

Burlington Stores Inc. (NYSE:BURL)

Give it a Burl



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BCom 2023

July 23rd, 2021

Executive Summary

Company Analysis



- **Overview:** Burlington Stores is an American off-price retailer that offers branded apparel, accessories, and home goods at up to 60% off of their original price.
- **Strengths:** High barriers to entry, strong supplier partnerships, and lean inventory management.
- **Strategy:** BURL's fiscal 2021 initiatives include: (1) Driving comparable sales growth; (2) Enhancing retail store base; and (3) Increasing operating margins.

Investment Theses

COVID-19 accelerated consolidation within the apparel retail industry and shifted consumer demographics. This presents off-price retailers with an opportunity to gain market share.

BURL's real estate strategy will allow it to capitalize on macroeconomic trends. This potential is largely being overlooked by the market.

With an experienced management with a track record of success, BURL can effectively execute its "Burlington 2.0 strategy" and drive shareholder value.

Industry Analysis

- **Industry Drivers:** The industry caters to customers who are seeking to purchase branded products at significantly lower prices. The business model is therefore driven by (1) economic recessions & downturns and (2) the availability of in-season products from suppliers.
- **Market Structure:** Overall apparel industry is highly fragmented with many competitors. However, within Off-Price retail, three key players control approximately 90% of the market share.
- **Historical/Projected Growth:** Off-price retail is projected to increase its market share within the retail industry significantly in upcoming years due to the decline of department stores, accelerated by the COVID-19 pandemic. Off-price retail's CAGR over the next five years is projected to be 4.7% versus the retail industry at 3.1%.

Valuation & Target Price

- Discounted Cash Flow analysis, Comparable Companies analysis were conducted to determine the intrinsic share price. We also took analyst estimates on the street into account.
- DCF was given a heavier 50% weighting due to the lack of appropriate competitors within the off-price retail industry as well as the predictability of future income streams.
- Based on our valuation of \$376.92, we recommend a BUY rating for BURL at \$329.97 with an implied return of 14.5%.

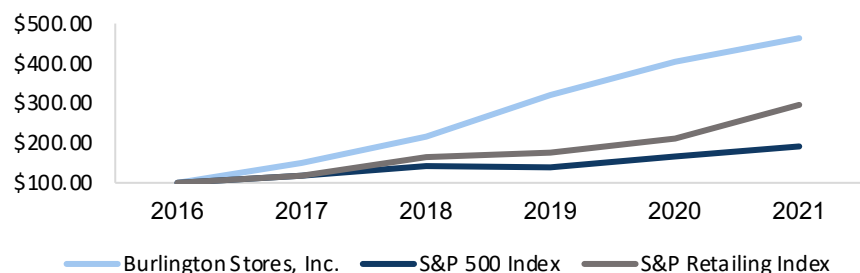
Company Overview

Company Highlights

- **Subsector:** Off-Price Retail.
- **Sector:** Consumer Discretionary.
- **Business & Revenue Model:** BURL derives over 99% of its net sales from stores operated under the “Burlington Store” brand. This is the only reportable revenue segment as of 2021. The store base is geographically diversified with a total of 761 stores located in 45 states and Puerto Rico.
- **Historical Performance:** Burlington has demonstrated a strong history of growth prior to the pandemic, with a CAGR of 8.6% from FY13 to FY19. For the past eight quarters, the company has beaten consensus EPS estimates by USD\$0.01 to USD\$0.32.

Financial Metrics

Cumulative Shareholder Return Performance, Assumes Initial Investment of \$100



Enterprise Value	\$23.4B	Revenue (FY21E)	\$7.0B
Market Cap	\$19.8B	EBITDA (FY21E)	\$0.9B
P/E	32.2x	EBITDA Margin	13.5%
EV/EBITDA	-279.7x	Debt / EV	19.9%

	Moderate Department Store	Burlington	Other Large Off-Price Retailers
Store Size (sq.ft.)	>=80,000	25000 -32000 (2021 Debut)	30,000
Product Breadth	Broad apparel range w/ more depth	Apparel, Baby Products, Accessories	Similar to BURL in categories, less depth
Brands	Moderate brands, private label	Premium and moderate brands	Premium and moderate brands
Pricing	Promotional	EDLP/Off-price	EDLP/Off-Price
Sourcing / Vendors	Pre-season sourcing strategy, limited flexibility	Substantial in-season liquidity for opportunistic buys	Reliance on packaway merchandise; pre-season cuttings
Customers	Older (45+ years) \$78K avg. income	Younger (20-39 years) \$64K avg. income	Younger (20-39 years) \$77K avg. income

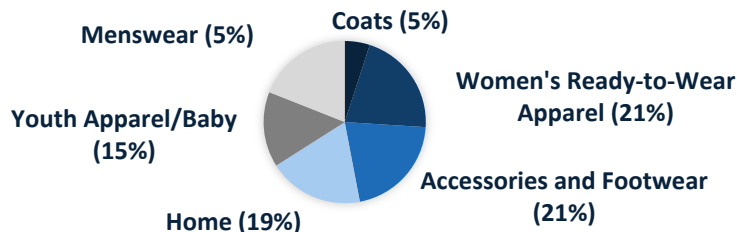
Growth Strategies

- Drive comparable sales growth** → Leaner inventory in FY21 expected to aid opportunistic buys.
- Enhance retail store base** → Long-term target of 2000; 100 new stores expected to open in FY21.
- Increase operating margins** → FY21 margins expected to expand by 125bps to 43%.

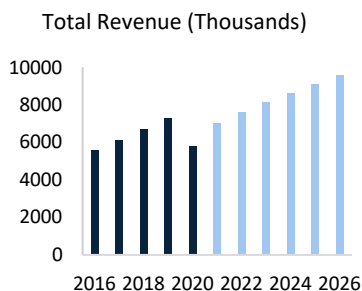
Company Overview

Revenue & Margin Analysis

Brand Merchandise Assortment

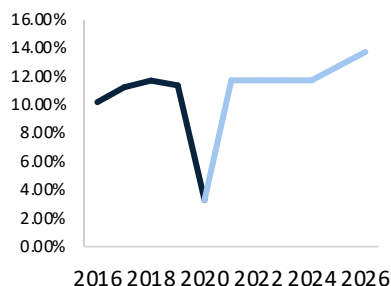


Historical & Projected Revenue Growth



- Historically, BURL opened 35-45 stores annually.
- The store base is due to expand by 100 in FY21 with the new real estate strategy.
- We expect 50 new stores to open in FY22 before gradually tapering off to the conservative estimate of 35 stores per year.

Historical & Projected EBIT Margins (% of Revenue)



- EBIT margins in pre-pandemic years had been expanding overtime.
- EBIT margins are projected to continue this upwards trajectory due to smaller stores and more efficient inventory management.

Company Head/Tailwinds

Growth Opportunities

- Recent M&A activities in retail industry encourage off-price retailers to gain significant market share.
- BURL is a well-established brand within the United States w/ high customer loyalty, which it can use to drive sales and store counts.
- Based on off-price benchmarks, BURL has the potential to drastically increase its profit margin through optimizing footprints.

Challenges

- BURL competes with major, well-known players in the off-price industry, as well as department stores and online retailers that offer seasonal brand-name merchandise at substantial markdowns.
- The popularity of e-commerce as well as its adoption by TJX and ROST, two of BURL'S strongest competitors, may pose significant challenges to the company's long-term growth.

Competitive Advantages



High Barriers to Entry

Significant capital investments, strong supplier relationships, and oligopolistic industry structure create high barriers to entry.



Liquidity for Opportunistic Buying

Compared to ROST and TJX, which rely primarily on pre-season cuttings, BURL obtains most of its inventory through opportunistic buying practices.



Strong Supplier Network

BURL possesses a strong and diverse supplier network consisting of many branded retailers.

Industry Overview

Industry Key Metrics

Off-Price Benchmarks

13.5%

EBIT Margin

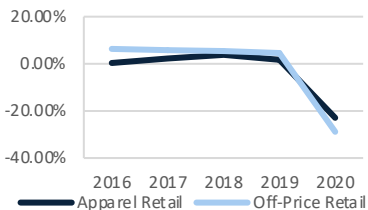
\$42B

U.S. Market Size

4.5%

Comp. Growth

Market Size YOY Growth – Off-Price Sector V.S. Apparel Retail Industry



- During the pandemic, off-price retailers suffered a greater loss due to the difficulties of starting e-commerce channels.
- However, this is not expected to last as stores re-open.

Key Trends

Upward Trajectory Expected for Off-Price Retail

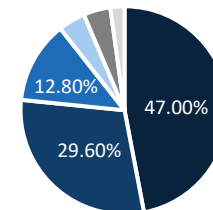
- **Economic Downturns:** The rise in U.S. jobless claims filed in the past month belies improving labor market conditions. During a downturn, customers are on the hunt for bargains. The continuous increase in U.S. inequality further contributes to this phenomenon.
- **Growth of E-Commerce:** The rise of fast fashion, e-commerce giants such as Amazon and Shein poses a significant threat to off-price retail as they attempt to appeal to similar target audiences.
- **M&A Activity:** Due to COVID-19, many struggling department stores have engaged in mergers, acquisitions, and in some cases, bankruptcy filings. The retail apparel industry as a whole has undergone significant consolidation, presenting an unique opportunity for off-line retail to gain market share.

Competitive Landscape

BURL Consistently Increases Market Share in Off-Price Retail

- **Structure:** The retail apparel industry as a whole is highly fragmented and competitive. However, the off-price retail sector is oligopolistic in nature, with 89.4% of the market share being dominated by three key players.
- **Historical Trends:** ROST, TJX, and BURL have dominated the industry for the past five years. Meanwhile, smaller companies, such as JWN and DBI have seen their market shares dwindle. In fact, Payless Holdings was driven to file for Chapter 11 Bankruptcy in 2017 due to the fierce competition.
- **BURL's Market Share** Since 2015, BURL has steadily increased its market share from 10.4% to 12.8% through offering in-season apparel at lower prices than those of its competitors.

Key Competitors and their Market Share within Off-Price Retail



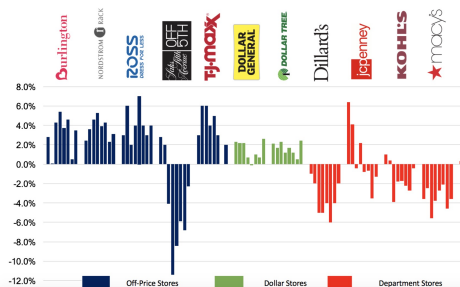
- TJX Cos (TJX)
- Ross (ROST)
- Burlington (BURL)
- Nordstrom (JWN)
- Designer Brands (DBI)
- All Others



Shifts in Demographics and Industry Dynamics Drive Growth

On the supply side, COVID-19 has accelerated consolidation within the retail apparel industry...

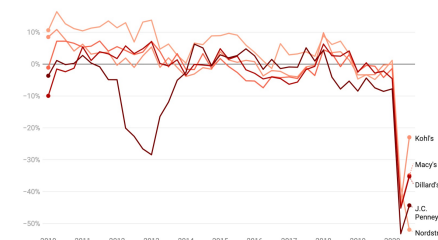
2019 Comp Sales Growth



Recent M&A Activity



Quarterly Revenue Growth – Department Stores



Prior to the pandemic, off-price retail had already begun stealing market share away from large department stores.

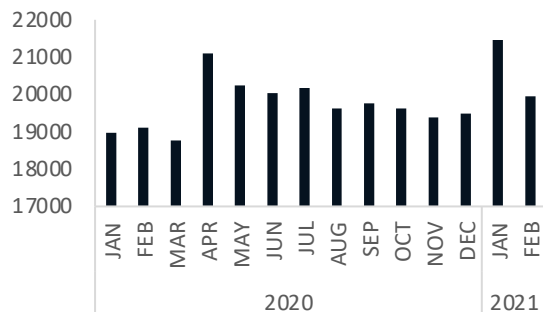
During the pandemic, many struggling apparel retail stores went under M&A.

As a result, brands resorted to wholesaling their inventory at low prices, benefitting off-price retailers.

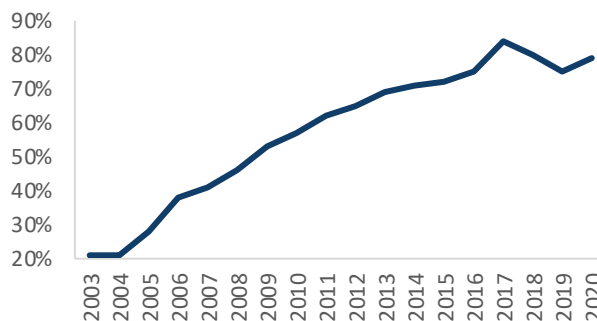
Additionally, the share loss from major department stores present a ripe opportunity for capture by off-price retailers.

...While on the demand side, it has shifted consumer preferences towards bargain purchases

Low personal discretionary income..

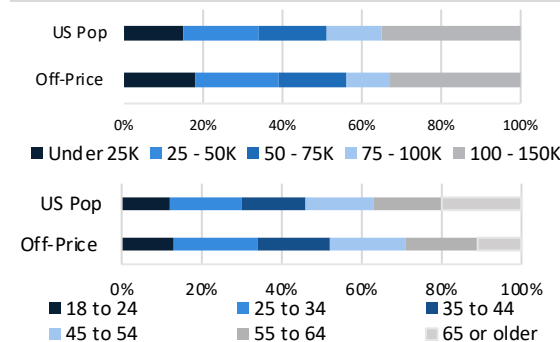


...and rising debt among younger generations



U.S. national student debt as % of Gross Domestic Product

...should continue to drive appeal for off-price



Demographic of off-price customers vs U.S. population : Favors younger generations w/ lower incomes

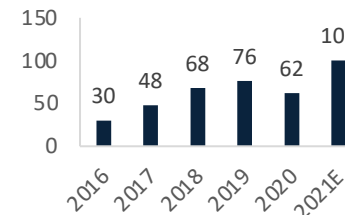
Real Estate Strategy Implies Significant Economic Benefits

“Burlington 2.0” Strategy capitalizes on new industry tailwinds through aggressive store expansions



Management doubled its long-term target of store base from 1000 to 2000 due to increasing confidence in small store prototype

Gross New Store Openings



Year	Avg Sq. Ft
2017	45000
2018	43000
2019	42000
2020	40000
2021E	32000

Smaller stores imply leaner inventory...

Unit Economics should improve to meet industry benchmarks

Burlington	FY15	FY16	FY17¹	FY18	FY19
Sales per Sq. Ft. (selling)	\$ 153	\$ 165	\$ 178	\$ 201	\$ 224
EBIT margin	6.6%	7.6%	8.5%	9.0%	9.2%
Comp Growth	2%	5%	3%	3%	3%
Unit count	567	592	629	675	727

Peer 1

Sales per Sq. Ft. (selling)	\$ 400	\$ 416	\$ 421	\$ 455	\$ 476
EBIT margin*	14.3%	14.1%	13.3%	13.5%	13.5%
Comp Growth	4%	5%	1%	7%	5%
Unit count	2,163	2,221	2,285	2,343	2,403

Peer 2

Sales per Sq. Ft. (selling)	\$ 383	\$ 395	\$ 409	\$ 422	\$ 432
EBIT margin	13.6%	14.0%	14.5%	13.6%	13.4%
Comp Growth	4%	4%	4%	4%	3%
Unit count	1,446	1,533	1,622	1,717	1,805

...and more “Treasure Hunt” experiences

Case Study – Supermarket Space

Walmart	\$45.00
Kroger	\$40.00
Whole Foods	\$39.00
Trader Joe's	\$36.00
Albertson	\$34.00
Aldi	\$34.00
Sprouts	\$32.00
Lidi	\$31.00

Aldi and Trader's Joe's bucket sizes are similar to stores with larger formats

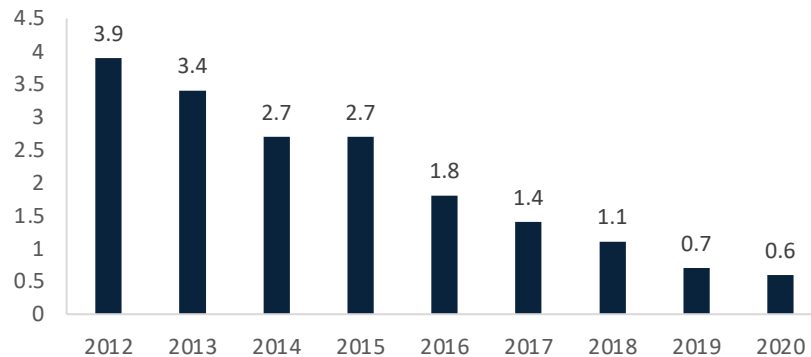
Smaller Size /=/ Smaller Average Bucket Spend per Trip

- Smaller physical stores allow BURL to better service the growing demand for “treasure hunt” experiences through higher inventory turnovers.
- Bargains are presented in a self service shopping environment, and the “first come first serve” sentiment encourages impulsive buying and large shopping volumes.

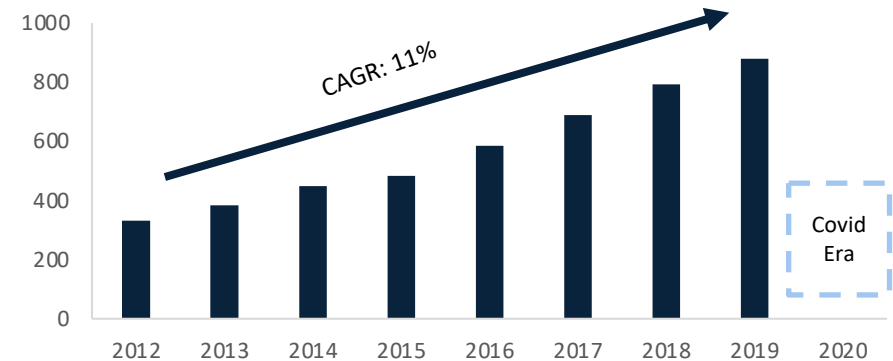
Strong Balance Sheet and Management Support Ambitious Expansions

BURL's current balance sheet should support new store openings and transformations...

Net Debt/EBITDA has continuously decreased since 2012...



...While rising EBITDA margins demonstrate strong record of cash generation



...Under a strong leadership team with extensive experience in off-price merchandising



Michael O'Sullivan – Chief Executive Officer

- Joined in September 2019 from Ross Stores (ROST)
- At ROST, Michael worked for 16 years as their COO & managed major functional areas such as supply chain, finance, IT, and merchandise allocations.
- Led company to achieve 18% annual EPS growth rate.



Jennifer Vecchio – Chief Merchandising Officer

- Has been with the company since 2015, but has served as CMO since April 2019.
- Over 20 years of experience in various merchandising positions in ROST and Macy's



Fred Hand – Chief Operating Officer

- Has served as COO since July 2020; previously chief customer officer & executive vice president of stores
- In previous roles, he drove improvements in operating costs for individual stores

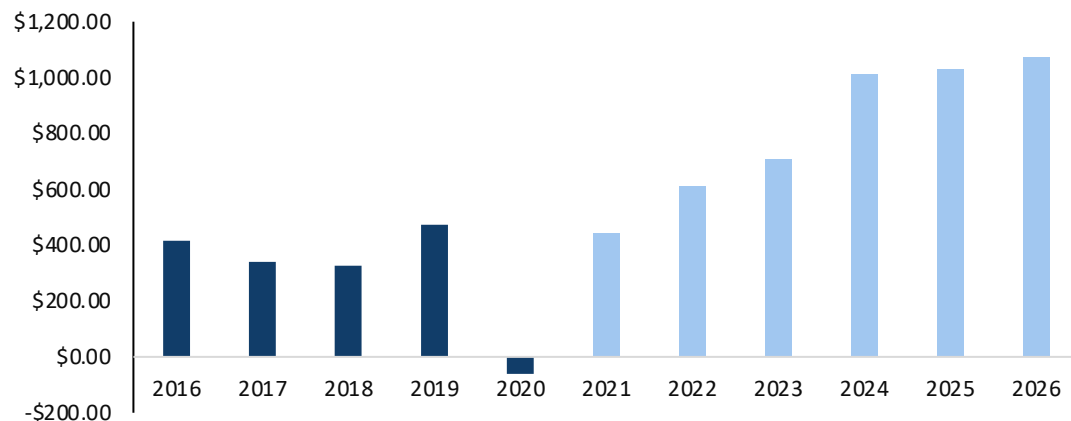


John Crimmins – Chief Financial Officer

- Became CFO in October of 2019.
- Came to Burlington in 2011 as a Senior Vice President in Finance & played a key role in improving company balance sheet.

Intrinsic Valuation

Free Cash Flow (mm)



Key Assumptions

- **Revenue:** Forecasted based on number of stores and comparable sales growth. Number of net new stores opened is predicted to reach 75 in FY 21, 50 in FY 22, before tapering off to an average of 35 per year. Comparable sales growth is expected to remain constant at 2.5% before decreasing to 2% in subsequent years.
- **EBITDA Margins:** Expected to expand with the transition to lean inventory management before stabilizing at approx. 17%, ~5% above the industry average
- **CAPEX:** Forecasted to increase to 30% of net P&E in the first three years to account for mass expansion, before gradually declining to historical range of 20-25% (in line with management expectations)
- **Exit Multiple:** Median EV/EBITDA multiple of peer set.

Perpetuity Growth

Perpetuity Growth Rate	2.5%
PV sum of unlevered FCF	4,668.1
Terminal value	25,247.9
Enterprise Value	29,916.0
Add: Cash	1,530.0
Less: Debt	4,850.0
Less: Other EV adjustments	
Equity Value	26,596.0
Shares outstanding	66.6
Implied Share Price	\$ 399.46

Exit Multiple

Terminal EV/EBITDA Multiple	15.0 x
PV sum of unlevered FCF	4,668.1
Terminal value	23,010.20
Enterprise Value	27,678.3
Add: Cash	1,530.0
Less: Debt	4,850.0
Less: Other EV adjustments	-
Equity Value	24,358.3
Shares outstanding	66.6
Implied Share Price	\$ 365.85

Relative Valuation

Comparable Companies

(Figures in mm CAD)

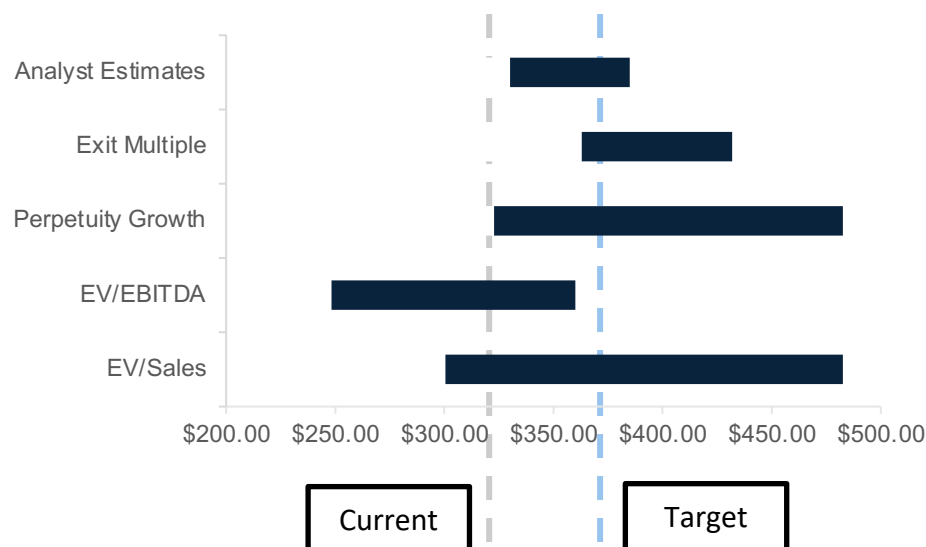
Company	Ticker	Equity Value	Enterprise Value	EV/Sales Multiple			EV/EBITDA Multiple			Company Fundamentals	
				2021A EV/Sales	2022E EV/Sales	2023E EV/Sales	2021A EV/EBITDA	2023E EV/EBITDA	2022E EV/EBITDA	YoY Revenue Growth	EBITDA Margins
ROSS STORES INC	ROST	43,625.9	43,915.2	2.4 x	2.2 x	2.1 x	28.4 x	15.1 x	13.9 x	-21.87%	10.89%
TJX COMPANIES INC	TJX	80,473.7	86,535.9	1.8 x	1.8 x	1.7 x	25.9 x	14.0 x	12.9 x	-22.96%	9.35%
FIVE BELOW	FIVE	11,012.7	11,790.7	4.1 x	3.5 x	3.0 x	22.2 x	22.4 x	18.9 x	6.25%	22.96%
CANADA GOOSE HOLDINGS INC	GOOS	4,817.4	6,108.4	5.5 x	4.6 x	4.0 x	28.9 x	16.3 x	13.0 x	-5.68%	22.30%
LULULEMON ATHLETICA INC	LULU	47,722.7	47,328.1	7.7 x	6.9 x	6.1 x	36.9 x	27.4 x	22.5 x	10.62%	23.58%
BURLINGTON STORES INC	BURL	21,221.1	24,541.1	2.8 x	2.5 x	2.4 x	23.3 x	19.7 x	17.2 x	-20.89%	15.03%
Median					3.5 x	3.0 x		16.3 x	13.9 x	-5.68%	22.30%
Mean					3.8 x	3.4 x		19.0 x	16.2 x	-6.73%	17.82%
High					6.9 x	6.1 x		27.4 x	22.5 x	10.62%	23.58%
Low					1.8 x	1.7 x		14.0 x	12.9 x	-22.96%	9.35%

- Comparable companies were chosen based on two main categories: **growth** and **core business**. Within the core business segment, BURL competes with TJX and ROSS, the two other major players within the off-price retail industry. However, given that BURL is expected to exponentially ramp up growth in the next few years through aggressive store openings, we believe that GOOS, FIVE, and LULU serve as more appropriate peers due to their similar growth and EBITDA margin profiles.
- Relative to the core business, BURL is trading at a premium on EV/Sales and EV/EBITDA. However, we believe that this is justified given its higher potential for growth and margin expansion (its EBITDA Margin is already significantly above both TJX and ROST). We believe that as it continues to grow, it should re-rate to even higher multiples in line with the growth group.

Valuation Summary



Valuation Football Field



Recommendation

We recommend a BUY rating for Burlington at \$329.97 (Jul 23 Close) with a target price of \$376.92 and an expected upside of 14.5%

Valuation Methodology

- Intrinsic and relative valuation were weighted 50% and 25% each, with more emphasis being placed on the former due to the lack of appropriate competitors within the off-price retail industry.
- The remaining 25% was composed of price targets obtained from sell-side coverage of BURL.

Intrinsic & Relative Valuation

DCF Valuation		
Perpetuity Growth Implied Price	\$	399.46
Exit Multiple Implied Price	\$	365.85
Comps Valuation		
Comps - EV/EBITDA Implied Price	\$	266.96
Comps - EV/Sales Implied Price	\$	482.61

Select Price Targets from Sell-Side

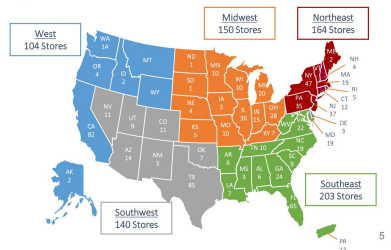
\$365 Beth Reed		Capital Markets	\$380 Matthew Boss	J.P.Morgan
\$354 Michael Binetti	CREDIT SUISSE		\$370 Adrienne Yih	BARCLAYS
\$385 Kimberly Greenberger	Morgan Stanley		\$345 Simeon Siegel	BMO

Consensus Target Price: \$366

Risks & Catalysts

Catalysts

Future Bankruptcies & Potential Store Locations



- New stores may move into Pier 1 or Modell's Sporting Goods locations. Both chains filed for Chapter 11 bankruptcy protection in 2020 and are closing all their stores.
- Future bankruptcies of department stores could pose more opportunities for gaining market share within the industry.

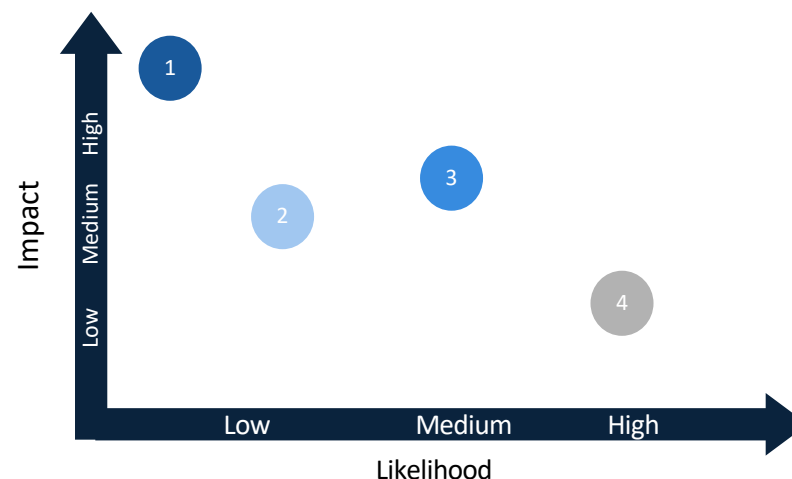
Supply Chain Disruptions within Traditional Retail

- The second wave of COVID-19 could bring about further disruptions and cancellations in the supply chain for traditional department stores. If the government continues to impose stricter restrictions on social gatherings, inventory will stockpile in department stores.
- Off-price retailers can take advantage through sourcing unwanted/oversupplied merchandise at significantly lower prices.

Quarterly Earnings Release

- New store openings may drive growth that is evident in quarterly earnings as soon as in the next quarter. Given that BURL has historically consistently beaten analysts' consensus EPS estimates, a positive earnings release is not unlikely and will likely drive the share price towards the target.

Risks



1

Dependence on New Openings: New stores may not generate expected profits due to factors such as locational disadvantages. BURL's financial position may be adversely affected.

2

Supplier Relationships: Ability to offer lower-than-average prices & introduce in-season items may be hindered if attractive branded merchandise cannot be purchased in large quantities.

3

Increased Competition: Some department stores, mass merchants, and specialty apparel stores have started to offer off-price concepts and this trend increases competition for BURL.

4

Seasonality: Majority of operating income is typically realized during the second half of the year. Significant amounts of inventory must be carried before holiday periods.