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BJORKLUND FUND

November 1, 2017

Five Below: FIVE

Hunter Sanna

Sector: Consumer Goods
Industry: Apparel Stores
Current Price: $56.90
Target Price: $62.88

Company Description: Five below is a specialty retailer who offers a range of trend-right, high-quality merchandise targeted to the teen and pre-teen customer. The offer a dynamic, edited assortment of products, all priced $5 and below. Five Below offers select brands and licensed merchandise over specific categories, which are transforming the shopping experience to a target demographic group.

BUY

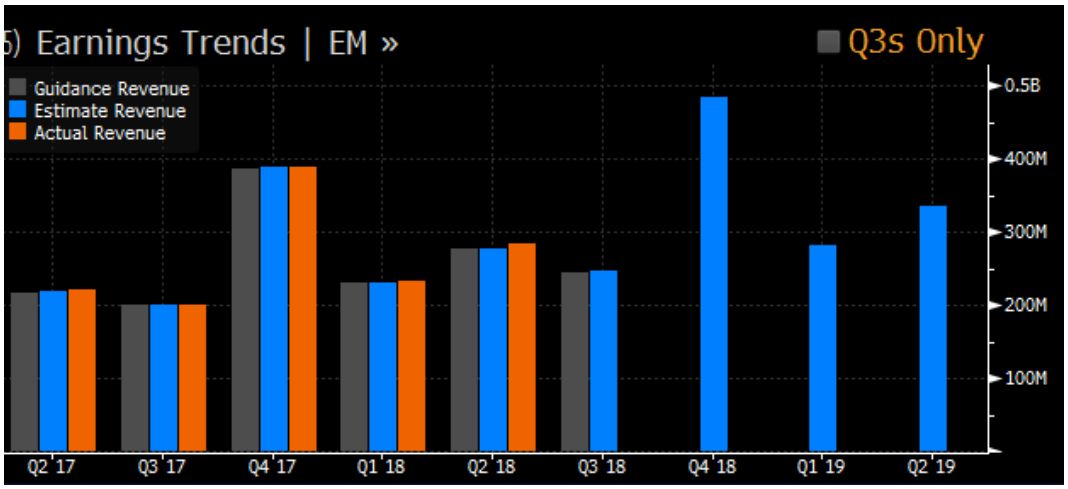
Current Price:	$56.90
Target Price:	$62.88
Market Cap:	$3.04B
Volume:	729,551
Profit Margin:	33.18%
EBITDA Margin:	14.13%
ROIC:	24.99%
WACC:	8.31%

Catalysts:

- **Short Term**: With the holiday season approaching, Five Below is expecting to see a large jump in sales.
- **Mid Term**: Management will keep up with trendy items in the market to gain more sales.
- **Long Term**: An increase in store locations should let Five Below maintain organic growth, which allows for sustainable foot traffic at various locations.

Thesis: Five Below has proven to outpace competitors by nearly 10% in revenue growth, while outpacing industry-operating margins by around 3%. Management is currently expanding into the market place by opening 100 new stores this year. At a low valuation, Five Below's formidable past figures and success during a busy holiday season bring about a positive outlook for shareholders.

Earnings Performance:



Five below has been experiencing solid growth in the past year and in the previous quarter. They have increased their net sales 28.7% to $283.3 million. Along with this, opened 33 new stores and experienced an increase of two more stores in the previous quarter of 2017. They ended quarter two with 584 stores and are on track to reach their 100-store roll out by the end of the year. Comparable sales for the quarter increased 9.3%, which is a significant difference compared to their competitors who are currently at 3.1%. This comparable sales increase was likely due to an increase in comparable transactions. Another growth driver this quarter was the trendy product the fidget spinner, which is hard to quantify, but it did introduce many new customers to the Five Below brand.

Gross profits increased 34.4% this quarter to $98.5 million up from $73.4 million during last years second quarter. Additionally, gross margin was positively impacted last quarter jumping 145 basis points to 34.8%. This jump in margins was due to improved merchandise margins from more profitable spinner sales. SG&A costs also decreased from 26.2% to 25.5% compared to the second quarter, which was due to a leveraging of expense on higher sales results. Operating income as a percent of sales increased to 9.3% up from last years quarter two which was at 7.1% of sales. Net income increased 70.7% to $16.8 Million, which resulted in generation of $167.5 million. Inventory was relatively flat compared to the second quarter last year.

During the hurricane season, hurricane Harvey put the city of Houston underwater, which resulted in the temporary close of 23 store locations within the metro area. As of today, four stores have reopened and they believe that only a handful of stores were seriously damaged.

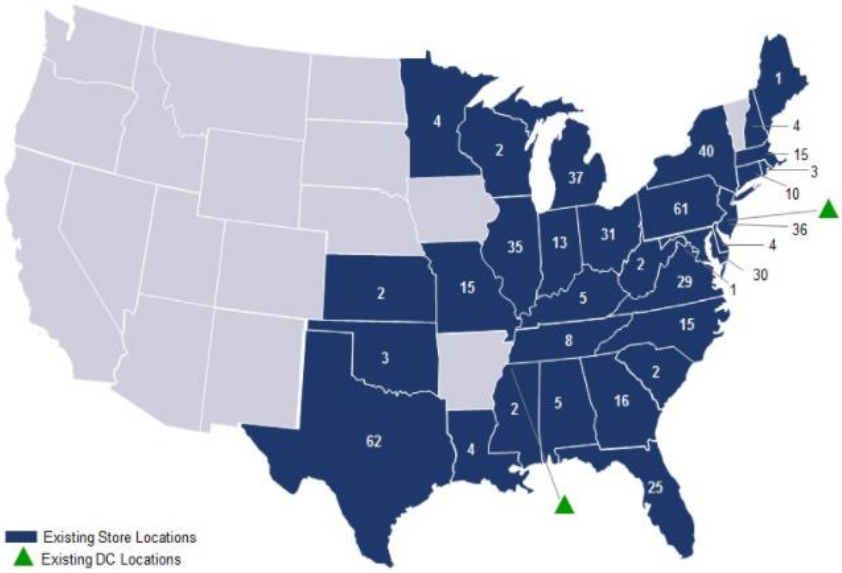
Industry Outlook:

The retail industry is an extremely stable market and results should thus remain relatively steady. The biggest competitor to retailers currently is Amazon, who has been preforming well throughout the years. Since Five Below only offers products that are below five dollars, they are not as affected as much other brands. This is due to the fee that one has to pay Amazon to hold and ship their

products. The current fee is around $2.99 to outsourcing to amazon which makes profit margins low so there is very little upside to have products that are this cheap to be on Amazons market. Innovation within this market is the key success factor and many companies position themselves on the cutting edge of innovation to stay relevant.

The economics of retail is strong, as consumers spending appears to be solid as of late. The labor market also continues to strengthen which leads to more disposable income for people to buy products. The average hour rate is also strong which means that all retails should see growth rates in the positive numbers. With consumer confidence also at an all-time high there should be strong performance in this sector especially with the holiday season around the corner.

Store Location:



Five Below currently has opened more than 522 stores and plans to expand by opening 100 more store this year. When they are determining where to open new stores they are very specific on how they lease out real estate. They only open new stores that contain at least three big box retailers (stores with floor space over 50,000 square feet) nearby and various smaller retailers with a common parking area. In addition to target their demographic they try to open in suburban areas that combines the traditional retail functions of a shopping mall with amenities oriented towards upscale customers. Five Below also targets community shopping centers that have a variety of discount, junior department and supermarkets to receive the maximum foot traffic past their stores. Another area they try to target are trade areas which can vary based on geographic size, population density, demographics and proximity to alternative shopping opportunities. Currently, Five Below is located across 32 states and based in the northeastern and southeastern but at the end of 2017 they plan on opening 15 stores into California, which is a very trendy area and a growth opportunity.

Company Strengths:

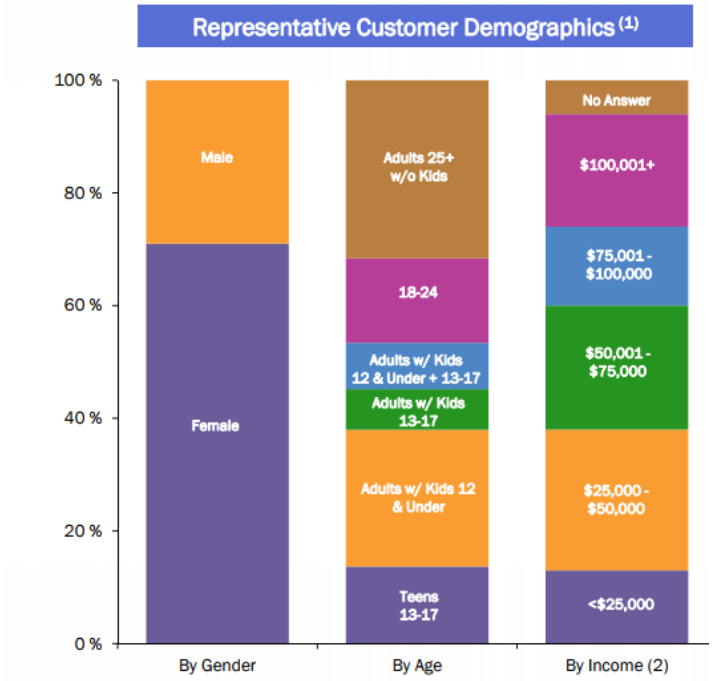
<u>Unique focus on Customer:</u>

The target audience for Five Below is mainly teens and pre-teens, which they leverage with trendy products that have high demand. They have built their entire concept around appealing specifically to their market and at a differentiated price point. The store layout also has an upbeat and lively ambience to drive

foot traffic into the store, while keeping the customer engaged in the store. Five Below is consistently analyzing trends within the changing teen and pre-teen market space to be responsive to the market and have products that become mainstream. The pricing of their products also allow teens to shop independently at Five Below and to be a repeat customer of these trendy products. Five

Trend right Products:

Five Below offers trend-right and everyday products to the customers in each category world they operate in. They positon themselves so that the products that are in high demand can be easily accessible for a cheap price. With a broad range of vendor mainly sourced domestically, they can easily obtain these trendy products at a fast rate and limit the cyclical period the product has. With these trendy products, they can be in extreme high demand where many other retailers will sell out due to the response time Five Below has with their domestic vendors. However, this does not happen quite as often.



Value Items for Customers:

Due to the unique pricing model Five Below has, there is a clear value proposition to their customer base. With their target audience, it is hard for teens to buy items that are pricy due to various reasons, but at Five Below they can get many products for the same amount of cash they would spend on one item elsewhere. Along with this, they have an opportunistic buying strategy to capitalize on excess inventory with their vendor. Many other vendors do not have this advantage.

Management Team:

Five Below has a very experienced management team with a wide variety of skills which include merchandising, real estate, store operations, finance, supply chain management, and information technology. With this teams background they drive a strong operating philosophy, which is focused on providing their customers with high quality merchandise at a great value.

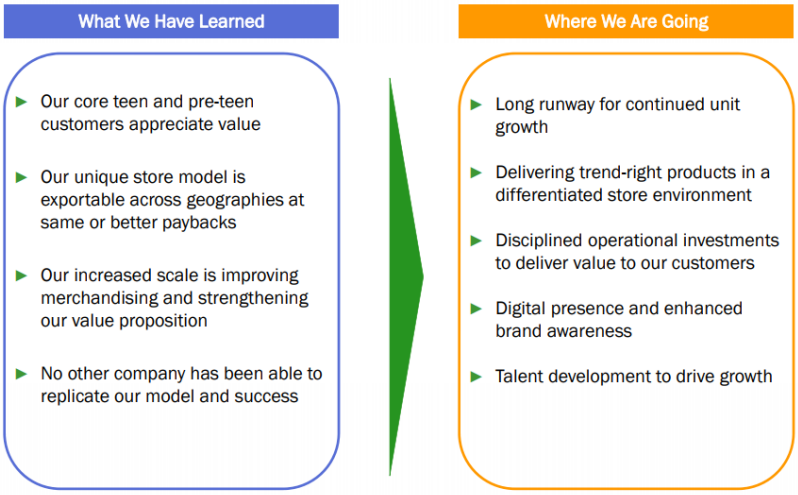
Growth Strategy:

Grow Store Base:

A major driver of growth within the retail industry is to expand store bases to draw more foot traffic into their stores. Management plans on opening 100 new stores across a wider geographic base this year to extend their reach and drive their brand awareness. Their long-term goal is to grow their store base to 2,000 locations within the United States. Their main store size is about 8,000 square feet, which is specifically

strategized to have customers buy their products. Five Below also has a talented real estate management team who picks their locations based on their strict guidelines. When opening new stores the team looks at performance of surrounding stores, foot traffic, and other site characteristics to ensure success at the location.

Drive Comparable Sales:



Comparable sales are the amount of revenue a store generates compared to its similar period in the past. This measure is a good indicator of growth within the retail industry because there are seasonality effects within this space and can skew the number if looked at by prior period. Where Five Below differentiates themselves with competitors is in this segment. This current year Five Below has produced comparable sales of 2%, while their main competitors Dollar tree and Dollar genera are at 1.8% and .9% respectfully. Five Below does this much better than their competitors by refining their merchandising offerings and a differentiated in-store shopping experience. To drive people back to these stores, they have an efficient marketing efforts and good customer engagement.

Increase Brand Awareness:

While capitalizing on marketing is a key success factor to raise brand awareness it is useless if not done properly. Five Below's current marketing strategy is mainly focused in the digital platforms that teens are consistently using. A major player for their campaign is to drive their social media presence to increase brand awareness at a decent cost. They also have an operating website to drive customers into their stores and increase their email list to get data on customer's needs.

Holiday Season:

Due to major events in the fourth quarter, the retail sector experiences a positive seasonality effect. Starting after thanksgiving, with the huge sale day of black Friday consumers are on the hunt to start buying bargains and gifts for their significant others. With these large shopping days ahead and how Five Below positions their stores near large retailers and heavy foot traffic areas the chance of them capitalizing on other stores customers are very high. Based on surveys, about 61% of people plan to shop on black Friday either online or going to stores to take advantage of these sales. Many people like the idea of e-commerce but with Gen-xer's and baby boomer still accounting for the majority of the population, people will still go into retail stores to buy their kids toys and stocking stuffers. With a cheap price and small toys to fill up the stockings on Christmas Five Below will capitalize on the upcoming holidays approaching. In addition, Five has historical seen almost double the revenue they receive in the fourth quarter compared to any other quarter.

Conclusion:

Five Below is a smart buy before their biggest earnings period hits. The majority of their revenue is based in the last quarter of the year due to the holiday season, which we will be able to see in the stock price. With growth rates above competitors and the continue opening of new stores, Five Below is in a growing trend which we will see in the years ahead.

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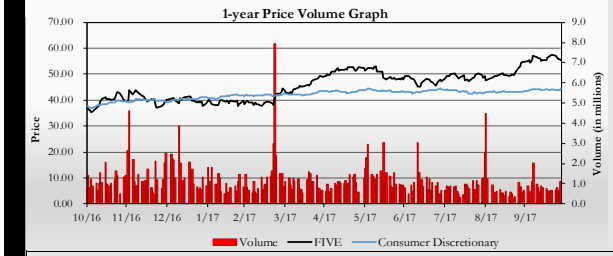
Five Below, Inc. (FIVE) — CENTER FOR GLOBAL FINANCIAL STUDIES — NEUTRAL

Analysis by Hunter Sanna	Current Price:	$55.25	Intrinsic Value	$56.95	Target 1 year Return: 14.27%
11/2/2017	Divident Yield:	0.5%	Target Price	$62.88	Probability of Price Increase: 85%



Description

Five Below, Inc. operates as a specialty value retailer in the United States.

General Information

Sector	Consumer Discretionary
Industry	Specialty Retail
Last Guidance	November 3, 2015
Next earnings date	December 2, 2017
Estimated Country Risk Premium	4.88%
Effective Tax rate	40%
Effective Operating Tax rate	40%

Market Data

Market Capitalization	$3,049.78
Daily volume (mil)	0.65
Shares outstanding (mil)	55.20
Diluted shares outstanding (mil)	55.32
% shares held by institutions	116%
% shares held by investments Managers	100%
% shares held by hedge funds	7%
% shares held by insiders	2.52%
Short interest	13.25%
Days to cover short interest	8.60
52 week high	$58.07
52-week low	$35.03
Volatility	37.19%

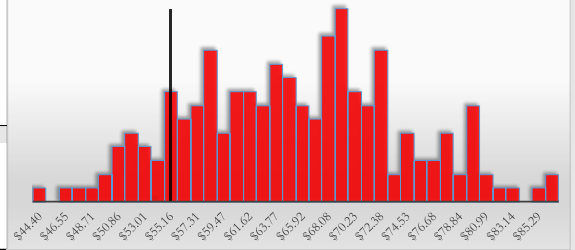
Past Earning Surprises

Quarter ending	Revenue	EBITDA
7/30/2016	0.56%	1.26%
10/29/2016	-0.81%	2.67%
1/28/2017	0.18%	0.06%
4/29/2017	0.99%	2.70%
7/29/2017	2.50%	13.12%
Mean	0.68%	3.96%
Standard error	0.5%	2.3%

Peers

Dollar General Corporation
Dollar Tree, Inc.
Tractor Supply Company

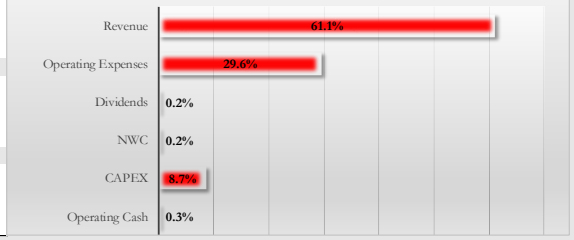
Intrinsic Value Distribution--Probability (Upside)=85%



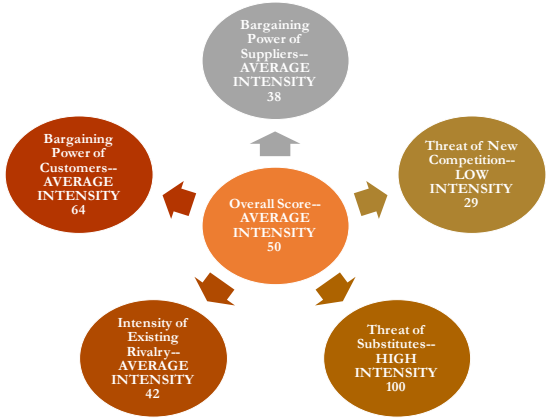
Management	Position	Total compensations growth	Total return to shareholders
Vellios, Thomas	Co-Founder & Executive Chair	-25.52% per annum over 5y	N/M
Anderson, Joel	President, CEO & Director	-28.56% per annum over 2y	-1.96% per annum over 2y
Bull, Kenneth	CFO & Treasurer	17.96% per annum over 5y	N/M
Specter, Eric	Chief Administrative Officer	-27.11% per annum over 2y	-1.96% per annum over 2y
Romanko, Michael	Executive Vice President of	20.56% per annum over 2y	-1.96% per annum over 2y
Rosadino, Eugene	Senior Vice President of Sup	N/M	N/M

Profitability	FIVE (LTM)	FIVE (5 years historical average)	Peers' Median (LTM)
Return on Capital (GAAP)	17.1%	32.75%	9.53%
Operating Margin	6%	6.00%	4.49%
Revenue/Capital (GAAP)	2.67	5.46	2.12
ROE (GAAP)	18.0%	-88.7%	22.1%
Net margin	6.1%	5.5%	4.9%
Revenue/Book Value (GAAP)	2.95	-16.27	4.54
Invested Funds	**FIVE (LTM)**	**FIVE (5 years historical average)**	**Peers' Median (LTM)**
Cash/Capital	16.9%	42.3%	2.4%
NWC/Capital	10.9%	18.9%	14.4%
Operating Assets/Capital	72.2%	38.9%	59.5%
Goodwill/Capital	0.0%	0.0%	23.7%
Capital Structure	**FIVE (LTM)**	**FIVE (5 years historical average)**	**Peers' Median (LTM)**
Total Debt/Market Capitalization	0.35	0.53	0.58
Cost of Existing Debt	11.5%	10.8%	4.6%
CGFS Rating (F-score, Z-score, and default Probability)	AA	BB	BBB
WACC	15.5%	16.2%	8.3%

Sensitivity Attribution Analysis



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue Growth Forecast	NOPAT Margin Forecast	Revenue to Capital Forecast
Base Year	21%	10.0%	2.13
7/29/2018	21%	10.7%	1.96
7/29/2019	20%	10.6%	1.78
7/29/2020	5%	10.2%	1.50
7/29/2021	23%	9.5%	1.51
7/29/2022	10%	9.6%	1.45
7/29/2023	9%	9.9%	1.34
7/29/2024	8%	10.2%	1.24
7/29/2025	7%	10.4%	1.16
7/29/2026	5%	10.7%	1.09
7/29/2027	4%	11.0%	1.01
Continuing Period	3%	11.2%	0.94

Period	Return on Capital Forecast	WACC Forecast	Price per share Forecast
Base Year	21.3%	15.5%	$57.02
7/29/2018	21.0%	8.7%	$62.71
7/29/2019	18.9%	9.2%	$68.65
7/29/2020	15.4%	8.2%	$74.17
7/29/2021	14.3%	8.6%	$80.31
7/29/2022	13.8%	8.6%	$86.74
7/29/2023	13.2%	8.0%	$93.13
7/29/2024	12.6%	8.0%	$99.80
7/29/2025	12.1%	8.1%	$106.79
7/29/2026	11.6%	8.1%	$113.90
7/29/2027	11.1%	8.1%	$121.33
Continuing Period	10.5%	8.0%	