

Vera Bradley, Inc.

NASDAQ: VRA

Analyst: Kara Carman
Sector: Cyclical Consumer Goods

BUY

Price Target: \$26.75

Key Statistics as of 11/10/2016

Market Price: \$14.15
Industry: Textiles, Apparel and Luxury Goods
Market Cap: \$491.0M
52-Week Range: \$10.41-20.69
Beta: 1.06
P/E: \$15.65

Catalysts:

- Holiday months expected to increase Q4 sales and operating income
- Earnings call December 7th, 2016
- New stores, including Manhattan to open in FY 2017
- Brand positioning and media plan launch in FY2017

Company Description:

Vera Bradley, Inc. designs and manufactures women's purses, totes, backpacks, accessories including eyewear, luggage and other travel items, blankets and towels, technology accessories, and other textiles. Vera Bradley has been publicly traded since 2010 and currently operates under two business segments. The direct business operations include the sale of merchandise through its e-commerce website, factory outlet stores located in the United States, and other various direct-to-consumer methods. The indirect operations include the sale of products to specialty retail and department stores, and third party sites. Dominant competitors include Coach, Kate Spade, Fossil, Michael Kors, and Vince Holding Corp. Revenues are currently up 1.1% compared to January, 2016.



Thesis

Vera Bradley, Inc. is an affordable, functional, and innovative brand that designs fashionable feminine products ranging from wallets to bedding. The company is unique due to its foundation arising from a friendship between Barbara Bradley Baekgaard and Patricia Miller, whom developed a passion-driven and customer service orientated culture. Vera Bradley has been publicly traded since 2010, and since has turned itself into an iconic, memorable women's fashion brand. For fiscal 2016, gross profit increased to 55.9% from 52.9% in fiscal 2015. With a recognizable, vibrant style, Vera Bradley maintains its strong brand identity and positioning amongst its competitors. Furthering its competitive strengths, Vera Bradley has a substantial number of loyal consumers, and a creative product development team providing those consumers with modern brand products to advocate for. November and December are huge months for Vera Bradley. Due to the holidays and gift-giving trends, higher sales and increasing operating income tend to occur during Q4. However, fluctuations do occur due to the impact of the timing of seasonal wholesale shipments and other events such as Black Friday. For the last reported fiscal year, Vera Bradley's ROIC/WACC was 1.33, whereas historically it has been 2.06. Although the company's ROIC/WACC is lower than its historical average, it remains well above the industry, suggesting that it is adding more value than its competitors. Vera Bradley is a company that has continued to add value, while continuously expanding and growing. The company is currently undervalued, priced at \$13.88.

Industry Outlook

General consumer spending trends and economic conditions impact mall traffic, therefore negatively affect any company operating a retail store within the industry. With that being said, the industry can be extremely cyclical due to seasonal trends and holidays, regardless of the state of the economy. The industry is expected to see an upward trend in the upcoming months due to the cyclical nature driven by the holiday season. The months of November and December have historically proven to generate higher revenues and operating incomes for businesses operating retail stores in the consumer cyclical goods sector. Because the industry has been experiencing

slower growth in comparison to previous years, companies need to expand into new markets and product categories using innovation and brand recognition. Vera Bradley has not only increased its focus on improving brand recognition, but a large part of its business model is centered on innovation and modernization.

Business Model

Vera Bradley operates a multi-channel distribution model designed to enable operational flexibility and increases the number of consumers who are accessed. The Direct segment consists of full-line stores, factory outlet stores, e-commerce, and the annual outlet sale. The store location selection strategy is pertinent to the success of the direct segment. Stores location decisions are made based upon demand, the location relative to moderate and high-end retailers, and other factors such as the size and shape of the actual space in which the store would be located. Vera Bradley's customer service philosophy thrives off of knowledge, openness, and passion. The indirect segment consists of the sale of Vera Bradley products at approximately 2,600 specialty retail locations such as department stores and third party e-commerce sites. The company's department store presence has nearly doubled since the spring of 2015. Vera Bradley operates under a multi-country manufacturing and supply chain. This model is intended to fulfill orders efficiently and accurately while balancing appropriate inventory levels. The company holds competitive advantage due to brand positioning and recognition, along with customer loyalty.

People

Barbara Baekgaard co-founded Vera Bradley in 1982 and has lead from various rolls since. Over time Ms. Baekgaard has served as director, Co-President, and Chief Creative Officer. Robert Wallstrom has been Vera Bradley's CEO, President and Director since November, 2013. Mr. Wallstrom served as Saks' flagship New York store's Group Senior Vice President and General Manager from 2002 to 2007. During his time there he improved merchandizing, service and consumers' in-store experience by initiating changes to return the store to its luxury heritage. From 2007 until 2013 when he joined Vera Bradley, Mr. Wallstrom was the President of

Saks Fifth Avenue's OFF 5th division. Kevin Sierks is Vera Bradley's Executive Vice President – Chief Financial Officer. Mr. Sierks has years of finance experience as he has served as the Controller at Biomet, Inc., the Director of Accounting and U.S. Shared Services at Boston Scientific, Corp. and the Director of Financial Reporting and Business Development at Guidant Corporation. In the earlier half of 2016, Vera Bradley had approximately 2,330 employees engaged in retail, 300 employees in distribution, sourcing and quality, 35 employees in product design, and 285 people employed in corporate and administrative support.

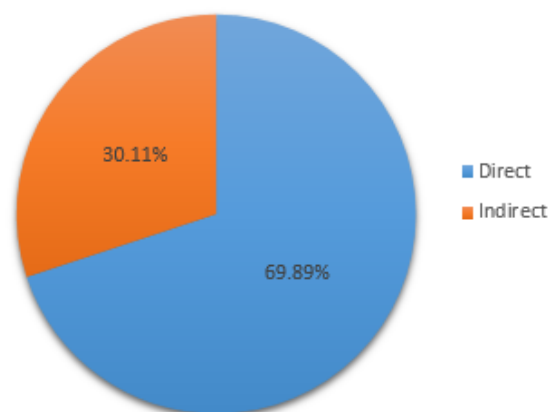
Product Differentiation

Although Vera Bradley faces strong competition in the market for handbags, the company holds a competitive advantage due to its product diversification. Vera Bradley offers products that are aesthetically appealing, are of high quality, have multi-functionalities, and are consciously priced. Over the past couple years, Vera Bradley has introduced new fabrics to its designs, setting its products apart from its competitors. Vera Bradley's travel products remain an essential differentiator for the company. Products such as collapsible luggage and chic luggage tags are not offered to the same extent by competing brands. On top of diverse products, Vera Bradley operates a unique product release strategy. Approximately eight times per year the company introduces new collections. New collections tend to consist of at least two signature patterns with smaller print and other fabric counterparts. On top of consistent new releases, the company also discontinues patterns and fabrications if they are not amongst their top performers.

Financials

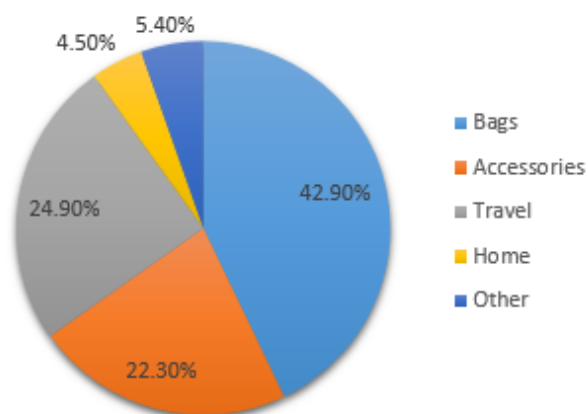
For the fiscal year end January 30th, 2016, revenues generated from the direct business segment equaled \$351,286,000 and revenues generated from the indirect segment were \$151,312,000. The revenues generated from the direct segment increased from 65.93% percent of net revenues to 69.89% while the revenues generated from the indirect segment's operations decreased from 34.07% of net revenues to 30.11% in the most recent fiscal year end. This can be partially attributed to an addition of 26 retail stores partially offset by gift card breakage which was first recognized for fiscal year 2015. The decrease of the percentage of indirect revenues is primarily due to lower orders from specialty retailers.

Portion of Revenues by Segment



Revenues can also be divided amongst five categories: bags, accessories, travel, home and other including apparel and footwear, stationary, gift cards, and licensing revenue. For the fiscal year ending January 30th, 2016, revenues generated from the sale of bags amounted to 42.9% of net revenue, accessories revenue was 22.3%, revenue from travel products was 24.9%, and sales from home products accounted for 4.5% of net revenues.

Revenues by Product Category



The gross margin increased from 52.9% to 55.9% year over year for fiscal 2016. The margin increase can be attributed to lower product costs, increased sales of higher-margin products, less promotional activity and lower levels of liquidation sales. In comparison to its competitors, Vera Bradley's operating income margin is well within the industry average. Its competitors Kate Spade and Coach are the only companies operating nearly as efficiently as Vera Bradley. The company's increased selling, general and administrative expenses for fiscal 2016 is due to an employee severance expense and a retail store early termination agreement, both of which are items that didn't occur to the same extent in the previous fiscal year. Vera Bradley also increased investments in new retail stores and increased marketing

and advertising efforts. Vera Bradley's primary source of liquidity is cash flows from operations which suggests it is running healthy business operations. The company currently has no long- or short-term debt and as of January 30, 2016 had \$125 million available to borrow. This is significant because Vera Bradley has the means to further growth and expansion.

Growth Strategies

Vera Bradley's ideal target consumer is the "Day Maker" which the company has defined as one who is thoughtful, organized and expresses beauty and femininity through prints, colors, and details. In order to deliver the Day Maker "beautiful solutions", Vera Bradley has a strategic growth plan focused on marketing, distribution channels, and product offerings. Five key businesses make up the product offerings deemed necessary to spur future growth. Such businesses include fashion bag and accessories, campus, home, travel, and wellness and beauty. Pattern and fabric innovation, along with modernity are key to future growth. Vera Bradley continues to focus on growing its direct and indirect channel relationships and works towards strengthening its specialty retail channel. Four new full-line stores are set to open in FY2017, including a store in Manhattan, along with six new factory outlet stores. In order to stay current and continue to grow, Vera Bradley discontinues unproductive specialty retail accounts while adding newer relevant accounts. In FY2016 Vera Bradley's marketing focus was increasing brand awareness, whereas for FY2017, its focus is on growing brand relevancy, desire and consumers' purchase intent. In FY2017 Vera Bradley is also activating its new branding and brand positioning, including an updated logo along with a media plan to target its "Day Maker" consumers.

Important Dates and Catalysts

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Summary

Vera Bradley is an iconic brand that has proven its intent to further growth and market reach. While developing unique growth strategies, Vera Bradley maintains multi-faceted competitive strengths. Aside from being functional and relatable, Vera Bradley is affordable and recognizable. With various catalysts approaching in the near future, along with some expected to occur in the next year or so, Vera Bradley has multiple opportunities to set itself apart from its competitors even further than it already has. The upcoming holiday season is promising in regards to net revenues. The increase in net revenues is expected to remain steady or take off even further after the introduction of new strategic brand positioning and media plans start to produce beneficial results.

Vera Bradley, Inc. (VRA)

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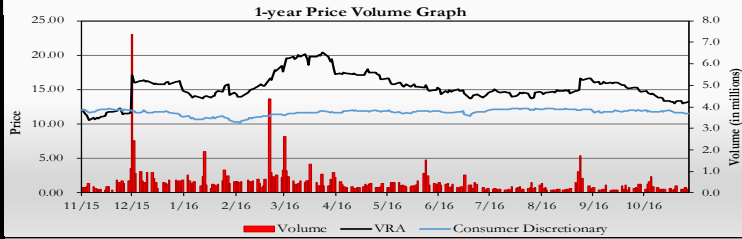
BULLISH

Analysis by Kara Carman
11/10/2016

Current Price: **\$13.88**
Divident Yield: **0.0%**

Intrinsic Value: **\$24.28**
Target Price: **\$26.75**

Target 1 year Return: 92.72%
Probability of Price Increase: 100%

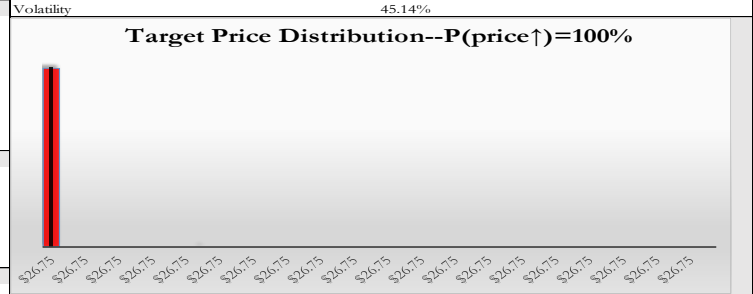


Description	
Vera Bradley, Inc., together with its subsidiaries, designs, manufactures, and sells handbags, accessories, and luggage and travel items for women of all ages under the Vera Bradley brand.	
General Information	
Sector	Consumer Discretionary
Industry	Textiles, Apparel and Luxury Goods
Last Guidance	November 3, 2015
Next earnings date	December 7, 2016
Estimated Country Risk Premium	6.00%
Effective Tax rate	40%
Effective Operating Tax rate	40%

Market Data	
Market Capitalization	\$507.81
Daily volume (mil)	0.15
Shares outstanding (mil)	36.59
Diluted shares outstanding (mil)	37.77
% shares held by institutions	75%
% shares held by investments Managers	47%
% shares held by hedge funds	8%
% shares held by insiders	48.98%
Short interest	8.18%
Days to cover short interest	11.33
52 week high	\$20.69
52-week low	\$10.41
Levered Beta	0.10
Volatility	45.14%

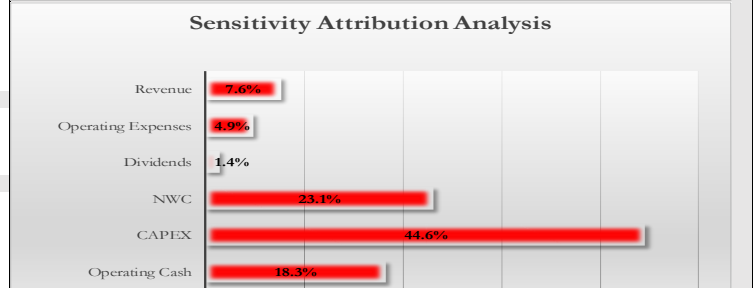
Past Earning Surprises	
Quarter ending	Revenue
8/1/2015	3.07%
10/31/2015	3.83%
1/30/2016	0.00%
4/30/2016	-3.01%
7/30/2016	-1.45%
Mean	0.49%
Standard error	1.3%

EBITDA	
8/1/2015	12.51%
10/31/2015	22.94%
1/30/2016	15.25%
4/30/2016	-14.41%
7/30/2016	14.85%
Mean	10.23%
Standard error	6.4%



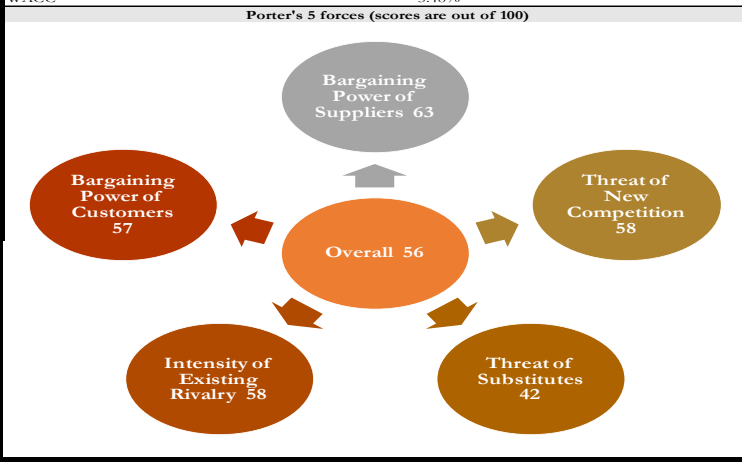
Management	
Wallstrom, Robert	Chief Executive Officer, Pre
Baekgaard, Barbara	Co-Founder, Chief Creative O
Miller, Patricia	Co-Founder and Director
Sierks, Kevin	Chief Financial Officer and
Fuller, Sue	Chief Merchandising Officer
Sours, Pamela	Senior Vice President of Ope

Total compensations growth	
18.92% per annum over 3y	-11.48% per annum over 3y
-0.83% per annum over 5y	-6.46% per annum over 5y
22.87% per annum over 5y	-6.46% per annum over 5y
37.49% per annum over 4y	-4.72% per annum over 4y
35.2% per annum over 3y	-11.48% per annum over 3y
N/M	N/M



Profitability	
ROIC	8.9%
NOPAT Margin	13%
Revenue/Invested Capital	0.68
ROE	11.6%
Adjusted net margin	13%
Revenue/Adjusted Book Value	0.92
Invested Funds	
Total Cash/Total Capital	9.9%
Estimated Operating Cash/Total Capital	6.4%
Non-cash working Capital/Total Capital	11.0%
Invested Capital/Total Capital	96.5%
Capital Structure	
Total Debt/Common Equity (LTM)	0.55
Cost of Existing Debt	1.05%
Estimated Cost of new Borrowing	1.00%
CGFS Risk Rating	AAA
Unlevered Beta (LTM)	0.08
WACC	3.48%

Peers	
Kate Spade & Company	
Coach, Inc.	
Vince Holding Corp	
Oxford Industries Inc.	
Fossil Group, Inc.	
Movado Group, Inc.	
Iconix Brand Group, Inc.	
PVH Corp.	
Total return to shareholders	
-11.48% per annum over 3y	
-6.46% per annum over 5y	
-6.46% per annum over 5y	
-4.72% per annum over 4y	
-11.48% per annum over 3y	
N/M	



Porter's 5 forces (scores are out of 100)	
Overall 56	
Bargaining Power of Suppliers 63	
Threat of New Competition 58	
Threat of Substitutes 42	
Intensity of Existing Rivalry 58	
Bargaining Power of Customers 57	

Valuation	
NOPAT margin	13.0%
ROIC/WACC	2.55
Net Claims	\$24.25
Price per share	\$26.16