

Ulta Beauty (Ticker: ULTA US)

Price and Performance (Values in USD)	
Price	272.89
52 week high	368.83
52 week low	222.00
YTD	7.8%
Average daily volume (un)	1,488,118
Market Capitalization (mn)	15,599
Beta	0.78
Dividend	0.00
EPS	11.00

Source: BiG Research;

Ulta Beauty	
Ticker Site BiG	ULTA
Ticker BiGlobal Trade	ULTA
Ticker BT24	ULTA
Ticker BiG Power Trade	ULTA
P/E Ratio 2019E	22.77
P/BV Ratio	8.46
EV/EBITDA	10.24

Source: BiG Research;

Analysts Consensus (last 3 months)	
Buy	16
Hold	11
Sell	1

Source: BiG Research;

Financial Data	
Sales (USD mn)	6,717
EBITDA (USD mm)	1,134
Number of Employees	16,000
ROA	16.9%
ROE	37.9%
D/E	0.00
Dividend Yield	0.00

Source: BiG Research;

Notes:

All quotes were updated in Bloomberg at 11h45 of January 31st, 2020.

Relevant Information:

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<https://www.big.pt/InformacaoMercado/s/TradingIdeas/Index/-1>

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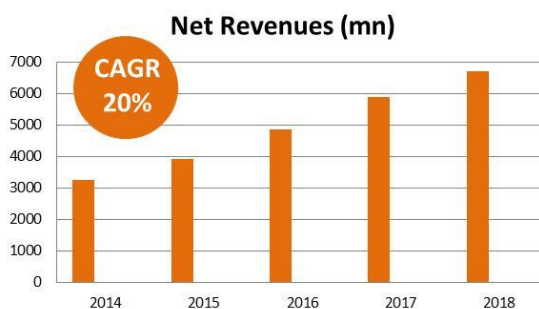
Analyst:
João Calado, CFA

With the contribution of:
Francisco Fonseca

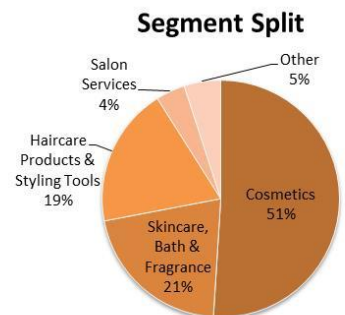
Research:
research@bia.pt

Description

Established in 1990 with headquarters in Washington, Ulta is the largest beauty retailer in the United States and the premier beauty destination for **cosmetics, fragrance, skin care products, hair care products, and salon services**. The company has 1241 retail stores across United States located in convenient, high-traffic locations such as power centers. A typical Ulta Beauty store carries more than **25,000 products** from approximately 500 well-established and emerging beauty brands across **all categories and price points**, including Ulta Beauty's own private label, Ulta Beauty Collection (6.5% of total sales). The company also has a strong position on the e-commerce sector, with YoY comparable growth rates higher than 40%, over the last years. Ulta Beauty trades in the NASDAQ Stock Market with a market capitalization of USD 15.6 bn.



Source: BiG Research



Investment Case

Free Cash Flow generation: The company generated around USD 950 mn in operating cash flow, which uses has around USD 300 mn for capex, being the remaining mainly allocated to buyback shares.

Robust Balance Sheet: Ulta has no debt and a net cash position of USD 400 mn, which can be used to expand the business.

E-commerce (omnichannel): Not only e-commerce has been reporting high comparable sales growth over the last years (more than 40%), but has also been driving considerable traffic to the stores. Ulta has significantly improved its omnichannel capabilities, with concrete strategies that potentiate the relation between the online shopping and physical stores shopping. For example, customers can buy online and pick the products up in the store or do the exact opposite, buy in-store and receive at home.

Expansion: There is still space in US to keep expanding the business. The company believes it can manage up to 1500/1700 stores only in US, which represents a 30% expansion opportunity, comparing with the present number of stores. In addition, Ulta will enter the Canadian market between the end of 2020 and the beginning of 2021.

Market share increase: The make-up industry (accounts for 50% of total revenue) is now facing a downside, with the industry even regressing in 2018 and 2019. Lack of incremental innovation and engaging newness were the main causes for this negative reverse. Consumers are moving from the make-up sector to skin care sector. Nevertheless, Ulta was able increase its market share across all segments, which allows the company to have a strong outlook to when the cycle positively reverses.

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Income Statement (USD mn)	2018	2017
Revenues	6,717	5,885
Cost of goods sold	4,307	3,788
Selling, General and admin.	1,535	1,287
Operating Expenses	5,863	5,099
EBIT	854	785
Interest expenses	-5	-2
EBT	859	787
Taxes	201	232
Net Income	659	555
Earnings Per Share	10.94	8.96

Source: Company's data

Free Cash Flow (USD mn)	2018	2017
Operational Cash Flow	956	779
Business Net Income	659	555
Depreciation and Amortization	279	253
Changes in Working Capital	-46	-33
Others	64	5
Investment Cash Flow	-215	-531
Financial investments & others	120	-90
Capex	-335	-441
Financial Cash Flow	-609	-356
Debt issuance costs	0	-1
Share buyback	-609	-356
Change in free cash flow	132	-108
Cash at the end of period	409	277

Source: Company's data

Balance Sheet (USD mn)	2018	2017
Assets	3,191	2,909
Cash & Equivalents	409	277
Financial Assets	-	120
Receivables	136	100
Inventories	1,214	1,096
Property and equipment	1,226	1,189
Intangible Assets & Goodwill	15	-
Other Assets	190	126
Liabilities	1,371	1,120
Short term Debt	0	0
Payables	404	326
Accrued liabilities	221	189
Deferred revenue	199	113
Deferred rent	435	408
Other liabilities	112	84
Total Shareowner's Equity	1,820	1,774
Total Equity and Liabilities	3,191	2,895

Source: Company's data

Income Statement

Ulta Beauty revenues increased by 14% and report an LfL of +8% in 2018. Both Gross (35.9%), EBIT (12.7%) and Net Income margin (9.8%) remain stable. The effective tax rate decreased to 23.3% (vs 29.4% in 2017), due to the reduction in the U.S. federal corporate tax rate from 35% to 21%.



Source: Company's data

Free Cash Flow

The company generated around USD 1 bn (+23% YoY) in operational cash flow of which used around USD 0.3 bn for capex. The remaining was mainly used to buy back shares (USD 0.6 bn).

Balance Sheet

Ulta Beauty has a net cash position of around USD 0.4 bn, since it has no debt. This condition confers a high degree of security for the balance sheet and its capacity to invest in the business.

Last Earnings (1Q20):

In the 3Q19, the company's revenues rose 7.9% YoY (LfL +3.2% vs est. 3.1%). Gross profit increased 30 basis points to 37.1% (vs est. 36.8%). EBIT was USD 168 mn (vs est. USD 162.5 mn) and Net Income was USD 129.7 mn (-1% YoY). Moreover, EPS was 2.25 (vs est. EPS 2.13), a positive surprise 5.63%

Management Team

Mary N. Dillon: Holds a Bachelor degree in Marketing and Asian Studies from the University of Illinois at Chicago. Started her carrier at PepsiCo in 1984 and left in 2005 already as president of the Quaker Foods Division. After, joined McDonald's where she stayed 5 years as Global Chief Marketing Officer. Then moved to US Cellular in 2010 to serve as President and CEO. Finally, in 2013, joined Ulta Beauty, and has been CEO ever since.

Mary Dillon is also a board member in Starbucks Corp, KKR & Co and Ulta Beauty.



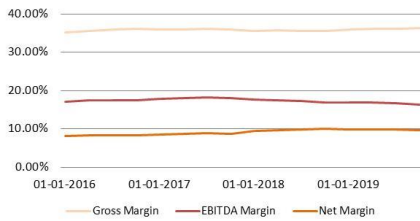
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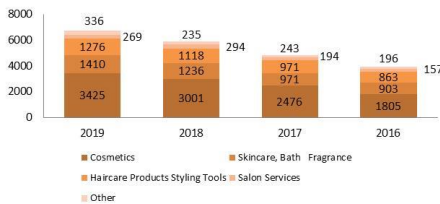
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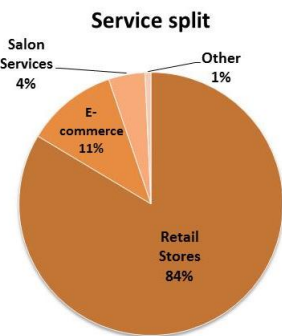
Margins



Source: Company's data

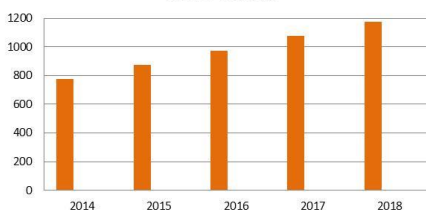


Source: Company's data



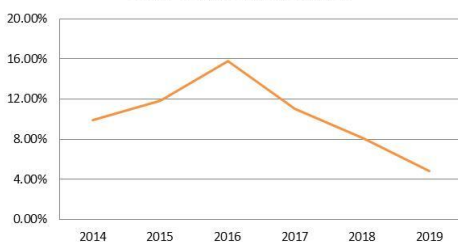
Source: Company's data

Store Count



Source: Company's data

Total comparable sales



Source: Company's data

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Main Suppliers

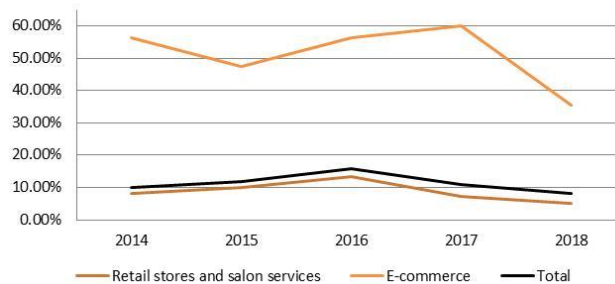
In terms of suppliers Ulta Beauty do not possess a diversified portfolio since the three main ones, aggregate around 40% of the total amount spent in COGS and 62% of total net sales.

1. **L'Oreal** (15.4% of COGS) - French cosmetic brand
2. **Estee Lauder** (14.7% of COGS) – North American cosmetic brand
3. **Shiseido** (9.4% of COGS) – Japanese cosmetic brand
4. **Coty** (5.4% of COGS) - French cosmetic brand
5. **LVMH** (4.3% COGS) – French luxury goods brand

Others: Christian Dior (French), Procter & Gamble (North American), Revlon (North American), CCL Industries (Canadian), Kose Corp (Japanese)

Main Segments

Comparable Sales



Retail Stores (84 % of revenues; growth of 8.5% in 2018): Until the end of the third quarter of 2019 Ulta opened 67 stores, which goes in line with the growth pace reported in the previous years (100 stores per year)

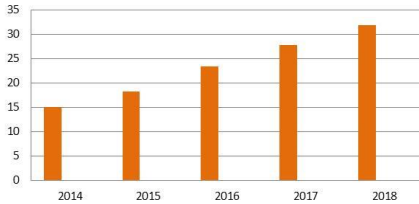
E-commerce (11% of revenues; lfl + 35.4% in 2018)

Salon Services (4% of revenues; lfl +3.6% in 2018): These services are provided within Ulta Beauty stores, and include hair, skin, brow, and makeup services. The segment was mainly created to improve the customer experience and ultimately increase the foot traffic. More than 50% of customers who use these services end up purchasing products as well, spending on average USD 45.

The graph on the left illustrates the update guidance for total comparable sales for 2019 – between 4.7% and 5% -, and clearly designs the cycle of the industry that started around 2014, and reached its peak in 2016. However, from then on, the industry has been decelerating and even regressing in 2018 and 2019. Yet, Ulta was able to keep increasing its market share across all segments, which enable the company to keep growing (even if with a slower pace). The cycle is expected to turn upwards until 2021.

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Active Loyalty Members (mn)



Active Loyalty Members

In November 2019, Ulta had 33.9 million loyalty members which generally represent over 95% of the annual total net sales. These consumers shop with higher frequency and spend more per visit as compared to non-members. The program enables customers to earn points based on their purchases which can be redeemed on any product we sell or service provided. As the program matures the growth pace will slow down, thus now the company is focusing more on driving greater spend per member.

Main Competitor

Sally Beauty: is an international specialty retailer and distributor of professional beauty supplies with operations in North America (80% of revenue), South America and Europe, with a total of 5000 stores (6 times smaller than Ulta, in terms of space). The company has two business segments, Sally Beauty Supply and Beauty Systems Group. The first targets retail consumers and the second salons and salon professionals

Over the last years, the company has been reporting negative or no comparable growth. In addition, Sally had to cut costs thus several stores were closed.

Sephora: The company intends to open 100 new stores in US, which is the company's largest expansion ever (20% increase YoY, since it has 500 stores nowadays). This brand belongs to LVMH which do not disclose Sephora individual performance.

Macy's: plans to open chain focused on selling apothecary beauty and hair-care items. The company already owns a beauty chain called Bluemercury

Relative Valuation

Name	Country	Market Cap	P/E next year	Dividend Yield	EV/EBIT DA	YTD	Organic Growth	Operational Margin	Profit Margin
SALLY BEAUTY HOLDINGS INC	UNITED STATES	1,784	6.3	0%	5.8	-16%	-1%	12%	7%
L'OREAL	FRANCE	157,448	30.0	2%	21.7	-3%	7%	18%	14%
LVMH MOET HENNESSY LOUIS VUI	FRANCE	221,687	22.0	2%	14.1	-4%	10%	21%	13%
MACY'S INC	UNITED STATES	5,200	7.0	9%	4.3	-1%	0%	6%	4%
CHRISTIAN DIOR SE	FRANCE	85,361	21.1	8%	7.8	-6%	10%	21%	5%
BED BATH & BEYOND INC	UNITED STATES	1,898	10.8	4%	n.a.	-14%	-3%	-8%	-7%
AMAZON.COM INC	UNITED STATES	931,244	35.7	0%	23.8	1%	20%	5%	4%
ULTA BEAUTY INC	UNITED STATES	15,690	21.0	0%	10.2	8%	14%	12%	10%
Average exc. ULTA		200,660	19.0	4%	12.9	-6%	6%	11%	6%

Source: BiG Research

Risks

Down cycle remains for longer than expected: Nowadays, the make-up segment is passing through a regressing phase, however is expected to positively invert in 2021. Nevertheless, there are no certainties regarding this timeline. It is possible that the negative trend remains longer than forecasted, which negatively impacts revenues.

Seasonal Fluctuations: Ulta Beauty business is subject to seasonal fluctuations, since net sales and profits are realized during the fourth quarter of the fiscal year, due to the holiday selling season.

Competitive market and low barriers to entry: The markets for beauty products and salon services are highly competitive with few barriers to entry.

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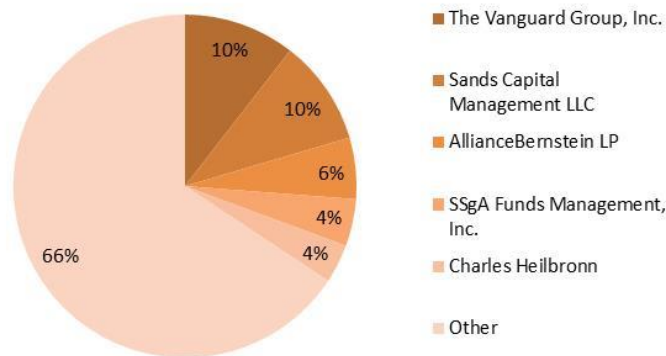
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Graph



Source: Bloomberg Source: Global Trade

Shareholders



Calendar

March 12nd 2020: 4Q19 earnings

Appendix



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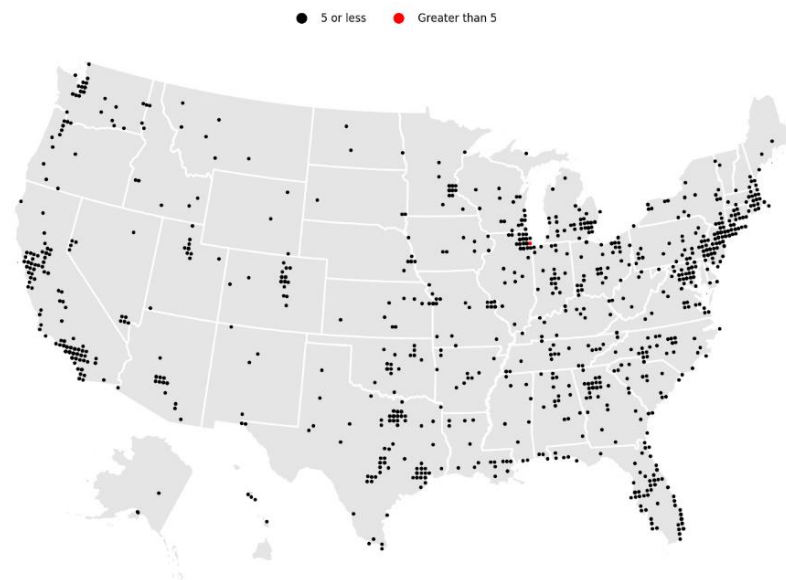
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Location	Number of stores	Location	Number of stores
Alabama	21	Montana	6
Alaska	3	Nebraska	5
Arizona	28	Nevada	15
Arkansas	10	New Hampshire	7
California	159	New Jersey	38
Colorado	26	New Mexico	7
Connecticut	16	New York	50
Delaware	3	North Carolina	34
Florida	84	North Dakota	3
Georgia	38	Ohio	43
Hawaii	4	Oklahoma	20
Idaho	9	Oregon	14
Illinois	55	Pennsylvania	45
Indiana	24	Rhode Island	3
Iowa	10	South Carolina	20
Kansas	13	South Dakota	2
Kentucky	14	Tennessee	26
Louisiana	18	Texas	112
Maine	3	Utah	14
Maryland	25	Vermont	1
Massachusetts	21	Virginia	29
Michigan	49	Washington	36
Minnesota	17	West Virginia	7
Mississippi	9	Wisconsin	20
Missouri	23	Wyoming	2
Total		Total	1,241




Ulta Beauty Locations in the USA
 Each grid point covers 10-mile radius with at least one location
 Source: ScrapeHero.com



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- Clarification of the qualitative terms implied in the recommendations:
 - Buy, expected absolute return above 15%;
 - Accumulate, expected absolute return between +5% and +15%;
 - Keep/Neutral, expected absolute return between -5% and +5%;
 - Reduce, expected absolute return between -5% and -15%;
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- The update of the investment recommendations models and respective price-targets will occur, usually, in a period of 6 to 12 months.
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