

Urban Outfitters Inc.

NASDAQ:URBN

Analyst: Justin Capuano

Sector: Consumer Disc.

BUY

Price Target: \$42

Key Statistics as of 10/21/2016

Market Price:	\$33.58
Industry:	Specialty Apparel Stores
Market Cap:	\$3.92B
52-Week Range:	\$19.26-\$37.82
Beta:	0.67

Catalysts:

- Execution of opening new store openings in Europe
- Results from expanding store size and product diversification
- Q3 FY2017 Earnings Report

Company Description:

Founded in 1970 in Philadelphia, Pennsylvania, Urban Outfitters Inc. is a leading lifestyle specialty retail company that operates under the brands Urban Outfitters, Anthropologie, and Free People and a wholesale operation under the Free People brand. The company retails women's and men's fashion apparel, intimates, footwear, beauty, home and apartment goods, active-wear, and electronics to young adults aged 18 to 28 under the Urban Outfitters brand; and an assortment of fashionable women's apparel, accessories, wedding dresses, home goods, jewelry and more for women aged 20-40 under the Anthropologie brand; and a merchandise mix of casual women's apparel, home products, and more for women aged 25-30 under its Free People retail and wholesale brand. Urban Outfitters core strategy is to provide unified environments that establish emotional bonds with the customers. In addition to brick and mortar retail stores, they sell and market their products directly to the consumer through e-commerce websites, mobile applications, and catalogs.



Thesis

A declining apparel industry and economic uncertainties was no match for Urban Outfitters as they are coming off a record setting level of second quarter sales of \$890.6 million. Even with high mark ups, customers are buying the latest fashions, accessories, and home goods at Urban Outfitter brand stores because of its superior shopping conditions. Plans to expand organically and geographically enable operating and logistical cost reductions and position the company to outperform its competitors in the following years. The company is financially sound and has favorable credit terms that will allow growth to occur.

Industry Outlook

The specialty retail industry is highly competitive and is extremely dependent on finding ways to cater to the evolving shopping patterns of the consumer. The emergence of online shopping has disrupted the conventional business model as consumers are turning away from buying products in brick and mortar stores. E-commerce growth has resulted in many store closings around the world and is a large factor for the increased level of consolidation among the industry's competitors in order to reduce operating costs and price competition. Today's customers are expecting high quality and on-demand customized products at fast shipping speeds. Awareness and execution in determining the latest and next seasons fashion trends to attract target customers are important factors in differentiating the top companies within the industry. The specialty retail industry has exceedingly outperformed the S&P 500 benchmark over the past 5 years. However, the industry has underperformed the market in the past year due to macro events like suppressed consumer spending on clothing, product cost inflation, volatility in commodity costs, and currency factors.



Business Model

Retail stores are placed in locations that put an emphasis on heavy foot traffic such as large metropolitan areas, select college communities, enclosed malls, and upscale urban and suburban streets. Each store is creatively designed to incorporate the tastes of the dynamic urban millennial. Merchandise is distributed to its stores throughout the world from the URBAN owned and operated distribution and fulfillment centers in Gap, Pennsylvania and Reno, Nevada to cover North American stores and leased centers in England to cover all European orders. Although a small portion of total sales, the Free People wholesale segment operates using a shop within shop sales model in over 1,800 department stores including Macy's, Nordstrom, and Bloomingdale's. The shop within shop strategy strengthens the brands image and benefits the entire company by providing insight on what styles and products are popular with customers shopping in other retail stores. Urban Outfitters markets its merchandise and brand name by using an omni-channel strategy that integrates all available shopping channels, including brick and mortar stores, websites, mobile applications, and hard copy catalogs. Fully functional omni-channel systems are necessary because of the growing importance of e-commerce and reliance on capturing large portions of the target customer base. Strategic plans to invest in omni-channel marketing and technology advancements are currently in place to improve inefficiencies and to provide the optimal shopping experience to the customer.

Expansion

Distribution Facilities: In June 2015, the company opened a 1 million square foot fulfillment center in

Gap, Pennsylvania, adding to the state of the art 291 thousand square foot distribution center in the same town. The new building will provide cost reductions for inventory hold and shipments. Compared to the old fulfillment facility in South Carolina, the Gap facility is conveniently located near major cities in the north east United States, allowing for overnight shipping to meet customer demand. The benefit of cost reductions and improved margins will increase over time as the transition to the new building is complete.

European Stores: The impact of the lower consumer spending in US stores is being felt by the specialty retail industry as a whole. Urban Outfitters plans to combat the weak domestic store sales by expanding their presence in Europe. At the end of Q2 2017, there were 499 stores in the US, 53 in Europe, and 36 in Canada, totaling 588. Domestically, the busy city streets are flooded with retail stores. The plan for the end of FY 2017 is to open at least 1 Urban Outfitters, 3 Anthropologie stores, and 2 additional Free People stores in Europe. European expansion provides a diversification safety net if the rate of consumer spending continues to decline in future years and establishes a foreign footing for potential expansion in to Asia in future years.

Products:

Product Expansion

EXPAND PRODUCTS & SERVICES

Expand existing categories: e.g.
 Anthropologie – Home
 Urban Outfitters – Beauty, Shoes
 Free People – Intimates, Party Dresses

Offer new categories: e.g.
 Anthropologie – Beauty, Registry
 Urban Outfitters – Without Walls
 Free People – FP Movement

Source: Urban Outfitters, Company Presentation, 2014

Product diversification provides Urban outfitters with a competitive advantage because they do not have an independent reliance on apparel sales, and also, a large portion of their product lines are exclusive to the company. Different and exclusive products attract an increase in foot traffic to stores and more website hits because the wide variety of products are not offered at competing locations. Over 90% of all women’s apparel in Q2 2017 was exclusive to the namesake brand. The Home and Apartment category has the most potential for future growth within all of the

brands because millennials are shopping at Urban Outfitters fulfil their college dorm room and first apartment needs. The company is well positioned to take on the extra growth and transition its focus towards the Home and Apartment product line. Anthropologie displayed a surprising positive (exact rate was not disclosed) growth rate in Q2 2017.

Anthropologie: Urban Outfitters acquired Vetri Family in Q1 2017, a small chain of family owned Italian restaurants, in \$10 mill all cash deal to add flavor to its Anthropologie stores. They will open 2 standalone restaurants and 2 will be attached to the newly expanded Anthropologie stores to improve the customer shopping experience. Anthropologie is experimenting by remodeling 2 of its store fronts to measure around 25,000 square feet compared to the average of 7,000 square feet. The test provided positive results because each store reported a greater value of sales per square feet (value not disclosed) than the average of \$.20 per square foot for normal Anthropologie stores. This increase may be attributed to the hype and excitement around the openings of the restaurant chain and the newly expanded stores, but management must be impressed because there are plans to expand the size of more stores in late FY 2017.

Financials and Competitors

	Statistics		
	2014	2015	2016
Revenue Growth	10.40%	7.70%	4.00%
Gross Profit Margin	37.60%	35.40%	35.10%
Operating Margin	13.83%	11.00%	10.26%
S, G, & A Margin	23.80%	24.40%	24.60%

It is important to remember that Q2 of FY2017 produced the highest level of quarterly sales in the history of the company as a result of the exclusivity of the products and high markups. The company’s products are currently in high demand even at higher prices. However, the snapshot of the Urban Outfitters’ financials display a year over year decay in growth and margins. Macro level effects like a decline in consumer spending on apparel, high competition within the retail industry, the emergence of online sales, and currency fluctuations played a large role in the decline in past performance. However, in 2016,

Urban Outfitters is outperforming its competitors in terms of revenue growth, 4% compared to the 3.08% industry average. In 2014, management set the goal of doubling sales to \$6 billion by 2020, requiring double digit revenue growth every year until then. Urban Outfitters has produced greater returns from its operations based on the industry average 9.67% operating margin. S,G,&A plays the biggest role in the diminishing operating margin due to the increase in administrative costs from expanding internationally and from the additional labor expenses. This trend will continue if management stays at its desired level of growth, but growth in revenue will offset the added expenses.

ROIC /WACC		
	<i>History</i>	<i>LFY</i>
URBN	2.52	2.10
Competitors	1.94	1.80

WACC			ROIC		
	<i>History</i>	<i>LFY</i>		<i>History</i>	<i>LFY</i>
URBN	10.1%	9.5%	URBN	22.4%	20.1%
Competitors	12.3%	11.9%	Competitors	23.1%	21.4%

Historically, Urban Outfitters has created more value compared to its competitors with respective ROIC to WACC values of 2.10 and 1.8 for the past fiscal year. Even with a high debt to equity ratio compared to the industry, 0.45 and 0.24 respectively, the company has favorable costs of debt. A high amount of debt is attributed toward the financing of the 1 million square foot distribution facility, an investment that is sure to pay itself off in the long run. The additional value added may signal that the company is undervalued because it is behind its peers in sales growth and other metrics. They are efficiently using cash and long term debt to finance future growth while never acquiring short term debt.

Summary

There is heavy risk involved in trying to expand in a declining market. However, Urban Outfitters is positioned to steal customers away from its competitors. Customers are the ultimate driver of value and they are recognizing the brand is selling the latest trends at the highest quality. Due to Urban Outfitter's plans for growth, cost reductions, and superior product lines, I propose that the stock will be a fitting addition to the portfolio with a BUY at \$33.00.

Urban Outfitters Inc.
(URBN)

CENTER FOR GLOBAL FINANCIAL STUDIES

BULLISH

Analysis by Justin Capuano
10/21/2016

Current Price:
Dividend Yield:

\$33.64
0.0%

Intrinsic Value
Target Price:

\$36.81
\$42.16

Target 1 year Return: 25.33%
Probability of Price Increase: 95%

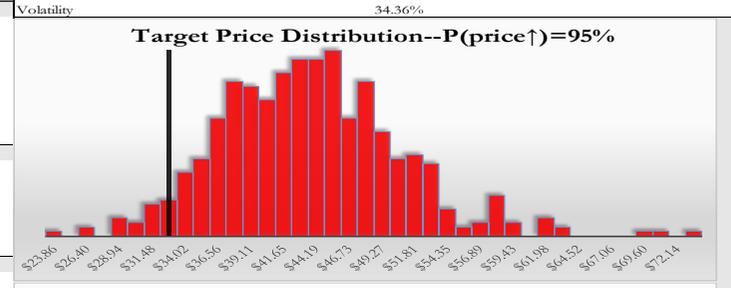


Description	
Urban Outfitters, Inc., a lifestyle specialty retail company, engages in the retail and wholesale of general consumer products.	
General Information	
Sector	Consumer Discretionary
Industry	Specialty Retail
Last Guidance	November 3, 2015
Next earnings date	November 22, 2016
Estimated Country Risk Premium	6.77%
Effective Tax rate	36%
Effective Operating Tax rate	46%

Market Data	
Market Capitalization	\$3,943.50
Daily volume (mil)	0.92
Shares outstanding (mil)	117.23
Diluted shares outstanding (mil)	119.29
% shares held by institutions	80%
% shares held by investments Managers	65%
% shares held by hedge funds	9%
% shares held by insiders	23.91%
Short interest	8.63%
Days to cover short interest	4.32
52 week high	\$37.82
52-week low	\$19.26
Levered Beta	1.03
Volatility	34.36%

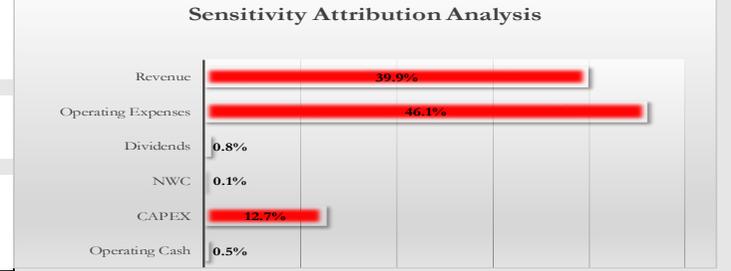
Past Earning Surprises	
Quarter ending	Revenue
7/31/2015	-4.59%
10/31/2015	-7.30%
1/31/2016	-3.12%
4/30/2016	-5.27%
7/31/2016	-4.23%
Mean	-4.91%
Standard error	0.7%

EBITDA	
7/31/2015	-1.51%
10/31/2015	-9.56%
1/31/2016	2.88%
4/30/2016	-1.70%
7/31/2016	2.54%
Mean	-1.47%
Standard error	2.2%



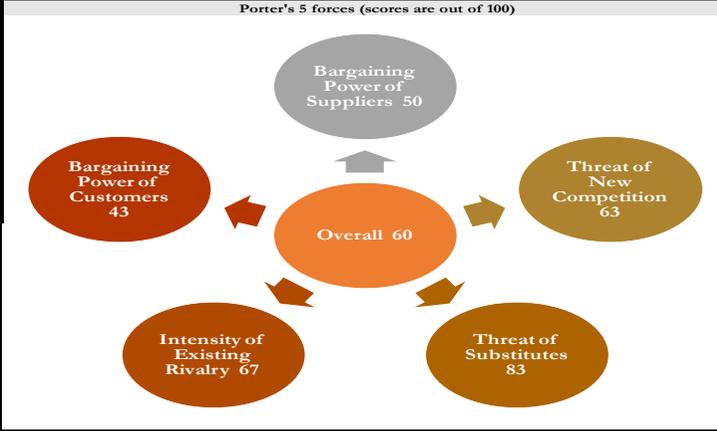
Management		Position	
Hayne, Richard	Co-Founder, Chairman of The		
McCreight, David	President and Chief Executive		
Belair, Scott	Co-Founder, Director and Mem		
Conforti, Francis	Chief Financial Officer		
Hollinger, Calvin	Chief Operating Officer		
Hayne, Margaret	Chief Creative Officer, Pres		

Peers	
Abercrombie & Fitch Co.	
American Eagle Outfitters, Inc.	
Chico's FAS Inc.	
The Gap, Inc.	
L Brands, Inc.	
Genesco Inc.	
Michael Kors Holdings Limited	
Express Inc.	



Profitability		URBN (LTM)		URBN (5 years historical average)		Industry (LTM)	
ROIC	8.2%	15.18%	21.85%	15.18%	21.85%	15.18%	21.85%
NOPAT Margin	7%	13.06%	7.53%	13.06%	7.53%	13.06%	7.53%
Revenue/Invested Capital	1.17	1.16	2.92	1.16	2.92	1.16	2.92
ROE	10.5%	15.91%	26.05%	15.91%	26.05%	15.91%	26.05%
Adjusted net margin	5%	11.95%	6.8%	11.95%	6.8%	11.95%	6.8%
Revenue/Adjusted Book Value	1.96	1.33	3.86	1.33	3.86	1.33	3.86

Invested Funds		URBN (LTM)		URBN (5 years historical average)		Industry (LTM)	
Total Cash/Total Capital	9.7%	12.5%	19%	12.5%	19%	12.5%	19%
Estimated Operating Cash/Total Capital	7.8%	6.9%	N/A	6.9%	N/A	6.9%	N/A
Non-cash working Capital/Total Capital	6.4%	5.7%	19%	5.7%	19%	5.7%	19%
Invested Capital/Total Capital	97.7%	90.2%	82%	90.2%	82%	90.2%	82%



Valuation	
Period	Revenue growth
Base Year	1.7%
7/31/2017	3.3%
7/31/2018	4.4%
7/31/2019	9.2%
7/31/2020	10.1%
7/31/2021	9.3%
7/31/2022	8.4%
7/31/2023	7.5%
7/31/2024	6.7%
7/31/2025	5.8%
7/31/2026	4.9%
Continuing Period	4.1%

ROIC/WACC	
Period	NOPAT margin
Base Year	7.0%
7/31/2017	9.9%
7/31/2018	10.2%
7/31/2019	11.6%
7/31/2020	12.4%
7/31/2021	12.2%
7/31/2022	11.8%
7/31/2023	11.4%
7/31/2024	11.1%
7/31/2025	10.7%
7/31/2026	10.4%
Continuing Period	10.0%

Invested Capital	
Period	Net Claims
Base Year	\$1,534.33
7/31/2017	\$1,160.80
7/31/2018	\$969.52
7/31/2019	\$567.17
7/31/2020	\$236.09
7/31/2021	-\$49.04
7/31/2022	-\$394.87
7/31/2023	-\$764.38
7/31/2024	-\$1,158.68
7/31/2025	-\$1,578.58
7/31/2026	-\$2,024.47
Continuing Period	

Price per share	
Period	Price per share
Base Year	\$36.49
7/31/2017	\$41.40
7/31/2018	\$46.69
7/31/2019	\$52.39
7/31/2020	\$58.29
7/31/2021	\$64.44
7/31/2022	\$70.84
7/31/2023	\$77.48
7/31/2024	\$84.35
7/31/2025	\$91.45
7/31/2026	\$98.77
Continuing Period	