January 12, 2024

Aritzia

The Everyday Luxury Apparel Company Poised for Long-Term Growth Amid a Crowded and Ever-Changing Retail Landscape

Summary: **I recommend a hold with a $36.18 target price.** Aritzia is a unique retailer operating in the everyday luxury fashion channel and has continued to demonstrate consistent growth and sticky or persistent brand awareness and loyalty. The company has seen tremendous success in the Canadian market and has subsequently undergone expansion into the U.S. where it is now seeing increased recognition from consumers. The retailer continues to excel with its omnichannel strategy and multi-brand moat which allows for decreased risk in an ever-changing fashion industry and strong growth and profitability prospects.

Key Drivers

Aritzia's omnichannel strategy has shown proven results and its continued development is a key lever of growth for the company. The firm has historically seen large success with their retail or brick and mortar channel which accounted for approximately 88% of total net revenues in fiscal 2016 with compelling store economics. The company embarked on growing their eCommerce business since its creation in fiscal 2013 and quickly surpassed all their strategic targets with 50% eCommerce penetration in fiscal 2021 compared to expectations of 25%. The eCommerce business has since continued to grow and has recently accounted for $212.5 million or 32.5% of net revenues in Q3 2024 with brick and mortar continuing to provide reliable and predictable growth with the added omnichannel functionality furthering the customer experience.

Expansion into the U.S. is a key component of Aritzia's growth strategy. The company's investment in the United States has contributed greatly to its current growth trajectory with 7 new store openings at the end of fiscal 2023 and another 6 planned for fiscal 2024. The company aims to open approximately 8-10 new boutiques annually in the US through fiscal 2027 and expand 3-5 boutiques per year, growing the firm's total boutique count to approximately 150 and increasing total retail square footage by up to 60% by fiscal 2027. The US business provided $1.1 billion growth in net revenue in fiscal 2023, representing a 66% increase from the previous year.

Aritzia's positioning and growing brand awareness mitigates the risks of everchanging retail and fashion preferences. Aritzia strategically positions themselves within everyday luxury with multiple clothing brands and lines to meet customer needs at competitive prices compared to fast fashion, affordable luxury and sub-luxury peers. As the brand continues to resonate with customers, Aritzia finds itself at the early stages of growing a powerful worldwide brand through product excellence, digital and strategic marketing, and enhanced client experience.

Joshua DeSousa

ATZ-TSX	RATING	PRICE	TARGET
	PERFORM	$32.01	$36.18

LHS: Stock Price ($C) / RHS: Volume

Valuation (Base Case) $36.18

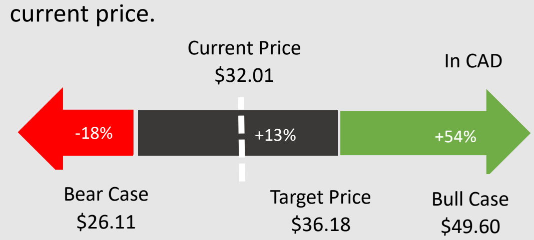
My target of $38.01 is based on a 7.0x EV/EBITDA exit year multiple. Aritzia shares are currently priced at 13.5x EV/EBITDA which is a slight premium compared to a number of their peers and my conservative multiple is more in line with their overall comparables and forecasted future EV/EBITDA multiples. However, Aritzia's long term growth prospects and guidance support attractive EBITDA growth over the long term along with top line revenue growth and a strong balance sheet.

Bull Case $49.60

My bull case forecasts Aritzia exceeding expectations in regards to their strategic plan through fiscal 2027. Better than expected gross margins, revenue growth, and adjusted EBITDA margins contribute to a price target of $49.60 at an 8.0x EV/EBITDA multiple, slightly higher than my base case. This implied price represents ~54% of upside potential compared to the current price.

Bear Case $26.11

My bear case forecasts headwinds for Aritzia's growth plan with slowing US growth and brand awareness. Lower expected gross margins, revenue growth, adjusted EBITDA margins, and a weaker balance sheet contribute to a price target of $26.11 at a 6.0x EV/EBITDA multiple, slightly lower than my base case. This implied price represents ~(18%) potential loss compared to the current price.



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Aritzia – Summary Model (in Thousands $CAD)

Income Statement	2023A	2024E	2025E	2026E	2027E	2028E	2029E
Total Canada Stores	68	68	68	68	69	70	70
Total US Stores	46	54	63	72	81	85	90
Total Stores	114	122	131	140	150	155	160
Total Revenues	2,195,630	2,338,346	2,665,714	3,092,229	3,633,369	4,069,373	4,476,310
Total Revenue Growth (%)	*46.9%*	*6.5%*	*14.0%*	*16.0%*	*17.5%*	*12.0%*	*10.0%*
Gross Profit	913,992	902,602	1,122,266	1,283,275	1,489,681	1,668,443	1,812,906
Gross Margin (%)	*41.6%*	*38.6%*	*42.1%*	*41.5%*	*41.0%*	*41.0%*	*40.5%*
SG&A	24,369	33,417	38,096	44,191	51,925	58,156	63,971
SG&A % of rev	*27.4%*	*30.4%*	*28.9%*	*28.2%*	*27.8%*	*27.7%*	*27.7%*
Net Income	187,588	95,131	205,174	240,228	279,652	316,140	331,640
Adjusted EBITDA	351,181	210,451	373,200	494,756	690,340	723,487	805,735
Adj EBITDA Margin (%)	*16.0%*	*9.0%*	*14.0%*	*16.0%*	*19.0%*	*18.0%*	*18.0%*
Tax Rate (%)	*28.9%*	*28.5%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*	*28.0%*
EPS	1.41	0.86	1.85	2.17	2.53	2.86	3.00
Balance Sheet	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	**2029E**
Total Current Assets	611,848	671,278	950,519	1,305,269	1,733,253	2,208,539	2,725,912
Total Assets	1,836,543	2,042,221	2,353,090	2,769,199	3,263,690	3,785,808	4,344,853
Total Current Liabilities	417,300	441,682	481,630	554,960	647,874	740,184	842,946
Total Liabilities	1,150,756	1,209,883	1,318,582	1,468,767	1,648,011	1,814,985	1,998,627
Retained Earnings	355,270	430,401	600,575	805,803	1,050,455	1,331,596	1,628,235
Total Shareholders' Equity	685,787	814,338	1,034,508	1,299,431	1,615,679	1,970,823	2,346,226
Total Liabilities and Equity	1,836,543	2,042,221	2,353,090	2,769,199	3,263,690	3,785,808	4,344,853
Cash Flow Statement	**2023A**	**2024E**	**2025E**	**2026E**	**2027E**	**2028E**	**2029E**
Change in Non-Cash WC	(228,956)	77,167	1,599	(13,370)	(16,401)	4,878	17,411
Cash Flow from Operations	74,913	389,652	511,614	570,415	659,702	766,015	839,557
Cash Flow from Financing	(122,537)	(97,082)	(108,949)	(115,486)	(122,416)	(129,760)	(137,545)
Capital Expenditure	(122,767)	(187,068)	(159,943)	(185,534)	(218,002)	(244,162)	(268,579)
Cash Flow from Investing	(131,213)	(189,8889)	(162,764)	(188,356)	(220,823)	(246,983)	(271,400)
Free Cash Flow	(34,316)	79,768	167,163	165,143	178,039	212,059	222,002

Aritzia – DCF Output Summary

PERPETUITY APPROACH	
FCF in Last	315,557
FCF t+1	321,868
Long term growth rate	2.0%
Terminal Value	5,293,052
PV of Terminal Value	3,554,198
PV of Stage 1 CF	996,313
Enterprise Value	4,550,511

EXIT EBITDA APPROACH	
Terminal Year EBITDA	805,754
Exit EBITDA Multiple	7.0x
Terminal Value	5,640,151
PV of Terminal Value	3,787,269
PV of Stage 1 CF	996,313
Enterprise Value	4,783,582
WACC	8.1%

Fair Value per Share	Perpetuity	Exit EBITDA
Enterprise Value	4,550,511	4,783,582
Less: Net Debt	658,846	658,846
Equity Value	3,891,665	4,124,763
Shares Outstanding	114,000	114,000
Equity Value per Share	$34.14	$36.18
Premium (Discount)	*6.65%*	*13.03%*

Aritzia – Comparables Table (In $CAD)

Name	Ticker	Share Price	Mkt Cap ($M)	EV ($M)	P/E	EV/EBITDA LTM	EV/EBITDA 2024E	EV/EBITDA 2025E
Abercrombie & Fitch Co.	ANF: NYSE	120.72	6,085	6,702	23.3x	5.9x	8.2x	8.1x
American Eagle Outfitters, Inc.	AEO: NYSE	26.45	5,226	6,534	18.0x	4.7x	8.6x	8.0x
Canada Goose Holdings Inc.	GOOS: TSX	15.25	1,519	2,373	29.2x	10.0x	8.6x	7.4x
H & M Hennes & Mauritz AB	HM B: OM	21.58	34,951	41,420	42.9x	10.2x	7.3x	7.0x
Industria de Diseño Textil, S.A.	ITX: BME	55.01	171,244	162,505	22.8x	12.8x	11.3x	10.6x
Lululemon Athletica Inc.	LULU: NASDQ	654.82	82,633	82,735	62.5x	21.5x	24.3x	21.2x
Tapestry, Inc.	TPR: NYSE	49.78	11,408	14,865	9.5x	5.7x	7.9x	7.3x
The Gap, Inc.	GPS: NYSE	27.72	10,280	15,876	174.7x	5.5x	11.6x	10.7x
Urban Outfitters, Inc.	URBN: NASDQ	45.84	4,253	4,928	11.9x	4.4x	7.2x	6.8x
Victoria's Secret & Co.	VSCO: NYSE	33.29	2,578	6,572	19.8x	4.6x	8.5x	8.1x
First Quartile		*25.23*	*3,835*	*6,132*	*16.44x*	*4.7x*	*7.7x*	*7.2x*
Median		*39.57*	*8,183*	*10,783*	*23.05x*	*5.8x*	*8.5x*	*8.0x*
Third Quartile		*71.44*	*46,872*	*51,749*	*47.77x*	*10.9x*	*11.4x*	*10.6x*

Aritzia	**ATZ: TSX**	**32.01**	**2,768**	**3,852**	**42.0x**	**13.5x**	**13.4x**	**9.1x**

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Investment Thesis

Omnichannel Strategy

Aritzia has continued to position itself for success across channels. The retailer has proved it has a successful operating strategy for their stores which have historically been their main driver of revenue while maintaining attractive margins and payback periods. To pair with their brick-and-mortar strategy, Aritzia launched its eCommerce initiative in 2012 with the goal of growing this business to further enhance growth by offering consumers increased ease of shopping. Since its inception, Aritzia's eCommerce channel has seen tremendous growth. From accounting for approximately 12% of total net revenue in fiscal 2016 to approximately 32.5% of net revenues in Q3 2024, the retailer is on pace to reach their strategic targets with respect to this channel. In their fiscal 2027 plan, Aritzia aims to have 45% of their total net revenue contributed by their eCommerce business and they look to be on path to do so as they continue to grow this channel after successive years of above target eCommerce penetration. Additionally, to help fuel their eCommerce growth or as Aritzia calls it, eCommerce 2.0, the retailer has indicated that they are in process of upgrading their tech stack to realize their full vision across three value propositions, tailored product discovery, intuitive experiences, and creative innovation.

Digital marketing has yet to play a factor. Aritzia increased their marketing spend over the last quarter which was a slight shift from a historically low budget allocated towards this initiative. However, they see tremendous opportunity in increasing their marketing spend to further drive eCommerce growth especially in the U.S., which has been one of their most profitable channels. The company targets marketing spend as a low percentage of revenue which will ramp up over time as the firm sees success with this initiative. This increase in marketing spend is essential in realizing one of their main levers of growth, increased brand awareness. As mentioned above and in their Q3 earnings call, management sees huge benefit in digital marketing especially within the U.S. as they continue to grow their brand and loyalty compared to Canada. This lever will assist the firm in gathering and retaining customers and further help drive their omnichannel strategy and reach their fiscal 2027 targets.

Aritzia boasts strong margins regardless of channel. Aritzia has many factors which contribute to their impressive margins including inventory management and lack of promotional sales or markups to name a few. All of these factors compound to produce impressive store economics, with approximately 1 year payback periods and leading sales per square foot among fast fashion retailers. In fact, management has indicated that there is no substantial difference between their eCommerce and boutique margins, with eCommerce slightly higher than their boutique counterpart. This further validates a push in growing their omni-channel capabilities which would signify a net positive for top line revenue growth and margins across channels. As trends shift and the way consumers shop changes, Aritzia is poised to offer a unique boutique experience while also offering a tailored and intuitive eCommerce experience for their customers.

Early Stages of U.S. Growth

Aritzia has seen early success with their entry into the U.S. market but still has plans to rapidly grow their share within the largest economy centered around boutique expansion. Aritzia placed continued geographic expansion as one of its key growth drivers in their strategic plan for fiscal 2027. The firm currently has 49 boutiques opened in the U.S. with 6 new stores planned for fiscal 2024 as well as 4 location expansions. They believe they still have significant runway to grow in the U.S. and plan to open 8-10 new boutiques annually through fiscal 2027, all of which meet their location criteria which has proven successful historically. This plan signifies a large bet on continued success in their expansion into the U.S., which as of now, has proven a very profitable strategic initiative. In fiscal 2023 alone, Aritzia's U.S. business contributed $1.1 billion in net revenue growth which represented a 66% increase from fiscal 2022 just after an increase of 123% in the year prior to that. As Aritzia continues to expand their locations and overall square footage in the U.S., we should expect continued excellence from their U.S. operations contributing to stronger top line growth and continued margin excellence.

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Even with continued boutique expansion, store economics remain strong and are a key strength for the retailer which relies on brick and mortar for a majority of their growth. Boutiques are a key pillar to Aritzia's growth strategy as they drive sales, build brand awareness, propel significant client acquisition, and fuel their eCommerce channel. Many retailers must be extremely selective in regards to retail expansion as new store openings are often a costly endeavour and require investment that takes time to recover. However, for Aritzia, the strength of their boutiques also lies with their extremely impressive store economics which make rapid boutique expansion rather attractive both in the short and long-run. Aritzia's guidance on payback periods for new boutiques is a range of between 12 and 18 months, but in their recent Q3 earnings call, the retailer has pointed to accelerated payback periods for their new store openings. With high sales performance, management of build-out costs, landlord allowances, and lower real estate prices, the retailer has indicated that they expect their newly launched stores and upcoming openings to payback in just under 12 months. Pairing a location expansion strategy with impressive store economics further suggests the retailer should enjoy continued success and growth in the U.S. market.

New Stores		
Estimated Revenue Contribution	**Sales per Sq. Ft.**	$1,000
	Total Sq. Ft.	8,000
	Revenue	$8 million
Estimated Net Investment		$3 million
Average Payback Period		12-18 Months

Impressive Store Economics (Aritzia 2024 Q3 Presentation)

Multi-Brand Differentiation

Aritzia maintains a competitive advantage relative to peers through differentiation which decreases overall fashion risk in a market dominated by trends. Aritzia's multi-brand moat provides multiple benefits for the retailer. The company owns and develops 11 exclusive brands, each treated as their own independent label with their own teams to further drive the brand. Through this strategy, Aritzia has doubled their style count and grown their product catalogue over the past 5 years. Unlike mono-brand retailers, Aritzia is able to leverage their house of brands to best drive revenue while strategically rotating through these brands and products to respond to changes in market demand. Their multi-brand approach decreases fashion risk by rotating products and brands to fit the ever-changing fashion market while driving revenue, customer acquisition and retention, and efficient inventory management.

wilfred   wilfred free   SUPER WORLD™   REIGNING CHAMP

BABATON   TEN BY BABATON   The Group BABATON

Sunday Best   TNA®   TnAction™   DENIM FORUM

Aritzia's Exclusive Brands (Aritzia 2024 Q3 Presentation)

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Aritzia's multi-brand moat both assists in customer acquisition and customer retention. The depth of brands and products for Aritzia is one driver of their unique boutique or shopping experience. The company prides itself on its brick-and-mortar locations which aim to provide a different feel or experience as compared to other fast fashion retailers and are the main source or driver of revenue growth. First time customers are faced with a breadth of options to fit their needs and an assortment of brands to choose from to find one that resonates with them. The benefit of the multi-brand strategy is highlighted as the customer develops and finds items, whether best sellers or new products, which fit their needs as they progress. For example, a younger female client may resonate with TNA which is geared towards more athleisure and less formal wear. As that customer progresses and matures, Aritzia's assortment of brands can assist her in getting ready for her next stage in life. Perhaps she needs formal wear as she progresses into the early stages of her career, Babaton and Wilfred can offer products fit for her while remaining in the Aritzia ecosystem which they know and love.

Demand-driven inventory leverages the multi-brand strategy to optimize inventory levels and revenue generation. The ability to rotate brands and products is a huge advantage for Aritzia who is able to ensure that they are able to keep inventory levels low and drive sales into stocked products. The retailer's strategy is to rely on what they call "proven sellers", products which have historically sold well, while also adding new products in the form of seasonal product lines. When adding these new products into stores, Aritzia maintains a margin of safety by first buying new products in small quantities to gauge demand and either follow up with more orders or cycle the product out in favor of proven sellers or other successful products within the new season. The retailer's ability to cycle products and brands ensures an optimized inventory management process which is flexible enough to respond to changes in consumer preference or capitalize on opportunities with certain products. The proof of the success of this strategy can be seen over the course of fiscal 2024 and especially in Q3, as the retailer began to see inventory normalize from elevated levels due to economic conditions affecting product sales. Additionally, since the retailer does not go on sale, ensuring efficient inventory management is paramount to move products at full price without much inventory risk.

Valuation Assumptions and Guidance

Aritzia presented their fiscal 2027 strategic plan in October 2022 with a substantial amount of guidance for targets the retailer plans to hit in that time span. Touched upon in the investment thesis section above, Aritzia's main levers to fuel their growth strategy are geographic expansion, eCommerce acceleration, and increased brand awareness. The success of these levers was introduced in the form of a long-term financial plan from the end of fiscal 2023 to 2027 which outlined:

- Net revenue between $3.5-$3.8B in fiscal 2027 which represents a 15-17% CAGR
- Adjusted EBITDA of approximately 19% of net revenue in fiscal 2027
- EPS growth to outpace revenue growth

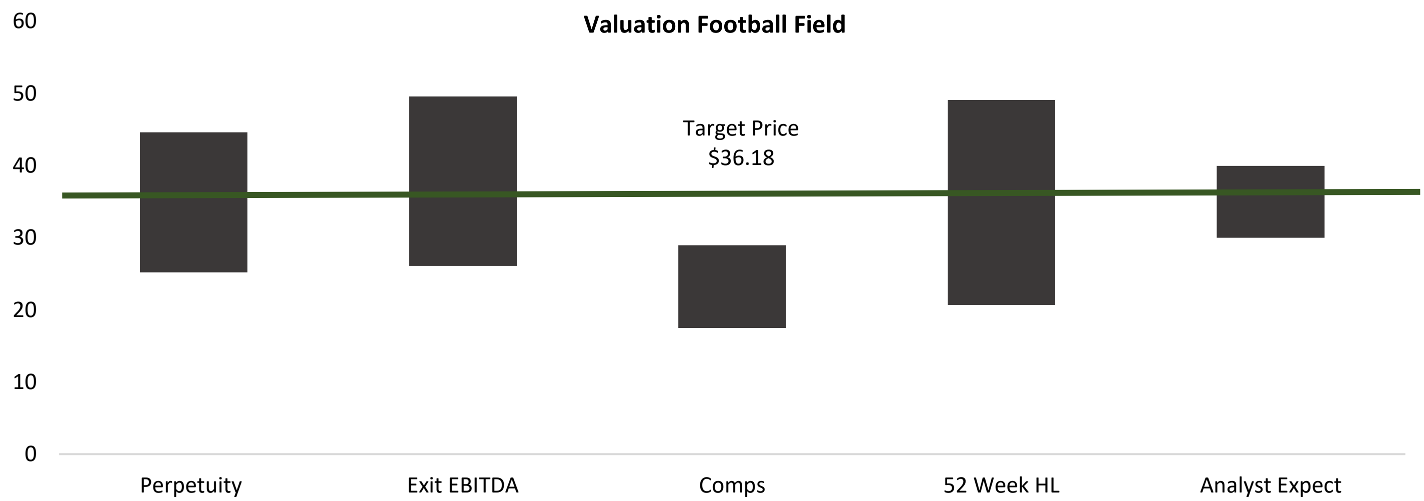
These targets were the basis of my inputs into the model with the following key assumptions for fiscal 2027 listed below:

- Increasing total boutiques to 150, largely driven by U.S. expansion with a target of 8-10 new stores annually
- Expanding 3-5 boutiques annually
- Increasing total retail square footage annually in the low double digits
- eCommerce revenue in the range of $1.5-$1.7B which represents approximately 45% of net revenues
- Net capital expenditures of approximately $500M through from fiscal 2024 to fiscal 2027
- Cash balance of $1B+ by fiscal 2027

Additionally, with the turbulent Q1 and Q2 of this year, my assumptions for the end of fiscal 2024 and rebound into fiscal 2025 were as follows:

- Net revenue to grow between 6-7% in fiscal 2024 and grow 14% in fiscal 2025 based on the CAGR needed for fiscal 2027 revenue targets
- Gross profit margin to decrease by 300bps and rebound 450bps to 42.1% in fiscal 2025 largely driven by 150bps in IMU improvement, 175bps from Aritzia's smart spending initiative, and 125bps improvement from transitory costs
- SG&A as a % of net revenue to increase by 300bps in fiscal 2024 with 150bps improvement in fiscal 2025
- Capital expenditures slightly above $180M in fiscal 2024
- Adjusted EBITDA margin of 9% in fiscal 2024 with 500bps of improvement in fiscal 2025

With these assumptions as the basis of my model, my final valuation utilized a more conservative exit multiple than Aritzia's current EV/EBITDA multiple and consensus forecasts. With a 7.0x EV/EBITDA multiple and a WACC of 8.1%, I reached a final target price of $36.18 representing an implied upside of approximately 13%. Below is a summary of all valuation approaches and other measures.



Risks and Uncertainties

While Aritzia boats strong growth prospects and proven success in their operations, some key risks that may impact the business and their financial conditions are noted below:

- **Uncertainty surrounding consumer spending.** Aritzia has seen a pullback in top line revenue growth as compared to previous double and even triple digit growth years. This is largely due to the current macroeconomic environment which has continued to weaken the consumer in both Canadian and U.S. markets. The company noted in their 2024 Q2 earnings call that customer traffic has been lower than historical levels and customers have been more selective in their purchases than in the past, citing that customers have been shopping less frequently with Aritzia than before but when they do shop, the average basket size and selling price remains consistent with historical levels. Although Aritzia has levers to pull to mitigate this risk, such as rotating to their top selling brands and products within their lineup, IMUs and transitory costs have been a drag on margins in fiscal 2024. Continued weakness in consumer spending and economic conditions may inhibit top line growth as well as continued margin compression.

- **U.S. growth may stagnate due to the competitiveness of the retail fashion market.** Aritzia's success in the Canadian market led to its decision to expand its footprint in the U.S. with a target of 8-10 new stores openings each year through fiscal 2027. The firm's decision to enter the U.S. market has proven successful with U.S. revenues comprising just over 50% total net revenue in fiscal 2023. Aritzia's decision for continued rapid U.S. expansion comes with substantial risk in an uber competitive retail marketplace ripe with many different options for the U.S. consumer. A more promotional environment compared to Canada, especially during tougher economic times, may drive traffic away from Aritzia who tend to not go "on sale". The competitiveness of the U.S. market may become a more substantial risk than previously thought during the initial stages of U.S. expansion.

- **Boutique oversaturation.** With increasing the number of stores being a key driver of growth and revenue for Aritzia, there is a risk of the firm getting away from the ethos of the brand today. Aritzia's approach to everyday luxury has led to its success in retail with stores feeling like boutiques as the firm themselves call their brick-and-mortar locations. Rapidly increasing their footprint may prove to be a reputational risk as the firm loses the "feel" many came in to experience.

<u>Analyst Thoughts and Recommendation</u>

I initially ran my model in the first week of January, prior to Q3 earnings, and finalized my price target at ~$34-35, which was above the consensus average at the time, when the stock price was sitting at $25. With this target, my rating was a buy with substantial upside as I felt the company was undervalued due to the pressures they faced in Q1 and Q2 of this year which painted a different picture than those who have covered the name have seen before. Management continued to emphasize that this was just a temporary period of turbulence and fiscal 2024 will largely be a tale of two halves. Although I was not expecting high double digit or triple digit top line growth in the fiscal years to come, I felt that management's growth plan through fiscal 2027 was achievable, even with the slower than usual first half of the year. With impressive Q3 earnings, Aritzia's proved that pressures have started to subside for the retailer. With margins and inventory levels beginning to once again normalize, and with transitory costs and IMUs starting to dissipate as well as continued strong store economics, Aritzia continues to be on track for sustained growth. Additionally, the recent reported quarter further cemented the retailer's commitment in building a strong balance sheet with a substantial increase to their cash balance in the quarter while paying off their revolver. As we await the end of the fiscal 2024, I have revised my price target upwards to $36.18 with the retailer proving that the start of the fiscal year was just a blimp in the radar and they are on track to meet their long-term growth plan set for fiscal 2027. Compared to when I first ran the model in early January, when upside was more substantial, I am now recommending a hold on Aritzia and encourage entering a position in the retailer when an attractive price presents itself once again.

In closing, I strongly believe that Aritzia will continue to grow into one of the top North American retailers. From experience, almost every girl around my age has at least shopped once at Aritzia with many being very frequent shoppers. The retailer has built a cult following with many choosing Aritzia as their one stop shop for everything fashion. With their assortment of brands and products, the company has expertly rotated between top sellers and new products to keep their boutique feel for both new and existing customers. I myself shopped there recently to pick out Christmas gifts for members of my family and one thing that I noted was that it was the first store that had a different feel compared to traditional fashion retailers. Although the near-term economic conditions continue to be uncertain, the foundation of the brand, with its planned geographic and channel growth, will propel Aritzia to new heights and one of the top fashion retailers in North America in the years to come.