

Victoria's Secret & Co

Downgrade to Underperform: Weaker sales mean deleverage as costs increase

Rating Change: UNDERPERFORM | PO: 15.00 USD | Price: 18.01 USD

Weaker-than-expected F24 guidance

We are downgrading VSCO to Underperform from Buy based on the steep slowdown in sales trends, expectation for operating leverage as SG&A growth more than offsets cost saving initiatives, and continued secular slowdown in the core lingerie market. Despite a return to a regular launch calendar and great success in the February launch of the New Body by Victoria bra, which was the largest launch in the L5Y, weakness in other areas led mgmt to guide 1Q sales down MSD and F24 -LSD. We lower our F24/25 EPS ests by 35%/43% to \$1.64/\$1.82 given challenged sales trends and higher-than-expected SG&A expense. We lower our PO to \$15 from \$34, 3.5x our F25 EV/EBITDA ests, in line with a group of mall-based peers (vs 6x F24 prior). We think a lower multiple is justified given the sales struggles and our expectation for lower margins.

Bra launches unable to offset impact of secular decline

We see risk to F24 sales guidance, as it assumes the broader lingerie market will stabilize in 2H after declining MSD in 1H, as well as the impact of initiatives in sport and technology materializing. We see downside risk to these assumptions should the broader lingerie market continue its secular decline throughout the year given the deflationary shift to less structured, more casual, and multi-functional bras. We were previously bullish on the potential for initiatives such as sport market share reclamation and synergies with Adore Me's technology platform to drive sales in 2024, but now expect benefits to take longer to materialize. International is a bright spot that continues to grow >20%, but it is currently too small to offset declines in the North America business.

Cost savings overshadowed by incremental spending

VSCO remains on track to realize \$120m of cost savings (out of a total \$250m) in 2024, and we estimate \$100m of benefit within COGS. We model GM +80bp to 37.6% in F24, as COGS initiative benefits will be offset by higher promotions (esp 1H) and B&O deleverage. We expect the remaining \$20m benefit to SG&A to be overshadowed by tech investments, wage inflation, and AdoreMe marketing. We model F24 SG&A +4.6%.

4Q was great, but weak outlook is problematic

4Q EPS of \$2.58 beat our/VA consensus ests of \$2.38/\$2.46 on better sales and GM following a strong holiday. QTD traffic is better y/y but conversion is flat. We model 1Q sales -5% to \$1.3bn.

Estimates (Jan) (US\$)	2023A	2024A	2025E	2026E	2027E
EPS	4.95	2.27	1.64	1.82	2.12
GAAP EPS	4.83	2.35	1.64	1.82	2.12
EPS Change (YoY)	-31.0%	-54.1%	-27.8%	11.0%	16.5%
Consensus EPS (Bloomberg)			2.45	3.00	NA
DPS	0	0	0	0	0
Valuation (Jan)					
P/E	3.6x	7.9x	11.0x	9.9x	8.5x
GAAP P/E	3.7x	7.7x	11.0x	9.9x	8.5x
EV / EBITDA*	4.7x	6.4x	7.2x	6.8x	6.3x
Free Cash Flow Yield*	16.8%	8.0%	11.9%	14.9%	17.2%

* For full definitions of *IQmethod*SM measures, see page 5.

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07 March 2024

Equity

Key Changes

(US\$)	Previous	Current
Inv. Opinion	C-1-9	C-3-9
Inv. Rating	BUY	UNDERPERFORM
Price Obj.	34.00	15.00
2025E Rev (m)	6,312.7	6,111.6
2026E Rev (m)	6,540.2	6,304.8
2027E Rev (m)	6,717.8	6,478.6
2025E EPS	2.53	1.64
2026E EPS	3.19	1.82
2027E EPS	4.02	2.12

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Stock Data

Price	18.01 USD
Price Objective	15.00 USD
Date Established	7-Mar-2024
Investment Opinion	C-3-9
52-Week Range	13.62 USD - 35.85 USD
Mkt Val (mn) / Shares Out (mn)	1,621 USD / 90.0
Free Float	98.5%
Average Daily Value (mn)	40.47 USD
BofA Ticker / Exchange	VSCO / NYS
Bloomberg / Reuters	VSCO US / VSCO.N
ROE (2025E)	33.8%
Net Dbt to Eqty (Jan-2024A)	203.7%
ESGMeter TM	NLA

ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".

L5Y: last five years

MSD: mid single digit

LSD: low single digit

B&O: buying and occupancy

iQprofileSM Victoria's Secret & Co

iQmethodSM – Bus Performance*

(US\$ Millions)	2023A	2024A	2025E	2026E	2027E
Return on Capital Employed	15.7%	8.5%	6.6%	7.0%	7.7%
Return on Equity	130.1%	44.4%	33.8%	32.4%	28.2%
Operating Margin	8.9%	5.3%	4.3%	4.5%	5.0%
Free Cash Flow	273	130	194	241	278

iQmethodSM – Quality of Earnings*

(US\$ Millions)	2023A	2024A	2025E	2026E	2027E
Cash Realization Ratio	1.0x	2.2x	3.1x	3.1x	2.7x
Asset Replacement Ratio	0.6x	0.9x	0.8x	0.8x	0.8x
Tax Rate	19.6%	20.8%	25.5%	25.5%	25.5%
Net Debt-to-Equity Ratio	220.1%	203.7%	213.6%	120.3%	49.0%
Interest Cover	9.4x	3.4x	3.4x	3.7x	4.6x

Income Statement Data (Jan)

(US\$ Millions)	2023A	2024A	2025E	2026E	2027E
Sales	6,344	6,181	6,112	6,305	6,479
% Change	-6.5%	-2.6%	-1.1%	3.2%	2.8%
Gross Profit	2,314	2,272	2,298	2,383	2,461
% Change	-16.2%	-1.8%	1.1%	3.7%	3.3%
EBITDA	840	612	544	573	623
% Change	-28.4%	-27.1%	-11.1%	5.4%	8.6%
Net Interest & Other Income	(61)	(95)	(78)	(76)	(71)
Net Income (Adjusted)	416	178	138	155	189
% Change	-35.5%	-57.4%	-22.2%	12.1%	22.2%

Free Cash Flow Data (Jan)

(US\$ Millions)	2023A	2024A	2025E	2026E	2027E
Net Income from Cont Operations (GAAP)	406	184	138	155	189
Depreciation & Amortization	274	285	281	290	298
Change in Working Capital	(195)	(381)	(41)	(11)	(17)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	(48)	297	46	47	48
Capital Expenditure	(164)	(256)	(230)	(240)	(240)
Free Cash Flow	273	130	194	241	278
% Change	-60.0%	-52.5%	49.2%	24.6%	15.4%
Share / Issue Repurchase	(250)	(125)	(200)	(50)	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	295	(150)	(41)	0	(145)

Balance Sheet Data (Jan)

(US\$ Millions)	2023A	2024A	2025E	2026E	2027E
Cash & Equivalents	427	270	222	414	547
Trade Receivables	141	152	152	152	152
Other Current Assets	1,169	1,111	1,131	1,181	1,234
Property, Plant & Equipment	846	843	792	742	684
Other Non-Current Assets	2,128	2,225	2,225	2,225	2,225
Total Assets	4,711	4,600	4,522	4,713	4,841
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	1,579	1,614	1,592	1,632	1,667
Long-Term Debt	1,271	1,120	1,079	1,079	934
Other Non-Current Liabilities	1,460	1,429	1,429	1,429	1,429
Total Liabilities	4,310	4,163	4,100	4,140	4,030
Total Equity	384	417	401	553	791
Total Equity & Liabilities	4,694	4,580	4,501	4,693	4,821

* For full definitions of iQmethodSM measures, see page 5.

Company Sector

Retailing-Specialty

Company Description

Victoria's Secret & Co (VSCO) is a retailer of apparel and intimates and beauty/personal care products based primarily in the US, with a growing presence internationally. Its brands include VS Lingerie, PINK, and VS Beauty. As of Mar 2024, VSCO operates approximately 830 locations in North America, 70 Joint Ventures, 6 Adore Me stores, and 440 franchisee locations globally.

Investment Rationale

Our rating on VSCO is Underperform. We view the US lingerie sector as challenged given continued trends into casual and less structured, and multifunctional bras. The turnaround and cost cutting initiatives are overshadowed by continued investments and wage inflation, leading to SG&A growth. We expect operating deleverage if sales growth does not return to positive.

Stock Data

Average Daily Volume 2,247,176

Quarterly Earnings Estimates

	2024	2025
Q1	0.28A	0.02E
Q2	0.24A	0.19E
Q3	-0.86A	-0.77E
Q4	2.58A	2.19E

4Q beat on strong holiday

4Q adj. EPS of \$2.58 beat our/VA consensus estimates of \$2.38/\$2.46 on better sales and GM following a strong holiday season. Sales grew 3% to \$2.08bn, inclusive of an \$80m benefit from a 53rd week. Average unit retail (AUR) and traffic improved sequentially. Adore Me contributed 3-4% of the growth (\$71mE). Beauty was the best performing category. Adj. GM increased 210bp to 40%, benefitting from COGS initiatives, lower freight cost, and favorable mix, partly offset by higher promotions. Quarter-to-date traffic is better y/y but conversion is flat. We model 1Q sales -5% to \$1.3bn.

Market share background and current consumer trends

VSCO has maintained its share in the secularly declining US core lingerie market over the last few quarters. We expect continued decline throughout the year given fashion trends that lead to deflation in the category: consumer preferences have continued to shift to less structured bras and bralettes, more casual and minimalistic bras, and multi-functional bras such as sports bras that double as a lounge bra or top (a negative for unit growth).

Victoria's Secret continues to hold the leading market share in the bra industry, although its share is far below what it was at peak. A decade ago, Victoria's Secret benefitted greatly from the popularity and its expertise in structured and push-up bras, and commanded 32% market share in 2015. By 2022, its market share was around 21%; by 4Q22, mgmt cited a 20% market share, and in 4Q23 VSCO held approximately a 20% market share in the US core lingerie market. We are encouraged by the outperformance of the launch of its invisible lift technology New Body by VS bra in February, as it demonstrates the effectiveness of innovation and newness; however, the inability of even such a large launch to drive sales growth leads us to worry about underlying softness in demand for the rest of the assortment.

Exhibit 1: Our PO reflects 3.5x EV/EBITDA on our F25 estimates. This is at the lower end of the peer group range of 3-8x, but in line with peers with negative sales growth rates

VSCO comparable company analysis

Company	Ticker	Price	Mkt Cap (\$mn)	Sales growth (y/y)		EBIT Margin		P/E		EV/EBITDA	
				F24E	F25E	F24E	F25E	F24E	F25E	F24E	F25E
American Eagle	AEO	\$23.00	\$4,543	4%	4%	8.0%	8.5%	14.2x	12.9x	5.8x	4.9x
Gap	GPS	\$19.33	\$7,168	-3%	2%	3.6%	3.4%	19.3x	20.3x	7.8x	7.8x
Urban Outfitters	URBN	\$41.94	\$3,892	8%	8%	7.9%	8.2%	11.9x	10.2x	5.5x	4.6x
Kohl's	KSS	\$26.83	\$2,970	-3%	-2%	4.0%	4.2%	13.2x	12.1x	3.1x	2.9x
Foot Locker	FL	\$24.34	\$2,292	-1%	4%	3.0%	4.1%	15.5x	9.9x	5.5x	4.0x
Average				1%	3%	5.3%	5.7%	14.8x	13.1x	5.5x	4.8x
VSCO	Price	\$18.01	\$1,395	-1%	3%	4.3%	4.5%	10.9x	9.9x	4.1x	3.6x
	PO	\$15.00	\$1,162					9.1x	8.2x	3.7x	3.5x

Source: BofA Global Research estimates, company filings

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Price objective basis & risk

Victoria's Secret & Co (VSCO)

Our \$15 PO is based on 3.5x our F25E EV/EBITDA, which is at the low end of specialty apparel peers (4-8x) but in line with negative sales growth peers at 3-4x. We view an in line valuation as appropriate as there is risk inherent in execution of the turnaround and continued sales declines in a shrinking market even if VSCO maintains its market share.

Upside risks to our PO are sales recovering more quickly than anticipated, consumer tastes shifting and bra demand increasing, reclamation of market share in Sports bras and synergies from Adore Me technology benefit sales sooner than expected.

Downside risks to our PO are continued competition from digitally native intimates retailers, overseas digital retailers taking share by offering lower-priced alternatives, and acceleration in weakness in North America consumer demand for apparel and the core lingerie category.

Analyst Certification

I, Alice Xiao, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Softline Retailing and Dept Stores Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Amer Sports Inc	AS	AS US	Lorraine Hutchinson, CFA
	Bath & Body Works Inc	BBWI	BBWI US	Lorraine Hutchinson, CFA
	Burlington Stores	BURL	BURL US	Lorraine Hutchinson, CFA
	Crocs, Inc.	CROX	CROX US	Christopher Nardone
	Deckers Outdoor Corp	DECK	DECK US	Christopher Nardone
	European Wax Center	EW CZ	EW CZ US	Lorraine Hutchinson, CFA
	lululemon athletica Inc	LULU	LULU US	Lorraine Hutchinson, CFA
	Oddity Tech	ODD	ODD US	Lorraine Hutchinson, CFA
	PVH Corp	PVH	PVH US	Christopher Nardone
	Ralph Lauren	RL	RL US	Christopher Nardone
	Ross Stores Inc	ROST	ROST US	Lorraine Hutchinson, CFA
	Tapestry Inc.	TPR	TPR US	Lorraine Hutchinson, CFA
	TJX Companies	TJX	TJX US	Lorraine Hutchinson, CFA
	Urban Outfitters	URBN	URBN US	Lorraine Hutchinson, CFA
NEUTRAL				
	American Eagle	AEO	AEO US	Christopher Nardone
	Birkenstock	BIRK	BIRK US	Lorraine Hutchinson, CFA
	FIGS, Inc.	FIGS	FIGS US	Alice Xiao
	Foot Locker	FL	FL US	Lorraine Hutchinson, CFA
	Levi Strauss & Co.	LEVI	LEVI US	Christopher Nardone
	Nike	NKE	NKE US	Lorraine Hutchinson, CFA
	Signet Jewelers	SIG	SIG US	Lorraine Hutchinson, CFA
	Ulta Beauty	ULTA	ULTA US	Lorraine Hutchinson, CFA
	Under Armour Inc	UAA	UAA US	Lorraine Hutchinson, CFA
UNDERPERFORM				
	Aritzia	YATZ	ATZ CN	Alice Xiao
	Aritzia	ATZAF	ATZAF US	Alice Xiao
	Carter's Inc	CRI	CRI US	Christopher Nardone
	Gap Inc.	GPS	GPS US	Lorraine Hutchinson, CFA
	Kohl's	KSS	KSS US	Lorraine Hutchinson, CFA
	Nordstrom	JWN	JWN US	Lorraine Hutchinson, CFA
	Revolve	RVLV	RVLV US	Alice Xiao
	V F Corp	VFC	VFC US	Lorraine Hutchinson, CFA
	Victoria's Secret & Co	VSCO	VSCO US	Alice Xiao

US - Softline Retailing and Dept Stores Coverage Cluster

Investment rating Company BofA Ticker Bloomberg symbol Analyst

iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity
Operating Margin
Earnings Growth
Free Cash Flow

Quality of Earnings

Cash Realization Ratio
Asset Replacement Ratio
Tax Rate
Net Debt-To-Equity Ratio
Interest Cover

Valuation Toolkit

Price / Earnings Ratio
Price / Book Value
Dividend Yield
Free Cash Flow Yield
Enterprise Value / Sales

EV / EBITDA

Numerator

$$\text{NOPAT} = (\text{EBIT} + \text{Interest Income}) \times (1 - \text{Tax Rate}) + \text{Goodwill Amortization}$$

Net Income
Operating Profit
Expected 5 Year CAGR From Latest Actual
Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations
Capex
Tax Charge
Net Debt = Total Debt – Cash & Equivalents
EBIT

Numerator

Current Share Price
Current Share Price
Annualised Declared Cash Dividend
Cash Flow From Operations – Total Capex
$$\text{EV} = \text{Current Share Price} \times \text{Current Shares} + \text{Minority Equity} + \text{Net Debt} + \text{Other LT Liabilities}$$

Enterprise Value

Denominator

$$\text{Total Assets} - \text{Current Liabilities} + \text{ST Debt} + \text{Accumulated Goodwill Amortization}$$

Shareholders' Equity
Sales
N/A
N/A

Denominator

Net Income
Depreciation
Pre-Tax Income
Total Equity
Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)
Shareholders' Equity / Current Basic Shares
Current Share Price
$$\text{Market Cap} = \text{Current Share Price} \times \text{Current Basic Shares}$$

Sales

Basic EBIT + Depreciation + Amortization

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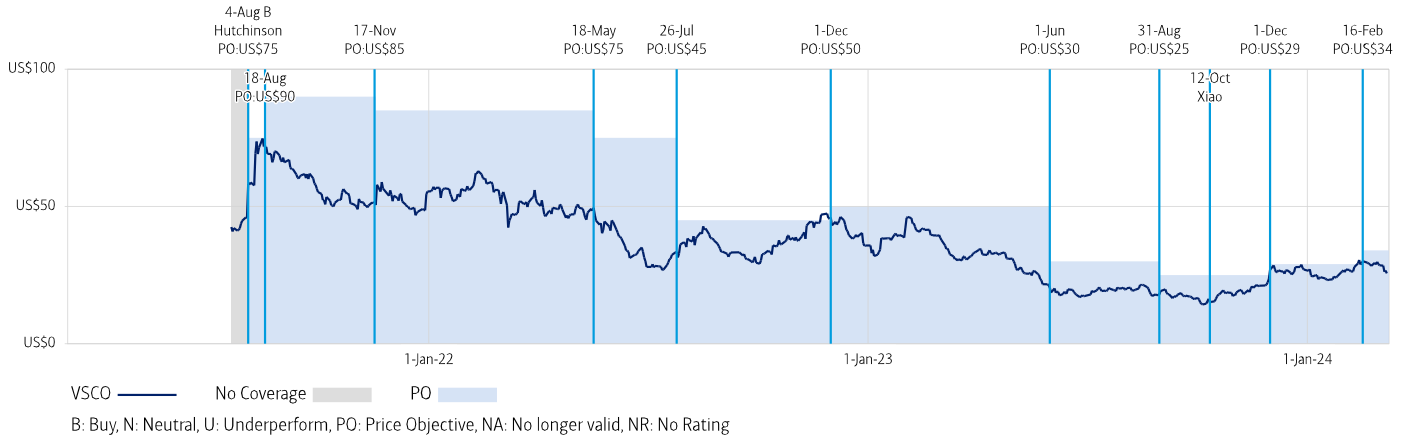
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Victoria's Secret (VSCO) Price Chart



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Equity Investment Rating Distribution: Retailing Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	96	57.83%	Buy	39	40.63%
Hold	32	19.28%	Hold	12	37.50%
Sell	38	22.89%	Sell	18	47.37%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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