Siena Market Line
2nd week of December 2015

The Men’s Wearhouse, Inc.
MW

Analyst: Kyle Ritchie
Sector: Consumer Discretionary

BUY on MW

Price Target: $ 26.28

Key Statistics as of 12/4/15

Market Price:	$20.95
Industry:	Specialty Apparel Retailer
Market Cap:	$998 M
52-Week Range:	$18.09 - $66.18
5 Year Beta:	1.11

Thesis Points:

- Stronger Margins than its Competitors
- Increasing Interest by Hedge Fund Managers
- Same Store Sales Growth by Segment

Company Description:

The Men’s Wearhouse, Inc. is a specialty apparel retailer that operates in the United States, Puerto Rico, and Canada. The company operates in two primary segments; Retail and Corporate Apparel. The retail segment offers a variety of business casual and formalwear clothing such as suits, sport coats, slacks, dress shirts, dress pants, ties, etc. It also offers a selection of tuxedo rental products. The retail segment operated roughly 1,700 stores under the Men’s Wearhouse, Joseph A. Bank, Moores and K&G brands. The Corporate Apparel segment provides corporate clothing uniforms to workforces under the Twin Hill, Dimensions, Alexandra, and Yaffy brands. This segment serves companies in the retail grocery, retail, banking, and postal, healthcare and public sectors. Men’s Wearhouse, Inc. was founded in 1973 and is headquartered in Houston Texas.

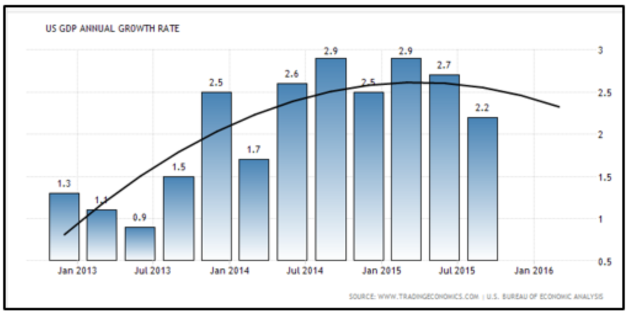
Thesis

Men's Wearhouse, Inc. is one of the largest retailers of men's apparel in the United States. The company differentiates itself from its competitors with its high quality, professional attire at reasonable prices. Within the past year, Men's Wearhouse completed integrating its acquisition of Joseph A. Bank. Since the acquisition, Men's Wearhouse implemented a major shift in the promotional strategies for Joseph A. Bank. The change in strategies has had a severe impact on store traffic and Joseph A. Bank's sales. However, the synergies that are to be gained from this merger are still underway. In the past, these two companies competed intensely with one another targeting slightly different demographics. Together, Men's Wearhouse and Joseph A. Bank will be able to expand its margins, increase purchasing power and improve sales in the upcoming years. A major recent concern in the retail industry is the competition posed by internet shopping. This will never be an issue for Men's Wearhouse as suit shopping requires fitting and tailoring along with customer interaction; a key essential to the success of this company. Men's Wearhouse stock price has taken a hit over the past few months but there are positive indications that it will recover posing an opportune time to buy for wise investors.

Industry Outlook

The graph below illustrates the industry growth since 2010 for public apparel retailers.

As you can see there has been a decay in growth in the retail industry over the past five years. The primary factors that have influenced this trend include GDP, internet shopping and unexpected seasonal climate changes. The retail industry as a whole has endured a difficult year due to the extended warmer weather. Apparel retailers that have stocked their inventory with winter clothing are unable to meet sales expectations. The continual rise in internet shopping has also drastically affected apparel retailers. Online retailers such as Amazon offer exceptional prices that are difficult to compete with. Lastly, GDP is another primary influence in the retail industry as it directly affects consumer spending. According to Trading Economics, GDP is expected to slightly decline in 2016.



Porter's Five Forces

Bargaining power of suppliers: **LOW**
Men's Wearhouse source their inventory through a number of quality brands. On the supplier side, maintaining a reputable brand image is a vital aspect for its product and there is high competition among these suppliers. There are a number of quality clothing manufacturers such as Calvin Klein that require the distribution capabilities of Men's Wearhouse.

Bargaining power of customers: **MODERATE**
The bargaining power of customers is moderate. The way to perceive this force is by analyzing store traffic and sales. As previously mentioned, the recent change in the promotional strategy has had a negative effect on Bank's store traffic and sales. If sales were to continue to decline, the demand for more store traffic would ultimately increase the bargaining power for customers as Men's Wearhouse would be forced to offer discounts/other marketing strategies.

Threat of substitutes: **LOW**
The threat of substitutes in the men's specialty apparel industry is low. There is really no alternative to formal attire. Professionals can turn to other retailers for button downs and slacks but the clothing line itself is not replaceable. It is not likely that professionals are

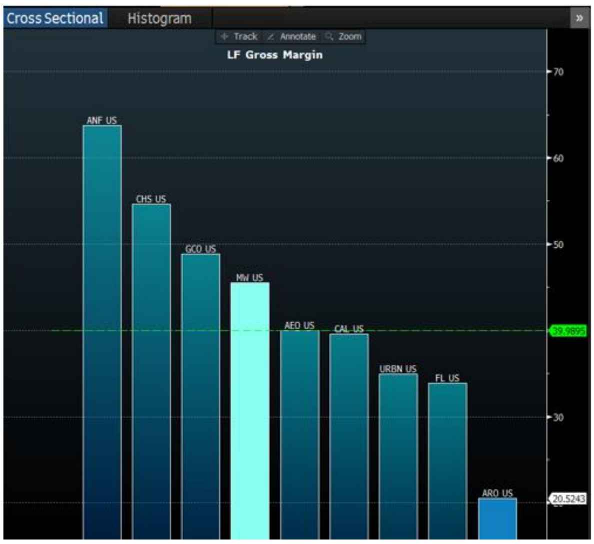
going to start wearing collared polo shirts to work every day rather than suits.

Existing rivalry: **HIGH**
The intensity of competition in the apparel retail industry is high. Competitive pricing will always exist and cutting costs is always a primary focus for companies. Increasing store traffic and improving same store sales is vital to apparel retailers.

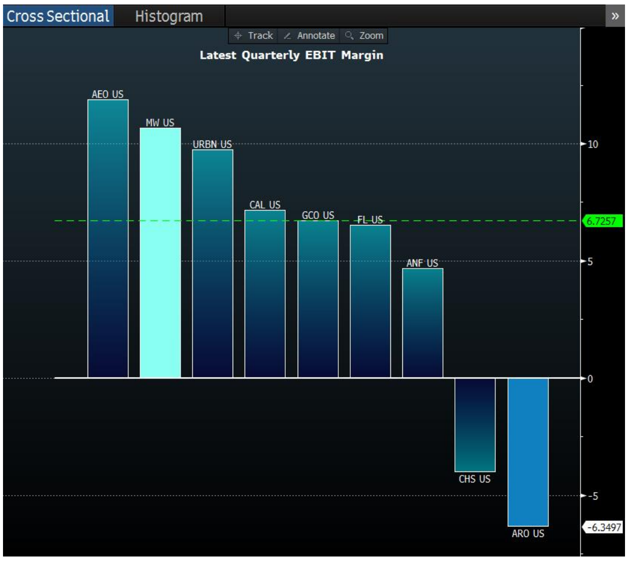
Barriers to Entry: **HIGH**
The apparel retail industry is an industry that is made up of mostly chain stores. These stores are well-established and the number of independent retailers has been decreasing over the last decade. It is difficult to establish favorable supply contracts and leases for start-up companies. Furthermore, the capability to immediately operate competitively is virtually impossible for a new entrant.

Stronger Margins than its Competitors

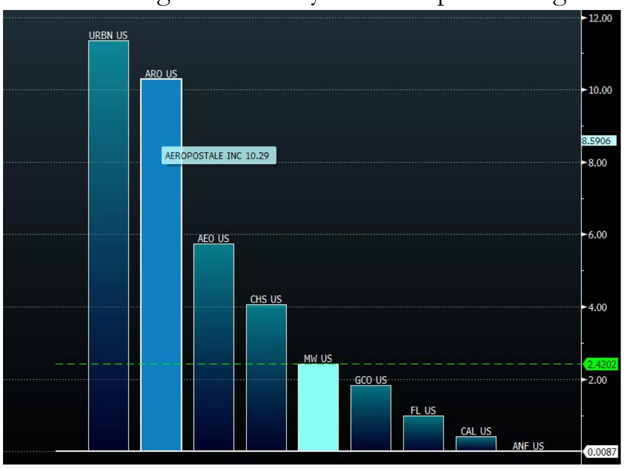
This section includes a cross sectional analysis of Men's Wearhouse compared to its relative peers. The peers have been selected based on other competitors in the retail industry and the companies' market capitalization. These peers include: Abercrombie and Fitch Co. (ANF), American Eagle Outfitters, Inc. (AEO), Genesco Inc. (GCO), Chico's FAS Inc. (CHS), Urban Outfitters Inc. (URBN), Foot Locker, Inc. (FL), Caleres, Inc. (CAL), Carter's, Inc. (CRI), Aeropostale, Inc. (ARO), and Guess? Inc. (GES). The first chart analyzes Men's Wearhouse gross margin (light blue) which is 45% while the median of its chosen peers is 40%.



This indicates that Men's Wearhouse is receiving a larger percentage of its net sales in comparison to the relative industry.
The chart below illustrates Men's Wearhouse EBIT margin. This margin demonstrates each company's earnings prior to taking into account interest and taxes.



Men's Wearhouse EBIT margin is 10.6% while the median among its peers is 6.7%. This margin is important when analyzing Men's Wearhouse because the company has just recently incurred a substantial amount of debt. Currently, Men's Wearhouse has a debt to equity ratio of 1.6. Due to the acquisition the company needed a notable amount of extra financing. Historically however, Men's Wearhouse has not had more than $100 million in total debt.
The next margin to be analyzed is the profit margin.



Men's Wearhouse average historical profit margin is 2.42%. This figure fell directly on the median line. The profit margin tends to be lower due to high operating costs. Selling, general and administrative (SG&A) costs as a percentage of sales in this industry is historically found to be above 30%. The five-year average for Men's Wearhouse SG&A as a percentage of sales is 36.4%.

Increasing Interest from Hedge Funds

Something to consider when analyzing a company is the ownership summary. The percentage of ownership for Men's Wearhouse is 67% Investment Advisor, 29% Hedge Fund Manager and the remaining 1% consists of a variety of investors which include Insurance Companies, Pension Funds, Government and others. The 29% that is made up of Hedge Funds is a positive indicator in regards to the level of interest in this company. What is even more important is the recent change in this percentage. As you can see from the chart below, on November 5, MW's stock price dropped (43.4%).

Eminence Capital LLC, a $6 billion hedge fund run by Ricky Sandler, is the largest stakeholder in MW. Prior to the drastic decline on Nov 5, Eminence held just under 10% in MW. Since the decline, Eminence increased their percentage of ownership from 10%-13% on the following day. It is obvious that as a major stakeholder Eminence would be inclined to increase its number shares in order to offset prior losses. However, what is more important to note is the history of Eminence's investment horizon in Men's Wearhouse. According to an article written by James B. Stewart, Mr. Sandler pushed for a merger between the two chains, Men's Wearhouse and Joseph A. Bank. As previously mentioned and spoken by Mr. Sandler, "men's tailored clothing will be relatively insulated from Internet competition, given customers' needs to try on clothing that often requires alterations." Men's tailored clothing is a timeless industry; and Men's Wearhouse along with Joseph A. Bank are two prominently known store chains. The chart below illustrates the five-year graph of hedge fund ownership (%) in MW.

The percentage of ownership prior to the acquisition of Joseph A. Bank was roughly 13.5% which then spiked to 35%, peaking at roughly 45% and now remains at 29%. The percentage increase since the acquisition has more than doubled (13.5%-29%).

Eminence is the only hedge fund stakeholder that increased their share count since the decline in MW's stock price. Lioneye Capital Management, Samlyn Capital LLC, Tourbillion Capital Partners LP, and Pointstate Capital are the next three largest stakeholders in MW respectively. Each hedge fund has also increased their share count on September 30 despite the recent performance of the company.

Same Store Sales Growth by Segment

Same store sales is a figure used to determine what amount of sales growth is attributable to new store openings, based on sales made by stores that have been open for more than a year. This figure tells us how strategically and productively the company is growing. Men's Wearhouse revenue by measure includes the following percentages: MW makes up 52%, Joseph A Bank 21%, K&G 10.3%, Moores at 8% and Dimensions and Alexandra at 6.7%. In 2015, Moores same store sales grew at 8.6%, Men's Wearhouse grew 3.9%, K&G grew 3.7% and Joseph A. Bank fell 2.5%. As previously mentioned, Joseph A. Bank's sales suffered as a result of the change in promotional strategy. However, the other major segments in regards to total revenue each had positive growth. Joseph A. Bank's sales are also likely to recover whether management revives the old promotional scheme or offers additional discounts as a result of the recent decline. The positive growth in each segment aside from Joseph A. Banks is a positive indicator of how this company operates.

Valuation

The valuation of Men's Wearhouse. is based on a valuation computed by a pro forma using a discounted cash flow method with a main focus on return on invested capital. Attached is an overview of the inputs, assumptions and results used in valuing this company.

When valuing MW given its current state, a conservative approach has been applied. In consideration of the recent sales decline at Joseph A. Bank, a 10-year period to convergence has been used. The average target price among the analysts who consider MW a buy is $30.80. The financial metrics of the company were made to converge to the sub-industry. A 7% market risk premium was used in this valuation given the stability of the industry along with a fast decay in revenue growth for its reversion to the continuing period. The pro forma calculated a lower-bound intrinsic value of the stock price to be $25.24 with a 1-year target of $26.28.

Conclusion

After a thorough analysis of Men's Wearhouse it is clear that this company is undervalued. What cannot be emphasized enough is the fact that this company operates in a timeless industry. The retail industry itself has endured a difficult which was strongly influenced by internet shopping. Men's Wearhouse and Joseph A. Bank will certainly be able to recover sales growth as well as improve promotional strategies. Together, the companies have gained purchasing power to suppliers and can continue to improve its margins. Despite the drastic decline in MW's stock price, the analysis only points to one direction, BUY.

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The Men's Wearhouse, Inc.	MW	Analyst Kyle Ritchie	Current Price $20.31	Intrinsic Value $25.24	Target Value $26.28	Divident 3%	1-y Return: 32.82%	BULLISH

General Info	
Sector	Consumer Discretionary
Industry	Specialty Retail
Last Guidance	November 5, 2015
Next earnings date	December 9, 2015
Market Data	
Enterprise value	$2,565.21
Market Capitalization	$4,449.48
Daily volume	0.22
Shares outstanding	48.36
Diluted shares outstanding	48.12
% shares held by institutions	26.01%
% shares held by insiders	0.80%
Short interest	11.19%
Days to cover short interest	2.96
52 week high	$66.18
52-week low	$18.09
5y Beta	1.11
6-month volatility	87.15%

Peers	Market Cap.
Abercrombie & Fitch Co.	$1,713.07
American Eagle Outfitters, Inc.	$2,993.98
Genesco Inc.	$1,242.54
Chico's FAS Inc.	$1,645.00
Urban Outfitters Inc.	$2,550.03
Foot Locker, Inc.	$8,907.87
Caleres, Inc.	$1,253.22
Carter's, Inc.	$4,478.45
Aéropostale, Inc.	$35.82
Guess? Inc.	$1,606.73
Current Capital Structure	
Total debt/Common Equity (LTM)	1.22
Cost of Borrowing (LTM)	6.26%
Estimated Cost of new Borrowing	4.84%
Altman's Z	2.34
Estimated Debt Rating	BAA
Current levered Beta	1.12
LTM WACC	4.65%

Management

Professional	Title	Comp. FY2013	Comp. FY2014	Comp. FY2015
Ewert, Douglas	Chief Executive Officer, Director and M	$3,622,131	$3,672,031	$0
Blake, Mary	President and Chief Merchandising Off	$907,076	$2,326,148	$0
Kimmins, Jon	Chief Financial Officer, Executive Vice F	$2,055,778	$2,488,276	$0
Souvenir, Carole	Chief Legal Officer and Executive Vice I	$0	$1,317,903	$0
Neutze, Mark	Executive Vice President of Store Oper	$0	$1,607,107	$0
Thorn, Bruce	Chief Operating Officer and Executive \	$0	$0	$0

Past Earning Surprises

	Revenue	EBITDA	Norm. EPS	Standard Error of "Surprise"
Last Quarter	-2.82%	-0.55%	1.90%	1.36%
Last Quarter-1	3.19%	2.64%	3.85%	0.35%
Last Quarter -2	0.77%	10.44%	NM	4.84%
Last Quarter -3	-2.57%	-2.57%	-4.60%	0.68%
Last Quarter -4	-5.46%	-3.83%	3.77%	2.85%
Standard error	1.5%	2.5%	2.0%	1.16%
Standard Error of Revenues prediction	1.5%			
Imputed Standard Error of Op. Cost predictic	2.1%			
Imputed Standard Error of Non Op. Cost pre	NM			

Industry Outlook (Porter's Five Forces)

Bargaining Power of Suppliers (100th Percentile), Bargaining Power of Customers (100th Percentile), Intensity of Existing Rivalry (100th Percentile), Threat of Substitutes (100th Percentile), Threat of New Competition (100th

Proforma Assumptions

onvergence Assumptio

All base year ratios linearly converge towards the Sub-industry ratios over an explicit period of 10 years

General Assumptions	
Money market rate (as of today)	0.37%
Risk-Free rate (long term estimate)	2.93%
Annual increase (decrease) in interest rates	0.1%
Marginal Tax Rate	37.5%
Country Risk Premium	7.0%

Forecast Year	Revenue Growth Forecast	Revenue ($) Forecast
LTM		$3,624.16
FY2016	1.0%	$3,660.40
FY2017	1.0%	$3,697.00
FY2018	-1.0%	$3,661.15
FY2019	1.0%	$3,698.32
FY2020	2.0%	$3,772.57
FY2021	2.5%	$3,867.02
FY2022	2.8%	$3,973.44
FY2023	2.9%	$4,087.71
FY2024	2.9%	$4,207.81
FY2025	3.0%	$4,332.74
Continuing Period	3.0%	$4,462.72

Items' Forecast Assumptions

	Base year (LTM)	onvergence period (Sub-industr	djustment per yea
Operating Cash/Rev.	0.00%	0.02%	0.0%
NWV/Rev.	20.24%	7.32%	-1.3%
NPPE/Rev.	15.23%	17.08%	0.2%
Dpr/NPPE	20.67%	20.54%	0.0%
NOPAT MARGIN	5.58%	6.67%	0.1%
Op. Exp./Rev.	89.74%	86.80%	-0.3%
SBC/Rev.	0.49%	0.55%	0.0%
Rent Exp./Rev.	6.44%	0.00%	-0.6%
R&D/Rev.	0.00%	0.42%	0.0%
E&D/Rev.	0.00%	0.00%	0.0%
SG&A/Rev.	36.70%	32.45%	-0.4%
ROIC	8%	25.47%	1.77%
EV/Rev.	1.24x	0.21x	-0.10x
EV/EBITA	14.78x	1.98x	-1.28x
Debt/Equity	122%	21%	-10.1%
Unlevered beta	0.63	1.18	0.06
Dividends/REV	1%	1%	0.0%

Other Assumptions

Tobin's Q	80%
Excess cash reinvestment	Money market rate
Other claims on the firm's asset	$0.00

Capitalization

100% of all rent expenses are capitalized and amortized 'straightline' over 10 years
100% of all R&D expenses are capitalized and amortized 'straightline' over 10 years
E&P expenses are not capitalized
SG&A expenses are not capitalized

Valuation Focus

DCF Valuation	100%
Relative valuation	0%
Distress Valuation	0%

Monte Carlo Simulation Assumptions

Revenue Growth deviation	Normal (0%, 1%)
Operating expense deviation	Normal (0%, 1%)
Continuing Period growth	Triangular (6.79%, 7%, 7.21%)
Country risk premium	Triangular (2.91%, 3%, 3.09%)
Intrinsic value σ(ε)	$0.09
1-year target price σ(ε)	$0.10

Valuation

Forecast Year	ROIC	WACC	Invested Capital	Implied Enterprise Value	Claims on Assets and Dilution	Shares Outstanding	Price per Share
LTM	7.8%	4.6%	$2,915.17	$4,087.00	$3,482.55	48.36	$25.05
FY2016	7.5%	4.9%	$2,725.70	$3,878.66	$3,240.71	48.36	$25.59
FY2017	8.2%	5.9%	$2,532.13	$3,688.22	$2,976.41	48.36	$27.57
FY2018	8.9%	6.1%	$2,284.25	$3,438.28	$2,658.67	48.36	$30.88
FY2019	10.1%	6.2%	$2,086.56	$3,223.84	$2,381.23	48.36	$34.19
FY2020	11.5%	6.3%	$1,905.44	$3,006.55	$2,110.02	48.36	$37.54
FY2021	13.0%	6.2%	$1,725.61	$2,763.80	$1,829.41	48.36	$40.84
FY2022	15.0%	5.7%	$1,539.73	$2,476.99	$1,535.10	48.36	$43.79
FY2023	17.5%	4.5%	$1,344.03	$2,122.72	$1,220.41	48.36	$45.83
FY2024	20.9%	0.8%	$1,136.43	$1,651.47	$882.44	48.36	$45.27
FY2025	25.8%	-25.3%	$915.62	$719.91	$519.33	48.36	$28.68
Continuing Period	25.5%	30.9%	$1,168.54				

Monte Carlo Simulation Results

The 3σ(ε)-adjusted intrinsic value is $25.24; t 3σ(ε)-adjusted target price is $26.28; and th analysts' median target price is $30.8

Sensitivity Analysis

Revenue growth variations account for 95.9% of total variar
Risk premium's variations account for 2.5% of total variance
Operating expenses' variations account for 1.4% of total var
Continuing period growth variations account for 0.2% of to