



Investment Thesis

Following the normalization of consumer demand within the beauty category and decreased forward guidance, Ulta stock has dropped 32% from its 52-week high, presenting a long-term investment opportunity with significant upside potential.

The following points describe the basis for the current Ulta buy recommendation:

- Over the past 10 years, Ulta has reported double-digit growth in both revenue and earnings.
- Since 2012, Ulta's profit margins have remained consistent, with slight growth exiting the pandemic.
- Significant free cash flows, store growth, and the development of E-commerce ensures Ulta's future growth.
- Ulta's premier loyalty program, made up of 42.2 million members, provides a considerable competitive advantage within a growing industry.
- Steady margins and other growth factors contribute to a target price of \$453.93 (22.81% upside).

2 Year Projection	Bull	Base	Bear
Net Sales	\$12,979	\$12,567	\$12,009
Net Sales CAGR	7.6%	5.9%	3.5%
New Stores Per Year	60	48	25
Comparable Sales CAGR	4.00%	3.00%	2.00%
Gross Profit	\$5,088	\$4,926	\$4,707
Gross Profit Margin	39.20%	39.20%	39.20%
Operating Income	\$1,817	\$1,697	\$1,441
Operating Margin	14.00%	13.50%	12.00%
Interest Expense	(\$10)	(\$10)	(\$10)
Income Tax (24%)	\$438	\$410	\$348
Net Income	\$1,389	\$1,297	\$1,103
Net Margin	10.70%	10.32%	9.18%
EPS	\$30.37	\$28.37	\$24.12
Forward PE	18	16	14
Current Fair Value Price	\$546.71	\$453.93	\$337.72

Figure 1 (all \$ in Millions besides EPS and Price)

Company Overview

Ulta Business Summary

For the past 30 years, Ulta has served as a specialty retailer of beauty products within the United States. By offering a broad range of products including cosmetics, fragrances, skincare, and haircare products, along with salon services within its stores, Ulta has been able to disrupt the beauty industry, all the while providing an accessible and unique shopping experience. Additionally, Ulta carries their wide range of products at each stage of luxury, whether it be mass, prestige, or luxury brands, and as a result, Ulta can meet every customer at their unique price point. As a testament to Ulta's success, Ulta has been able to expand across all 50 states with approximately 1,385 stores, with the goal of expanding to 1,500-1,700 stores nationally.

Current Management

David Kimbell stepped in as Ulta's CEO in 2021, following a prior two-year period as president, and five years as Chief Marketing and Merchandising Officer before that. During Kimbell's career, he has gained significant Marketing, E-commerce, and Digital/Technology experience through his executive roles at leading retail companies, including VP of Marketing at PepsiCo (2001-2008), along with Chief Marketing Officer at U.S. Cellular (2011-2012). Kimbell's experience in the highlighted

areas will prove critical to the future success of Ulta as they counter the short-term demand slowdown and develop an E-commerce platform to enhance the omnichannel shopping experience.

To ensure the diligent application of executive expertise such as Kimbell's, Ulta has developed a compensation package where the guaranteed annual salary, on average, only makes up a quarter of total possible pay. Within Kimbell's package the salary share drops to 11%. Figure 1 outlines the compensation in greater detail.

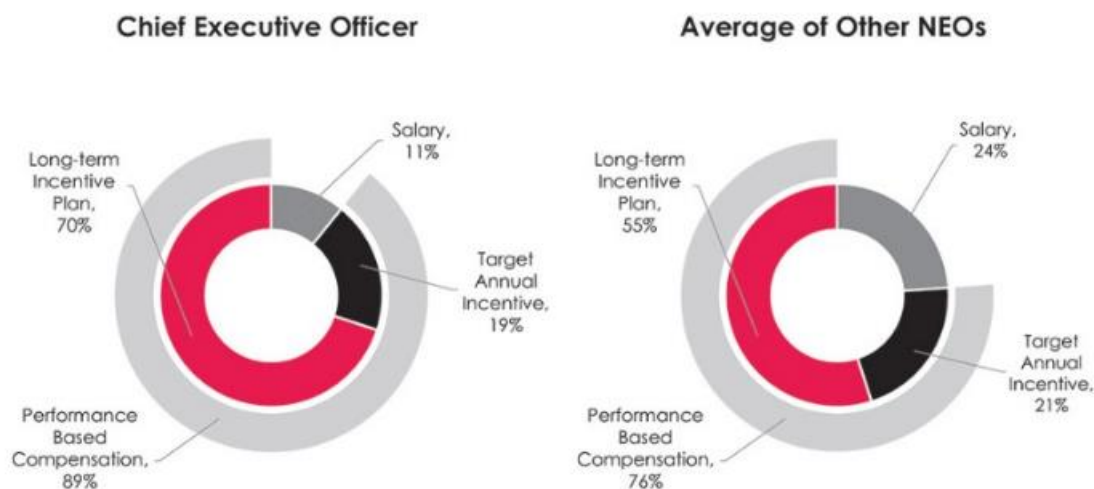


Figure 2 (NEO = Named Executive Officer)

With performance-based incentives being based on annual EBT (earnings before taxes) goals set by the Board of Directors, along with the fact that these incentives constitute the majority of Ulta executive's pay package, the financial success of an executive is strongly tied to the financial success of Ulta. Furthermore, each executive is required to carry a minimum number of shares in relation to their base salary. The minimums are as follows:

- 2X Base Salary for Chief Non-NEOs
- 3X Base Salary for Other NEOs
- 6X Base Salary for the CEO

These required share-holding amounts further increase the share of performance-based compensation within each executive's contract, outlining the clear incentives each executive has toward pursuing and maintaining future growth.

Future Growth Opportunities

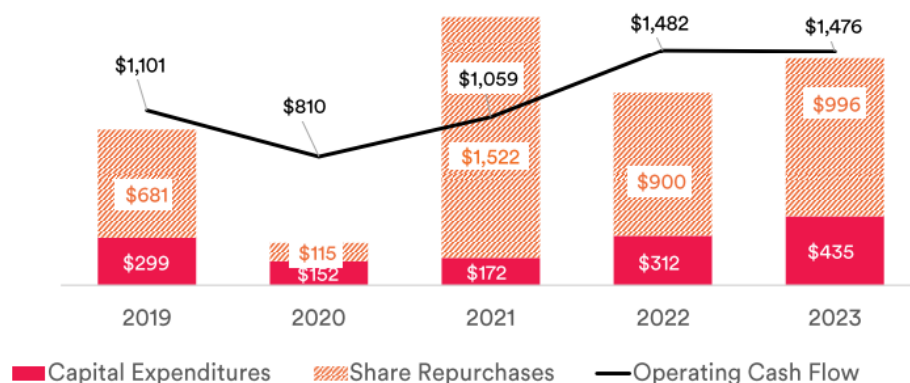
As we will explore later, future runway for all beauty industry participants holds promise, and while Ulta is positioned well to take advantage of future industry trends, we will first turn our focus to how they will outcompete their industry.

Significant Cash Flows

With no interest-bearing liabilities, and the only significant long-term debt on their balance sheet being operating leases, Ulta is considered a debt-free company. The implications of such means Ulta has few recurring obligations and can dedicate vast amounts of its cash flows to reinvestment.

Strong, consistent cash flow generation supports strategic reinvestments and shareholder returns

Cash Generation and Capital Allocation Highlights



Note: Fiscal year 2023 is a 53-week year.
Net sales in the 53rd week in fiscal 2023 were approximately \$181.9 million.



Figure 3 (numbers in Millions)

In the 2024 Q1 earnings call, David Kimbell outlined all Ulta has accomplished with reinvestment.

[Completion of our] retrofit of our Greenwood distribution center, [we] began the retrofit of our Dallas distribution center, opened our Greer market fulfillment center, and began work on our Bolingbrook market fulfillment center. We successfully transitioned our Jacksonville, Greer, and Chambersburg distribution facilities and key merchandising processes to our new enterprise resource planning platform, and we converted key merchandising and commerce elements of our digital store to a new architecture. We built a new enterprise data platform on Google cloud infrastructure, establishing a modern ecosystem for future analytics and data-driven decision-making capabilities, and we completed our rollout of new POS systems, including mobile checkout, in all stores.

In an industry that relies heavily on the supply chain to fulfill new beauty trends, Ulta's capital investments will continue to drive profits well into the future, and with an average of 26.37% return on invested capital from 2012-2024, these investments are clearly effective. The established new enterprise data platform that Kimbell mentioned will also allow Ulta to leverage its industry-leading loyalty program to dive into customer insights, and proactively accommodate inventory needs.

In March of 2024, Ulta also announced a share repurchase program worth \$2.0 billion. As of May 4, 2024, \$1.8 billion remained available under this repurchase program as Ulta had successfully repurchased 588,004 shares for \$285.1 million. Ulta plans on continuing this progress as the 2024 Fiscal Year is budgeted to contain approximately \$1 billion in share repurchases, leaving the remaining \$1 billion for future year(s). While share repurchase programs tend to have negligible effects on share prices, the main effect of this repurchase program comes from its compounded signaling. With consistent reinvestment into the supply chain through new fulfillment centers and upgraded ERP systems, commitment to growing store networks, and conversion towards E-commerce, Ulta possesses a variety of new opportunities as to which they invest their money. Furthermore, as will be explored later, Ulta's revenues and earnings continue to grow, margins remain consistent, and promotional activities remain prominent. The stockpile of positive signals, tied together with the announcement of this share repurchase program highlights how this move is not meant to be a short-term earnings manipulation, but rather genuine confidence from a management team that believes the best investment they can make is within their own shares.

Store Growth

Within capital expenditures, Ulta has not only focused their excess cash flows on reinvesting in their supply chain, but they have also continued to grow their store network across the United States, and plan to continue to do so until they reach 1500-1700 standing stores. With that in mind, Ulta has, on average, opened 48 new stores per year based on the previous 5 years, and plans to open 60-65 during 2024. Calculating the average revenue per store during 2023, each new store generates roughly

\$8.1 million per year. Together, average new store openings and revenue per store can generate an increase of \$388.8 million per year. However, it is important to note how most new stores will not generate an average stores revenue during the first year. The following figure highlights the average net sales increase from each new store between the 2022 fiscal year and the 2023 fiscal year.

New Store Openings:	30
Revenue for 2022 fiscal year:	\$10,209
Revenue for 2023 fiscal year:	\$11,207
Total Revenue increase:	\$998
Comp Growth was 5.7%	5.7%
Revenue Increase from Comp Growth	\$582
Increase in other revenue and extra week of sales is factored out:	\$250
Revenue increase from new stores:	\$166
Net sales increase from each new store:	<u>\$5.53</u>

Figure 4 (all \$ in millions)

With each new store generating roughly \$5.53 million during the 2023 fiscal period, followed by the assumption that a new store sales will grow 50% year over year until it reaches the average store revenue, it will only take a year for each new store to generate the average net sales. With new stores' ability to generate strong revenue during their first year, along with the short expected time horizon until they generate at the company average, new stores serve as an important driver behind consistent revenue growth. Moreover, Ulta's budgeted new store openings for fiscal 2024 remained unchanged after the decreased forward guidance, indicating a revenue increase of \$331.8 million at the end of fiscal 2024 (a 3% increase from fiscal 2023).

Although new store growth is a strong driver of revenue increases, it alone does not constitute the entirety of Ulta's revenue growth. In fact, old store growth continues to perform. During the 2023 fiscal year, comp growth, which measures the percent change of comparable same-store sales, was reported at 5.7%. As of the most recent quarter, Q1 of 2024, old stores grew with comp growth of 1.6%, with 1.3% being a result of increased traffic and 0.3% coming from increased ticket size. Management highlighted how this comp growth was expected to rise in future quarters as the holiday season approaches and level out between 2-4% for the year. Combined, new store openings and comp growth can be expected to increase revenues between 5-7% annually. For perspective, the National Retail Federation cited an average of 3.6% in retail sales growth from 2010-2019, and forecasts national retail sales to increase by 2.5-3.5% during 2024. Even during a short-term demand slowdown, Ulta can be expected to beat the industry by at least 1.5%, highlighting the irrationality behind the sudden price drop.

Development of E-commerce

Enhancing the digital experience has been one of Ulta's key strategic pillars to which they have made significant progress. This mission comes as the industry consumer leans towards an omni-channel experience. As stated in the McKinsey report titled "The beauty market in 2023: A special State of Fashion report", "consumers are increasingly shopping across price points and report that both online and offline stores influence their shopping behavior. Their preference for omnichannel shopping is expected to continue to fuel legacy brands' shift online and independent labels' move into a brick-and-mortar presence." To quantify this preference and its future impact, Figure 9 within Industry Breakdown highlights how the E-commerce channel is expected to grow 12% year over year from 2022-2027, and Specialty Retail is expected to grow 7% year over year during the same period. Additionally, not only are consumers drawn more to an omni-channel experience, but they are also willing to spend more money within it. Per the 2024 Q1 earnings call, loyalty members who shop both in stores and online spend nearly 3 times as much as retail-only guests.

To take advantage of such trends, Ulta has focused on enhancing the user experience within its E-commerce app by simplifying the user interface and offering new categories such as customer favorites. As a result of these improvements, Ulta's digital app now accounts for 57% of E-commerce, an increase of 4.5% compared to last year. A new partnership with DoorDash has also allowed Ulta to extend their product line to over 70 million active DoorDash users. To further accommodate this expected growth, Ulta has begun opening market fulfillment centers, which while smaller than their regional

distribution centers, focus primarily on Ulta’s most popular products and support E-commerce demand. Such fulfillment centers enable Ulta to improve service and responsiveness across all E-commerce fronts, especially in markets with high store or population density, offering same-day delivery in most cases. Combined, the renewed supply chain and advancing storefront within E-commerce will ensure Ulta’s continued growth as the preemptive establishment of itself within E-commerce will allow Ulta to capitalize on any growth within the market.

Quantitative Analysis

Over the past 10 fiscal periods, Ulta’s financials have proved strong against market competitors and stores of similar structure. The following figure organizes the revenue and earnings growth of such companies.

Company	Revenue Growth		Earnings Growth	
	Unfactored 10-Year	Factored 12-Year	Unfactored 10-Year	Factored 12-Year
Ulta Beauty	16.32%	18.50%	55.61%	23.16%
Dicks Sporting Goods	7.91%	5.97%	22.32%	-1.54%
Bath and Body Works	-0.23%	-3.99%	-48.13%	-20.01%
LVMH (Sephora)	12.44%	-	25.1%	-
Amazon	9.1%	10.60%	12.06%	10.15%
Estee Lauder	4.85%	5.40%	25.6%	3.94%
CVS	11.18%	11.64%	-121.87%	-120.80%

Figure 5

NOTE: 2021 and 2022 YoY changes diverged considerably from the means. Therefore, when possible, they have been factored out and replaced with 2012 and 2013 in the Factored 12-Year columns.

Over the past 10 reported fiscal years, Ulta can be seen outpacing in-store competitors such as Bath and Body Works, CVS, and the similarly structured Dicks Sporting Goods. Along with this, they have even outgrown digital competitors such as Amazon. Most importantly, Ulta outgrows their main competitor, LVMH-owned Sephora. As main competitors, Ulta and Sephora often open new stores within miles of each other, and from a quantitative perspective, even when met with the same economic environment, Ulta delivers the best growth, providing a strong argument for investment within Ulta.

Average growth in free cash flow was also 41.87% over the previous 10 years, and 45.83% over the factored 12 years. This growth was previously mentioned to allow for past reinvestment in the supply chain and the opening of new stores. However, it can be used as an indicator of Ulta’s future ability to sustain such investments as well. Figure 5 below depicts how Ulta has been able to sustain its margins over these periods of leading growth. This explains how increased revenue has, and will continue to, consistently transfer into increased earnings.

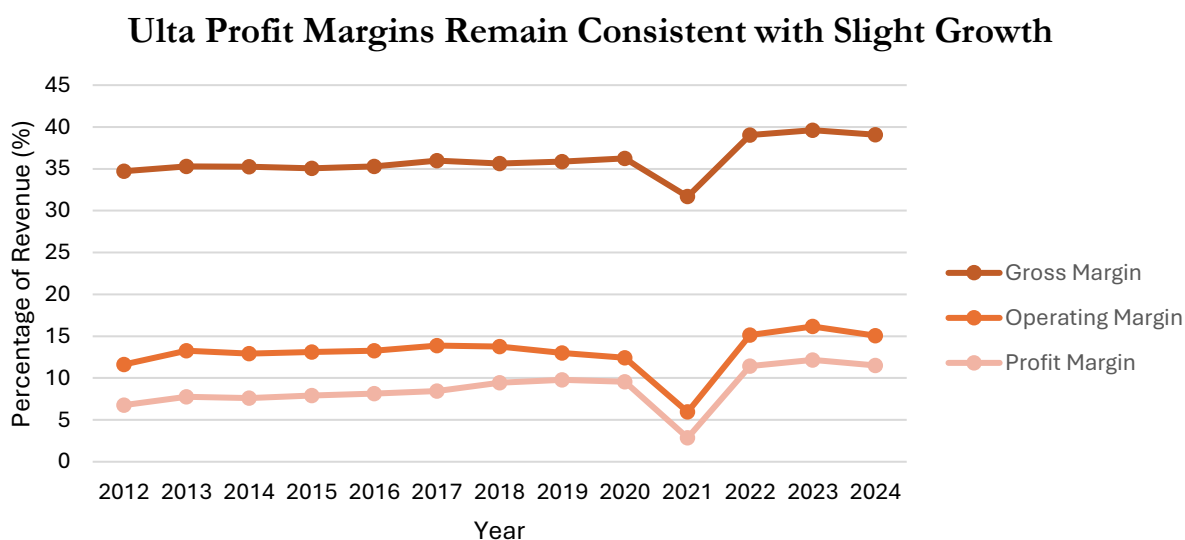


Figure 6

Valuation

Previously, we discussed Ulta's advantageous strategic moves, strong growth in revenues and earnings, and consistent margins. Using the following Discounted Cash Flows model allows us to take each one of these subjects into account and use conservative estimates to quantify the intrinsic value of Ulta on a per-share basis. Within this DCF, the following assumptions were made:

- Ulta revenue will continue to be driven by new store openings with comp growth leveling off at 3% per year.
 - Ulta will open its average of 48 stores per year.
- New stores generate \$5.53 million during their first year, increasing to the comped average in the following years.
- Following 2025 Ulta's Free Cash Flow will grow 4% per year (previous 12 year average)
- The discount rate equaled Ulta's WACC of 8.5% (calculated as an average from 5 separate sources).

Free Cash Flow Projection	Units:	Past		Projected	
		FY22	FY23	FY24	FY25
Retail Square Feet	Sq. Ft (Millions)	14.20	14.52	15.02	15.52
Growth Rate:	%	2%	2%	3%	3%
Total Sales	\$ (Millions)	10,209	11,207	11,809	12,567
Sales per Square Foot:	\$/Sq. Ft	719	772	786	810
Growth Rate:	%	18%	7%	2%	3%
COGS and OpEx	\$ (Millions)	8,570	9,529	10,215	10,871
COGS and OpEx per Square Foot:	\$/Sq. Ft	604	656	680	700
Growth Rate:	%	17%	9%	4%	3%
NOPAT	\$ (Millions)	1,262	1,292	1,212	1,289
NOPAT per Square Foot:	\$/Sq. Ft	89	89	81	83
Growth Rate:	%	-	0%	-9%	3%
CapEx	\$ (Millions)	312	435	466	498
CapEx per Square Foot:	\$/Sq. Ft	22	30	31	32
Growth Rate:	%	81%	36%	3%	3%
D&A	\$ (Millions)	240	243	266	284
D&A per Square Foot:	\$/Sq. Ft	17	17	18	18
Growth Rate:	%	-10%	-1%	6%	3%
Change in NWC	\$ (Millions)	369	482	241	60
Change in NWC per Square Foot:	\$/Sq. Ft	26	33	16	4
Growth Rate:	%	-	28%	-52%	-76%
Other	\$ (Millions)	367	423	211	53
Other per Square Foot:	\$/Sq. Ft	26	29	14	3
Growth Rate:	%	-	13%	-52%	-76%
Free Cash Flow	\$ (Millions)	1,188	1,041	982	1,068
Growth Rate:	%	34%	-12%	-6%	9%
NOPAT = Operating Income * (1-tax rate)		Valuation (\$ Millions)		\$21,215.54	
FCF = NOPAT + D&A + Other - Change NWC - CapEx		Per share		\$ 444.62	

Figure 7

With conservative estimates such as 3% comp growth and new stores only producing the average store revenue, Ulta's base case valuation listed 20.29% higher than its July 24th closing share price of \$369.61. Additionally, this DCF model displays that while Free Cash Flow decreases from increased capital expenditure and changes net working capital from investments in new storefronts, these cash flows rebound within the growth period and provide benefit in the form of higher per-share valuations.

Taking a more simplistic valuation approach, previously within the store growth section of Future Growth Opportunities we found that store and comp growth will increase revenues by 5-7% each year. Considering that Ulta margins have stayed consistent for the past 12 years it is safe to assume an increase in top-line revenues will be mirrored in earnings. Therefore, by using the industry average P/E, which includes companies such as Bath and Body Works, Dicks Sporting Goods, Tractor Supply Company, and Chewy, Inc., the following valuation can be made:

ULTA Current EPS	Projected CAGR	Period	Projected EPS	Industry Average P/E	Projected Price
\$26.18	5.00%	2 Years	28.86	17.9	\$438.88

Figure 8

NOTE: Industry Average P/E taken from S&P Capital IQ's "Other Specialty Retail" industry.

The significant gap between both model's valuations and the current market price of Ulta's stock begs the question of why such mispricing exists, which leads us to our next section.

Why Everyone Else Is Wrong

On April 3rd, 2024, following J.P. Morgans 10th Annual Retail Roundup Conference, Ulta's share price dropped 15.34% from \$519.68 to \$439.98. Since then, it has continued to drop 16% to \$369.61 per share. Through the lens of P/E ratios, the 2023 P/E average is down to 17.74, 43.44% lower than its 2012-2023 average of 31.36. This significant drop can be attributed to two main factors: 1) The announcement of "a bit slower growth than we had anticipated in the category so far this year" from David Kimbell during the J.P. Morgan Conference, and 2) subpar earnings results announced in Q1 of 2024 that have resulted in a decreased forward guidance for Ulta.

	Prior FY24 Outlook	Updated FY24 Outlook
Net sales	\$11.7 billion to \$11.8 billion	\$11.5 billion to \$11.6 billion
Comparable sales	4% to 5%	2% to 3%
New stores, net	60-65	no change
Remodel and relocation projects	40-45	no change
Operating margin	14.0% to 14.3%	13.7% to 14.0%
Diluted earnings per share	\$26.20 to \$27.00	\$25.20 to \$26.00
Share repurchases	approximately \$1 billion	no change
Interest income	approximately \$11 million	approximately \$13 million
Effective tax rate	approximately 24.3%	approximately 24%
Capital expenditures	\$415 million to \$490 million	no change
Depreciation and amortization expense	\$275 million to \$280 million	\$270 million to \$275 million

Figure 9 (updated guidance)

Over the previous 3 years, as the economy has emerged from the pandemic, the beauty and cosmetics industry experienced "unprecedented double-digit growth" as Kecia Steelman put it during Oppenheimer's 24th Annual Virtual Consumer Growth and E-commerce Conference. Therefore, when the slower-than-expected category growth was announced due to demand moderation, followed by decreased 2024 guidance, the market overreacted. This market price drop is an overreaction due to the consistent growth Ulta has reported even during this slowdown. Furthermore, the "subpar" reported numbers of the Q1 report provided the basis for both the Discounted Cash Flow model along with the P/E model, which both calculated significant market undervaluations.

Continuing the argument against this overreaction, no matter the demand slowdown, Ulta will be able to continuously grow for all the reasons listed in the "Future Growth Opportunities" section, along with the expansion of provided brands. According to the McKinsey study, "42 percent of respondents to McKinsey's 2023 survey of consumers across China, France, Germany, Italy, the United Kingdom, and the United States say they enjoy trying new brands." Fortunately, this year's brand pipeline for Ulta includes 25 new brands, balancing a mix between growth-driving brands like Sol de Janeiro and emerging exclusives like WYN by Serena Williams. Specifically, within Fragrance, the newness from existing brands and new brand launches like Kylie Jenners Cosmic drove "double-digit growth" as Paula Oyibo stated in the 2024 Q1 earnings call. Standing alone, Ulta has clear avenues for growth, these avenues become even more prosperous when analyzed in the context of the overall industry, which we will now explore.

Industry Breakdown

In 2022, the beauty market in which Ulta operates, which is defined as skincare, fragrance, makeup, and haircare, made \$430 billion in revenue globally and \$112 billion in the U.S. Beauty Products Market. By 2027, global revenue is expected to reach \$580 billion, growing at 6% per year. Per the charts below from Ulta's 2022 Investor Relations Presentation, the majority of said revenue does not stream from one beauty product category, nor is the industry dominated by one distribution channel.

We operate in an attractive, large, and fragmented category

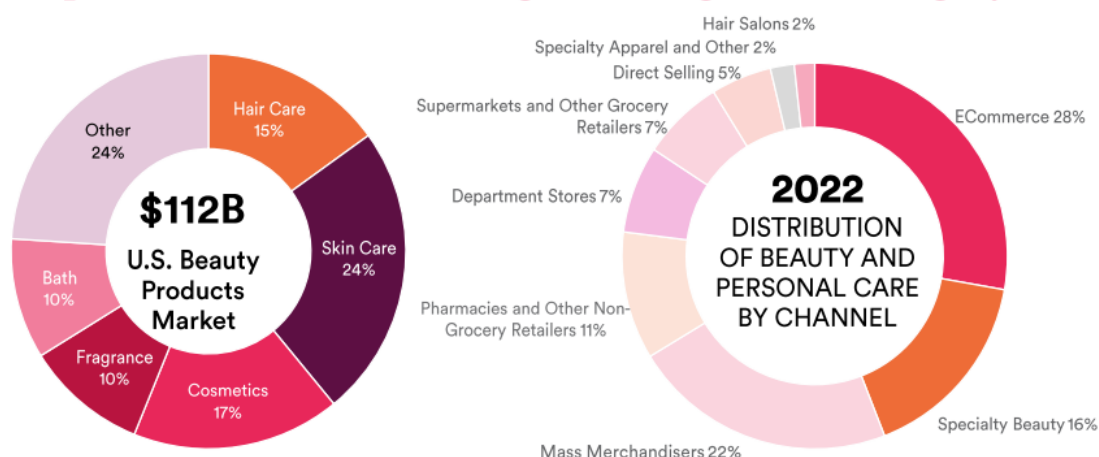
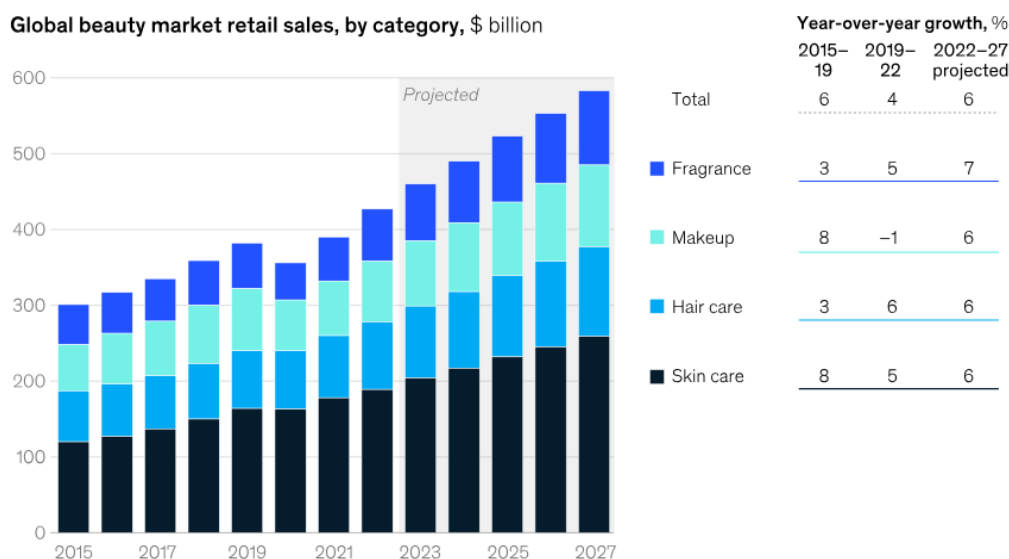


Figure 10

This fragmentation of product and distribution channel revenue highlights the variety of opportunities to reach customers and remain profitable within the Beauty Industry. Ulta has specifically taken advantage of such opportunities by providing each beauty product within its stores, developing the previously mentioned E-commerce channel, and partnering with Mass Merchandisers like Target to increase exposure to customers. Each of these strategic alignments position Ulta extremely well for generous revenue gains as a recent study by McKinsey & Company predicts growth within the four main beauty product categories.

The four main beauty categories are projected to grow in the next few years.

Global beauty market retail sales, by category, \$ billion



Source: Euromonitor; McKinsey analysis; McKinsey Global Institute analysis

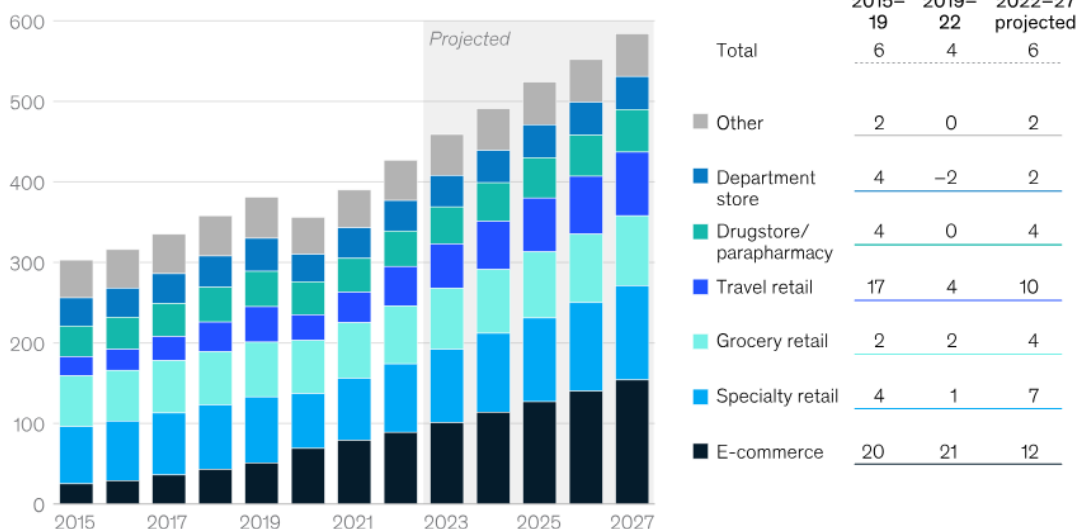
McKinsey & Company

Figure 11

Along with the prediction of the growth within Fragrance, Makeup, Hair care, and Skin care, McKinsey noted that "E-commerce in beauty nearly quadrupled between 2015 and 2022, and its share now exceeds 20 percent, with significant runway ahead." This expansion of E-commerce within the industry along with a growing consumer preference for omni-channel shopping creates a large growth opportunity for industry participants, with a particular advantage to Ulta as they have already established a highly efficient digital supply chain paired with an upgraded digital app.

E-commerce is the fastest-growing channel for beauty products.

Global beauty market retail sales, by channel, \$ billion



Source: Euromonitor; McKinsey analysis; McKinsey Global Institute analysis

McKinsey & Company

Figure 12

Competitive Landscape

Within the Beauty industry, Ulta's main competitors are Sephora, Amazon, Estee Lauder, and CVS, with the less competitive Dick Sporting Goods and Bath and Body Works. Within this space, Sephora and CVS are the major in-store competitors while Amazon and Estee Lauder compete mainly on E-commerce. Each of these companies was previously compared to Ulta in the Quantitative Analysis sections, during which Ulta was proven to be the most successful when it came to revenue and earnings growth. Here, we will analyze more strategic moves between Ulta and its competitors, once again demonstrating Ulta as the best option.

With 42.2 million members and growing, Ulta's loyalty program is one of the best in the industry. While it may not yet rival Amazon's premier loyalty program Amazon Prime, it continues to outcompete the rest of the competition on size and contributions to revenue. To enroll in this program, new shoppers simply need to make their first purchase, being automatically enrolled in the program and receiving rewards points from the start. From this point, Ulta members gain rewards for every following purchase and receive tailored recommendations on the digital app based on tastes determined from previous purchases. To incentivize continued purchases, Ulta increases the benefits for members who have higher annual spending. For example, Platinum members who spend \$500 annually receive exclusive deals, gifts & early access along with 1.25 points per dollar spent rather than the general member's 1 point per dollar. Diamond members who spend \$1,200 annually receive a choice of full-size Diamond Gift, \$25 off beauty service, and free shipping on any order above \$25. These rewards are meant to continuously pull customers into Ulta storefronts, and the success of the program can be seen by member purchases accounting for 95% of total sales, illustrating the unique positioning Ulta has over the competition to develop a deep understanding of their customers.

Apart from its loyalty program, Ulta can further distinguish itself from the competition through a selection of products across multiple price points. By carrying mass, prestige, and luxury brands, Ulta has a product for each consumer, unlike competitors such as CVS and Estee Lauder. While Sephora and Amazon both carry a vastly similar product array, Ulta outcompetes Sephora with its loyalty program, and Amazon with its in-store presence and omni-channel shopping experience. Conclusively, while all industry competitors will benefit from the projected industry growth, Ulta's loyalty program, product selection, and omnichannel presence position it best to receive the bulk of profits.

Risks

While the outlook for Ulta is positive, the risks are not to be forgotten. With the future promise and past success of the Beauty Industry becoming more and more attractive, over 1000 new competitive locations have opened within the last 2 years and competed for Ulta's market share. Although Ulta has historically proven to be able to absorb this competition and rebound in the long run, David Kimbell pointed out, "What's unique about right now is the scale of it to have over 1,000 new locations within a short-term period. It's unprecedented in our history, and probably in retail more broadly." Considering Ulta has not had to compete with the same scale of new competition as they are now this new competition may continue to drag down revenues and outcompete in the long run. When it comes to consumer preferences, McKinsey outlines the risk that "Overall, beauty is expected to be characterized by "premiumization," with the premium beauty tier projected to grow at an annual rate of 8 percent (compared with 5 percent in mass beauty) between 2022 and 2027." This could prove to be an issue for Ulta as they began to lose in-store market share of premium products as they focused their efforts on premium E-commerce development.