

EPS Accretion Modelling & Strategic Rationale:

Acquisition of Tapestry Inc. by Bath & Body Works, Inc.

Proposed Terms

We propose that Bath & Body Works, Inc., ticker BBWI, pays \$51.45 per share, a premium of 18.0% over the \$43.61 current market price, to acquire 100% of Tapestry, Inc., ticker TPR. Cash and stock for stock acquisition will make up 67/33 of the funding for the transaction. Bath & Body Works, Inc. will be able to integrate the resources of the two companies, create new opportunities, and boost value for shareholders once it has full ownership of Tapestry, Inc.

Reasons for the Deal

While the three brands owned by Tapestry Inc. are engaged in two distinct industries, notably luxury clothing (Coach & Kate Spade) and Stuart Weitzman (luxury shoe brand), Bath & Body Works, Inc. is an American retailer that offers bath and beauty products. In 2020, Bath & Body Works, Inc. sold its 55% share in Victoria's Secret to Sycamore Partners. Victoria's Secret controls a 24% market share in women's lingerie industry.

If this M&A deal goes through successfully, the two companies will enjoy significant operation cost savings. Bath & Body Works is more than capable of managing Tapestry's all three brands because it has the expertise in the clothing and accessory industry given that it had established a previous subordinate brand as successful as Victoria's Secret. As a global retailer that manages tens of thousands of SKU's, Bath & Body Works' robust supply chains and inventory management system can suffice operational demands of all four lines of business. Consequently, the merger could lead to reduction of redundant operational activities which in turn reduces cost and increases efficiency of the newly integrated entity.

The merger of the two companies can also bring synergy in terms of product development, distribution channels sharing and marketing collaboration. Bath & Body Works will be able to grow into the Tapestry's mid-high end customer markets that it does not currently service. Along the process of achieving this, value is also generated by Tapestry's creative team as it contributes novel, fresh ideas to develop new luxury lines of Bath & Body Works' bath and beauty products that caters to their respective target customers. Correspondingly, Tapestry will be able to increase its online presence by implementing Bath & Body Works' extensive internet retail marketing technology, as well as attracting attention from the customer base of Bath & Body Works during marketing collaboration activities. Although each company is a leader in its own industry, from the customers' perspective, fashion items and selfcare products lie under one single lifestyle category. The merger of the two companies, both with dynamic product offering, is a strategic move to expand their product line and market share.

The 3.2% of revenue growth at Tapestry, Inc. and 4.3% of revenue growth at Bath & Body Works demonstrates that both businesses are at a mature stable stage of their business lifecycle, where creating cost savings and opening new market territories is vital for the sustainability of their businesses. And this can be achieved by the merger of the two companies.

Accretion, Premium and Synergies

The acquisition of Tapestry, Inc. will only be considered if it generates value. According to our research and model, the proposed merger is both highly accretive and synergistic, with a projected increase in EPS of the combined firms of around 46.7% compared to Bath & Body Works, Inc.'s standalone EPS in 2025. The accretion percentage and premium on the target's share price are influenced by a number of factors, including the current share price, share's fair value, synergy, as well as the cash/stock funding ratio. To demonstrate the sensitivities regarding these two metrics. According to our model, we found that when synergies are considered, the accretion percentage increases dramatically as percentage of cash spent increases; and since Tapestry's shares are very undervalued, so the higher premium offered, the more likely that shareholders will tender their shares.

In order to avoid interest rate risk imposed on an overleveraged combined entity (this will be explained more in detail in the following risk section), we advise Bath & Body Works, Inc. to pay a conservative level of premium of 18% above the \$43.61 clean price, which is \$51.45 per share, as the acquisition price. The percentage of accretion from this offer price will be 67.4% based on the estimate that the total synergies from the merger will be roughly \$1988.4 million. Cost synergies of \$520 million might be achieved by pooling inventory management systems and supply chain logistics networks and by combining back-office activities like accounting and human resources. Additionally, the merger may create value of \$1100 million in SG&A synergies by distribution channels sharing, brand value increment through marketing collaborations, and revenue growth by cross-selling products, which could produce revenue synergies of roughly \$368.4 million. The estimated EPS for 2025 at the \$51.45 offer price is still accretive by 5.3% without synergies, making this transaction exceptionally beneficial for Bath & Body Works, Inc. The higher the premium offered, the lower the accretion figure with or without synergies.

According to the pessimistic scenario, the EPS accretion will be 34.4%, the normal scenario, 46.7%, and the optimistic scenario, 59%. The sensitivity analysis shows that cost and SG&A synergies have a significant impact on EPS. The cost reductions rise and fall by \$100 million in both the optimistic and the pessimistic scenarios. Similarly, the SG&A yields \$200 million more or less saving in the optimistic scenario and pessimistic scenario respectively. It is as intuitive as it is shown in sensitivity analysis that larger savings translate into higher EPS.

By creating data table sensitizing the variable of effective tax rate (ETR), we can conclude that the earning per share is only affected by the ETR of the acquiring company, not that of the target company. The target company's price per share is only affected by its own ETR obviously, but this price per share reflects the share's fair value. And if the target company's ETR fluctuation causes an increased fair value, then the acquiring company is also pressured to offer a higher premium. Thus, changes of ETRs of both Bath & Body Works and Tapestry may affect the rate of accretion of this merger transaction in terms of earning per share, directly or indirectly.

Risks Associated

The proposed deal of Bath & Body Works, Inc. acquiring Tapestry, Inc. entails several risks that could delay closing with long-term consequences. One major risk is whether the proposed premium is appealing enough so that shareholders will tender in their shares, given that according to our model, the current share price of \$43.61 per share is much undervalued. Taking the average of the results of fair value of Tapestry's share calculated by the two DCF methods, terminal EBITDA multiple and terminal perpetuity growth rate, Tapestry's shares should be valued at around \$66 per share, a 52.6% premium. If we increase from our proposed 18% premium to 52.6% to attract shareholders tendering their shares, although with synergy we still have a positive accretion of 48%, without synergy we have a dilution (negative accretion) of 8.1%. If our method estimation of synergies is at error, then the merger might reflect a low accretion in the forthcoming years, if not a negative accretion.

We may remedy this potential risk by using more cash for the acquisition, for example, increasing to using 75% cash and 25% stock to achieve a positive accretion of 9.3% without synergy. However, this will lead the company under exposure to high interest rate risk. Bath & Body Works, Inc. is holding \$6058 million in total debt as of June 30, 2023. The company is expose to high interest rate risk with potential drastic interest expenses increase if the variable rate borrowings under the Term Loan B Facility and Revolving Facility had risen by June 30, 2024. This increase cost of debt may materially adversely affect Bath & Body Works, Inc.'s ability to make debt payments. Bath & Body Works, Inc. now has a 58.4% debt load, which could get worse if borrowing costs increase. Financing the acquisition with 75% (significantly higher than current 58.4%) cash from debt entails a much more levered capital structure and a sizable degree of risk in the face of rising interest rates.

Conclusive Recommendation

We suggest Bath & Body Works proceed with the acquisition at the offer price of \$51.45 per share, a premium of 18% compared to Tapestry's current market price. The acquisition will be financed with 67% cash and 33% shares. By this merger deal, the company will be able to extend its product lines, diversify its markets, and enhance its value proposition to customers. The expected increase of 46.7% in the combined company's EPS from 2025 makes the proposed merger an accretive transaction that improves the value for shareholders. The concept significantly adds value in cash transactions. Although the company has a "healthy" debt-to-EV ratio of 58.4%, the transaction shouldn't be paid for fully in cash.