

Teavana Holdings, Inc.

Plug-and-Play Acquisition of Teaopia Creates Strong Foothold in Canada

- Monday morning, Teavana announced the pending purchase of Teaopia, a similar concept to Teavana with 46 company-owned locations in Canada that generated \$17 million (Canadian dollars) in 2011 revenue. The acquisition, expected to close in the second quarter, will expand Teavana's company-owned base by more than 20% and establish a firm foothold in Canada, where Teavana recently opened its first store in Vancouver.
- Teavana will pay \$26.9 million in cash in the deal, using cash on hand (roughly \$18 million at the end of the fourth quarter) and an existing untapped credit facility (\$40 million expanded to \$50 million for 2012). The price represents roughly 1.6 times 2011 sales (versus Teavana's valuation of approximately 4.5 times) and the acquisition is expected to be neutral this year (excluding \$0.04 to \$0.05 of transaction and integration expenses) and accretive by \$0.03 to \$0.04 in 2013. The transaction and integration expenses include a transition services agreement with Teaopia whereby Teavana will utilize Teaopia's existing distribution center and some store support staff for a short period (likely up to a few months) until a successful transition to Teavana's distribution center in Connecticut and store support center in Atlanta.
- Teaopia was founded in 2005 and its stores are very similar to Teavana's, with similar sizes and layouts and even the same POS system. Teaopia's real estate selection has also been quite similar and is completely complementary to Teavana, with mall-based stores in high-productivity malls (average of \$500 per square foot) providing Teavana with immediate access to highly desirable locations in Canada.

Exhibit 1
Comparison of Teaopia and Teavana

	<u>Teaopia</u>	<u>Teavana*</u>
Number of stores	46	200
Average sales per store	\$435,000	\$913,000
Average mall sales productivity	\$500	\$500
Average size of store (square feet)	900	920
Occupancy cost \$ per store	100% of Teavana	NA
Loose-leaf tea as % of revenue	50%	55%

*Represents 2011 data

Source: Company documents

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

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

Symbol: TEA (NYSE)
Price: \$19.76 (52-Wk.: \$14-\$29)
Market Value (mil.): \$732
Fiscal Year End: January
Long-Term EPS Growth Rate: 30%
Dividend/Yield: None

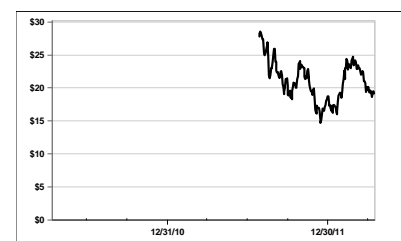
	2011A	2012E	2013E
Estimates*			
EPS Q1	\$0.09	\$0.11	NA
Q2	\$0.03	\$0.04	NA
Q3	\$0.02	\$0.05	NA
Q4	\$0.32	\$0.41	NA
FY	\$0.46	\$0.61	\$0.82
CY		\$0.61	\$0.82
Sales (mil.)	168	226	289
Valuation			
FY P/E	43.0x	32.4x	24.1x
CY P/E		32.4x	24.1x

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

Trading Data (Thomson Financial)	
Shares Outstanding (mil.)	38
Float (mil.)	NA
Average Daily Volume	270,239

Financial Data (Thomson Financial)	
Long-Term Debt/Total Capital (MRQ)	NA
Book Value Per Share (MRQ)	NA
Enterprise Value (mil.)	739.5
EBITDA (TTM)	17.0
Enterprise Value/EBITDA (TTM)	43.4x
Return on Equity (TTM)	9.8

Two-Year Price Performance Chart

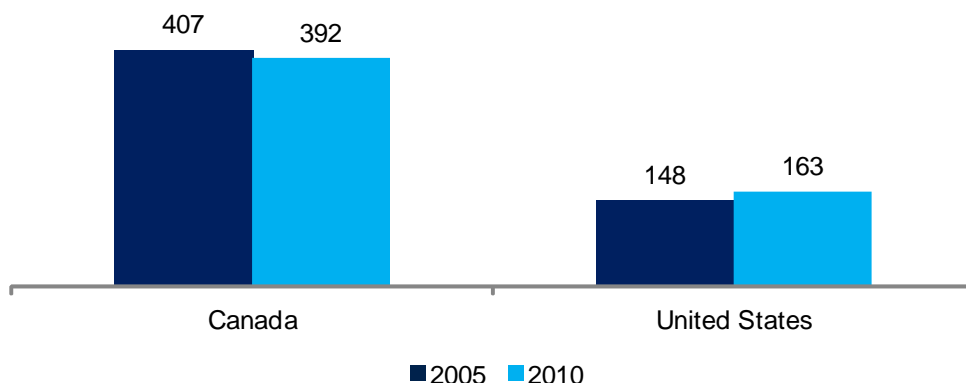


Sources: Thomson Financial, William Blair & Company estimates

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- Despite similar underlying characteristics, Teaopia's stores underperform Teavana's, generating average sales productivity per store of \$435,000, versus Teavana's \$913,000. Given both lower average volumes and a modestly lower percentage of high-margin loose leaf tea (50% versus Teavana's 55%), we estimate Teaopia's unit-level cash contribution margin at roughly 20%, versus Teavana's 30%-plus.
- Teavana plans to transition all Teaopia stores to the Teavana brand during fiscal 2012, with most of the rebranding completed before the fourth quarter. Given the similarity to Teavana, management anticipates modest capital investments of about \$25,000 per store for rebranding. Teaopia generated less than 5% of sales from e-commerce last year (versus 7.6% for Teavana), and the company expects to transition Teaopia's customers to Teavana's website.
- With Teavana's new stores in Canada already achieving similar sales productivity as its U.S. stores, we see the opportunity for improvements in Teaopia's top- and bottom-line performance as Teavana introduces its products (85% of Teavana's tea blends are proprietary) and merchandising strategies and invests in training store-level employees in Teavana's sales processes (where we believe Teaopia significantly lagged Teavana). Canada is a strong market for tea, with tea consumption more than twice that of the United States in 2010 (392 cups annually versus 163 in the United States), according to Euromonitor International.

Exhibit 2
Per Capita Tea Consumption in Canada More Than Double the U.S.
(number of cups)



Source: Euromonitor International

- Competitively, Teavana's acquisition of Teaopia serves as a strong countermove to DavidsTea, which operates more than 75 stores in Canada with very little store overlap with Teaopia (just one mall). DavidsTea recently entered the United States with two store openings in New York City, and earlier this month announced a \$14 million (CAD) minority investment by Highland Consumer Fund and lululemon (LULU \$73.15; Outperform) founder Chip Wilson.
- We are maintaining our 2012 EPS estimate of \$0.61 (excluding \$0.04 to \$0.05 in anticipated transaction and integration expenses), a penny ahead of consensus and at the high end of management's \$0.58 to \$0.61 guidance. For 2013, we are increasing our estimate by \$0.03, to \$0.82, up 34% and versus consensus of \$0.79. Our 2013 estimate assumes an improvement in Teaopia's store productivity to \$550,000 per location, still well below Teavana's existing average.
- The stock reacted well to news of the acquisition, with the stock now trading at about 32 times our 2012 EPS estimate. We view the acquisition as a good strategic move for Teavana and expect a smooth transition given existing similarities between the concepts. Moreover, we continue to believe that Teavana's premium valuation is justified given its strong growth prospects and historically resilient sales trends, and we expect investors to be rewarded with healthy 30% annual EPS growth with the potential for upside. We reiterate our Outperform rating.

Teavana Holdings, Inc.
April 16, 2012: \$19.73 (\$14-\$29)
Quarterly Earnings Model

(\$ in millions, except per-share items)

Rating: Outperform
Company Profile: Aggressive Growth

<u>FYE January</u>	<u>2010</u>	<u>Apr-11</u>	<u>Jul-11</u>	<u>Oct-11</u>	<u>Jan-12</u>	<u>2011</u>	<u>Apr-12E^(a)</u>	<u>Jul-12E</u>	<u>Oct-12E</u>	<u>Jan-13E</u>	<u>2012E^(b)</u>	<u>2013E</u>
Company-owned	146	161	179	196	200	200	219	281	301	306	306	376
Franchised	<u>15</u>	<u>19</u>	<u>19</u>	<u>19</u>	<u>19</u>	<u>19</u>	<u>19</u>	<u>20</u>	<u>20</u>	<u>20</u>	<u>20</u>	<u>22</u>
Total stores	161	180	198	215	219	219	238	301	321	326	326	398
% change	30.9%	35.3%	38.5%	37.8%	36.0%	36.0%	32.2%	52.0%	49.3%	48.9%	48.9%	22.1%
Same-store sales (including e-commerce)	11.4%	8.9%	8.7%	8.5%	8.6%	8.6%	5.0%	6.0%	6.5%	8.0%	6.4%	6.0%
Revenues	\$124.7	\$34.9	\$31.3	\$33.4	\$68.4	\$168.1	\$45.2	\$40.0	\$46.4	\$94.9	\$226.4	\$289.1
Cost of sales (including occupancy)	<u>46.3</u>	<u>12.5</u>	<u>12.2</u>	<u>12.7</u>	<u>23.5</u>	<u>60.9</u>	<u>15.9</u>	<u>15.4</u>	<u>18.1</u>	<u>33.3</u>	<u>82.7</u>	<u>104.7</u>
Gross profit	\$78.4	\$22.5	\$19.1	\$20.7	\$44.9	\$107.2	\$29.3	\$24.6	\$28.3	\$61.6	\$143.8	\$184.4
Selling, general, and administrative	50.6	14.8	15.4	17.5	22.0	69.7	20.0	20.4	23.2	32.3	95.9	120.8
Depreciation and amortization	<u>4.4</u>	<u>1.3</u>	<u>1.4</u>	<u>1.6</u>	<u>1.7</u>	<u>5.9</u>	<u>1.7</u>	<u>1.8</u>	<u>1.9</u>	<u>2.1</u>	<u>7.5</u>	<u>9.2</u>
Operating income	\$23.5	\$6.5	\$2.3	\$1.6	\$21.2	\$31.6	\$7.6	\$2.4	\$3.2	\$27.2	\$40.3	\$54.4
Interest expense, net	<u>2.6</u>	<u>0.7</u>	<u>0.7</u>	<u>0.1</u>	<u>0.1</u>	<u>1.7</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.1</u>	<u>0.4</u>	<u>0.4</u>
Pretax income	\$20.9	\$5.8	\$1.6	\$1.5	\$21.1	\$29.9	\$7.5	\$2.3	\$3.1	\$27.1	\$39.9	\$54.0
Tax rate	<u>42.6%</u>	<u>42.4%</u>	<u>35.2%</u>	<u>37.2%</u>	<u>40.8%</u>	<u>40.6%</u>	<u>39.8%</u>	<u>39.8%</u>	<u>39.8%</u>	<u>39.8%</u>	<u>39.8%</u>	<u>39.8%</u>
Net income	\$12.0	\$3.3	\$1.0	\$0.9	\$12.5	\$17.8	\$4.5	\$1.4	\$1.8	\$16.3	\$24.0	\$32.5
Diluted average shares	37.7	37.7	37.8	39.0	39.1	38.4	39.2	39.3	39.4	39.5	39.3	39.6
EPS	\$0.32	\$0.09	\$0.03	\$0.02	\$0.32	\$0.46	\$0.11	\$0.04	\$0.05	\$0.41	\$0.61	\$0.82
Margins:												
Gross margin	62.9%	64.4%	61.1%	61.9%	65.6%	63.8%	64.8%	61.6%	61.0%	64.9%	63.5%	63.8%
Selling, general, and administrative	40.6%	42.2%	49.1%	52.4%	32.2%	41.5%	44.3%	51.1%	50.1%	34.0%	42.4%	41.8%
Depreciation and amortization	<u>3.5%</u>	<u>3.6%</u>	<u>4.6%</u>	<u>4.6%</u>	<u>2.4%</u>	<u>3.5%</u>	<u>3.8%</u>	<u>4.5%</u>	<u>4.1%</u>	<u>2.2%</u>	<u>3.3%</u>	<u>3.2%</u>
Operating margin	18.8%	18.5%	7.4%	4.8%	31.0%	18.8%	16.7%	6.0%	6.8%	28.7%	17.8%	18.8%
Growth rates:												
Revenues	38.2%	35.6%	36.3%	35.1%	33.6%	34.8%	29.2%	27.7%	38.7%	38.8%	34.7%	27.7%
Selling, general, and administrative	32.6%	36.6%	42.2%	44.5%	30.9%	37.8%	35.6%	32.9%	32.6%	46.4%	37.7%	26.0%
Depreciation and amortization	<u>25.0%</u>	<u>30.9%</u>	<u>34.7%</u>	<u>40.0%</u>	<u>37.0%</u>	<u>35.9%</u>	<u>33.4%</u>	<u>26.1%</u>	<u>22.3%</u>	<u>25.7%</u>	<u>26.5%</u>	22.7%
Operating income	92.6%	62.3%	40.7%	26.1%	27.8%	34.5%	17.1%	2.8%	95.6%	28.6%	27.7%	34.8%
EPS	124.4%	71.3%	77.2%	165.9%	31.7%	45.3%	30.2%	29.2%	94.4%	29.7%	32.3%	34.3%

^(a)Excludes anticipated \$0.01 in transition and integration expenses related to Teaopia acquisition

^(b)Excludes anticipated \$0.04 to \$0.05 in transition and integration expenses related to Teaopia acquisition

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Outperform (Buy)	60	Outperform (Buy)	7
Market Perform (Hold)	32	Market Perform (Hold)	1
Underperform (Sell)	1	Underperform (Sell)	0

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