Teavana Holdings, Inc.

Raising Estimates on Continued Healthy Sales Trends

- Teavana reported third-quarter EPS of $0.02 (versus $0.01 last year), meeting our and consensus expectations in what is seasonally a low-profit quarter for the company. Total revenue rose 35% to $33.4 million, about $1 million ahead of our and consensus expectations, including a healthy 46% increase in direct-to-consumer sales.

- Comps remained healthy, increasing 8.5% (including e-commerce) against a 7.1% year-ago comparison, ahead of management's guidance for a midsingle-digit gain and similar to the second quarter's 8.7% increase.

- Transactions improved sequentially both including and excluding beverage-only transactions, with transactions including beverage-only declining 0.6% versus a 2.3% decline in the second quarter and transactions excluding beverage-only increasing 0.5% versus a 0.1% increase in the second quarter.

- Gross margin was much better than expected, increasing 330 basis points to 61.9%, primarily reflecting the benefit of the company's shift to direct sourcing as well as leverage on strong sales. SG&A increased 340 basis points to 52.4%, with about half of the increase stemming from accelerated new store openings and the remainder stemming from expenses related to being a public company as well as set-up costs for pending Canadian operations and increased occupancy costs associated with the company's new support center. Therefore, operating margin contracted 40 basis points to 4.8%.

- Teavana opened 17 new company-owned stores in the third quarter (versus our projection for nine), meeting the company's target of 50 new stores this year one quarter ahead of time. New stores continue to perform on plan, albeit with average sales productivity somewhat lower than last year given a greater percentage of B and C malls versus A malls (as discussed in our initiation report). Teavana now expects to open four additional stores in the fourth quarter, including the company's first store in Canada, for a total of 54 new stores this year, representing store growth of 37%. For 2012, management still anticipates 60 new store openings, representing store growth of 30%.

- Inventory increased 79% year-over-year to $32.5 million at the end of the third quarter, reflecting new store openings as well as early receipts to take advantage of product and freight discounts and a greater depth of inventory to support holiday sales (particularly big-selling items). Therefore, the company is in a much better inventory position heading into the fourth quarter than it was in the year-ago period when the company experienced out-of-stocks during the holiday selling season.

December 02, 2011

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

Symbol:	TEA (NYSE)
Price:	$16.65 (52-Wk.: $18-$29)
Market Value (mil.):	$723
Fiscal Year End:	January
Long-Term EPS Growth Rate:	30%
Dividend/Yield:	None

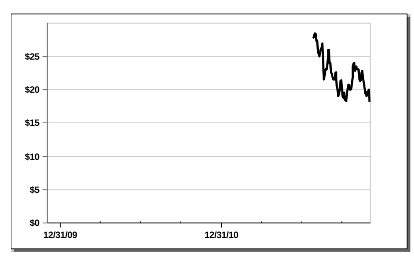
		2010A	2011E	2012E
Estimates*				
EPS	Q1	$0.05	A$0.09	$0.13
	Q2	$0.02	A$0.03	$0.04
	Q3	$0.01	A$0.02	$0.03
	Q4	$0.24	$0.31	$0.40
	FY	$0.32	$0.45	$0.60
	CY		$0.45	$0.60
Sales (mil.)		125	168	213
Valuation				
FY P/E		52.0x	37.0x	27.8x
CY P/E			37.0x	27.8x

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

Trading Data (Thomson Financial)	
Shares Outstanding (mil.)	37
Float (mil.)	NA
Average Daily Volume	234,004

Financial Data (Thomson Financial)	
Long-Term Debt/Total Capital (MRQ)	NA
Book Value Per Share (MRQ)	NA
Enterprise Value (mil.)	690.9
EBITDA (TTM)	25.4
Enterprise Value/EBITDA (TTM)	27.2x
Return on Equity (TTM)	14.2

Two-Year Price Performance Chart



Sources: Thomson Financial, William Blair & Company estimates

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

Sharon Zackfia, CFA
+1 312 364 5386
szackfia@williamblair.com

Tania Anderson, CFA
+1 312 364 8942
tanderson@williamblair.com

Matthew Curtis, CFA
+1 312 364 8384
mcurtis@williamblair.com

- Management issued fourth-quarter guidance calling for revenues of $62 million to $66 million (versus consensus of $67 million), including a midsingle-digit comp increase including e-commerce. EPS guidance was set at $0.29 to $0.31, encompassing consensus of $0.31 and our estimate of $0.30. Given the lapping of the shift to direct sourcing as well as management's expectation for strong sales of lower-margin merchandise, we expect roughly flat to modestly down gross margin in the fourth quarter.

- For the full year 2011, management raised revenue guidance to $162 million to $166 million, versus prior expectations for $160 million to $164 million and consensus of $166 million. EPS guidance is now $0.43 to $0.45 versus prior expectations of $0.42 to $0.44, our prior estimate of $0.44, and consensus of $0.46.

- We are raising our 2011 EPS estimate by a penny to $0.45 (up 42%), bringing it to the high end of revised guidance, and our 2012 estimate by a penny to $0.60, up 32% and versus consensus of $0.61. Our 2013 estimate remains unchanged at $0.77, up 29% and versus consensus of $0.78.

- Despite a healthy quarter and in-line outlook, Teavana's stock traded down 9%, as investors digested sales trends that were largely driven by average ticket gains. We continue to believe that Teavana's transactions will perk up in the new year, as the company builds a marketing department (virtually nonexistent now) and a CRM system. At 28 times our new 2012 EPS estimate, we would be buyers of Teavana's shares given the company's strong growth prospects and historically resilient sales trends, and we expect investors to be rewarded with 30%-plus EPS growth with the potential for upside. We reiterate our Outperform rating.

Third Quarter Meets Expectations
Teavana reported third-quarter EPS of $0.02 (versus $0.01 last year), meeting our and consensus expectations in what is seasonally a low-profit quarter for the company. Comps remained healthy, increasing 8.5% (including e-commerce) against a 7.1% year-ago comparison, ahead of management's guidance for a midsingle-digit gain and similar to the second quarter's 8.7% increase. Average ticket increased 9.1% and transactions declined 0.6%, but improved sequentially from -2.3% in the second quarter. Excluding beverage-only transactions, average ticket increased 8.3% and transactions increased 0.5%, also improved from a 0.1% increase in the second quarter. Store-only comps increased 6.0% against a 5.9% year-ago comparison, ahead of our 4% projection and at the higher end of management's guidance for a low- to midsingle-digit increase.

Total revenue rose 35% to $33.4 million, about $1 million ahead of our and consensus expectations, including a healthy 46% increase in direct-to-consumer sales. Tea represented 59% of sales (up from 58% in the year-ago period), merchandise remained flat at 37% of sales, and prepared beverages were 4% of sales (down from 5% in the year-ago period as the company continues to deemphasize the category).

Gross margin was much better than expected, increasing 330 basis points to 61.9%, primarily reflecting the benefit of the company's shift to direct sourcing last year (including higher product margins) as well as leverage on occupancy and depreciation on strong sales. Looking forward, given that the company lapped the shift to direct sourcing during the third quarter, management does not expect any associated gross margin benefit in the fourth quarter.

Selling, general, and administrative expenses increased 340 basis points to 52.4%, with about half of the increase related to accelerated store openings in the quarter (pre-opening, travel, and payroll related to training, relocation costs, and general supply expenses), while the remainder stemmed from new hires related to being a public company (finance, legal, and compliance), increased stock compensation, D&O insurance costs, audit and compliance fees, set-up costs for pending Canadian operations, and increased occupancy costs associated with the company's new support center. Depreciation and amortization increased 10 basis points to 4.6%, yielding operating margin contraction of 40 basis points to 4.8%.

Inventory increased 79% year-over-year to $32.5 million at the end of the third quarter, reflecting new store openings as well as early receipts to take advantage of product and freight discounts and a greater depth of inventory to support holiday sales (particularly big-selling items). Therefore, the company is in a much better inventory position heading into the fourth quarter than it was in the year-ago period when the company experienced out-of-stocks during the holiday selling season.

Finally, Teavana ended the third quarter with $4.5 million in debt and total liquidity of $35.3 million (including cash and availability on the company's $40 million revolver facility).

New Store Development Ahead of Plan

Teavana opened 17 new company-owned stores in the third quarter (versus our projection for nine), meeting the company's target of 50 new stores this year one quarter ahead of time. Therefore, the company ended the third quarter with 196 stores, up 39%. Moreover, 48 of the 50 new store openings thus far this year were opened with an internally promoted general manager, equating to a 96% internal promotion rate (versus 87% in 2010 and 39% in 2009), and management indicated that new stores are performing on plan.

Looking forward, Teavana now expects to open four additional stores in the fourth quarter, including the company's first store in Canada, for a total of 54 new stores this year, representing store growth of 37%. For 2012, management still anticipates 60 new store openings, representing store growth of 30%. In addition, plans remain on track for the company's first international franchised store to open in 2012 through its 10-year franchise development agreement with Alshaya.

Outlook and Stock Perspective

Management issued fourth-quarter guidance calling for revenue of $62 million to $66 million (versus consensus of $67 million), including a midsingle-digit comp increase (including e-commerce). EPS guidance was set at $0.29 to $0.31, encompassing consensus of $0.31 and our estimate of $0.30. Given the lapping of the shift to direct sourcing as well as management's expectation for strong sales of lower-margin merchandise, we expect roughly flat to modestly down gross margin in the fourth quarter.

For the full year 2011, management raised revenue guidance to $162 million to $166 million, versus prior expectations for $160 million to $164 million and consensus of $166 million. EPS guidance is now $0.43 to $0.45 versus prior expectations of $0.42 to $0.44, our prior estimate of $0.44, and consensus of $0.46.

We are raising our 2011 EPS estimate by a penny to $0.45 (up 42%), bringing it to the high end of revised guidance, and our 2012 estimate by a penny to $0.60, up 32% and versus consensus of $0.61. Our 2013 estimate remains unchanged at $0.77, up 29% and versus consensus of $0.78.

Despite a healthy quarter and in-line outlook, Teavana's stock traded down 9%, as investors digested sales trends that were largely driven by average ticket gains. We continue to believe that Teavana's transactions will perk up in the new year, as the company builds a marketing department (including a VP of marketing expected to be hired this quarter) and a CRM system. At 28 times our new 2012 EPS estimate, we would be buyers of Teavana's shares given the company's strong growth prospects and historically resilient sales trends, and we expect investors to be rewarded with 30%-plus EPS growth with the potential for upside. We reiterate our Outperform rating.

Teavana Holdings, Inc.

December 2, 2011: $16.65 ($16-$29) — **Rating: Outperform**

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

($ in millions, except per-share items)

FYE January	2009	Apr-10	Jul-10	Oct-10	Jan-11	2010	Apr-11	Jul-11	Oct-11	Jan-12E	2011E	Apr-12E	Jul-12E	Oct-12E	Jan-13E	2012E	2013E
Company-owned	108	118	128	141	146	146	161	179	196	200	200	215	225	245	260	260	330
Franchised	15	15	15	15	15	15	19	19	19	19	19	19	20	20	20	20	22
Total stores	123	133	143	156	161	161	180	198	215	219	219	234	245	265	280	280	352
% change	20.6%	24.3%	23.3%	27.9%	30.9%	30.9%	35.3%	38.5%	37.8%	36.0%	36.0%	30.0%	23.7%	23.3%	27.9%	27.9%	25.7%
Same-store sales	**6.9%**	**15.7%**	**6.9%**	**5.9%**	**7.5%**	**8.7%**	**6.0%**	**6.9%**	**6.0%**	**4.0%**	**5.3%**	**4.0%**	**3.0%**	**4.0%**	**4.0%**	**3.8%**	**4.0%**
Revenues	$90.3	$25.8	$23.0	$24.7	$51.2	$124.7	$34.9	$31.3	$33.4	$68.0	$167.6	$46.6	$39.5	$41.4	$85.7	$213.2	$272.1
Cost of sales (including occupancy)	36.4	10.0	9.5	10.2	16.6	46.3	12.5	12.2	12.7	22.0	59.3	16.4	15.2	15.6	27.5	74.8	94.4
Gross profit	$53.8	$15.8	$13.5	$14.5	$34.6	$78.4	$22.5	$19.1	$20.7	$46.0	$108.3	$30.2	$24.3	$25.8	$58.2	$138.4	$177.7
Selling, general, and administrative	38.1	10.8	10.8	12.1	16.8	50.6	14.8	15.4	17.5	23.8	71.4	19.8	19.8	21.7	29.7	91.0	115.9
Depreciation and amortization	3.5	1.0	1.1	1.1	1.2	4.4	1.3	1.4	1.6	1.7	6.0	1.8	1.9	2.0	2.2	7.9	10.5
Operating income	$12.2	$4.0	$1.7	$1.3	$16.6	$23.5	$6.5	$2.3	$1.6	$20.5	$30.9	$8.6	$2.6	$2.1	$26.2	$39.5	$51.3
Interest expense, net	2.4	0.6	0.6	0.7	0.6	2.6	0.7	0.7	0.1	0.1	1.6	0.1	0.1	0.1	0.1	0.4	0.4
Pretax income	$9.8	$3.4	$1.0	$0.6	$15.9	$20.9	$5.8	$1.6	$1.5	$20.5	$29.3	$8.5	$2.5	$2.0	$26.1	$39.1	$50.9
Tax rate	45.8%	42.6%	42.6%	42.7%	42.6%	42.6%	42.4%	35.2%	37.2%	41.0%	40.8%	39.8%	39.8%	39.8%	39.8%	39.8%	39.8%
Net income	$5.3	$1.9	$0.6	$0.3	$9.1	$12.0	$3.3	$1.0	$0.9	$12.1	$17.4	$5.1	$1.5	$1.2	$15.7	$23.5	$30.6
Diluted average shares	37.3	37.5	37.6	37.6	37.7	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	**$0.14**	**$0.05**	**$0.02**	**$0.01**	**$0.24**	**$0.32**	**$0.09**	**$0.03**	**$0.02**	**$0.31**	**$0.45**	**$0.13**	**$0.04**	**$0.03**	**$0.40**	**$0.60**	**$0.77**
Margins:																	
Gross margin	59.6%	61.1%	58.9%	58.6%	67.7%	62.9%	64.4%	61.1%	61.9%	67.7%	64.6%	64.8%	61.4%	62.3%	67.9%	64.9%	65.3%
Selling, general, and administrative	42.3%	41.9%	47.0%	49.0%	32.9%	40.6%	42.2%	49.1%	52.4%	35.0%	42.6%	42.5%	50.0%	52.5%	34.7%	42.7%	42.6%
Depreciation and amortization	3.9%	3.8%	4.6%	4.5%	2.4%	3.5%	3.6%	4.6%	4.6%	2.5%	3.6%	3.9%	4.8%	4.8%	2.6%	3.7%	3.9%
Operating margin	13.5%	15.4%	7.2%	5.2%	32.4%	18.8%	18.5%	7.4%	4.8%	30.2%	18.4%	18.4%	6.6%	5.0%	30.6%	18.5%	18.8%
Growth rates:																	
Revenues	41.3%	43.3%	33.1%	32.4%	41.0%	38.2%	35.6%	36.3%	35.1%	32.7%	34.4%	33.4%	26.2%	23.9%	26.1%	27.2%	27.6%
Selling, general, and administrative	30.4%	26.2%	26.1%	33.2%	41.4%	32.6%	36.6%	42.2%	44.5%	41.3%	41.2%	34.2%	28.5%	24.2%	25.0%	27.4%	27.3%
Depreciation and amortization	30.9%	21.6%	21.8%	22.0%	34.1%	25.0%	30.9%	34.7%	40.0%	39.3%	36.6%	41.3%	33.1%	28.7%	29.4%	32.6%	32.9%
Operating income	156.2%	276.4%	338.4%	100.3%	63.8%	92.6%	62.3%	40.7%	26.1%	23.8%	31.6%	33.1%	11.6%	27.7%	27.9%	27.7%	29.8%
EPS	339.3%	686.6%	NM	NM	74.9%	124.4%	71.3%	77.2%	165.9%	27.4%	42.2%	48.2%	40.7%	24.7%	29.0%	32.4%	29.3%

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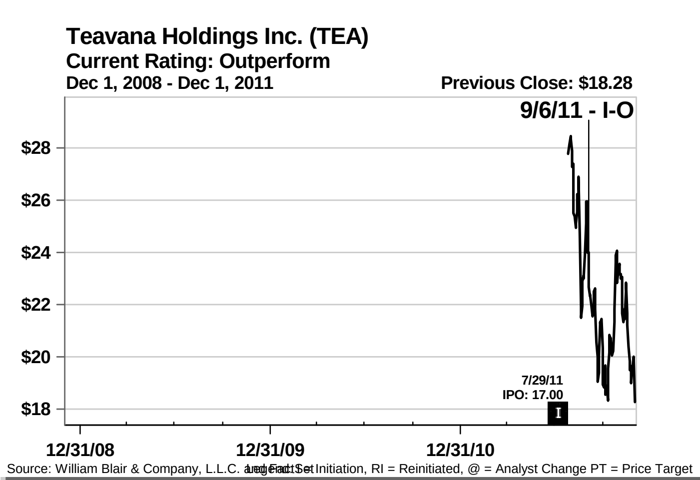
Additional information is available upon request.



Current Rating Distribution (as of 11/30/11)

Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	58	Outperform (Buy)	7
Market Perform (Hold)	34	Market Perform (Hold)	2
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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