represent a fairly substantial portion of total costs. In this light, the cost of labour represents a proportionately larger expenditure then the broader retail sector, indicating sensitivity to wage growth and minimum wage legislation.

Pressure from Imports

Imported goods into Canada and the U.S. determine the extent to which foreign-made products serve as substitutes for domestically made products. According to IBIS World, the total value of clothing imports into Canada will grow at annualized rate of 5.8%. Import-substitution is particularly concerning trend for women's clothing products, as production is less capital intensive and therefore easier for developing countries to specialize in it. This in turn, we reckon, will amplify price competition and drive higher-cost producers out of the market. Thus, this emphasizes the importance of competing on a differentiated strategy basis. As Aritzia, in our view, holds a differentiated value proposition and simultaneously sourcing lower cost materials from scalable producers, we believe they are well situated to weather industry headwinds.

All figures in CAD

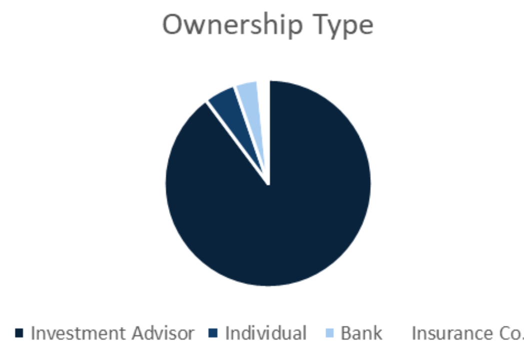
Demographic Analysis

Aritzia's core demographic is women aged 15-45. A key influencer of this demographic is social media. A report by PWC indicates that 84% of shoppers aged 18-24 have had their shopping behaviours influenced by social media. However, PWC asserts that many Canadian retailers haven't grasped an effective handle on social media, citing an inability for them to effectively analyze and distill data. In the case of Aritzia, however, we believe their strategy of investing in their "advanced business intelligence and behaviour analytics units" will drive ecommerce growth by personalizing customers shopping experience and thereby increasing the conversion rate. Moreover, we believe that their use of Instagram is consistent with the core communication channel associated with this demographic and will continue to build brand equity.

Shareholder Base, Liquidity, Market Depth

Shareholder Base

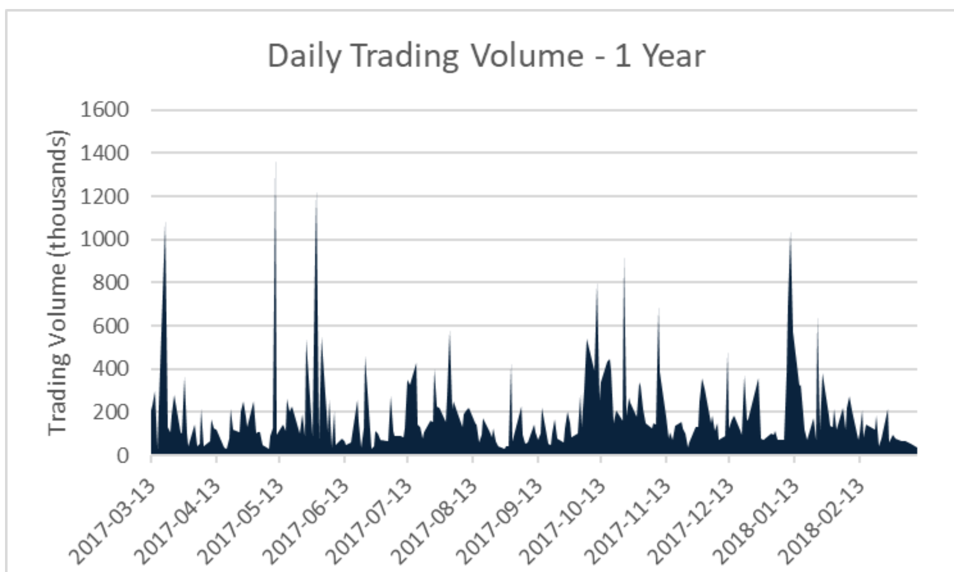
As of February 5th, 2018, Aritzia had approximately 116MM shares outstanding. Its three main largest shareholders are QV Investors, RBC Global Asset Management, and CI Investments, comprising 11.14%, 9.86%, and 5.73% respectively. With institutional investors holding 61% of the float, we consider this stock to be of institutional quality.



Source: Bloomberg LP

Trading Volume and Liquidity

The stock has an average daily trading volume of 136.0K. Accordingly, we think there is little to suggest liquidity risk is of significant concern. Its short interest as a percentage of its float is 1.64%, suggesting little negative sentiment towards the stock.



Source: Bloomberg LP

All figures in CAD

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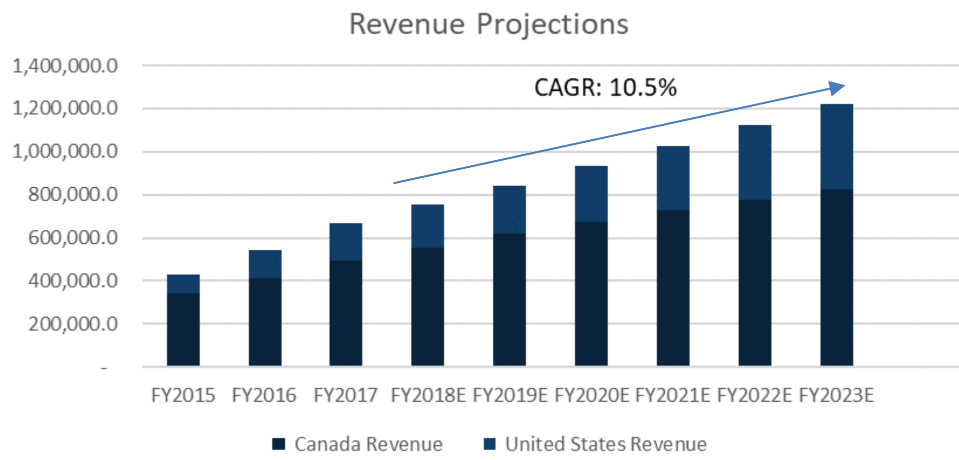
Valuation

Revenue Estimates



Source: Bloomberg LP, WestPeak Research Estimates

Revenue has been modelled on a same-store basis and driven by an average revenue per store figure, which we have forecasted to grow at 5%. Concerning the effects of seasonality which were discussed earlier, in our revenue projections - where applicable on a quarterly basis -, we have adjusted the average revenue per store in the former half of the year to be lower relative to the latter. We have factored in management's strategic aim of opening approximately 6 stores each fiscal year into our revenue projections. At the beginning of our revenue projection horizon, we used the most current average revenue per store figure of $8.72 million and applied a 5% same-store sales growth rate. We also considered segmental geography in forecasting revenue, attributing higher growth rates to its United States operating segment. As a result of these assumptions, we have forecasted revenue to grow at an annualized rate of 10.5% over our 6-year projection horizon.

Costs

Aritzia operates with a considerable degree of operating leverage (approximately 25% over last 3 years) and we have assumed that this continues. Align with managements inorganic growth initiatives, we expect that SG&A will climb with the opening of new stores, ecommerce expansion and generally higher expenses associated with being a public company (in contrast to pre-IPO years). In terms of cost of goods sold, we believe management will realize cost-cutting efficiencies resulting from sourcing more cost-effective materials and supply chain integration initiatives, as it will begin to recognize productivity increases from its Columbus and Vancouver distribution center expansion. In line with these expectations, we have forecasted a COGS margin that stays constant comprising 52% of sales. As a considerable proportion of Aritzia's cost of goods sold is denominated in American dollars, it is worth noting that this report has not included foreign exchange fluctuations given the uncertainty of the USD/CAD relationship. As a result of these assumptions, over our forecast period, we have projected an EBITDA margin of 22% throughout our projection horizon.

Depreciation and Amortization

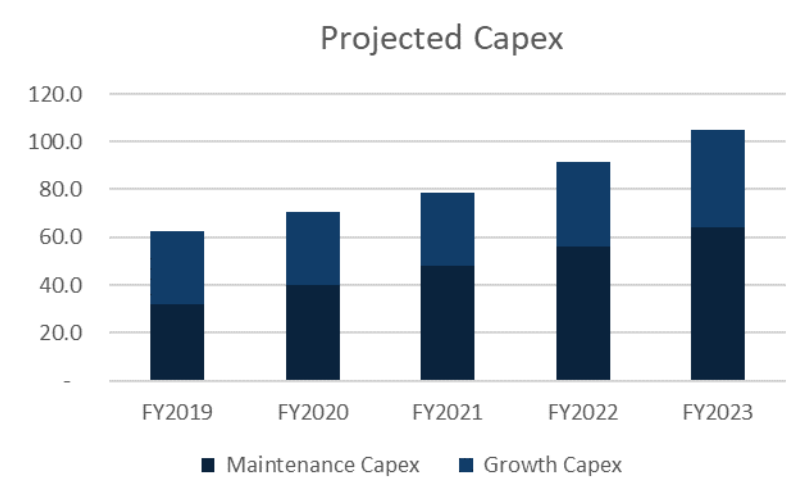
In projecting depreciation and amortization, we have utilized a depreciation schedule on a straight-line basis. As indicated by historical analysis, the most current effective useful life of PP&E is 4.6 years. Thus, in forecasting D&A along our projection horizon, we have assumed that this useful life measure does not change.

All figures in CAD

Working Capital

Throughout our projection horizon, we assumed that net working capital will grow at a pace necessary to facilitate Aritzia's expansion. Inventory as a percentage of revenue was forecasted on the basis of an inventory turnover rate. We expect Aritzia to continue to turnover its inventory 4 times per year. Lastly, regarding current liabilities, accounts payable as a percentage of COGS was forecasted on the basis of days payable outstanding. We expect Aritzia to take 45 days on average to pay its suppliers into the future, thus, allowing us to hold A/P as a percentage of COGS constant at 12%.

Capital Expenditures



Source: WestPeak Research Estimates

Capital expenditures were forecasted to reflect new store expansion, leasehold improvements to existing retail stores and the purchase of furniture and equipment for such stores. As Aritzia's market expansion ambitions is a critical component of our thesis, we have forecasted capital expenditures align with management's guidance of opening approximately 6 stores per year, mostly in the United States. Analyzed using horizontal analysis based on historical data, we have estimated the capitalized costs associated with opening a single new store to be $5.1 million dollars. Given plans to expand their store base at a rate of 5 stores per year and reposition approximately 5-6 stores as well, we have forecasted capital expenditures to comprise approximately 40% of their fixed asset base in our projection horizon. Our capital expenditure forecasts have also taken into account management's guidance of expending $25-30 million (growth capex) on new stores each year for the next 5 years. Our maintenance capex projections comprise of anticipated spending on repositioning/expanding stores. In terms of divestures, we have not forecasted any cash inflows from investing activities due to management's track record and lack of store closures expected.

Effective Tax Rate

Based on its most recent quarterly results (Q3 2018), 35% of Aritzia's earnings before taxes was attributable to tax authorities. In previous years, Aritzia's tax expense has been somewhat inconsistent, primarily due non-tax-deductible stock-based compensation skewing net income. After weighing the marginal impact of different taxation scenarios on our valuation, we have concluded that the applicable tax rate is rather insensitive to the outcome of our valuation, and, accordingly, have conservatively assumed a 35% tax rate.

All figures in CAD

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Weighted-Average Cost of Capital (WACC)

We have based our calculation of the weighted average cost of capital for Aritzia from multiple sources. To determine the relative weights of each capital source, we used the market value of debt and the market value of equity. In determining the cost of debt, we used Prof. Aswath Damodaran's estimated YTM of retail bonds and found it to be 3.91%. In determining a discount rate to fairly compensate equity holders to bear idiosyncratic and market risk endemic to Aritzia's common stock, we have assumed a levered beta of 1.12. This levered beta is composed of Prof. Aswath Damodaran's estimate of an industry-specific unlevered beta of 1.05, and our subsequent levering-up to 1.12 (using a debt/equity ratio of 9% and effective tax rate of 35%) to reflect the financial risk of the company. Moreover, as a proxy for the cost of equity, we utilized the 10-year average return of the S&P/TSX, and came up with 8%. Lastly, we have assumed a risk-free rate of 1.86% based on the most recent YTM of 5-year CAD T-bills. To reflect the effects of the interest tax-shield, we have carried forth our assumption of a normalized effective tax rate of 35%. As a result of these inputs, we have calculated our weighted-average cost of capital to be approximately, 8.23% We have included a sensitivity analysis to show readers how are target share price will fluctuate with changes in WACC.

Terminal Multiple and Growth Rate

Beyond our projection horizon of 10 years, we calculated a terminal value using a perpetual growth rate of 2%. This growth rate of 2% approximately reflects the rate of economic growth (GDP) in Aritzia's operating environment (United States and Canada), thus serving as a reliable proxy for perpetual cash flow growth. In addition to a perpetual growth rate, we have assumed an 8.8x EV/EBITDA multiple which reflects the median trading multiple based on comparable companies in the consumer discretionary/retail fashion sector. We have included a sensitivity analysis to demonstrate to readers to what extent incremental changes in the aforementioned variables will have on our valuation.

Comparable Companies Analysis

In determining a relevant universe upon which to choose comparable companies, we focused on choosing companies within the North American women's retail fashion industry, with an established Canadian presence. We believe the companies chosen offer a useful, market-oriented comparison.

Lululemon

Lululemon Athletica is an apparel company that design, distributes, and retails athletic apparel for women and men. The company operates through two distinct segments: company-operated stores and direct to consumer.

Canada Goose Holdings

Canada Goose Holdings Co. is a Canadian based holding company that, through its subsidiaries, designs, manufactures and distributes outerwear for men, women and children.

Michael Kors

Michael Kors is a holding company that designs, distributes and retails apparel and accessories such as handbags, shoes, watches, sunglasses, and outerwear.

Urban Outfitters

Urban Outfitters is an American based retailer that sells fashion apparel, accessories, and household merchandise to customers in North America through its retail stores and ecommerce platform.

Reitman's Ltd.

Reitman's limited is a Canadian based retailer that sells women's apparel through its brick-and-mortar store network throughout Canada.

Guess Inc.

Guess Inc. is a Los Angeles based fashion designer/retailer that designs, produces and distributes casual apparel for men, women and children.

American Eagle Outfitters

American Eagle Outfitters is an American based clothing and accessory retailer. The company conceives, designs, manufactures and retails clothing garments and accessories for men and women.

Tailored Brands Inc.

Tailored Brands is a U.S. based retail holding company for various apparel stores, including Men's Warehouse and Joseph A. Banks.

Comparable Companies Analysis Summary

Our comparable companies' analysis yielded a target share price of approximately $14.00. To determine the comprehensive share price for Aritzia's common stock, we decided to utilize a 50% weighting of this analysis to ensure we captured the market sentiment and the broader retail industry valuation concerns that characterize Aritzia's market price.

Recommendation

Despite investor skepticism about the company's ability to execute on its IPO objectives, we believe the skepticism is being driven by a more general sentiment toward the fashion retail industry as a whole. Aritzia is strategically positioned and on track to execute on its IPO five-year growth plan. We believe the company offers a distinctly unique value proposition from that of its peers; one that offers high-quality fashionable products at affordable prices. Moreover, we believe there is a compelling case to be made for the viability of managements target of developing its ecommerce business segment to help drive topline growth and international awareness. In contrast to a retail fashion industry with few catalysts to drive growth, we see Aritzia's diverse brand portfolio, unpenetrated market locations in the United States, and promising comparable stores growth rate as indicating a compelling growth narrative. We also see organic growth initiatives, albeit to a lesser extent, contributing to future revenue growth. Where many retailers seem to be in retreat from predominantly brick-and-mortar based business model, Aritzia is wholeheartedly embracing concurrent ecommerce and physical store expansions – something we see as channel synergy that will in turn drive increased brand awareness. By utilizing a 50% and 50% weighting from our discounted cash flow analysis and comparable companies analysis respectively, we have devised a target share price of CAD $16.00. This share price is reflective of management executing on its expansion initiatives as well as having conservative comparable store sales growth assumptions built in. Thus, we believe investors should commit long-term capital to this firm.

Risks

Fashion Risk

Perceived value on part of the consumer is what enables Aritzia to mark-up and charge a premium for their labels, allowing for a healthy gross margin – a key driver of revenue. Unforeseen changes in consumer's perception of the Aritzia and/or its associated brand may cause a negative impact on its valuation. Although we have outlined in our thesis that we reckon Artizia's multi-brand strategy diversifies them to an extent against this risk, value lies in the eye of the beholder.

Seasonality Risk

The impact of unforeseen weather patterns effecting regional operating segments can have an adverse influence in the direction of consumer trends and contribute to cyclicality. For instance, if the East Coast region experiences a prolonged period of warm weather stretching into the winter season, that could adversely affect the company's ability to allocate its inventory, as its product lines tend to be seasonally themed. Resulting inventory surpluses are often sold at discount or disposed and incur the business a loss. Based on our analysis of the dispersion of annual revenue on a quarterly basis, it is evident that the latter half Aritzia's fiscal year generates a higher share of the fiscal years total revenue, highlighting the factors of back-to-school (Q3) and holiday shopping (Q4) that pronounce the effects of seasonality on revenues.

Expansion Risk

As Aritzia broadens its geographic presence - particularly in the United States – it faces the inherent uncertainty of how the new market will perceive its existing offering. The retail fashion landscape varies regionally, and it is extraordinarily difficult to anticipate consumer preferences/expectations. Moreover, the company must carefully balance the risk of spreading its resources too thin whilst expanding.

Currency Risk

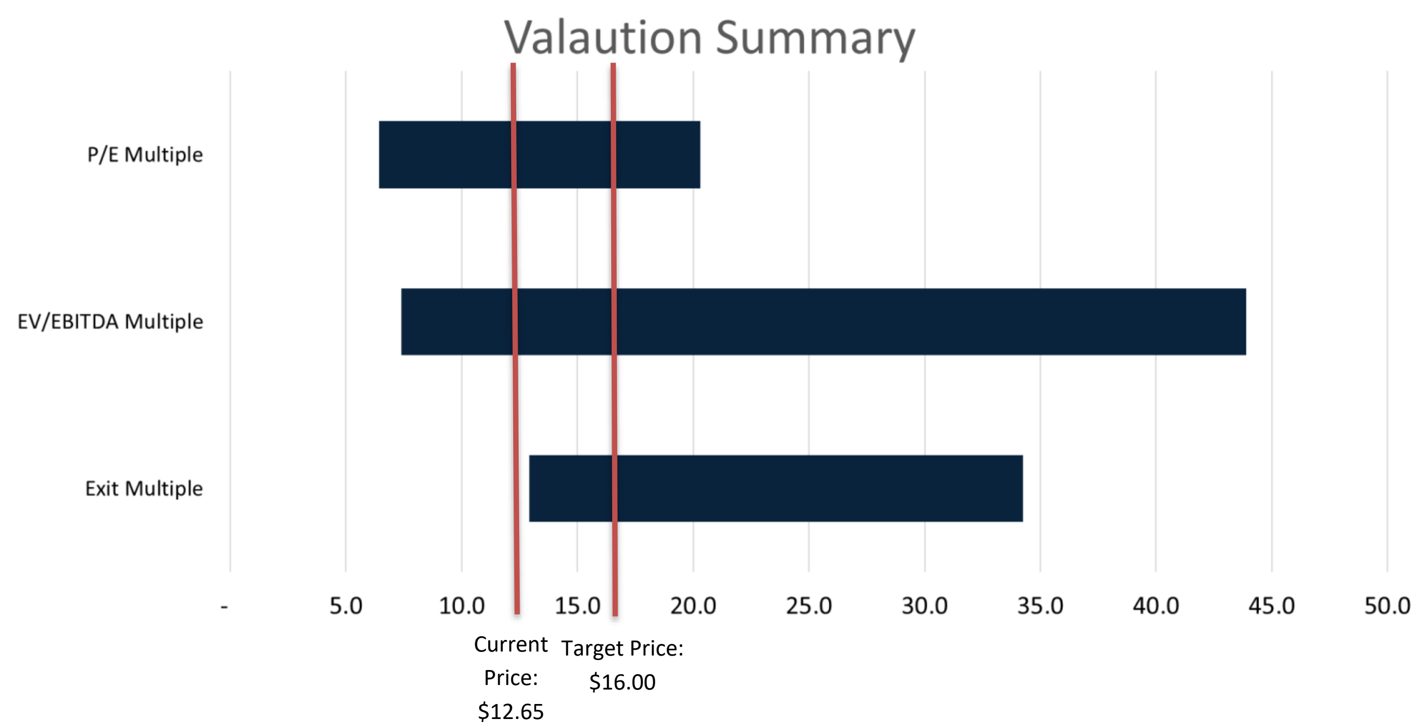
In its 2017 fiscal year, Aritzia derived 26% of its revenue from the United States. Given management's guidance of focusing 2/3 of its new store openings to be in the U.S., this proportion will gradually increase. As indicated by our analysis, Aritzia will be deriving close to 31% of its revenue from the U.S. However, while revenue tends to be skewed toward Canadian dollars, a strong majority of their cost of goods sold is denominated in U.S. dollars. Accordingly, a change in the value of the Canadian dollar relative to the U.S. dollar will materially affect gross profitability.

Macroeconomic Risk

Given the discretionary nature of Aritzia's offerings, macroeconomic factors, such as increases in interest rates or employment levels, may adversely affect the disposable income of Aritzia's core demographic – 15-45-year-old women.

Appendices

Exhibit 1: Valuation Summary



All figures in CAD

Exhibit 2: Pro Forma Income Statement

	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
	FY2015	**FY2016**	**FY2017**	**FY2018**	**FY2019**	**FY2020**	**FY2021**	**FY2022**	**FY2023**
Income Statement									
Revenue	**427.4**	**542.5**	**667.2**	**749.5**	**926.3**	**998.9**	**1,106.0**	**1,226.4**	**1,366.5**
COGS	**250.8**	325.9	380.5	407.2	481.7	519.4	575.1	637.7	710.6
Gross profit	**176.6**	**216.6**	**286.7**	**342.3**	**444.6**	**479.5**	**530.9**	**588.7**	**655.9**
% margin	41.3%	39.9%	43.0%	45.7%	48.0%	48.0%	48.0%	48.0%	48.0%
SG&A + OPEX	125.4	145.8	281.8	201.3	234.4	259.7	287.6	318.9	355.3
EBITDA	**51.2**	**70.8**	**4.9**	**141.0**	**210.3**	**219.7**	**243.3**	**269.8**	**300.6**
% margin	*12.0%*	*13.1%*	*0.7%*	*18.8%*	*22.7%*	*22.0%*	*22.0%*	*22.0%*	*22.0%*
D&A	17.3	18.2	21.1	28.5	33.0	37.5	44.7	52.1	60.7
EBIT	**33.9**	**52.6**	**(16.3)**	**112.6**	**177.3**	**182.2**	**198.6**	**217.7**	**240.0**
% margin	*7.9%*	*9.7%*	*-2.4%*	*15.0%*	*19.1%*	*18.2%*	*18.0%*	*17.8%*	*17.6%*
Interest expense	13.0	11.0	10.5	5.2	5.4	5.4	5.4	5.4	5.4
Other expenses (income)	(1.8)	(3.5)	(1.4)	2.2	-				
EBT	**22.7**	**45.1**	**(25.4)**	**105.1**	**171.9**	**176.9**	**193.3**	**212.4**	**234.6**
Income taxes	6.2	12.8	30.7	**35.5**	**60.2**	61.9	67.6	74.3	82.1
Net income	**16.5**	**32.4**	**(56.1)**	**69.7**	**111.7**	**115.0**	**125.6**	**138.0**	**152.5**
% margin	3.8%	6.0%	-8.4%	9.3%	12.1%	11.5%	11.4%	11.3%	11.2%
Shares outstanding, basic	173.7	173.7	104.8	110.0	110.0	110.0	110.0	110.0	110.0
Shares outstanding, diluted	173.7	173.7	104.8	116.2	116.2	116.2	116.2	116.2	116.2
Earnings per share, basic	**$0.09**	**$0.19**	**-$0.54**	**$0.63**	**$1.02**	**$1.05**	**$1.14**	**$1.26**	**$1.39**
Earnings per share, diluted	**$0.09**	**$0.19**	**-$0.54**	**$0.60**	**$0.96**	**$0.99**	**$1.08**	**$1.19**	**$1.31**

Note: Historical COGS has been adjusted to reflect depreciation

All figures in CAD

Exhibit 3: Pro Forma Cash Flow Statement

	Dec-14	Dec-15	Dec-16	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
	FY2015	**FY2016**	**FY2017**	**FY2018**	**FY2019**	**FY2020**	**FY2021**	**FY2022**	**FY2023**
Cash Flow Statement									
Operating activities									
Net income	16.5	32.4	(56.1)	69.7	111.7	115.0	125.6	138.0	152.5
Depreciation and amortization	21.1	22.1	21.5	28.5	33.0	37.5	44.7	52.1	60.7
Cash flow before working capital	**54.4**	**69.3**	**91.3**	**95.8**	**144.8**	**152.5**	**170.3**	**190.1**	**213.2**
Cash flow from operating activities	**33.9**	**57.6**	**112.1**	**99.4**	**142.4**	**117.7**	**165.8**	**185.0**	**207.2**
Cash used in investing activities	**(12.7)**	**(28.2)**	**(31.1)**	**(70.8)**	**(62.6)**	**(70.6)**	**(78.6)**	**(91.7)**	**(104.8)**
Cash from financing activities	**(21.5)**	**(33.1)**	**(5.1)**	**6.7**	**-**	**-**	**-**	**-**	**-**
FX effect	0.1	0.0	0.0	(0.1)	-				
Net change in cash	**(0.2)**	**(3.6)**	**76.0**	**35.2**	**79.8**	**47.1**	**87.2**	**93.3**	**102.4**
Beginning cash balance	**7.4**	**7.2**	**3.6**	**79.5**	**114.7**	**194.5**	**241.6**	**328.8**	**422.1**
Ending cash balance	**7.2**	**3.6**	**79.5**	**114.7**	**194.5**	**241.6**	**328.8**	**422.1**	**524.5**

All figures in CAD

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Exhibit 4: Pro Forma Balance Sheet

	Dec-14	*Dec-15*	*Dec-16*	*Dec-17*	*Dec-18*	*Dec-19*	*Dec-20*	*Dec-21*	*Dec-22*
	FY2015	**FY2016**	**FY2017**	**FY2018**	**FY2019**	**FY2020**	**FY2021**	**FY2022**	**FY2023**
Balance Sheet									
Current assets									
Cash and cash equivalents	7.2	3.6	79.5	114.7	194.5	241.6	328.8	422.1	524.5
Total current assets	**85.7**	**95.5**	**169.1**	**231.5**	**335.9**	**390.2**	**491.8**	**601.3**	**722.6**
Non-current assets									
Property and equipment	63.9	81.5	95.7	142.9	172.5	205.6	239.5	279.1	323.3
Total non-current assets	**287.7**	**305.6**	**317.8**	**364.6**	**394.2**	**427.3**	**461.2**	**500.8**	**544.9**
Total assets	**373.4**	**401.1**	**486.8**	**596.1**	**730.1**	**817.4**	**952.9**	**1,102.1**	**1,267.6**
Current liabilities									
Current portion of long-term debt	39.4	11.3	16.1	15.3	15.3	15.3	15.3	15.3	15.3
Total current liabilities	**86.5**	**67.2**	**101.5**	**113.6**	**135.9**	**108.3**	**118.2**	**129.3**	**142.2**
Non-current liabilities									
Long-term debt	135.0	134.2	118.5	118.6	118.6	118.6	118.6	118.6	118.6
Total non-current liabilities	**206.6**	**221.3**	**183.7**	**192.4**	**192.4**	**192.4**	**192.4**	**192.4**	**192.4**
Total liabilities	**293.1**	**288.4**	**285.2**	**306.0**	**328.3**	**300.7**	**310.6**	**321.7**	**334.6**
Shareholders' equity									
Total shareholders' equity	80.3	112.7	201.6	**290.0**	**401.7**	**516.7**	**642.3**	**780.4**	**932.9**
Total equity	**80.3**	**112.7**	**201.6**	**290.0**	**401.7**	**516.7**	**642.3**	**780.4**	**932.9**

All figures in CAD

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Exhibit 5: WACC Calculation and Sensitivty Analysis

WACC Calculations

Cost of Equity	
Risk-free rate	1.8%
Expected market return	8.0%
Market risk premium	6.2%
Beta	1.12
Cost of equity	**8.7%**

Cost of Debt	
Pre-tax cost of debt	3.9%
Effective tax rate	35.0%
Cost of debt	**2.5%**

WACC	
Total shareholders' equity	1,478.6
Total outstanding debt	133.8
Total capitalization	1,612.5
Cost of equity	8.7%
Cost of debt	2.5%
WACC	**8.23%**

Terminal EV/EBITDA Multiple	WACC: 9.23%	8.73%	8.23%	7.73%	7.23%
6.8 x	$ 12.93	$ 13.24	$ 13.57	$ 13.91	$ 14.26
7.8 x	$ 14.52	$ 14.88	$ 15.25	$ 15.63	$ 16.02
8.8 x	$ 16.11	$ 16.51	$ 16.92	$ 17.35	$ 17.78
9.8 x	$ 17.70	$ 18.14	$ 18.60	$ 19.06	$ 19.55
10.8 x	$ 19.29	$ 19.77	$ 20.27	$ 20.78	$ 21.31

All figures in CAD

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Exhibit 6: DCF Analysis

	Dec-13	Dec-14	Dec-15	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
	FY2014	**FY2015**	**FY2016**	**FY2017**	**Q1-2018**	**Q2-2018**	**Q3-2018**	**Q4-2018**	**FY2018**	**FY2019**	**FY2020**	**FY2021**	**FY2022**	**FY2023**
Free Cash Flow														
EBIT	41.6	33.9	52.6	(16.3)	12.0	15.5	39.9	45.1	112.6	177.3	182.2	198.6	217.7	240.0
Less: Tax expense	(14.5)	(11.9)	(18.4)	5.7	(4.2)	(5.4)	(14.0)	(15.8)	(39.4)	(62.0)	(63.8)	(69.5)	(76.2)	(84.0)
Add: Depreciation and amortization	16.8	17.3	18.2	21.1	6.8	7.5	7.2	6.9	28.5	33.0	37.5	44.7	52.1	60.7
Less: Capital expenditures	(26.2)	(11.4)	(28.0)	(29.8)	(16.5)	(13.0)	(17.0)	(23.3)	(69.8)	(62.6)	(70.6)	(78.6)	(91.7)	(104.8)
Less: Change in net working capital	(3.3)	(20.5)	(11.7)	20.8	(4.5)	(6.6)	17.1	(2.5)	3.5	(2.3)	(34.8)	(4.6)	(5.1)	(6.0)
Unlevered free cash flow	**14.4**	**7.5**	**12.7**	**1.6**	**(6.3)**	**(1.9)**	**33.3**	**10.4**	**10.4**	**83.3**	**50.6**	**90.6**	**96.8**	**105.9**
Discount factor					-	-	-	0.25	0.25	1.25	2.25	3.25	4.25	5.25
Present value of unlevered free cash flow								**10.2**	**10.2**	**77.3**	**42.3**	**70.1**	**69.1**	**69.9**

All figures in CAD

Exit Multiple Method		
Terminal EV/EBITDA multiple		**8.8 x**
PV sum of unlevered FCF		338.9
PV of terminal value		1,746.7
Enterprise value		**2,085.6**
Add: Cash		56.2
Less: Debt		133.8
Less: Other EV adjustments		-
Equity value		**2,008.0**
Shares outstanding		116.2
Implied share price	**$**	**17.27**

Current price	$	12.65
Implied price	**$**	**17.27**
Total return		**36.6%**

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Exhibit 7: Comparable Companies Analysis

Comparable Company Analysis

Company	Ticker	LTM EV/EBITDA	NTM EV/EBITDA	2017E EV/EBITDA	2018E EV/EBITDA	LTM P/E	NTM P/E	2017E P/E	2018E P/E
		EV/EBITDA Multiple				P/E Multiple			
Canada Goose	NYSE:GOOS	43.1 x	34.1 x	34.1 x	27.0 x	-	-	-	-
Micheal Kors	NYSE:KORS	8.8 x	10.0 x	10.0 x	9.4 x	17.8 x	15.9 x	15.9 x	15.7 x
Urban Outfitters	NASDAQ:URBN	8.4 x	8.5 x	8.5 x	8.3 x	23.8 x	22.6 x	22.6 x	19.8 x
Lululemon	NASDAQ:LULU	14.1 x	13.5 x	13.5 x	11.9 x	29.9 x	27.0 x	27.0 x	22.0 x
Guess Inc.	NYSE:GES	8.8 x	8.6 x	8.6 x	6.9 x	37.7 x	38.6 x	38.6 x	20.2 x
American Eagle Outfitters	NYSE:AEO	6.3 x	6.0 x	6.0 x	5.9 x	19.9 x	17.3 x	17.3 x	14.1 x
Tailored Brands Inc.	NYSE:TLRD	6.3 x	7.0 x	7.0 x	6.8 x	16.1 x	11.2 x	11.2 x	10.2 x
Aritzia	**TSE:ATZ**	**14.7 x**	**11.9 x**	**11.9 x**	**9.7 x**	**97.8 x**	**25.4 x**	**25.4 x**	**20.2 x**
Median		**8.8 x**	**8.6 x**	**8.6 x**	**8.3 x**	**19.9 x**	**17.3 x**	**17.3 x**	**15.7 x**
Mean		**13.7 x**	**12.5 x**	**12.5 x**	**10.9 x**	**20.7 x**	**18.9 x**	**18.9 x**	**14.6 x**
High		**43.1 x**	**34.1 x**	**34.1 x**	**27.0 x**	**37.7 x**	**38.6 x**	**38.6 x**	**22.0 x**
Low		**6.3 x**	**6.0 x**	**6.0 x**	**5.9 x**	**16.1 x**	**11.2 x**	**11.2 x**	**10.2 x**

	EV/EBITDA Implied Price			P/E Implied Price		
Median	$ 9.00	$ 9.00	$ 10.69	$ 8.64	$ 8.64	$ 9.88
Mean	**$ 13.49**	**$ 13.49**	**$ 14.31**	**$ 9.46**	**$ 9.46**	**$ 9.18**
High	$ 37.91	$ 37.91	$ 36.50	$ 19.29	$ 19.29	$ 13.87
Low	$ 6.14	$ 6.14	$ 7.40	$ 5.58	$ 5.58	$ 6.44

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