

Teavana Holdings, Inc. (TEA)

Overweight

Same-Store Sales Tripping Shares; Taking A Longer View; Reiterate OW Rating

CONCLUSION

Consistent with market reactions of late, TEA shares are underperforming significantly, owing in large part to FQ1 comparable sales of +1.7% missing consensus of +3.4%. Though management has guided for a re-acceleration in sales trends for FQ2 (+LSD% to +MSD%) tied to recent weeks of improvement, the results of FQ1 settle neither side of the investment case. The bear case focuses on the continued string of negative trends in "traffic"--too early in their minds for a young 200+ unit chain. As part of the bull camp, we contend that the tea trend is early in the U.S., and TEA is the leading purveyor nationally of all-things-tea; as the category grows, so too will the traffic metrics. As well, we believe early adopters into the brand typically "pantry load" which can cause delayed visits back to TEA stores upon initiation into the habit.

- **Same-store sales down 0.1% in FQ1; up 1.7% including e-commerce.** For FQ1, same-store sales were down 0.1% y/y, which was below our estimate of +2%. Including ecommerce, comparable sales were up 1.7%. Excluding prepared beverages, average ticket was up 2.0% and transactions were down 0.5%. Teavana's e-commerce channel continues to outpace overall sales results, with e-commerce sales growing 20% y/y during the quarter. Longer-term, we believe e-commerce penetration can exceed 10% of sales in the next three to four years, up from 7.6% in FY12 and 7.0% in FY11. EPS was \$0.09 for FQ1, in line with our estimate of \$0.09. Excluding transaction and integration costs associated with the acquisition of Teaopia, EPS would have been \$0.10 (our \$0.09 estimate included these costs).
- **Teaopia acquisition remains on track for FQ2.** Teavana remains on track to acquire Teaopia--a 46-store chain that began operations in 2005 and looks, acts, smells, and feels a lot like Teavana. We believe sales and margin expansion tied to this integration are on deck in the years to come. Our FY13 EPS estimate includes about \$0.05 in integration costs associated with the acquisition. Excluding these integration costs, management expects the acquisition to be accretive by \$0.03-\$0.04 to EPS in FY13.
- **Maintaining EPS outlook; lowering price target from \$29 To \$25.** We are keeping our FQ2, FY13, and FY14 EPS estimates intact at \$0.02, \$0.56, and \$0.83, respectively. We are lowering our price target from \$29 to \$25, which reflects 30x FY14E EPS versus our prior target multiple of 35x. We believe a lower multiple is prudent given heightened investor concerns about TEA's growth potential as well as increased volatility in the shares.

RISKS TO ACHIEVEMENT OF PRICE TARGET

Macroeconomic pressures, risk to opening stores internationally and working with franchise partners, reliance on key top management, limited ability to hedge costs.

COMPANY DESCRIPTION

Teavana is a specialty retailer of loose tea and related accessories operating approximately 223 stores.

PRICE: US\$16.81
TARGET: US\$25.00
30x FY14E EPS

Neely J.N. Tamminga

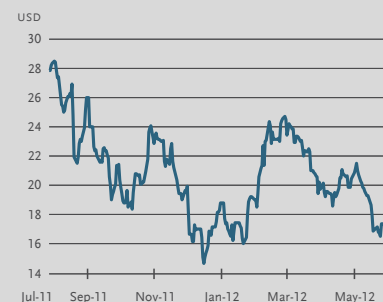
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Changes	Previous	Current
Rating	—	Overweight
Price Tgt	US\$29.00	US\$25.00
FY13E Rev (mil)	US\$230.4	US\$228.3
FY14E Rev (mil)	US\$297.3	US\$293.9
FY13E EPS	—	US\$0.56
FY14E EPS	—	US\$0.83
52-Week High / Low	US\$29.35 / US\$14.28	
Shares Out (mil)	39.1	
Market Cap. (mil)	US\$657.3	
Avg Daily Vol (ooo)	237	
Book Value/Share	US\$1.85	
Net Cash Per Share	US\$0.51	
Debt to Total Capital	0%	
Div (ann)	US\$0.00	
Fiscal Year End	Jan	

Price Performance - 1 Year



Source: Bloomberg

YEAR	REVENUE (US\$ m)								EARNINGS PER SHARE (US\$)							
	Apr	Jul	Oct	Jan	FY	CY	FY RM	CY RM	Apr	Jul	Oct	Jan	FY	CY	FY P/E	CY P/E
2012A	34.9A	31.3A	33.4A	68.4A	168.1A	228.3E	3.9x	2.9x	0.09A	0.03A	0.02A	0.32A	0.46A	0.56E	36.5x	30.0x
2013E	44.3A	43.9	46.6	93.5	228.3	293.9	2.9x	2.2x	0.09A	0.02	0.02	0.43	0.56	0.83	30.0x	20.3x
2014E	—	—	—	—	293.9	—	2.2x	—	—	—	—	—	0.83	—	20.3x	—

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Income Statement
(Millions of Dollars, Except Per-Share Data)

5/30/2012

	FY 2007	FY 2008	FY 2009	FY 2010	Q1 Apr-10	Q2 Jul-10	Q3 Oct-10	Q4 Jan-11	FY 2011	Q1 Apr-11	Q2 Jul-11	Q3 Oct-11	Q4 Jan-12	FY 2012	Q1 Apr-12	Q2E Jul-12	Q3E Oct-12	Q4E Jan-13	FYE 2013	FYE 2014
Net sales	33.760	47.200	63.860	90.260	25.770	22.980	24.750	51.200	124.700	34.939	31.313	33.426	68.422	168.100	44.319	43.890	46.638	93.454	228.301	293.868
% Change		39.8%	35.3%	41.3%	43.2%	33.1%	32.4%	41.0%	38.2%	35.6%	36.3%	35.1%	33.6%	34.8%	26.8%	40.2%	39.5%	36.6%	35.8%	28.7%
Cost of goods sold	15.930	19.970	27.190	36.430	10.020	9.460	10.240	16.560	46.280	12.451	12.186	12.749	23.517	60.903	15.895	17.117	17.723	32.242	82.976	106.893
% of Net sales	47.2%	42.3%	42.6%	40.4%	38.9%	41.2%	41.4%	32.3%	37.1%	35.6%	38.9%	38.1%	34.4%	36.2%	35.9%	39.0%	38.0%	34.5%	36.3%	36.4%
Gross profit	17.830	27.230	36.670	53.830	15.750	13.520	14.510	34.640	78.420	22.488	19.127	20.677	44.905	107.197	28.424	26.773	28.916	61.212	145.325	186.975
% Gross Margin	52.8%	57.7%	57.4%	59.6%	61.1%	58.8%	58.6%	67.7%	62.9%	64.4%	61.1%	61.9%	65.6%	63.8%	64.1%	61.0%	62.0%	65.5%	63.7%	63.6%
Selling, general, and administrative expenses	16.500	22.230	29.240	38.140	10.800	10.810	12.120	16.840	50.570	14.758	15.367	17.511	22.045	69.681	20.786	23.191	24.951	30.092	99.021	120.668
% of Net sales	48.9%	47.1%	45.8%	42.3%	41.9%	47.0%	49.0%	32.9%	40.6%	42.2%	49.1%	52.4%	32.2%	41.5%	46.9%	52.8%	53.5%	32.2%	43.4%	41.1%
EBITDA	1.330	5.000	7.430	15.690	4.950	2.710	2.390	17.800	27.850	7.730	3.760	3.166	22.860	37.516	7.638	3.581	3.964	31.120	46.304	66.307
EBITDA Margin	3.9%	10.6%	11.6%	17.4%	19.2%	11.8%	9.7%	34.8%	22.3%	22.1%	12.0%	9.5%	33.4%	22.3%	17.2%	8.2%	8.5%	33.3%	20.3%	22.6%
Depreciation & amortization	1.510	2.020	2.670	3.490	0.970	1.060	1.110	1.220	4.360	1.274	1.428	1.554	1.671	5.927	1.779	2.300	2.440	2.560	9.079	11.570
% of Net sales	4.5%	4.3%	4.2%	3.9%	3.8%	4.6%	4.5%	2.4%	3.5%	3.6%	4.6%	4.6%	2.4%	3.5%	4.0%	5.2%	5.2%	2.7%	4.0%	3.9%
Operating income	(0.180)	2.980	4.760	12.200	3.980	1.650	1.280	16.580	23.490	6.456	2.332	1.612	21.189	31.589	5.859	1.281	1.524	28.560	37.225	54.737
% Operating Margin	-0.5%	6.3%	7.5%	13.5%	15.4%	7.2%	5.2%	32.4%	18.8%	18.5%	7.4%	4.8%	31.0%	18.8%	13.2%	2.9%	3.3%	30.6%	16.3%	18.6%
Interest expense	(1.270)	(1.590)	(2.060)	(2.440)	(0.620)	(0.650)	(0.690)	(0.630)	(2.590)	(0.689)	(0.742)	(0.122)	(0.120)	(1.673)	(0.072)	(0.100)	(0.100)	(0.100)	(0.372)	(0.400)
Pre-tax income	-1.450	1.390	2.700	9.760	3.360	1.000	0.590	15.950	20.900	5.767	1.590	1.490	21.069	29.916	5.787	1.181	1.424	28.460	36.853	54.337
Income Taxes	-0.100	1.010	1.500	4.470	1.430	0.430	0.250	6.800	8.910	2.444	0.559	0.554	8.600	12.157	2.286	0.470	0.567	11.327	14.650	21.626
Tax Rate	6.9%	72.7%	55.6%	45.8%	42.6%	43.0%	42.4%	42.6%	42.6%	42.4%	35.2%	37.2%	40.8%	40.6%	39.5%	39.8%	39.8%	39.8%	39.8%	39.8%
Net income (GAAP)	-1.350	0.380	1.200	5.290	1.930	0.570	0.340	9.150	11.990	3.323	1.031	0.936	12.469	17.759	3.501	0.711	0.857	17.133	22.203	32.711
% Net Margin	-4.0%	0.8%	1.9%	5.9%	7.5%	2.5%	1.4%	17.9%	9.6%	9.5%	3.3%	2.8%	18.2%	10.6%	7.9%	1.6%	1.8%	18.3%	9.7%	11.1%
Net income per share (Basic)	\$ (0.04)	\$ 0.01	\$ 0.03	\$ 0.14	\$ 0.05	\$ 0.02	\$ 0.01	\$ 0.25	\$ 0.33	\$ 0.09	\$ 0.03	\$ 0.02	\$ 0.33	\$ 0.47	\$ 0.09	\$ 0.02	\$ 0.02	\$ 0.44	\$ 0.58	\$ 0.84
EPS Growth Rate		NM	NM	NM	NM	NM	NM	77%	127%	72%	81%	165%	31%	45%	1%	-34%	-10%	35%	21%	46%
Net income per share (Diluted)	\$ (0.04)	\$ 0.01	\$ 0.03	\$ 0.14	\$ 0.05	\$ 0.02	\$ 0.01	\$ 0.24	\$ 0.32	\$ 0.09	\$ 0.03	\$ 0.02	\$ 0.32	\$ 0.46	\$ 0.09	\$ 0.02	\$ 0.02	\$ 0.43	\$ 0.56	\$ 0.83
EPS Growth Rate		NM	NM	NM	NM	NM	NM	75%	124%	71%	81%	167%	32%	45%	2%	-34%	-10%	36%	22%	47%
Shares outstanding (Millions)																				
Basic	36.702	36.749	36.749	36.749	36.749	36.749	36.749	36.749	36.749	36.749	36.762	38.138	38.251	37.481	38.306	38.496	38.686	38.876	38.591	38.876
Diluted	36.702	36.751	37.095	37.322	37.472	37.725	37.725	37.725	37.725	37.729	37.802	38.965	39.059	38.419	39.086	39.406	39.506	39.606	39.401	39.606
Same-Store Sales (% Change)	3.7%	8.4%	3.0%	6.9%	15.7%	6.9%	5.9%	7.5%	8.7%	6.0%	6.4%	6.0%	4.4%	5.5%	-0.1%	0.0%	2.5%	2.5%	1.2%	3.0%

Notes:

Estimates assume Teapopia's revenues and expenses including \$0.05 of transaction/integration expenses in FY13 (2012)

Current disclosure information for this company can be found at <http://www.piperjaffray.com/researchdisclosures>.

Teavana

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STORE ECONOMICS

	FY 2007	FY 2008	FY 2009	FY 2010	Q1 Apr-10	Q2 Jul-10	Q3 Oct-10	Q4 Jan-11	FY 2011	Q1 Apr-11	Q2 Jul-11	Q3 Oct-11	Q4 Jan-12	FY 2012	Q1 Apr-12	Q2E Jul-12	Q3E Oct-12	Q4E Jan-13	FYE 2013	FYE 2014
NET SALES																				
Teavana Stores (ex- Teaopia acquisition)				\$ 85.025					\$ 115.800					\$ 155.324					\$ 16.100	\$ 29.900
% Change, year-over-year									36.2%					34.1%					NM	0.650
Stores Acquired From Teaopia																\$ 4.600	\$ 4.600	\$ 6.900		
Sales per store																0.100	0.100	0.150		
Teavana E-Commerce				\$ 5.235					\$ 8.900					\$ 12.776						
% Change, year-over-year									70.0%					43.5%						
% of total sales				5.8%					7.0%					7.6%						
Total net sales (ex-Teaopia acquisition)	\$ 33.760	\$ 47.200	\$ 63.860	\$ 90.260	\$ 25.770	\$ 22.980	\$ 24.750	\$ 51.200	\$ 124.700	\$ 34.939	\$ 31.313	\$ 33.426	\$ 68.422	\$ 168.100	\$ 44.319	\$ 39.290	\$ 42.038	\$ 86.554	\$ 212.201	\$ 263.968
% Change, year-over-year		39.8%	35.3%	41.3%	43.2%	33.1%	32.4%	41.0%	38.2%	35.6%	36.3%	35.1%	33.6%	34.8%	26.8%	25.5%	25.8%	26.5%	26.2%	24.4%
Total net sales	\$ 33.760	\$ 47.200	\$ 63.860	\$ 90.260	\$ 25.770	\$ 22.980	\$ 24.750	\$ 51.200	\$ 124.700	\$ 34.939	\$ 31.313	\$ 33.426	\$ 68.422	\$ 168.100	\$ 44.319	\$ 43.890	\$ 46.638	\$ 93.454	\$ 228.301	\$ 293.868
% Change, year-over-year		39.8%	35.3%	41.3%	43.2%	33.1%	32.4%	41.0%	38.2%	35.6%	36.3%	35.1%	33.6%	34.8%	26.8%	40.2%	39.5%	36.6%	35.8%	28.7%
% CHANGE SAME-STORE SALES	3.7%	8.4%	3.0%	6.9%	15.7%	6.9%	5.9%	7.5%	8.7%	6.0%	6.4%	6.0%	4.4%	5.5%	-0.1%	0.0%	2.5%	2.5%	1.2%	3.0%
NUMBER OF TEAVANA STORES (ex-Teaopia acquisition)	47	59	87	108	118	128	141	146	146	161	179	196	200	200	223	236	253	260	260	330
% Change, year-over-year		25.5%	47.5%	24.1%	28.3%	26.7%	31.8%	35.2%	35.2%	36.4%	39.8%	39.0%	37.0%	37.0%	38.5%	31.8%	29.1%	30.0%	30.0%	26.9%
Average number of stores (T4Q)				101	105	112	120	129	129	139	150	164	177	177	192	207	221	236	236	299
NUMBER OF STORES ACQUIRED FROM TEAOPIA																46	46	46	46	46
Gross Sq. Feet (Mil.) (ex-Teaopia acquisition)	43	54	77	95					130					178					232	294
% Change, year-over-year		25.6%	42.6%	23.4%					36.8%					37.0%					30.0%	26.9%
Gross Sq. Feet Acquired From Teaopia (Mil.)																			41	41
TOTAL Gross Square Feet (Mil.)	43	54	77	95					130					178					273	335
% Change, year-over-year		25.6%	42.6%	23.4%					36.8%					37.0%					53.2%	22.8%

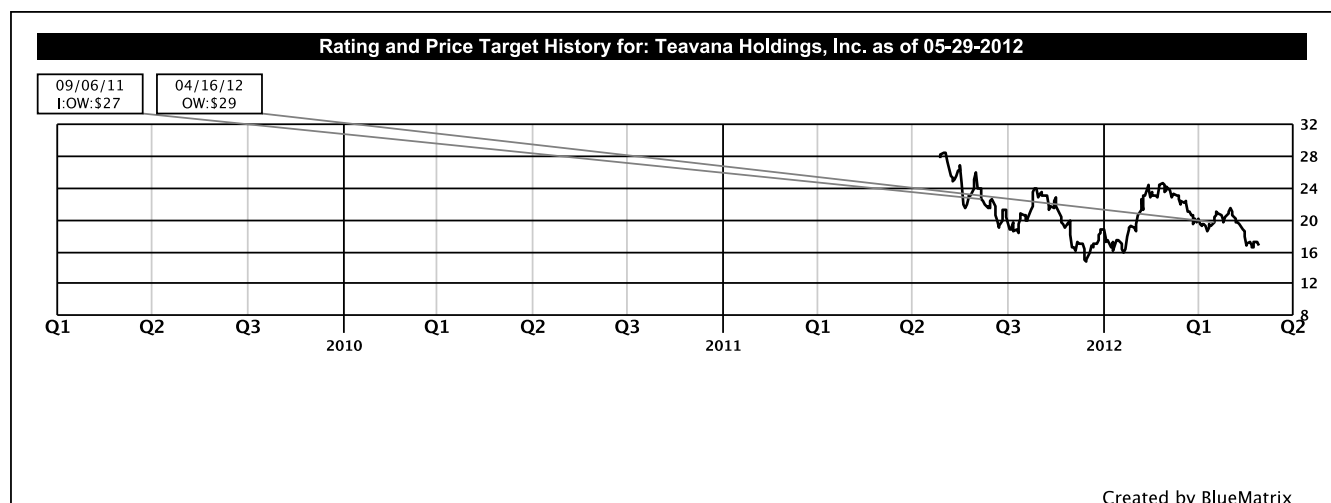
Consolidated Balance Sheet
(Millions of Dollars)

	FY 2010	FY 2011	Q1 Apr-11	Q2 Jul-11	Q3 Oct-11	Q4 Jan-12	FY 2012	Q1 Apr-12
CURRENT ASSETS:								
Cash and cash equivalents	\$1.314	\$7.901	\$3.740	\$1.623	\$0.036	\$17.818	\$17.818	\$20.040
Accounts receivable	0.284	0.292						
Prepaid expenses and other assets	1.003	2.041			4.082	2.475	2.475	4.305
Prepaid rent	1.061	1.400				1.856	1.856	
Inventory	11.615	16.928	18.286	22.720	32.512	25.676	25.676	23.035
Deferred tax asset and other	0.772	1.629	5.827	11.647	8.106	1.839	1.839	2.830
Total current assets	16.049	30.191	27.853	35.990	44.736	49.664	49.664	50.210
Property & equipment, net	22.513	31.028	34.795	38.000	40.669	42.785	42.785	47.630
Goodwill	2.394	2.394	2.394	2.394	2.394	2.394	2.394	2.394
Deferred tax asset, non-current	0.184	-						
Other non-current assets	0.627	0.513	0.760	0.693	0.673	0.775	0.775	0.634
Total assets	\$41.767	\$64.126	\$65.802	\$77.077	\$88.472	\$95.618	\$95.618	\$100.868
CURRENT LIABILITIES								
Accounts payable	\$2.564	\$3.631	\$2.112	\$5.751	\$6.770	\$3.898	\$3.898	\$5.136
Income taxes payable	\$3.994	\$4.809				1.821	1.821	
Deferred revenue	\$1.083	\$1.344				1.813	1.813	
Note payable	\$0.250	\$0.000						
Series A redeemable preferred stock	\$0.000	\$12.992	13.591	14.217				
Other current liabilities	\$3.395	\$5.539	9.659	6.865	8.116	5.034	5.034	5.950
Total current liabilities	11.286	28.315	\$25.362	\$26.833	\$14.886	\$12.566	12.566	\$11.086
Deferred franchise income	0.600	0.525						
Deferred tax liability, non-current	-	0.420			2.547	2.570	2.570	2.602
Deferred rent	3.851	7.524	8.943	11.139	12.134	12.905	12.905	14.192
Long-term debt	1.000	1.000	1.000	5.359	4.501			
Series A redeemable preferred stock	10.848	-						
Other long-term liabilities			0.870	2.997	0.575	0.575	0.575	0.616
Total liabilities	27.585	37.784	36.175	46.328	34.643	28.616	28.616	28.496
Stockholders' equity (deficit)								
Total stockholders' equity (deficit)	14.182	26.342	29.627	30.749	53.829	67.002	67.002	72.372
Total liabilities and stockholders' equity	\$41.767	\$64.126	\$65.802	\$77.077	\$88.472	\$95.618	\$95.618	\$100.868

Condensed Statement of Cash Flows
(Millions of Dollars)

	FY 2010	FY 2011	Q1 Apr-11	Q2 Jul-11	Q3 Oct-11	Q4 Jan-12	FY 2012
Operating activities:							
Net Income	\$5.291	\$12.003	\$3.323	\$4.354	\$5.291	\$17.759	\$17.759
Adjustments to reconcile net income to net cash:	0.000						
Depreciation and amortization	3.489	4.361	1.274	2.703	4.257	5.927	5.927
Non-cash interest expense	1.925	2.279	0.633	1.282	1.304	1.327	1.327
Deferred income taxes	0.532	(0.253)					
Stock based compensation	0.169	0.157	0.037	0.063	0.527	0.790	0.790
Excess tax benefit from stock options					(2.577)	(2.925)	(2.925)
Other		0.130	0.140	0.099	0.150	0.160	0.160
Change in assets and liabilities:							
Inventory	(3.646)	(5.313)	(1.359)	(5.792)	(15.584)	(8.748)	(8.748)
Income tax receivable	(0.230)	(1.452)	(0.081)	(5.874)	(6.004)		
Income taxes payable	2.772	0.815	(2.696)	(4.809)	(2.232)	(0.063)	(0.063)
Deferred rent	1.124	3.673	1.419	3.615	4.610	4.925	4.925
Accounts payable				1.164	2.896	0.013	0.013
Other current assets				1.866	(0.417)	(0.117)	(0.117)
Deferred income taxes					1.892	1.940	1.940
Other accrued liabilities	(0.355)	2.997	(1.548)	1.018	0.970	(0.033)	(0.033)
Net cash (used in) provided by operating activities	11.071	19.397	1.142	(0.311)	(4.917)	20.955	20.955
Investing activities:							
Capital Expenditures	(6.640)	(12.560)	(5.056)	(8.848)	(13.785)	(17.566)	(17.566)
Net cash used in investing activities	(6.640)	(12.560)	(5.056)	(8.848)	(13.785)	(17.566)	(17.566)
Financing activities:							
Proceeds from revolving credit facility	93.980	132.239	35.510	74.338	113.152	181.414	181.414
Payments on revolving credit facility	(98.265)	(132.239)	(35.510)	(69.979)	(109.652)	(182.414)	(182.414)
Proceeds from IPO, net					15.322	15.079	15.079
Proceeds from stock option exercises					0.552	0.637	0.637
Payment on note payable		(0.250)					
Payment to redeem preferred stock					(10.683)	(10.683)	(10.683)
Payments on term loan							
Cash paid for financing costs				(0.433)	(0.433)	(0.433)	(0.433)
Payment of initial public offering costs			(0.247)	(1.110)			
Other				0.065	2.577	2.925	2.925
Net cash used in financing activities	(4.285)	(0.250)	(0.247)	2.881	10.835	6.525	6.525
Effect of exchange rate					0.002	0.003	0.003
Net increase (decrease) in cash and cash equivalent	0.146	6.587	(4.161)	(6.278)	(7.865)	9.917	9.917
Cash and cash equivalents, beginning of period	1.168	1.314	7.901	7.901	7.901	7.901	7.901
Cash and cash equivalents, end of period	\$1.314	\$7.901	\$3.740	\$1.623	\$0.036	\$17.818	\$17.818

IMPORTANT RESEARCH DISCLOSURES



Notes: The boxes on the Rating and Price Target History chart above indicate the date of the Research Note, the rating, and the price target. Each box represents a date on which an analyst made a change to a rating or price target, except for the first box, which may only represent the first Note written during the past three years.

Legend:

I: Initiating Coverage

R: Resuming Coverage

T: Transferring Coverage

D: Discontinuing Coverage

S: Suspending Coverage

OW: Overweight

N: Neutral

UW: Underweight

B: Buy (Piper Jaffray discontinued use of the B, N, and S ratings on June 30, 2009)

N: Neutral

S: Sell

AL On/AL Off: Placed on/removed from the Alpha List maintained by Piper Jaffray (AL use discontinued March 2010)

NA: Not Available

UR: Under Review

Distribution of Ratings/IB Services Piper Jaffray				
Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent
BUY [OW]	364	55.32	65	17.86
HOLD [N]	265	40.27	19	7.17
SELL [UW]	29	4.41	1	3.45

Note: Distribution of Ratings/IB Services shows the number of companies currently in each rating category from which Piper Jaffray and its affiliates received compensation for investment banking services within the past 12 months. FINRA rules require disclosure of which ratings most closely correspond with "buy," "hold," and "sell" recommendations. Piper Jaffray ratings are not the equivalent of buy, hold or sell, but instead represent recommended relative weightings. Nevertheless, Overweight corresponds most closely with buy, Neutral with hold and Underweight with sell. See Stock Rating definitions below.

Analyst Certification — Neely J.N. Tamminga, Sr Research Analyst
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- **Underweight (UW):** Anticipated to underperform relative to the median of the group of stocks covered by the analyst.

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