

American Eagle Outfitters, Inc.
NASDAQ:AEO

Analyst: Thomas Marano
Sector: Consumer
Discretionary

BUY

Price Target: \$21.23

Key Statistics as of 12/9/2016

Market Price: \$18.09
Industry: Specialty Retail
Market Cap: \$3,222.90M
52-Week Range: \$12.78- 19.55
Beta: 0.85

Catalysts:

- No Debt and Positive Cash Flows
- Expansion of Company's Aerie Brand
- Cyclical Holiday Sales

Company Description:

Founded in 1977 American Eagle (NASDAQ:AEO) is a U.S. Based clothing and accessory store that operates around the world. The company retails men and women's clothing, shoes, and accessories. With an additional "Aerie" department specializing in woman's lingerie, intimate apparel, and active wear. Their main target market are young adults aged 15-25, However their denim and accessories appeal to all ages. American Eagle markets through Television ads, radio promotion, and home flyers. They sell their product through store locations, catalogs, and online websites. The company operates more than 1,000 stores within the United States, Canada, Mexico, China, Hong Kong, and the United Kingdom and ships to 81 countries worldwide.



Thesis

Originally started 37 years ago as a casual sportswear retail company, American Eagle has grown to much more than that. Performing well through a down turning industry, analysts are optimistic about future revenues. Posting great results over the past few quarters, American Eagle has proven they're one of the top clothing brands across the country. From clothing to lingerie, American Eagle has kept up with modern trends and consumer preferences. With many long-term goals targeted around expansion I believe the increase in revenue will drive margins and increase shareholder return, overall making the stock more attractive to investors. With stock declines after last quarter's earnings call, I believe that American Eagle Outfitters is cheap, my thought is that we should long shares of AEO.

Industry Outlook

The Specialty retail industry is highly competitive and is very dependent on consumer spending. The implementation of online shopping via on phone apps or computers has slowed down the growth in traditional store fronts. The issue is, consumers are expecting rapid delivery at comparative instore prices. Moving through 2016 and into 2017 it's imperative that retailers improve shipment processes, incorporate digital aspects, and advance technologies to overall improve the customer experience.

Within this industry a huge aspect is customer preference. Some customers prefer a lower cost product but don't mind taking a cut in quality. While on the opposite side, some users will pay upward prices to be assured the quality of their clothes is good. To cope this, American Eagle must post competitively priced products with high quality products.

To combat this competitive industry, American Eagle has developed smart phone apps to make online shopping easier. What's convenient about the app is that it will stores your sizes making checkout and appeal selection convenient and quick. American Eagle also does a tremendous job keeping up with relevant fashion trends with a strong product assortment that appeals to customers of all shapes and sizes. Which is very important in today's retail industry.

Business Model

Retail Stores strategically place their locations based on a variety of considerations. With the largest being retail foot traffic. Since American Eagle appeals to 15-25 year olds they tend to place their storefronts within malls. Since their clothes are reasonably price, American Eagle places their store fronts in middle to high end malls. Their two main brands are, the traditional American Eagle and Aerie. American Eagle specializes in modern day clothing trends, with their main revenue driver being their denim line. While Aerie sells lingerie and intimates.

The American Eagle Outfitters retails clothing through approximately 950 stores and online while Aerie retails through 100 stand-alone and 65 side-by-side stores. While both the traditional American Eagle store front and Aerie bring in revenue, it's the side by side locations that attract the most female customers. Here they can shop both modern clothing and Aerie products. According to 2015 data, about 54% of revenue comes from women's appeal and accessories, 36% from men's, and the remaining 9% from Aerie.

Rise of Aerie

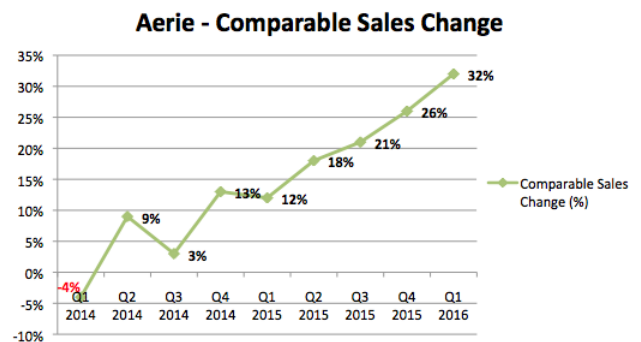


Exhibit: 1

As you can tell from the graph above, Aerie's comparable sales change has drastically increased over through 2015 and into Q1 2016. These increases continued through Q2 and Q3. Sales increased from Q1 2014- Q3 2016 due to Aerie's advertisement models.

In 2014 Aerie launched a new campaign focused on the beauty of woman all shapes and sizes. This campaign centered on unphotoshopped ads and models that challenged "Supermodel Standards." The campaign AerieReal caused sales to increase 20% in the 2015 fiscal year.

Moving forward into 2017 management has plans to expand Aerie locations into a storefront similar to Victoria Secrets. The loyalty to Aerie from woman has increased retail traffic throughout American Eagle as a whole.

Ownership

According to the graph below showing short interest, you can see American Eagle's short interest is continuing to decrease from mid September. This decline could be an indication that investors are beginning to sell their short positions, meaning they possibly believe that AEO's share price may pick up traction and raise again. This supports my thesis for longing shares of AEO.



Exhibit: 2

People

One very impactful person on American Eagle is Jennifer Foyle, the current president of Aerie. It was Foyle's idea for Aerie to use un-photoshopped photos and promote body positivity. Foyle is indirectly responsible for the increase in Aerie sales 2014 onward. Jay L. Schottenstein served as on the executive board of American Eagle since the start alongside his brother. Although he took time off from 2005-2009 to take on the role of CEO at DSW, he recently stepped up as CEO in 2014. Schottenstein has a deep understanding and knowledge of the industry and company. Being one of the original founders of AEO I believe this show strength. Being one of the original founders Schottenstein will truly do what's best for the corporation on both short and long term.

Competition

COMPETITORS	SYMBOL
Abercrombie & Fitch Co.	NYSE:ANF
Urban Outfitters, Inc.	NasdaqGS:URBN
Tailored Brands, Inc.	NYSE:TLRD
Coach, Inc.	NYSE:COH
Express, Inc.	NYSE:EXPR
L Brands, Inc.	NYSE:LB
Under Armour, Inc.	NYSE:UA
Tiffany & Co.	NYSE:TIF
Burlington Stores, Inc.	NYSE:BURL

Exhibit: 3

As you can tell from the list above American Eagle competes with many well-known retailers. When choosing competitors to compare, I chose both clothing and accessory driven retailers. Clothing contributes most revenue to American Eagle, but a strong portion is attributed to accessories.

Product differentiation is crucial for AEO. As mentioned earlier American Eagle's top product is their denim line. They have a strong line with various colors and different prints. Their prices are placed perfectly between expensive Abercrombie & Fitch and lower cost Aeropostale. Where American Eagle really differentiates themselves is within their product line. They have good quality clothes while also keeping up with modern trends. American Eagle also has athletic wear, which may appeal to consumers looking for gym/sporting clothes. What I believe hurts American Eagle is the "age limit" on their clothes. Meaning the thought that the brand only appeals to a younger generation. Corporations like Express appeal to an older generation while they struggle with the younger end.

Financials

ROIC /WACC		
	History	LFY
AEO	1.52	2.23
Competitors	1.72	1.30

ROIC		
	History	LFY
AEO	14.5%	21.7%
Competitors	22.1%	15.7%

Exhibit:4

Above is the ROIC/WACC ratio and ROIC in percent form. As you can tell when compared to top competitors (Exhibit: 3) American Eagle is creating value at a much higher rate than their customers. They've historically underperformed their competition, but recently it has switched. As the competitor drop in value, American Eagle is showing great signs of Value Creation.

American Eagle's ROIC is 21.7% compared to competitors 15.7%. This higher ROIC suggests that American Eagle more efficiently uses money to generate returns.

Long Term Plan

Moving forward into 2017 American Eagle Outfitters has many long term plans.

- Expand global retail presence by licensed stores throughout Chili and Peru. Continuing to build on existing growth markets throughout regions such as Colombia, Panama, Caribbean, and Mexico.
- Expand more stand-alone Aerie's and side-by-side stores of American eagle and Aerie throughout the United States.
- Globally expand Aerie and continue to market untouched models, promoting positive body image.

Important Dates and Catalysts

Moving forward in 2017 management would like to expand the number of stand-alone Aerie locations. Since there are only around 100 throughout the country there is room for an increase in physical presence. The expansion of Aerie will increase revenue and drive margins up. Overall increasing the value of American Eagle.

American Eagle has no debt and positive cash flows, meaning the company is very attractive for investors. With no debt American Eagle can continue to operate in this competitive industry without the risk of defaulting on a loan or the possibility of bankruptcy.

The upcoming holiday season is expected to increase net revenue. Since the holidays prompt gift giving trends, higher sales and operating income tend to occur during quarter 4.

Conclusion

American Eagle is a great brand that has proven itself both trendy and popular. Proving that they can keep up with what consumers want they will continue to increase revenue and margins. American Eagle has maintained strength throughout a harsh industry downturn. With the expansion of Aerie along with the other long-term plans I believe the AEO stock price will rise. I believe it would be best to long American Eagle Outfitters.

American Eagle Outfitters, Inc. (AEO)

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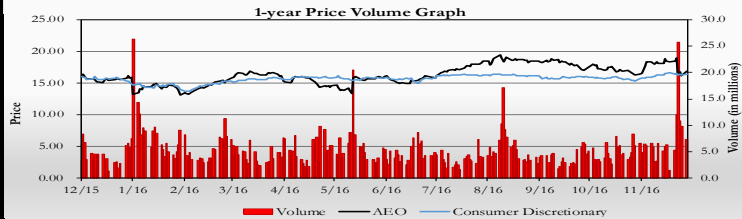
BULLISH

Analysis by **Thomas marano**
12/9/2016

Current Price: \$18.09
Divident Yield: 3.3%

Intrinsic Value: \$19.44
Target Price: \$21.23

Target 1 year Return: 20.66%
Probability of Price Increase: 93.6%



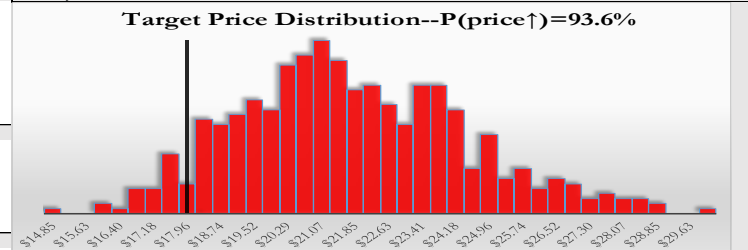
Description
American Eagle Outfitters, Inc. operates as a specialty retailer offering on-trend clothing, accessories, and personal care products under the American Eagle Outfitters and Aerie brands.

General Information
Sector: Consumer Discretionary
Industry: Specialty Retail
Last Guidance: November 3, 2015
Next earnings date: March 3, 2017
Estimated Country Risk Premium: 6.75%
Effective Tax rate: 38%
Effective Operating Tax rate: 35%

Market Data	
Market Capitalization	\$3,222.90
Daily volume (mil)	6.26
Shares outstanding (mil)	181.88
Diluted shares outstanding (mil)	186.21
% shares held by institutions	74%
% shares held by investments Managers	88%
% shares held by hedge funds	9%
% shares held by insiders	5.52%
Short interest	23.36%
Days to cover short interest	8.05
52 week high	\$19.55
52-week low	\$12.78
Levered Beta	0.85
Volatility	36.80%

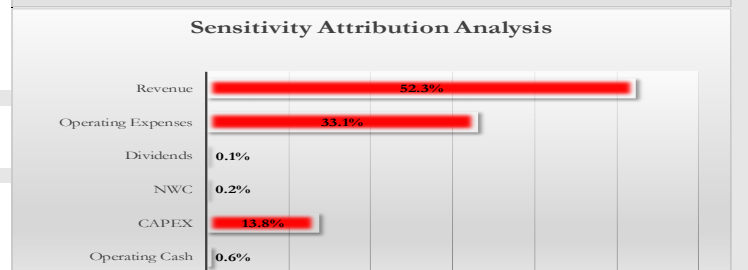
Past Earning Surprises	
Quarter ending	Revenue
10/31/2015	-6.99%
1/30/2016	-4.27%
4/30/2016	0.95%
7/30/2016	-3.58%
10/29/2016	-2.03%
Mean	-3.18%
Standard error	1.3%

EBITDA		Peers	
	-3.35%	Abercrombie & Fitch Co.	
	-15.05%	Urban Outfitters, Inc.	
	2.87%	Chico's FAS, Inc.	
	-2.88%	Tailored Brands, Inc.	
	-2.10%	Coach, Inc.	
	-4.10%	Express, Inc.	
	3.0%	L Brands, Inc.	
		Under Armour, Inc.	



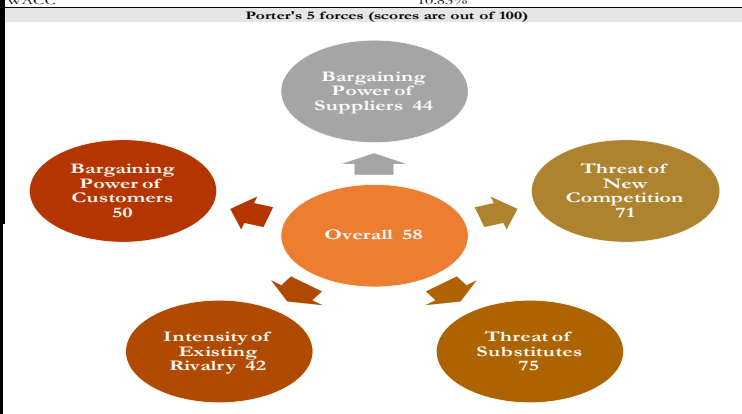
Management		Position	
Schottenstein, Jay	Executive Chairman and Chief		
Rempell, Michael	Chief Operations Officer and Global Brand President of Am		
Kessler, Charles	Chief Financial Officer and Chief Accounting Officer and Chief Global Commercial and		
Madore, Robert			
Hurd, Scott			
Horvath, Peter			

Total compensations growth		Total return to shareholders	
-100% per annum over 4y		7.56% per annum over 4y	
-100% per annum over 2y		7.65% per annum over 2y	
-100% per annum over 1y		7.83% per annum over 1y	
N/M		N/M	
N/M		0% per annum over 0y	
N/M		N/M	



Profitability		AEO (LTM)		AEO (5 years historical average)		Industry (LTM)	
ROIC	15.4%	12.14%	21.08%				
NOPAT Margin	9%	9.15%	7.1%				
Revenue/Invested Capital	1.66	1.33	2.97				
ROE	13.8%	9.16%	24.67%				
Adjusted net margin	6%	6.39%	6.5%				
Revenue/Adjusted Book Value	2.41	1.43	3.82				

Invested Funds		AEO (LTM)		AEO (5 years historical average)		Industry (LTM)	
Total Cash/Total Capital	10.9%	16.0%	17%				
Estimated Operating Cash/Total Capital	10.9%	9.8%	N/A				
Non-cash working Capital/Total Capital	3.1%	1.6%	21%				
Invested Capital/Total Capital	97.5%	91.3%	83%				



Capital Structure		AEO (LTM)		AEO (5 years historical average)		Industry (LTM)	
Total Debt/Common Equity (LTM)	0.31	0.30	0.22				
Cost of Existing Debt	22.54%	22.23%	7.32%				
Estimated Cost of new Borrowing	22.32%	22.32%	7.32%				
CGFS Risk Rating	F	F	C				
Unlevered Beta (LTM)	0.71	0.86	0.95				
WACC	10.83%	11.58%	10.15%				

Valuation		NO PAT margin		ROIC/WACC	
Base Year	3.7%	9.3%	1.43		
10/29/2017	0.3%	8.2%	1.07		
10/29/2018	0.0%	11.1%	1.38		
10/29/2019	2.3%	11.1%	0.97		
10/29/2020	1.4%	11.5%	0.99		
10/29/2021	1.8%	12.5%	1.08		
10/29/2022	2.2%	13.5%	1.18		
10/29/2023	2.6%	14.5%	1.28		
10/29/2024	2.9%	15.6%	1.38		
10/29/2025	3.3%	16.6%	1.48		
10/29/2026	3.7%	17.6%	1.58		
Continuing Period	4.1%	18.6%	1.57		

Invested Capital		Net Claims		Price per share	
Base Year	\$2,202.77	\$957.73	\$19.60		
10/29/2017	\$2,289.57	\$969.49	\$21.14		
10/29/2018	\$2,420.40	\$1,939.14	\$23.36		
10/29/2019	\$2,072.42	\$1,761.05	\$26.16		
10/29/2020	\$2,175.19	\$1,583.89	\$29.00		
10/29/2021	\$2,608.16	\$1,372.62	\$31.91		
10/29/2022	\$2,709.95	\$1,151.01	\$34.88		
10/29/2023	\$3,969.23	\$918.06	\$37.89		
10/29/2024	\$4,049.44	\$672.61	\$40.94		
10/29/2025	\$4,119.96	\$413.36	\$43.99		
10/29/2026	\$4,179.05	\$138.84	\$47.03		
Continuing Period					