

# Teavana Holdings, Inc.

## Thoughts on Starbucks Upcoming Test of Tazo Tea Store

- News came out today that Starbucks (SBUX \$55.64; Outperform) plans to open its first stand-alone Tazo Tea store in Seattle as early as this fall, following successful testing of loose-leaf tea in Starbucks's Roy Street Coffee & Tea store. The Tazo Tea store is expected to offer more than 80 varieties of loose-leaf tea and feature a tea bar that will offer hot- and iced-tea drinks and tea lattes as well as brewing equipment, pastries, packaged chocolates, and infused sugars and honeys.
- We are not surprised by this news, particularly as Starbucks has made no secret of its desire to expand its Tazo Tea brand. Tea has been one of Starbucks's fastest-growing beverage categories, and the Tazo Tea brand has grown to \$1.4 billion in revenues.
- However, we see distinct differences between the upcoming launch of the Tazo Tea store and Teavana, including what we suspect will be a more-hybrid beverage/merchandise mix at Tazo Tea versus Teavana, generating less than 5% of revenues from beverages. In addition, we suspect the real estate strategies will differ, with Tazo Tea likely to focus more on street/neighborhood locations versus Teavana's goal of growing from roughly 220 mall-based domestic locations to 500. It also remains a question as to how effective Tazo's selling and educational techniques will be for a U.S. customer base that remains largely untutored in the art of tea, whereas Teavana's intensive training processes are well proven, given incredibly high sales productivity of nearly \$1,000 per square foot. As a result, we do not view today's news as an immediate negative for Teavana, although in a fast-growing and highly profitable category such as tea, we are not surprised to see more competitive entrants.
- The bigger long-term question will be whether Starbucks learns anything from the Tazo Tea test that can be incorporated in the company's approximate 7,000 domestic company-owned Starbucks locations. However, with Starbucks focused primarily on beverages and food, we suspect that any learnings from the Tazo Tea test are more likely to translate into enhancing Starbucks' high-margin, prepared-tea beverage platform, with merchandising inherently somewhat constrained by Starbucks' small footprint and already-intensive labor paradigm (Teavana's success to date would suggest that selling loose-leaf tea remains a selling-intensive process in the U.S.).
- We also note that Teavana already competes successfully with Argo Tea in the Chicago market, which caters to tea drinkers through roughly 15 stores (primarily in street/neighborhood locations) with a prepared-beverage focus, although it also offers premium loose-leaf tea as well as tea-related merchandise.
- We continue to believe the Teavana concept remains a solid growth vehicle, with new units performing at the high end of plan and the opportunity to nearly double the store base in the next three years. We 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.*

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Please consult the last page of this report for all disclosures.  
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June 21, 2012

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

Symbol: TEA (NYSE)  
Price: \$12.96 (52-Wk.: \$12-\$29)  
Market Value (mil.): \$501  
Fiscal Year End: January  
Long-Term EPS Growth Rate: 30%  
Dividend/Yield: None

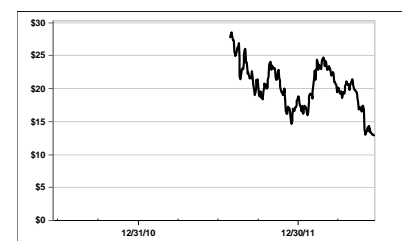
	2011A	2012E	2013E
<b>Estimates*</b>			
EPS Q1	\$0.09	A\$0.10	NA
Q2	\$0.03	\$0.03	NA
Q3	\$0.02	\$0.02	NA
Q4	\$0.32	\$0.44	NA
FY	\$0.46	\$0.59	\$0.78
CY		\$0.59	\$0.78
Sales (mil.)	168	223	282
<b>Valuation</b>			
FY P/E	28.2x	22.0x	16.6x
CY P/E		22.0x	16.6x

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

<b>Trading Data</b> (Thomson Financial)	
Shares Outstanding (mil.)	38
Float (mil.)	NA
Average Daily Volume	301,444

<b>Financial Data</b> (Thomson Financial)	
Long-Term Debt/Total Capital (MRQ)	NA
Book Value Per Share (MRQ)	NA
Enterprise Value (mil.)	480.7
EBITDA (TTM)	37.5
Enterprise Value/EBITDA (TTM)	12.8x
Return on Equity (TTM)	26.5

### Two-Year Price Performance Chart



Sources: Thomson Financial, William Blair & Company estimates

## Teavana Holdings, Inc.

June 20, 2012: \$12.96 (\$12-\$29)

### Quarterly Earnings Model

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

Rating: Outperform

Company Profile: Aggressive Growth

FYE January	2010	Apr-11	Jul-11	Oct-11	Jan-12	2011	Apr-12 <sup>(a)</sup>	Jul-12 <sup>(b)</sup>	Oct-12E	Jan-13E	2012E <sup>(c)</sup>	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%	9.1%	8.7%	8.5%	8.6%	8.6%	1.7%	3.0%	4.0%	5.5%	3.6%	6.0%
<b>Revenues</b>	\$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
<b>EPS</b>	<b>\$0.32</b>	<b>\$0.09</b>	<b>\$0.03</b>	<b>\$0.02</b>	<b>\$0.32</b>	<b>\$0.46</b>	<b>\$0.10</b>	<b>\$0.03</b>	<b>\$0.02</b>	<b>\$0.44</b>	<b>\$0.59</b>	<b>\$0.78</b>
<b>Margins:</b>												
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%
<b>Growth rates:</b>												
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%

<sup>(a)</sup> Excludes \$0.01 in transition and integration expenses related to Teaopia acquisition

<sup>(b)</sup> Excludes anticipated \$0.03 in transition and integration expenses related to Teaopia acquisition

<sup>(c)</sup> Excludes anticipated \$0.04 to \$0.05 in transition and integration expenses related to Teaopia acquisition

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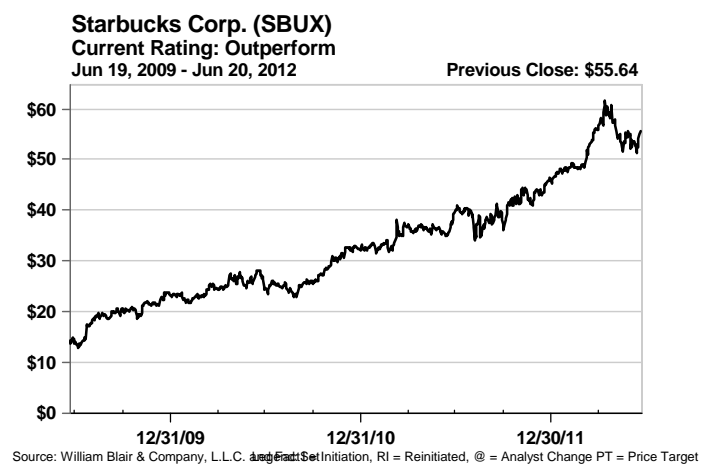
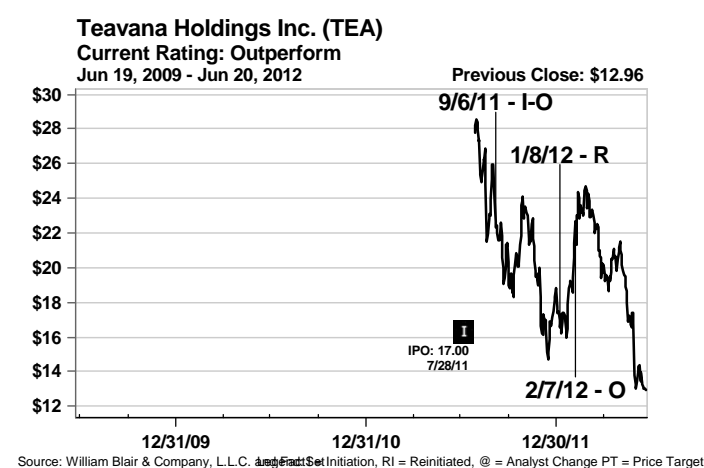
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Sharon Zackfia or members of her immediate family own shares of Starbucks Corporation.

Additional information is available upon request.



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Coverage Universe	Percent	Inv. Banking Relationships*	Percent
Outperform (Buy)	60	Outperform (Buy)	9
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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