

January 1, 2016

## Christopher & Banks Corporation (CBK:NYSE)

General Retailers – Apparel Retailers

### “An Ill Fit”

#### Company Profile

Christopher & Banks (CBK) is a middle-market women’s apparel retailer operating in 43 American states with over 500 stores. Targeting primarily plus-sized and petite women, CBK designs and sell its own label through both brick-and-mortar stores and an e-commerce website.

#### Recent Developments

Although many retailers have seen a drop in sales this year, CBK has gone to great lengths to try to ensure their long term survival. This past year, CBK has spent significant capital in implementing business intelligence tools to better manage inventory and in hiring a consulting firm to help them review the business and better understand their customers’ buying behaviours. In addition, CBK has plans to upgrade customer analytic capabilities, launch a new website platform, create an enhanced loyalty program, and bring in a new POS system.

#### Investment Thesis

CBK is in a precarious position both facing declining sales for the last 3 years, and having posted losses for the last 3 quarters. At present, the company is currently relying on both excess cash and a \$39M tax credit to offset years of significant negative free cash flow.

#### Valuation & Recommendation

At present, CBK’ management team plans to continuously invest capital in an attempt to restructure the business, however, without any material results so far. Currently trading at a value of Cash + Deferred Tax Assets, reflecting management’s inability to create shareholder value.

Stephanie Mah, Analyst

Bachelor of Commerce 2017

#### Equity Research Canada

<b>Price Target</b>	<b>CAD\$ 00.52</b>
<b>Rating</b>	Hold
<b>Current Share Price, close</b>	CAD\$ 1.65
<b>Total Return</b>	-71.10%

#### Key Statistics

<b>52 week H/L</b>	\$6.51/\$0.96
<b>Market Capitalization</b>	\$61.44M
<b>Net Debt</b>	-\$36M
<b>Enterprise Value</b>	\$32.06M
<b>Net Debt/Enterprise Value</b>	--%
<b>Diluted Shares Outstanding</b>	\$36.9M
<b>Free Float %</b>	97%
<b>Dividend Yield</b>	0%
<b>LTM P/E</b>	2.05x
<b>LTM EV/EBITDA</b>	16.03x

#### WestPeak’s Forecast

	<u>2016E</u>	<u>2017E</u>	<u>2018E</u>
<b>Revenue</b>	\$383M	\$395M	\$433M
<b>EBITDA</b>	\$19M	\$20M	\$21M
<b>EBIT</b>	\$7M	\$5M	\$5M
<b>Net Income</b>	\$6M	\$4M	\$3M
<b>P/E</b>	0.01x	0.02x	0.02x
<b>EV/EBITDA</b>	0.002x	0.002x	0.001x
<b>Price/Book</b>	<b>1.0x</b>	<b>0.5x</b>	<b>1.0x</b>



# Business Overview/Fundamentals

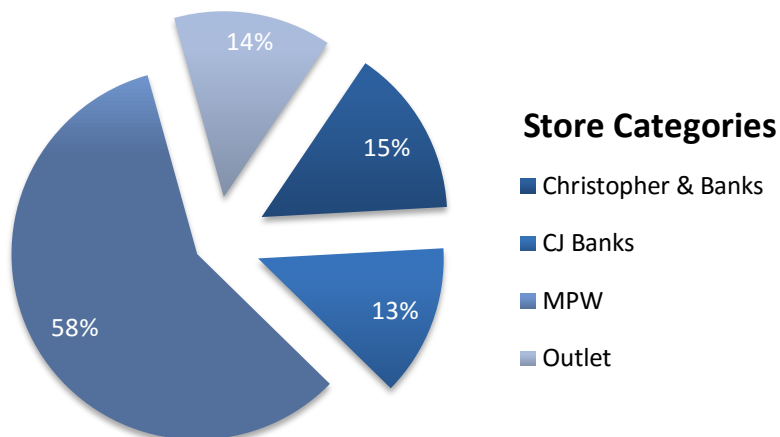
## Products

CBK retails ready-to-wear clothing, accessories and shoes for women of all ages and sizes including missy, petite and plus-size. The types of apparel offered include tops, bottoms, dresses, skirts, outerwear, and intimates in addition to a limited selection of jewellery, scarves, wraps, hosiery, belts and shoes. CBK offers apparel lines suitable for casual, work, and active wear.

In an effort to return to the pre-financial crisis success of CBK, the company has transitioned their product line from trendier options to more updated versions of classic styles. Customers have been responding well to the changes as they better target the 39 - 60 year old demographic that CBK has been known to appeal to. However, while the looser fitting styles have sold well in store, CBK has seen a younger crowd online reacting well to more fitted, work-oriented options.

## Retail Channels

As of October 31st, CBK operates 538 brick-and-mortar stores and an e-commerce site. The stores are further divided into four different categories.



Of the four categories, CBK carries both missy and petite apparel, CJ Banks carries plus-size apparel, MPW carries missy, petite and plus-size apparel, and the outlet offers discounted missy, petite and plus-size apparel. Over the last year and continuing into the future, CBK has worked to convert CBK and CJ Banks stores into MPWs as well as open new MPWs and outlet stores. While the CBK and CJ Banks stores have not performed as well as the MPW and outlet stores, converting them will result in fewer options for each size line as they compete for square footage in the combined stores. These conversions and store openings, however, will start to slow down as CBK focuses more on building their e-commerce customer base including the debut of a new website platform in 2016, which is expected to significantly reduce operating costs associated with traditional brick-and-mortar stores. At the moment, online sales are coming from customers shifting from only in-store buys to both in-store and online buys.

## Growth Opportunities

CBK continues to focus on improved merchandising and higher sales productivity for long term growth. Their plans to facilitate this focus consist of:

- optimizing their current real estate portfolio to boost individual store productivity
- finding a better merchandise mix
- refining their marketing
- improving the customer experience

However, while this all sounds well and good, CBK has yet to propose a solid date for which these plans will be complete and, despite having spent the better part of 2015 on these plans, has little to show in terms of concrete evidence of improvement beyond significant capital outlay.

## Macro Environment / Industry Overview

The apparel industry consists of retail giants and one-off boutiques and each have ways of making a profit. Concentration in the industry is low as start-up costs are low and there are few barriers to entry. On the other hand, competition is high, but that is battle fought over branding and design more than anything. At this time, players in the industry are seeing mall traffic declining, one-stop-shop retailers increasing competition, increased spending on luxury goods, “e-tailing” picking up speed, and a slow shift to “slow fashion”. While CBK has seen double digit growth in e-commerce over the last two quarters, and is redoubling their efforts by launching a new website this year, they face considerably higher competition in that arena.

## Consumer Confidence and Disposable Income

As apparel is a necessary good for the average American citizen, apparel retailers have little to fear in the face of recessions. Instead, apparel retailers have to concern themselves with aligning their price points with their target customer. While CBK has seen an increase in average dollar sales per customer from an increase in units bought per customer in addition to increases in both traffic and conversion, is it enough? Steadily declining sales per store and sales per square foot would say no.

At the moment, the American public is facing higher consumer confidence and an increase in per capita disposable income. While this may be positive for the apparel industry as a whole, it take profits away from lower or middle-market retailers as customers shift to more expensive luxury goods. Given that CBK is a middle-market retailer, they will have to work harder to increase customer retention which they plan to do through their enhanced loyalty program. This is likely part of CBK’s justification for spending significant capital on a consulting firm to track buyer behaviour.

## Management Team

This past year at CBK has seen a few changes in management from the election of a new Board of Directors member, the resignation and subsequent hiring of the Vice President, Controller, and a reorganization of the merchandising team.

CBK kicked off the fiscal year with the election of Edwin J. Holman to its Board of Directors, following an extensive search process with the help of a national search firm. Mr. Holman brings much experience to the role, having spent many years in senior executive positions at retail companies such as Macy's Central, The Pantry Inc., and Bloomingdale's. His election has increased the number of Board members to nine.

Prior to the August 31<sup>st</sup> quarter ending which reported sales nearly \$10M short of guidance, a 47% drop in stock price, and an investigation of securities claims by Rosen Law Firm, Belinda Meier resigned from her position as Vice President, Controller on June 12th. Meier's position was later filled by Marc Ungerman, previously the Assistant Controller at SUPERVALU.

This year also saw the division of the merchandising team into two distinct divisions of financial buying and product development in order to increase accountability and ownership. With the buying team better aligned with planning and allocation, they are able to make decisions quicker, and adjust inventory more efficiently by partnering more effectively with suppliers.

### Executives

#### **LuAnn Via** – *President and CEO*

- Elected in 2012
- Has over 30 years of retail experience including high level positions at Payless ShoeSource, Inc., Charming Shoppes, Inc., Sears Holding Company, and Saks, Inc.

#### **Peter G. Michielutti** – *Executive Vice President, COO and CFO*

- Elected in 2014, but held position of Senior Vice President, CFO since 2012
- Extensive retail and financial leadership background having held CFO positions at Whitehall Jewelers, Wilsons Leather and Fingerhut

CBK is at an important turning point for their company. Facing down three straight quarters of losses, only careful decisions and prudent management can save them. At this point, it isn't apparent whether senior management has the skillset to pull off a restructuring of this magnitude. Ms. Via has not spent more than 5 years in a chief executive role at any company and has little to no experience with restructuring. Mr. Michielutti may have more applicable experience having worked as an independent consultant specializing in restructuring, bankruptcy, turnaround, and due diligence, but considering the fact that he has been with CFO since 2012 and that CBK has been declining since then, one would assume that if he were capable of making the company profitable again, it would have already happened.

## Compensation

If last year is anything to go by, CBK executives could still expect a healthy salary this year. With revenue of \$147M and EBITDA of \$21M in 2014, executives earned a total of \$3.13M with Ms. Via earning \$0.86M and Mr. Michielutti earning \$0.90, half of which he earned through performance-based restricted stock awards. Whereas this may not seem extraordinarily high, it is quite significant considering a current market capitalization of ~60M – given the current precarious situation, it is questionable whether such a compensation structure necessarily acts to maximize shareholder value.

CBK executive compensation policies are composed of three parts: base salary, annual cash incentives, and long-term equity incentives. The cash incentives program aims to reward executives by tracking three metrics:

- 60% Operating Income excluding extraordinary items
- 30% Gross Margin Return on Inventory
- 10% Net Sales

If the metrics are tracked anywhere above or between their threshold and target ranges, the executives receive a cash bonus on a predetermined percentage of their base annual salary. For Ms. Via, she was eligible for 25% at the threshold level, 100% at the target level to a maximum of 200%. Mr. Michielutti was eligible for 18.75% at threshold, and 75% at target to a maximum of 150%. The equity incentive program works to align executive interests with that of their shareholders by awarding executives shares of common stock. This incentive is measured by the following three metrics:

- 50% Operating Margin as a Percent of Sales
- 30% Compounded Annual Net Sales Growth Rate
- 20% Total Shareholder Return as compared to a select group of retailers

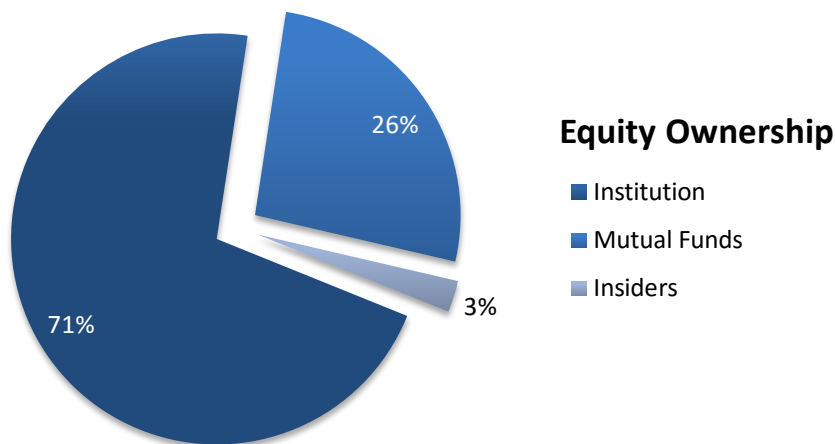
Once again, these incentives are paid out depending on where a metric falls above or between a predetermined threshold and target range. In addition to these awards, there is also exists a set of guidelines for minimum stock ownership among executives.

While compensation is ultimately determined by the board, it is important to be aware of, and consider such information as shareholders while considering the viability of CBK as an investment throughout this precarious period.

# Shareholder Base, Liquidity, Market Depth

## Key Facts

Presently, CBK is all equity owned and trading at an average of 451,769 shares per day. The breakdown of equity ownership is as follows:



In the wake of waning investor confidence and a low share price, insider buying has ramped up this past December with 205,590 shares purchased by insiders. CEO LuAnn Via herself purchased 100,000 at \$1.115 per share for a total of 221,635 shares at a market value of \$332,452.

Overall, we're seeing 2-3 times more divestments than investments, though the top ten institutional investors make up 43.13% ownership of the company with no one investor claiming more than 7.17% ownership.

## Activist Investor Macellum Capital Breaks Rank

As seen above, the majority of CBK stock is held by institutional investment managers. While most investors have chosen to remain silent in the face of CBK current situation, Macellum Capital spoke up. In a letter to Paul Snyder, Chairman of the Board, on April 1<sup>st</sup>, 2015, Macellum criticised the lack of oversight by the Board and an earlier rebuff by CBK on an offer of additional assistance and expertise in the form of previous, highly successful CBK CEO Joel Waller. Macellum further stated that a company of this size should be more than capable of achieving high single digit operating margins while delivering meaningful revenue growth by gaining back market share within its target demographic. As a final comment, Macellum also mentioned the possibility of acquisition given the heightened interest in the missy segment of CBK's business. And they aren't wrong; with CBK's equity value being as low as it is, there is value in the liquidation of assets. At present, with over 500 stores across the US, CBK' property and equipment alone has a book value of over \$61M. Considering that the company currently holds in \$36M cash, acquisition could be a viable option.

# Valuation

## Revenue Growth Outlook

Consensus estimates for the upcoming year suggest negative revenue growth of 1% for 2016, but positive growth of 3% and 10% year over year for 2017 and 2018 respectively. Although they are operating fewer stores than they were last year, CBK is hoping that the difference will be made up in online traffic and sales.

CBK plans to manage their cash carefully rather than draw on revolving credit facilities or take on long term debt. Over the coming months, management is looking to deleverage merchandise, buying and occupancy expense and review payroll costs for savings opportunities gained from improved vendor pricing and eliminating expenses.

This past year, capital expenditures made up a big chunk of change as CBK implemented inventory management systems. While the company considers the hike in capex to be a one-off, their plans to upgrade customer analytic capabilities, instate loyalty programs, bring in a new POS system, launch a new website platform, and continue to open and convert real estate suggests otherwise.

## DCF Analysis

Our DCF analysis puts the share price of CBK between \$0.42 and \$0.63, significantly less than our comparable companies analysis below. What it really comes down to is a history of negative net working capital and cash flows mixed with large increases to capex. Management at CBK knows that there is a problem and they are trying to fix it by spending money, and we have yet to see any tangible results. If things still continue to decline, it's entirely possible that CBK will continue to throw money at the problem and further drive the value of the company down. This is reflected in our model and why our valuation is so low.

		Discount Rate (WACC)							
		5.00%	7.50%	10.00%	12.50%	15.00%	17.50%	20.00%	22.50%
Long-term Growth Rate	0.00%	\$0.86	\$0.64	\$0.56	\$0.53	\$0.52	\$0.52	\$0.52	\$0.52
	0.50%	\$0.90	\$0.66	\$0.57	\$0.53	\$0.52	\$0.52	\$0.52	\$0.52
	1.00%	\$0.95	\$0.67	\$0.57	\$0.54	\$0.52	\$0.52	\$0.52	\$0.52
	1.50%	\$1.02	\$0.68	\$0.58	\$0.54	\$0.52	\$0.52	\$0.52	\$0.52
	2.00%	\$1.10	\$0.70	\$0.58	\$0.54	\$0.52	\$0.52	\$0.52	\$0.52
	2.50%	\$1.23	\$0.72	\$0.59	\$0.54	\$0.52	\$0.52	\$0.52	\$0.52
	3.00%	\$1.41	\$0.75	\$0.60	\$0.55	\$0.52	\$0.52	\$0.52	\$0.52
	3.50%	\$1.73	\$0.78	\$0.61	\$0.55	\$0.53	\$0.52	\$0.52	\$0.52

## Comparable Companies Analysis

As retail sales dropped over 2015, we saw a lot of acquisitions activity as bigger companies padded their portfolios by acquiring other brands such as the acquisition of Ann Inc. by Ascena Group (ASNA:NASDAQ). As such, there is a big divide between larger and smaller apparel retailers. However, CBK wasn't the only apparel company to face negative EBIT for the past 12 months, with even big players like Chico's FAS, Inc. (CHS:NYSE) coming up negative. As a result, the most meaningful metric for comparison was EV/EBITDA, which is on the

higher end of the scale comparatively for CBK. EV/EBITDA puts the share price between \$1.01 and \$1.68 which is in line with the current share price.

Company	Mkt-Cap	EV	LTM	
			EBITDA	EV/EBITDA
Ascena Retail Group Inc. (ASNA)	1930.25	3413.15	-62.00	n.m.
Cato Corp (CATO)	1027.25	762.75	116.38	6.55
New York & Company, Inc. (NWY)	147.77	115.28	9.99	11.54
L Brands (LB)	27733.60	32189.60	2593.00	12.41
Chico's FAS, Inc. (CHS)	1487.41	1443.54	86.95	16.60
Express Incorporation (EXPR)	1427.90	1336.68	264.27	5.06
Zumiez (ZUMZ)	403.48	352.35	86.46	4.08
Bebe Stores, Inc. (BEBE)	45.13	3.13	-14.33	n.m.
<b>Christopher &amp; Banks Corporation</b>	<b>61.44</b>	<b>32.06</b>	<b>2.00</b>	<b>16.03x</b>
High				16.6x
Average				9.4x
Median				9.0x
Low				4.1x

## Recommendation

### Lack of Strong Management

In 2012, CBK made a historic turnaround with customers returning in droves as new merchandise leadership made a resonating impact on their target customer. Sadly, on the heels of CBK's major strides in market share, the appointment of a new CEO by the Board of Directors against shareholder sentiment soon saw the beginning of the decline we still see today. While Ms. Via and Mr. Michielutti, both hired in 2012, faced healthy growth and sales that year due in no small part to prior CEO Joel Waller, they have not been able to achieve that same level of success. Although steps have been taken this year to revamp CBK both as a brand and as an operation, their falling nearly \$10M short of guidance in Q2 was a solid sign of the shortcomings of its management and their investors have already long begun to notice.

### Investment Summary

In the early 2000s, CBK was a profitable company with great brand recognition. Unfortunately, a combination of inexperienced executives, lack of board oversight, and unbridled spending has depleted what value the company had. With management only now taking steps to better cater to their customers' needs, and at the same time reducing the amount of product available to them by consolidating product lines into single concept stores, there's no telling how many customers are left to retain. Over the past three quarters, CBK has seen increases in store traffic, conversion, and average dollar sales, but despite the fact that there are less operational stores than last year, the sales per store are down. When considering numbers, even if we're only talking price relative to other companies, there isn't much positive room to move.



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