

Teavana Holdings, Inc.:

TEA: Initiating Coverage with a BUY Rating: Steeping Growth

KeyBanc Capital Markets Inc.
Member NYSE/FINRA/SIPC

Edward Yruma: (917) 368- 2394 — eyruma@keybanccm.com
Jane Thorn Leeson: (917) 368- 2220 — jthornleeson@keybanccm.com

Rating	BUY
Price	\$22.30
12- Mo. Price Target	\$28.00
Dividend	\$0.00
Yield	0.0%
52- Wk. Range	\$14 - \$29
Trading Volume (000)	231
Market Cap. (mm)	\$869.7
Shares Out. (mm)	39.00
Book Value/Share	\$1.38

EPS (Net) Summary

FY Jan	2010A	2011E	2012E
1Q	\$0.05	\$0.09A	\$0.12
2Q	\$0.02	\$0.03A	\$0.04
3Q	\$0.01	\$0.02A	\$0.03
4Q	\$0.24	\$0.31	\$0.40
YEAR	\$0.32	\$0.45	\$0.59
First Call	--	\$0.47E	\$0.61E
P/E	69.7x	49.6x	37.8x

ACTION STATEMENT

Teavana Holdings, Inc. (TEA-NYSE) has a strong combination of a distinctive store environment, attractive secular trends and a visible gross margin tail – we initiate with a BUY rating. The Company's 19% operating margin is one of the highest in our coverage universe. We believe the Company has continued margin expansion opportunity as the penetration of loose tea increases from store maturation. Also, our proprietary field work points to a unique performance management and compensation model; we think this helps institutionalize the highly consultative nature of the business. Finally, and perhaps most importantly, the store's "theater" differentiates it from other mall-based retailers, and we think evokes the best from our lifestyle-focused retailers (including lululemon athletica inc. and Zumiez Inc.). We think this will drive 25%+ EPS growth for the next three to five years.

We establish a price target of \$28, which implies a 47.1x P/E and a 1.2x PEG based on our 2012 estimates. This compares to a 30.1x 2012E P/E and 1.5x 2012E PEG for the high growth retail peer group.

KEY INVESTMENT POINTS

The Company has a highly consultative sales force and a distinct store environment. Our proprietary field work points to an in- store operations model that combines many of the best elements of our other covered companies. Employees have rigorous goal setting, and the Company has intensive training. Sales incentives drive a consultative environment similar to Nordstrom and Buckle. A unique store environment that stimulates the senses evokes lululemon athletica. We think these attributes that differentiate the store experience are important in the age of internet retailing.

TEA has a leading position in the secularly attractive specialty tea market. Eighty-five percent of TEA's products are blends, which we think adds an element of stickiness to the consumer offer. Despite the ubiquity of tea, the Company does not have a national specialty retail competitor that offers high quality loose tea. Our analysis indicates that Teavana is generally the only loose tea retailer located in its shopping centers.

Store operating metrics are some of the strongest in our coverage and loose tea penetration provides a gross margin tail. The Company has roughly \$1,000 in sales PSF, one of the highest in our coverage universe. Moreover, we view its 60% gross margin as defensible given a positive tailwind from higher penetration of loose tea (600- 800+ bps maturation mix benefit). The Company continues to see strong performance from its most recent store vintages, and we believe that store performance from smaller markets will remain strong.

VALUATION

At 37.8x 2012E P/E, 4.0x 2012E EV/Sales and 1.2x 2012E PEG, valuation is reasonable for a high growth retailer. The stock is up over 32% from its \$17 IPO price, compared to an 8% gain in the S&P 500 Index over the same time period. We think the Company can sustain accelerating earnings growth, particularly given its aggressive new store opening program, strong new store economics and multi-year runway for gross margin expansion compared to the specialty retail peer group. Thus, we think TEA deserves to trade at a premium to the high growth retail peer group averages of 30.1x 2012E P/E, 3.0x 2012E EV/Sales and 1.3x 2012E PEG. We establish a \$28 price target, which implies a 47.1x P/E based on our \$0.59 2012 EPS estimate. We think the multiple is fair given the Company's earnings profile and compelling unit growth opportunity.

RISKS

Risks that could impede the stock from achieving our price target:

TEA is moving into smaller markets. The Company has 196 stores, and a number of new stores will be opened in shopping malls with lower average sales per square foot than the malls in which the Company currently has a presence. New stores will generally operate at lower gross margins and higher operating expenses, as a percentage of sales, compared to mature stores. Our estimates could be at risk if the Company is unable to identify suitable locations to open new stores, obtain favorable lease terms, attract customers, hire and retain personnel, and maintain sufficient levels of cash flow to support expansion.

While we see few national competitors, the tea market remains highly competitive. The U.S. tea market remains highly fragmented with low barriers to entry. Our estimates could be at risk if the Company is unable to provide a differentiated, superior customer experience and attract more business than its regional and local competitors.

Management, particularly founder and CEO Andrew Mack, has been instrumental in the development of the concept; continued involvement is a key area of our investment thesis. Having founded the Company in 1997, CEO Andrew Mack has hired experienced senior managers to implement the Company's long-term growth strategy. The potential sudden departure of key management executives would likely impact the stock price in a significant manner, in our opinion.

COMPANY DESCRIPTION

Teavana Holdings, Inc. (TEA- NYSE) is a rapidly growing, multi-channel specialty tea retailer that develops, sources and offers more than 100 varieties of premium loose-leaf teas, authentic artisanal teawares and other tea-related merchandise through 196 company-owned stores and a number of franchised stores. TEA is well-positioned to capitalize on growing tea awareness in the United States; tea is already the second most popular drink globally. In 2010, loose leaf tea sales represented 56% of total Company sales, while tea-related merchandise (40%) and prepared beverages (4%) made up the remainder.

Revenue Summary

	2010A	Prior 2010A	2011E	Prior 2011E	2012E	Prior 2012E
1Q	\$25.8	--	\$34.9A	--	\$47.1	--
2Q	\$23.0	--	\$31.3A	--	\$40.9	--
3Q	\$24.7	--	\$33.4A	--	\$42.9	--
4Q	\$51.2	--	\$66.6	--	\$85.7	--
YEAR	\$124.7	--	\$166.2	--	\$216.6	--

Source: KeyBanc Capital Markets Inc. estimates

KeyBanc Capital Markets Inc. Disclosures and Certifications

Teavana Holdings, Inc. - TEA

We expect to receive or intend to seek compensation for investment banking services from Teavana Holdings, Inc. within the next three months.

Reg A/C Certification

The research analyst(s) responsible for the preparation of this research report certifies that: (1) all the views expressed in this research report accurately reflect the research analyst's personal views about any and all of the subject securities or issuers; and (2) no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this research report.

Three- Year Rating and Price Target History



Rating Disclosures

Distribution of Ratings/IB Services Firmwide and by Sector									
KeyBanc Capital Markets					CONSUMER				
Rating	Count	Percent	IB Serv/Past 12 Mos.		Rating	Count	Percent	IB Serv/Past 12 Mos.	
			Count	Percent				Count	Percent
BUY [BUY]	227	44.42	48	21.15	BUY [BUY]	59	45.04	7	11.86
HOLD [HOLD]	272	53.23	50	18.38	HOLD [HOLD]	70	53.44	2	2.86
SELL [UND]	12	2.35	4	33.33	SELL [UND]	2	1.53	0	0.00

Rating System

BUY - The security is expected to outperform the market over the next six to 12 months; investors should consider adding the security to their holdings opportunistically, subject to their overall diversification requirements.

HOLD - The security is expected to perform in line with general market indices over the next six to 12 months; no buy or sell action is recommended at this time.

UNDERWEIGHT - The security is expected to underperform the market over the next six to 12 months; investors should reduce their holdings opportunistically.

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