William Blair

Teavana Holdings, Inc.

In-Line Quarter Despite Comp Miss; Trends Improving in May

- Teavana's first-quarter EPS rose 8%, to $0.10, on net income growth of 12%, meeting consensus expectations and the high end of guidance of $0.09 to $0.10. However, comps of 1.7% (+1.5% transaction and +0.2% ticket), while within guidance for a low- to midsingle-digit comp, fell shy of consensus of 3% to 4% and marked a deceleration from mid- to high-single-digit comps throughout 2011.

- The geographic variability in Teavana's comps was the greatest in the company's history, with comps in the West up midsingle digits and comps in the Central and Eastern parts of the country down low single digits, almost an exact overlay of the unusual weather patterns that created the warmest winter on record for most of the country (with the West Coast the major exception). In addition, the variability began in the second half of the fourth quarter (in keeping with the advent of the unusually warm winter).

- While trends were weaker in the second half of the first quarter than the first half (in keeping with weaker mall traffic in April), management indicated that trends have improved in May, particularly in the past few weeks as the geographic dispersion has begun to compress again, with trends firming in the East and Central United States.

- As a result, management guided to low- to midsingle-digit comp trends for the second quarter and maintained midsingle-digit comp guidance for the full year, with full-year EPS guidance maintained at $0.58 to $0.61 and second-quarter guidance issued at $0.02 to $0.03 (encompassing consensus of $0.03).

- Teavana opened 23 new company-owned stores in the first quarter, ahead of plan of 18 to 20 new stores and bringing the company-owned store count to 223, up 39%. Encouragingly, new stores continue to perform well, with sales and profitability at the high end of Teavana's new store model. Looking forward, management continues to anticipate 60 new company-owned store openings this year, representing store growth of 30%, as well as the consummation of the Teaopia acquisition in the second quarter (46 Canadian locations).

- We are tweaking our 2012 EPS estimate down by $0.02, to $0.59 (up 27% and roughly in line with consensus of $0.60), on a 3% to 4% comp gain and, for 2012, we anticipate EPS of $0.78, up 33% and versus consensus of $0.80.

- Teavana's stock is down about 18% on the first-quarter sales miss and is now trading at 23 times our new 2012 EPS estimate. While we understand investors' concern on the sales miss, we see little that appears to be Teavana-specific in the sales slowdown, as weather has affected nearly all of our consumer names over the past five months in the Central and Eastern United States, either to the positive or the negative. As a result, despite the slower start to the year, we still believe the Teavana concept remains a solid growth vehicle, with new units performing at the high end of plan and the opportunity to double the store base in the next three years. We would be buyers on weakness and reiterate our Outperform rating.

Teavana is a rapidly growing mall-based specialty tea retailer, specializing in premium loose-leaf teas, tea-related merchandise, and prepared beverages.

May 30, 2012

Stock Rating:	**Outperform**
Company Profile:	**Aggressive Growth**

Symbol:	TEA (NYSE)
Price:	$14.03 (52-Wk.: $14-$29)
Market Value (mil.):	$634
Fiscal Year End:	January
Long-Term EPS Growth Rate:	30%
Dividend/Yield:	None

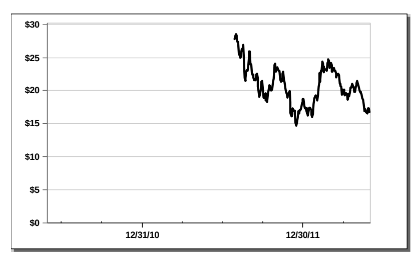
	2011A	2012E	2013E
Estimates*			
EPS Q1	$0.09	A$0.10	NA
Q2	$0.03	$0.03	NA
Q3	$0.02	$0.02	NA
Q4	$0.32	$0.44	NA
FY	$0.46	$0.59	$0.78
CY		$0.59	$0.78
Sales (mil.)	168	223	282
Valuation			
FY P/E	30.5x	23.8x	18.0x
CY P/E		23.8x	18.0x

* Estimates do not reflect the adoption of FAS 123R.

Trading Data (Thomson Financial)	
Shares Outstanding (mil.)	38
Float (mil.)	NA
Average Daily Volume	233,191

Financial Data (Thomson Financial)	
Long-Term Debt/Total Capital (MRQ)	NA
Book Value Per Share (MRQ)	NA
Enterprise Value (mil.)	626.1
EBITDA (TTM)	37.5
Enterprise Value/EBITDA (TTM)	16.7x
Return on Equity (TTM)	26.5

Two-Year Price Performance Chart



Sources: Thomson Financial, William Blair & Company estimates

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Quarterly Detail
Teavana's first-quarter EPS rose 8%, to $0.10, on net income growth of 12%, meeting consensus expectations and the high end of guidance of $0.09 to $0.10, excluding a penny in anticipated transition and integration expenses related to the Teaopia acquisition.

Comps, including e-commerce, increased 1.7%, in line with management's guidance for a low- to midsingle-digit gain, but shy of consensus of 3% to 4% and marking a deceleration from the mid- to high-single-digit comps experienced in 2011. Overall, traffic was positive for the second straight quarter, increasing 1.5%, while average ticket increased 0.2%. Excluding beverage-only transactions, transactions declined 0.5%, while ticket increased 2.0%.

Store-only comps declined 0.1% against a 6.0% year-ago comparison, below our projection for a low-single-digit increase, with two-year stacked comp growth falling to 6% from 12% in the fourth quarter. Store-only comps comprised a 0.2% increase in average ticket (2.7% excluding beverage-only transactions), more than offset by a 0.3% decrease in transactions (down 3.0% excluding beverage-only transactions).

Total revenues increased 27%, to $44.3 million, in line with guidance of $44 million to $45 million, but shy of our and consensus expectations for $45 million, including a 20% increase in e-commerce sales. Tea represented 59% of sales (down from 60% in the year-ago period), merchandise increased to 37% of sales (up from 36% in the year-ago period), and prepared beverages remained flat at 4% of sales. Encouragingly, new stores continue to perform well, with new store productivity at 77.1% of non-comp stores in the first quarter, implying an average annual run-rate of $704,000, above the high end of management's new-store unit economic model calling for first-year sales of $600,000 to $700,000.

Gross margin declined 30 basis points to 64.1%, reflecting mix shift toward lower-margin merchandise as well as less leverage on store occupancy given the low-single-digit comp gain. SG&A increased 400 basis points to 46.2% (excluding 70 basis points in transition and integration expenses related to the Teaopia acquisition), reflecting increased costs associated with being a public company, higher preopening and training costs because of more new store openings than originally anticipated (23 versus guidance of 18 to 20), and higher stock compensation expenses. D&A increased 40 basis points to 4.0% of sales, yielding overall operating margin contraction of 460 basis points to 13.9%.

Teavana ended the first quarter with about $20 million in cash and no outstanding borrowings on the company's $40 million revolver facility. Inventory was well-controlled, up 26% year-over-year versus a 27% increase in sales.

New Store Development and Teaopia Acquisition on Track
Teavana opened 23 new company-owned stores in the first quarter, ahead of plan of 18 to 20 new stores and bringing the quarter-end store count to 223, up 39%. Looking forward, management continues to anticipate 60 new company-owned store openings this year (excluding the acquisition of 46 Teaopia stores), representing organic store growth of 30%. The company expects to open 13 to 14 stores in the second quarter, and similar to last year, management continues to expect new store openings to be essentially completed before the fourth quarter. In addition, plans remain on track for the company's first franchised store in the Middle East in the second half of this year through its 10-year franchise development agreement with Alshaya.

Teavana's acquisition of Teaopia remains on track to close in the second quarter, and management continues to expect the acquisition to be neutral to earnings this year, excluding anticipated transaction and integration expenses of $0.04 to $0.05, including $0.03 in the second quarter. Teaopia stores are very similar to Teavana's, with similar sizes and layouts and even the same POS system, and management continues to expect to transition all Teaopia stores to the Teavana brand during fiscal 2012, with most of the rebranding completed before the fourth quarter.

Finally, Teavana continues to work with a national executive search firm in its search for a vice president of marketing, with several candidates in various stages of the interview process. Key responsibilities for the new marketing head will be putting together an overall marketing strategy for the company's store and e-commerce businesses, implementing a loyalty program, and selecting and implementing a CRM system.

Teavana Holdings, Inc.

May 30, 2012: $13.80 ($13-$29) **Rating: Outperform**

Quarterly Earnings Model **Company Profile: Aggressive Growth**

($ in millions, except per-share items)

FYE January	2010	Apr-11	Jul-11	Oct-11	Jan-12	2011	Apr-12[a]	Jul-12E[b]	Oct-12E	Jan-13E	2012E[c]	2013E
Company-owned	146	161	179	196	200	200	223	283	303	306	306	376
Franchised	15	19	18	18	18	18	18	19	19	19	19	21
Total stores	161	180	197	214	218	218	241	302	322	325	325	397
% change	30.9%	35.3%	37.8%	37.2%	35.4%	35.4%	33.9%	53.3%	50.5%	49.1%	49.1%	22.2%
Same-store sales (including e-commerce)	**11.4%**	**8.9%**	**8.7%**	**8.5%**	**8.6%**	**8.6%**	**1.7%**	**3.0%**	**4.0%**	**5.5%**	**3.6%**	**6.0%**
Revenues	$124.7	$34.9	$31.3	$33.4	$68.4	$168.1	$44.3	$39.3	$43.7	$95.2	$222.6	$282.2
Cost of sales (including occupancy)	46.3	12.5	12.2	12.7	23.5	60.9	15.9	15.2	16.6	32.5	80.2	100.5
Gross profit	$78.4	$22.5	$19.1	$20.7	$44.9	$107.2	$28.4	$24.1	$27.2	$62.7	$142.4	$181.8
Selling, general, and administrative	50.6	14.8	15.4	17.5	22.0	69.7	20.5	20.1	23.6	31.5	95.8	120.0
Depreciation and amortization	4.4	1.3	1.4	1.6	1.7	5.9	1.8	1.8	2.2	2.3	8.1	10.0
Operating income	$23.5	$6.5	$2.3	$1.6	$21.2	$31.6	$6.2	$2.2	$1.3	$28.9	$38.6	$51.8
Interest expense, net	2.6	0.7	0.7	0.1	0.1	1.7	0.1	0.1	0.1	0.1	0.4	0.4
Pretax income	$20.9	$5.8	$1.6	$1.5	$21.1	$29.9	$6.1	$2.1	$1.2	$28.8	$38.2	$51.4
Tax rate	42.6%	42.4%	35.2%	37.2%	40.8%	40.6%	38.9%	39.8%	39.8%	39.8%	39.7%	39.8%
Net income	$12.0	$3.3	$1.0	$0.9	$12.5	$17.8	$3.7	$1.2	$0.7	$17.4	$23.1	$30.9
Diluted average shares	37.7	37.7	37.8	39.0	39.1	38.4	39.1	39.2	39.3	39.4	39.2	39.5
EPS	**$0.32**	**$0.09**	**$0.03**	**$0.02**	**$0.32**	**$0.46**	**$0.10**	**$0.03**	**$0.02**	**$0.44**	**$0.59**	**$0.78**
Margins:												
Gross margin	62.9%	64.4%	61.1%	61.9%	65.6%	63.8%	64.1%	61.3%	62.1%	65.9%	64.0%	64.4%
Selling, general, and administrative	40.6%	42.2%	49.1%	52.4%	32.2%	41.5%	46.2%	51.2%	54.0%	33.1%	43.0%	42.5%
Depreciation and amortization	3.5%	3.6%	4.6%	4.6%	2.4%	3.5%	4.0%	4.6%	5.0%	2.4%	3.6%	3.5%
Operating margin	18.8%	18.5%	7.4%	4.8%	31.0%	18.8%	13.9%	5.5%	3.1%	30.4%	17.3%	18.4%
Growth rates:												
Revenues	38.2%	35.6%	36.3%	35.1%	33.6%	34.8%	26.8%	25.6%	30.8%	39.1%	32.4%	26.8%
Selling, general, and administrative	32.6%	36.6%	42.2%	44.5%	30.9%	37.8%	38.8%	31.0%	34.9%	42.9%	37.4%	25.3%
Depreciation and amortization	25.0%	30.9%	34.7%	40.0%	37.0%	35.9%	39.6%	26.1%	41.6%	37.6%	36.3%	23.8%
Operating income	92.6%	62.3%	40.7%	26.1%	27.8%	34.5%	-4.7%	-6.8%	-16.7%	36.5%	22.2%	34.3%
Net income	126.9%	72.4%	78.1%	175.3%	36.3%	48.0%	11.8%	21.0%	-20.1%	39.2%	29.9%	34.2%
EPS	124.4%	71.3%	77.2%	165.9%	31.7%	45.3%	7.9%	16.7%	-20.8%	38.0%	27.2%	33.3%

[a] Excludes $0.01 in transition and integration expenses related to Teaopia acquisition

[b] Excludes anticipated $0.03 in transition and integration expenses related to Teaopia acquisition

[c] Excludes anticipated $0.04 to $0.05 in transition and integration expenses related to Teaopia acquisition

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Current Rating Distribution (as of 04/30/12)

Coverage Universe	**Percent**	**Inv. Banking Relationships***	**Percent**
Outperform (Buy)	60	Outperform (Buy)	8
Market Perform (Hold)	32	Market Perform (Hold)	1
Underperform (Sell)	1	Underperform (Sell)	0

*Percentage of companies in each rating category that are investment banking clients, defined as companies for which William Blair has received compensation for investment banking services within the past 12 months.

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