



Victoria's Secret (NYSE: VSCO)

September 30th, 2021

Dean Ponce
Sr. Portfolio Manager

Adam McWatt
Sr. Portfolio Manager

Kate Newell
Portfolio Manager

Emma Andison
Portfolio Manager

MacGregor Milne
Analyst

Agenda



1 Company Overview

2 Industry Outlook

3 Investment Thesis

4 Valuation

5 Risks & Mitigants

6 Recommendation

Victoria's Secret & Co. (NYSE: VSCO)

Business Description

- Victoria's Secret & Co. ("VSCO," "VS," or the "Company") operates as a specialty retailer of women's intimate, personal care, and beauty products worldwide under the Victoria's Secret and PINK brands
- Operates ~1,400 retail stores in 70+ countries
- Sells products via physical brick-and-mortar locations and an e-commerce platform
- Founded in 1977 in Palo Alto by Roy Raymond and went public in July of 2021, after a spinoff from parent company, Bath & Body Works (formerly L Brands)

Capitalization

US\$ mm¹

| | Enterprise Value (EV) Build | % of EV | x Adj. LTM EBITDA |
|---|-----------------------------|-------------|-------------------|
| Share Price (as at Sept. 27, 2021) | \$58.37 | | |
| Fully Diluted Shares Outstanding | 88.36 | | |
| Market Capitalization | 5,158 | 70% | 3.9x |
| (+) Long-Term Debt | 688 | 9% | 0.5x |
| (+) Current Portion of Capitalized Leases | 332 | 5% | 0.3x |
| (+) Long-Term Capitalized Leases | 1,457 | 20% | 1.1x |
| (-) Cash and Equivalents | (293) | (4%) | (0.2x) |
| Enterprise Value | 7,341 | 100% | 5.6x |

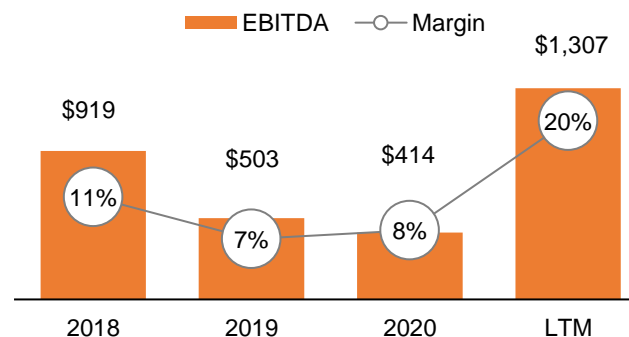
Management Team



| Name | Martin Waters | Amy Hauk | Greg Unis | Donna James |
|-------------------|---|--|-------------------------|--|
| Position | CEO, VS & Co | CEO, PINK | CEO, VS Beauty | Chair of the Board |
| Years Exp. | 25+ | 30+ | 20+ | 30+ |
| Background | Previously Head of International Division at L Brands | Previously SVP of The Children's Place | Previously EVP of Coach | Managing Director at Lardon & Associates |

Historical Adjusted EBITDA

US\$ mm



| Store Count | 2018 | 2019 | 2020 | LTM |
|-------------|-------|-------|-------|-------|
| | 1,664 | 1,661 | 1,625 | 1,387 |

Free Cash Flow Bridge

FCF Analysis

| US\$ mm | FY 2018 | FY 2019 | FY 2020 | 1Q21 | 2Q21 | LTM |
|---------------------------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Revenue | 8,103 | 7,509 | 5,413 | 1,554 | 1,614 | 6,621 |
| % YoY Growth | | (7%) | (28%) | 74% | 51% | 10% |
| (-) Cost of Goods Sold (excl. D&A) | (5,414) | (5,446) | (3,842) | (882) | (944) | (3,882) |
| Gross Profit | 2,689 | 2,063 | 1,571 | 672 | 670 | 2,739 |
| % Margin | 33% | 27% | 29% | 43% | 41% | 41% |
| (-) Operating Expenses (excl. D&A) | (1,864) | (2,544) | (1,346) | (366) | (389) | (1,482) |
| Reported EBITDA | 825 | (481) | 225 | 306 | 281 | 1,257 |
| % Margin | 10% | (6%) | 4% | 20% | 17% | 19% |
| Reported EBIT | 400 | (892) | (101) | 226 | 203 | 944 |
| % Margin | 5% | (12%) | (2%) | 15% | 13% | 14% |
| (+) Asset Impairments | 81 | 252 | 214 | - | - | - |
| (+) Other Income (Loss) | (7) | 1 | 1 | - | (1) | (1) |
| (+) Impairment of Goodwill | - | 720 | - | - | - | - |
| (+) Store Closures | - | - | (36) | - | - | - |
| (+) Establishment of JV | - | - | (30) | - | - | (30) |
| Reported Adj. EBITDA | 899 | 493 | 374 | 306 | 280 | 1,226 |
| % Margin | 11% | 7% | 7% | 20% | 17% | 19% |
| (-) IS Impairment | (81) | (252) | (214) | - | - | - |
| (+) CFS Impairment | 101 | 263 | 254 | - | - | 80 |
| Adj. EBITDA | 919 | 503 | 414 | 306 | 280 | 1,307 |
| % Margin | 11% | 7% | 8% | 20% | 17% | 20% |
| (-) Taxes Paid | (140) | 2 | 34 | (51) | (48) | (188) |
| (-) Interest Paid | (2) | (8) | (6) | (1) | (3) | (6) |
| (-) Amortization of Landlord Accounts | (29) | - | - | - | - | - |
| (-) Deferred Income Taxes | (35) | (30) | (64) | 34 | 25 | 121 |
| (+) Share Based Compensation | 39 | 38 | 25 | 7 | 8 | 24 |
| (-) Other Items | - | - | (27) | - | - | (24) |
| (-) Change in Working Capital | (54) | (190) | 298 | (193) | 25 | (22) |
| CFO | 698 | 315 | 674 | 102 | 287 | 1,211 |
| (+) Interest Paid | 2 | 8 | 6 | 1 | 3 | 6 |
| Unlevered CFO | 700 | 323 | 680 | 103 | 290 | 1,218 |
| (+) Other Investing Activities | (2) | (18) | 4 | - | - | 6 |
| (-) Capex | (341) | (225) | (127) | (19) | (47) | (123) |
| Unlevered Free Cash Flow | 357 | 80 | 557 | 84 | 243 | 1,101 |
| (-) Interest Paid | (2) | (8) | (6) | (1) | (3) | (6) |
| (-) Debt Repayments | (109) | (162) | (189) | - | - | (104) |
| Levered Free Cash Flow | 246 | (90) | 362 | 83 | 241 | 991 |
| (+) Debt Raises | 172 | 167 | 131 | - | 600 | 698 |
| (+) Effects of Foreign Exchange | 2 | (4) | 4 | 2 | - | 7 |
| (-) Net Transfers to L Brands | (327) | (197) | (407) | (88) | (279) | (929) |
| Change in Cash | 93 | (124) | 90 | (3) | 562 | 767 |
| Beginning Cash | 276 | 369 | 246 | 335 | 333 | 127 |
| Ending Cash | 369 | 246 | 335 | 333 | 894 | 894 |

Commentary

1. VSCO has acquired strong Gross Profit and EBITDA margins, supported by superior pricing power as a market leader in recent quarters
2. Recent margin improvements attributable to improved response to merchandise assortments, disciplined inventory management, and buying & occupancy expense leverage
3. Asset and goodwill impairments occurred while a part of Parent Co, L Brands
4. LTM Adj. EBITDA displays cleaner financials with fewer adjustments required to Reported EBITDA, giving us confidence in the earnings quality going forward

Agenda



1 Company Overview

2 Industry Outlook

3 Investment Thesis

4 Valuation

5 Risks & Mitigants

6 Recommendation

Intimates and Loungewear Industry at a Glance

Industry at a Glance

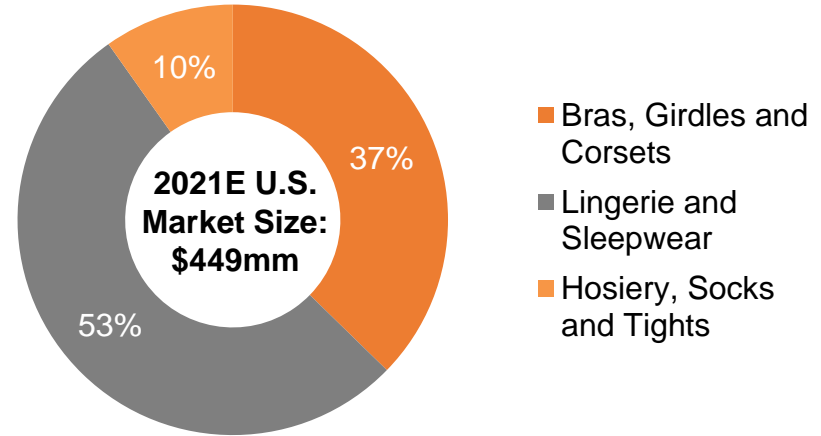
- Intimates and loungewear are a category of women's clothing, including shapewear, undergarments, and PJs
- Intimates and loungewear tend to command higher profit margins than regular apparel items
- "Weekend wear" is typically the most expensive category of items, but "everyday wear" drives the majority of sales volume
 - Consumers are increasingly willing to pay more for items that are high quality and comfortable
 - Lingerie and loungewear are often the most worn items in a woman's closet

Global Intimates Market Size



Demand for intimates is growing; China's demand has increased to 17.21B pieces annually from 10.52B in 2015

Product Revenue Segmentation



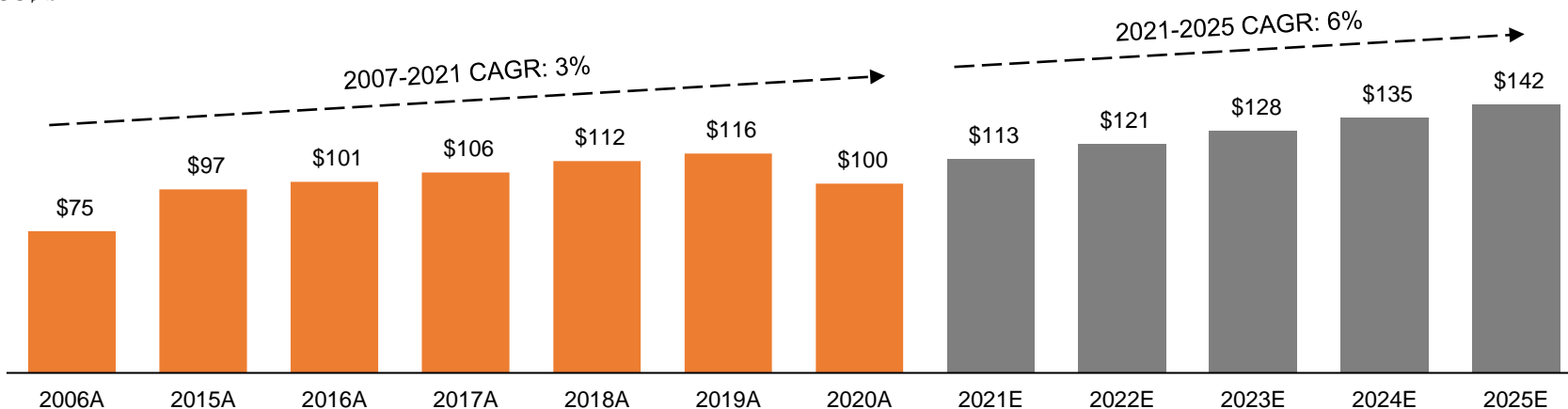
Major Players



Large and Growing Addressable Markets

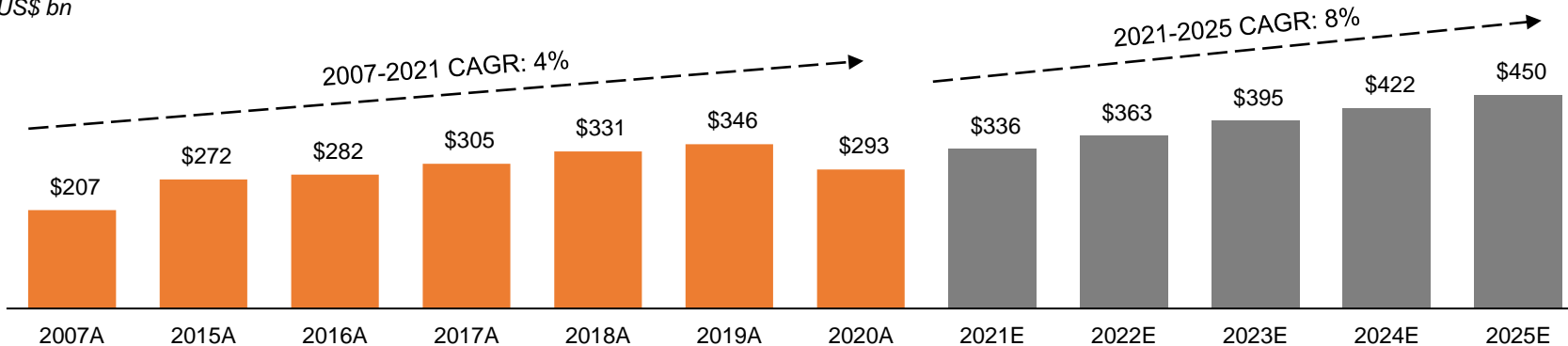
Global Intimates Apparel

US\$ bn



Global Loungewear Apparel

US\$ bn



Loungewear and intimates are a relatively recession-resilient industry with steady projected growth

Agenda



1 Company Overview

2 Industry Outlook

3 Investment Thesis

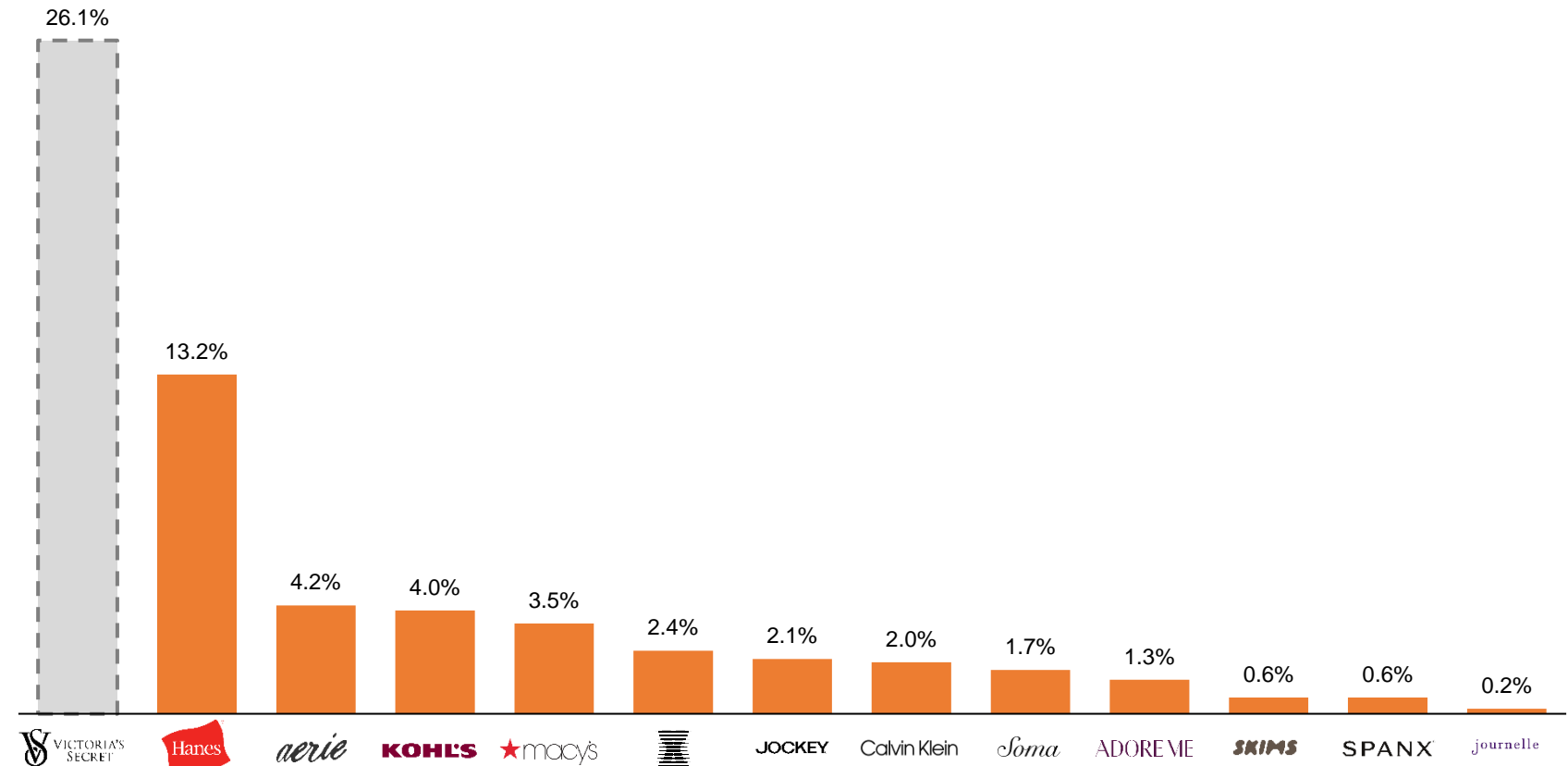
4 Valuation

5 Risks & Mitigants

6 Recommendation

VSCO is the Definitive Market Leader in Intimate Wear

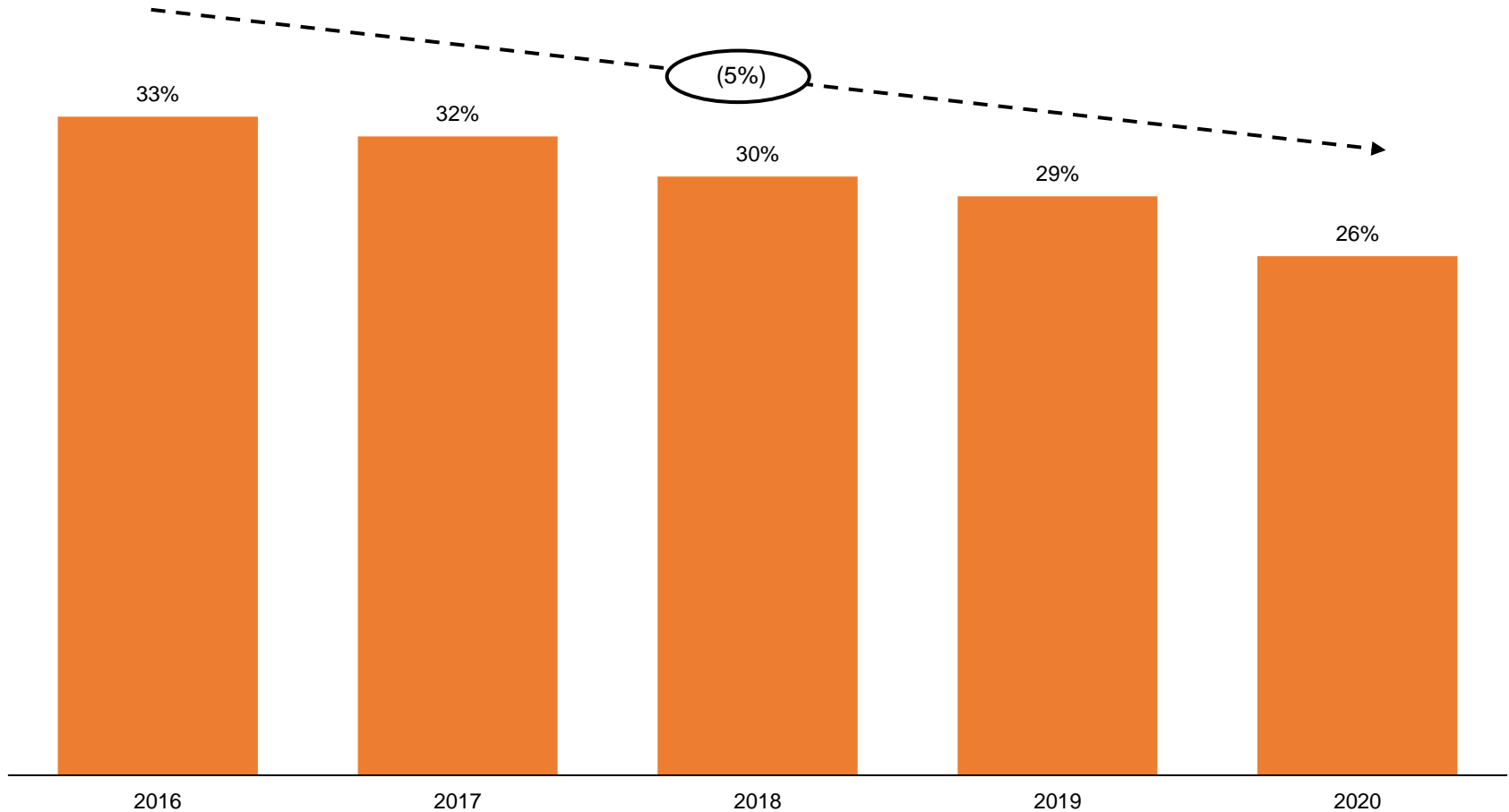
Global Intimate Wear Market Share, 2020



VSCO's global market share in intimate wear is 2x larger than the #2 player and larger than the other top 10 players combined

However, Market Share has Been Declining Since 2016

VSCO Intimate Wear Market Share, 2016 – 2020



Factors Resulting in Market Share Loss

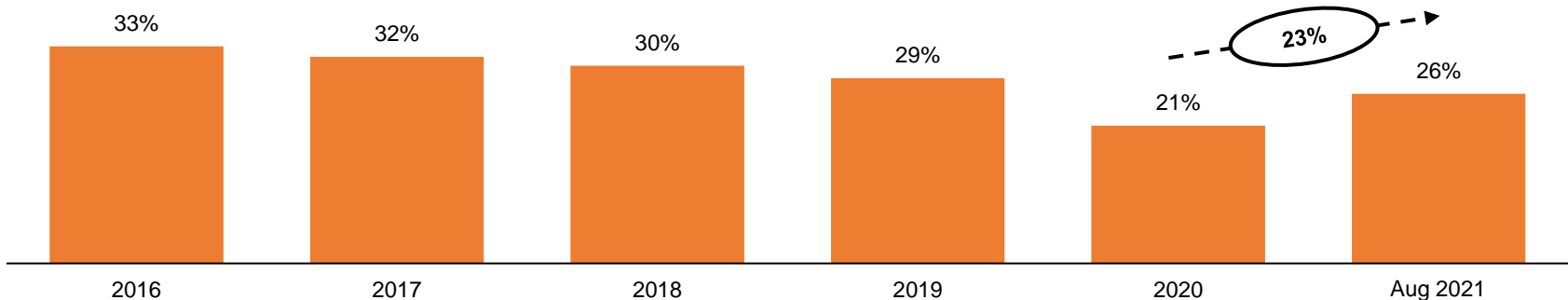
| | | |
|---|----------------------------------|---|
| 1 | Out-of-Touch Marketing | <ul style="list-style-type: none">Victoria's Secret built a brand around the "ideal female figure"Recent shift in how people, especially young women, think about beauty<ul style="list-style-type: none">Ideals are changing - people want diversity and representation in terms of ethnicity, body shape, and body typeVictoria's Secret failed to communicate a compelling, up-to-date image that resonates with today's customersThis led to customers feeling uncomfortable shopping in VSCO stores |
| 2 | Lack of Sizes / Inventory | <ul style="list-style-type: none">VSCO has historically refused to offer larger sizesUpstarts such as ThirdLove, Lively, Savage X Fenty, and Aerie began selling a wider array of Bra sizes and using more inclusive advertisingAlthough VSCO began advertising a more comprehensive range of sizes, stores often only stocked sizes up to medium |
| 3 | Wexner-Epstein Connection | <ul style="list-style-type: none">Les Wexner, founder of L Brands, maintained a close relationship with EpsteinIn addition to managing the billionaire's money, Epstein was a trustee for the Wexner Foundation and two other family trustsGiven the nature of the product, individuals felt uncomfortable purchasing from a company associated with Epstein |

Turnaround Plan Has Resulted in Return of Market Share

Outline of VSCO's Proposed Turnaround Strategy

| Female Focus | Executive Team | Rebuilding Operating Model | Range of Products |
|--|---|--|--|
| <ul style="list-style-type: none"> Aiming to reposition away from operational missteps, emphasizing inclusive branding New models look more like customers – emphasis on cultural relevance Messaging has been amended to be more inclusive | <ul style="list-style-type: none"> Martin Waters was hired as VSCO's CEO in November 6/7 BOD representatives are now female The board is highly independent, with only two members coming from within L Brands | <ul style="list-style-type: none"> Investing in product quality and supply chain base SKU count reductions in order to drive more depth around best-selling SKUs (emphasized with smaller stores) Re-entry into high-performing VS swim segment | <ul style="list-style-type: none"> Introduce more inclusive product lines, including products geared towards mothers Introduce wider variety of sizes, including an increase to XXXXXL |

VSCO Intimate Wear Market Share – Last 5 Years



The question remains: Why does the consumers team believe VSCO can maintain / increase market share to historic levels?

Summary of Investment Theses

VSCO Suffers from Lacking Investor Confidence, Owing to History of Scandals and Poor Execution

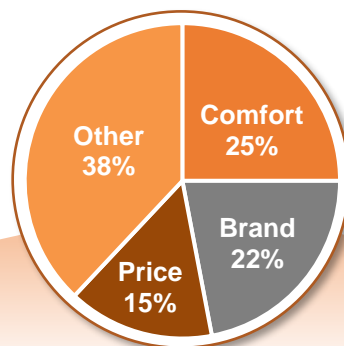
Street View ✘

Limestone's Variant View ✔

| | | |
|---|---|--|
| <p>1</p> <p>Market Leader in Industry of Recurrent Demand</p> | <p><i>VSCO has yet to produce material results from its turnaround strategy, warranting cautiousness in investment near-term</i></p> <p><i>Consumers now prefer to purchase simple undergarments while shopping for clothing at retailers such as Aerie and Aritzia</i></p> | <ul style="list-style-type: none"> ▪ VSCO maintains unrefuted leadership within its niche market, LTM performance through COVID demonstrates captivity and relevance ▪ Superior growth and margin profile is indicative of continued customer willingness to pay as well as the effective execution of brand re-imaging ▪ Expected to maintain operating profile after COVID, owing to recurrent demand for offerings |
| <p>2</p> <p>Unappreciated Recurring Customer Base</p> | <p><i>After a series of mishaps between 2016 – 2018, VSCO is no longer a relevant brand in the minds of consumers, who value a progressive brand image</i></p> | <ul style="list-style-type: none"> ▪ Recurring customer maintained through continued repeat purchases, industry-leading product mix, foothold over entire age demographic of market through PINK brand ▪ There are synergies between PINK (for female youth) and the Victoria's Secret brand, which enables customer captivity |
| <p>3</p> <p>Tangible Pathways to Realize Further Upside</p> | <p><i>VSCO operates in a low-growth space, with minimal ability to catalyze growth within the broader highly-saturated clothing industry</i></p> | <ul style="list-style-type: none"> ▪ VSCO has shown progress in building out dominance in e-commerce and international markets – both carry favorable business economics for the brand ▪ Given the traction shown, current valuation levels of 5.9x LTM EBITDA will inevitably increase |

VSCO Demonstrates Strong Business Fundamentals

Intimate Wear Purchase Criteria¹



Comfort

- Wide variety of sizes and styles ensures customers can select the perfect size
- Wearing the wrong bra size can lead to significant health problems
- Once a size has been found, customers often remain with a specific brand / product
- Customers often purchase the same item, creating a form of switching costs

Brand

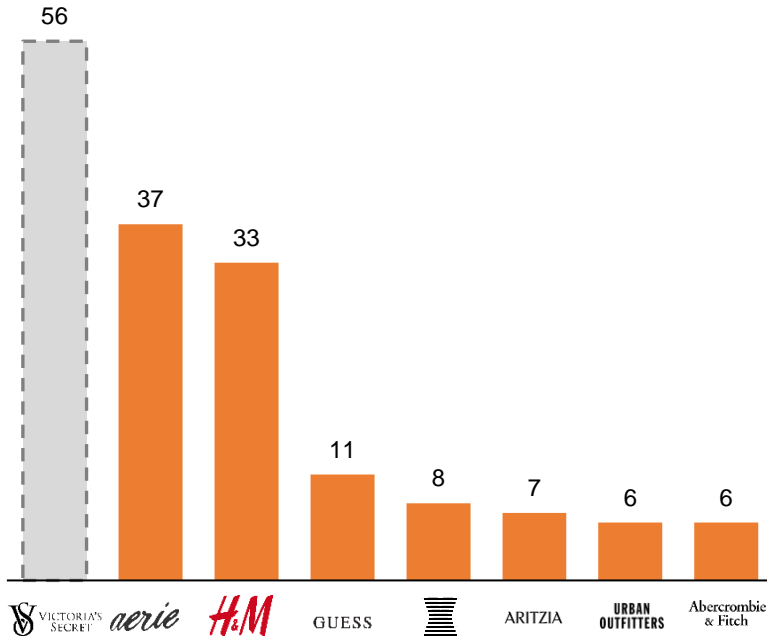
- As with traditional retail, brand is a main factor in the purchase experience
- Individuals tend to favour 'high-quality' brands, which provide assurance of quality
- VSCO remains synonymous with the intimate wear market, as denoted by its leading NPS, Awareness, and scale

Price

- ~45% of intimate wear sells between the \$10 – \$30 range; VSCO most frequently sells items for \$13
- VSCO continues to slash discounts, raise prices, and become stricter with inventory
- VSCO commands premium prices as a market leader, resulting in competitive Gross Profit and EBITDA margins

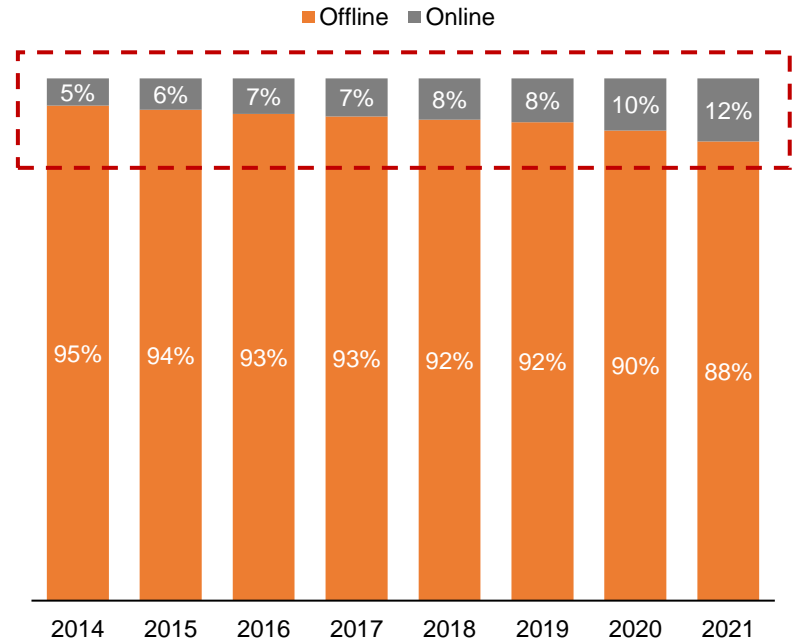
Comfort: Leading Number of Sizes

Number of Sizes by Brand



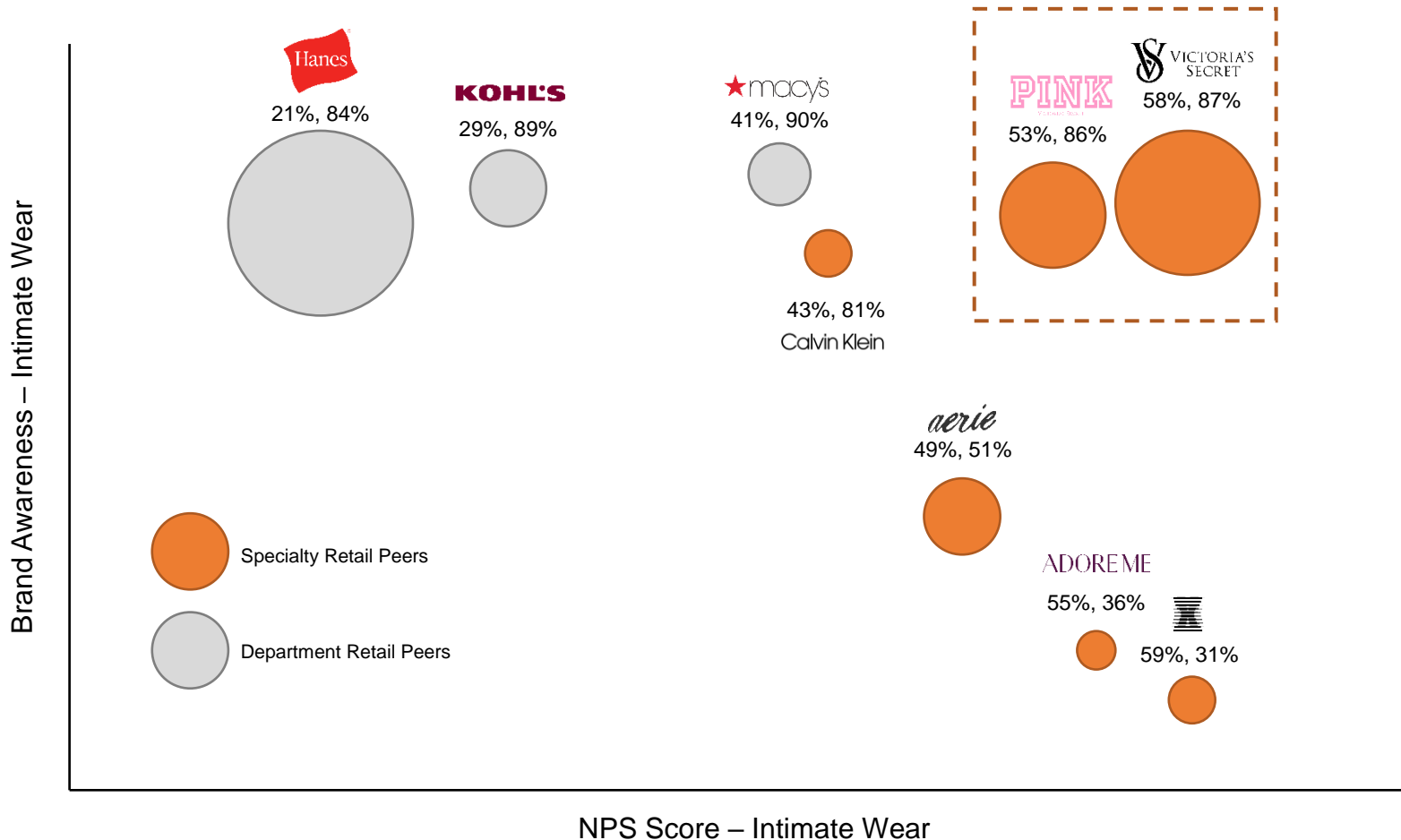
- Wide variety of sizes and styles ensures customers can select the perfect size
- Once the perfect size has been found, customers tend to remain with a specific product
- Customers often purchase the same item, creating a form of switching costs

Increasing Prominence of Digital Sales (Industry)



- As digital sales becomes more prominent, size is becoming a more important decision factor
- Individuals tend to purchase online from companies with which they know their size
- Helps combat competition from digitally native peers, including True&Co, ThirdLove, and Savage X Fenty

Brand: Leading Net Promoter Score, Awareness & Scale



VSCO's brand remains the industry standard, with leading NPS, Awareness, and Scale

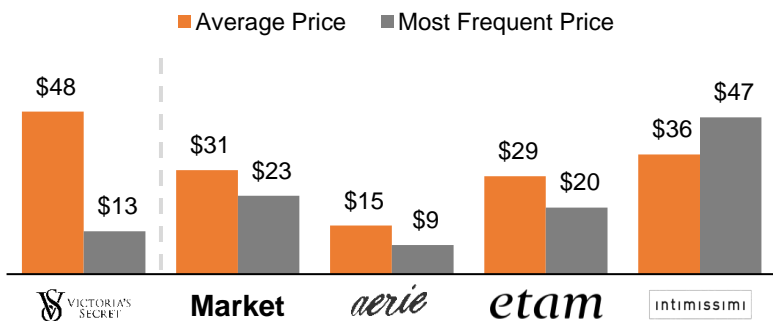
Price: VSCO Prices Align With Market Demand

Pricing of Women's Intimates Category¹

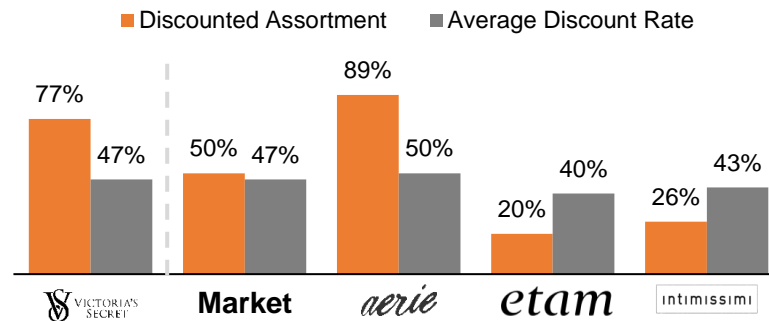
| Price Points (US\$) | US in stock | US best sellers |
|---------------------|-------------|-----------------|
| \$0-10 | 3% | 10% |
| \$10-20 | 29% | 35% |
| \$20-30 | 17% | 15% |
| \$30-40 | 16% | 20% |
| \$40-50 | 14% | 13% |
| \$50-60 | 9% | 3% |
| \$60-70 | 7% | 2% |
| \$70-100 | 5% | 5% |

- Intimates market is pressured by the fast fashion industry to claim market share and capitalize on customers' increasing WTP
- Companies that hold a high value perception are less inclined to sacrifice margins and offer continual discounts
- US market emphasizes the \$10-20 range; however, demand figures confirm US players have the capacity to push into upper price brackets given \$30-40 range WTP

Pricing Indicators: VSCO vs. Competitors



Discounting Strategies: VSCO vs. Competitors






VSCO's prices align with the market's largest demand segment

Criticized for perpetual promotions and bundling, VSCO is slashing discounts, raising prices, and becoming stricter with inventory; VSCO's inventory levels were down 8% per square foot in 2Q21

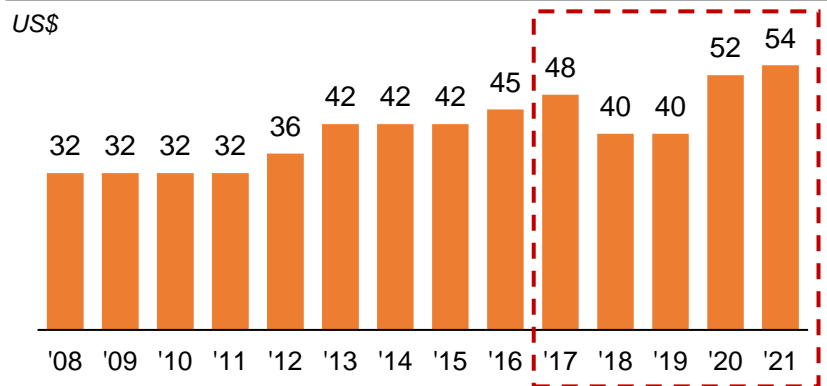
Price: Market Leader Status Permits Premium Pricing

Selected Price Points of Competitors

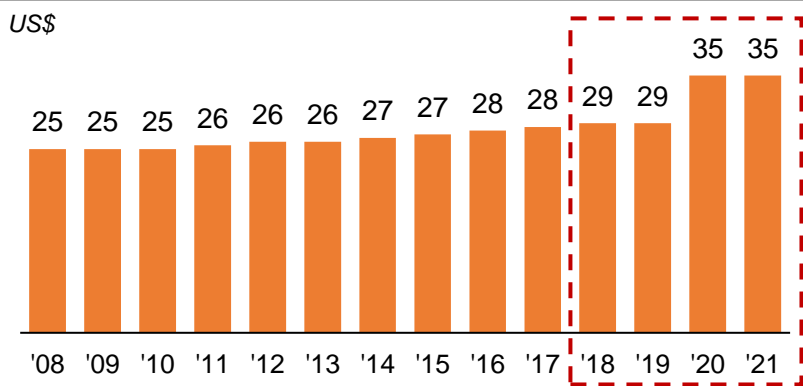
| | Specialty Bra | Best Seller | Bra Bundles | Specialty Underwear | Individual Underwear |
|---|----------------|----------------|---------------|---------------------|----------------------|
|  | \$69.50 | \$49.50 | 5/\$30 | \$18.50 | \$14.50 |
|  | \$53.95 (-22%) | \$31.46 (-36%) | 5/\$25 (-17%) | \$8.95 (-52%) | \$8.95 (-38%) |
|  | \$64.95 (-7%) | \$32.95 (-33%) | - | \$22.95 (+24%) | \$14.95 (+3%) |

The Future of Fabric: VSCO can command higher prices for its intimate garments because its customers refuse to practice the historical phrase 'beauty is pain;' VSCO utilizes advanced synthetic materials to incorporate a more comfortable fit without sacrificing design

Pricing on PINK '2 for' Bra Bundle Deals



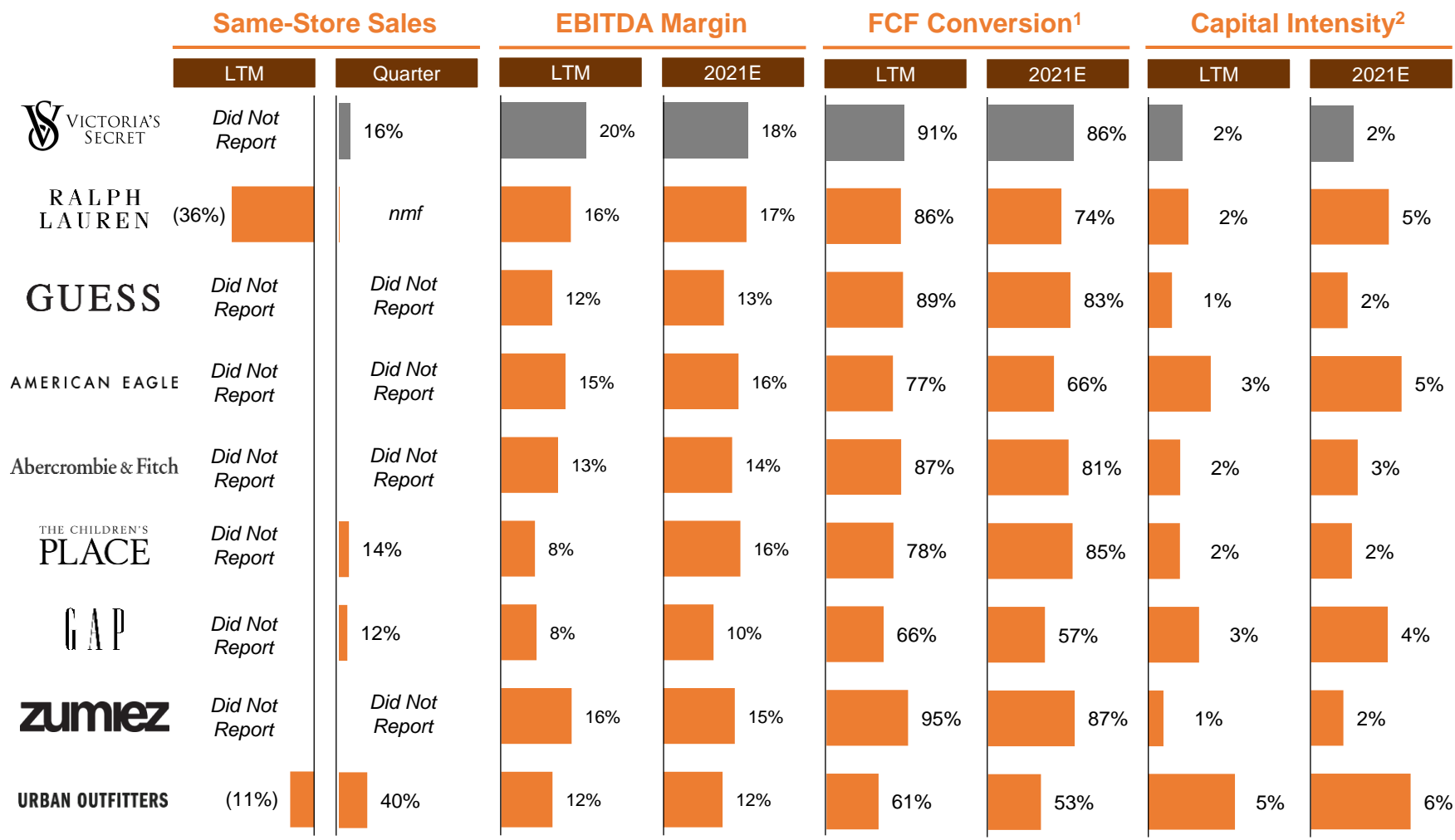
Bundle Pricing on VS '7 for' Underwear



VSCO's market leader position has enabled consistent price increases in best-selling products

Price: Premium Prices and Efficient Operations

Superior Operating Metrics Compared to “Peers”



Sources: Company Files,

1. Free Cash Flow Conversion (“FCF”) calculated as: EBITDA – Capex (\$US mm) all divided by EBITDA

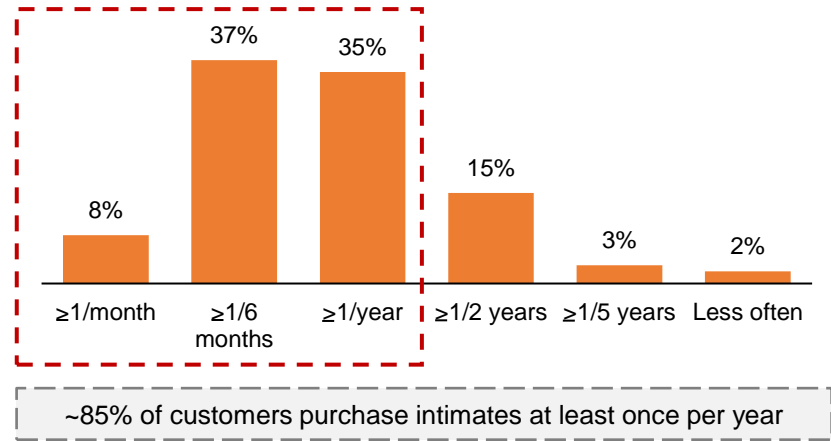
2. Capital Intensity calculated as: Capex / Revenue

VSCO has Cultivated a Recurring Customer Base

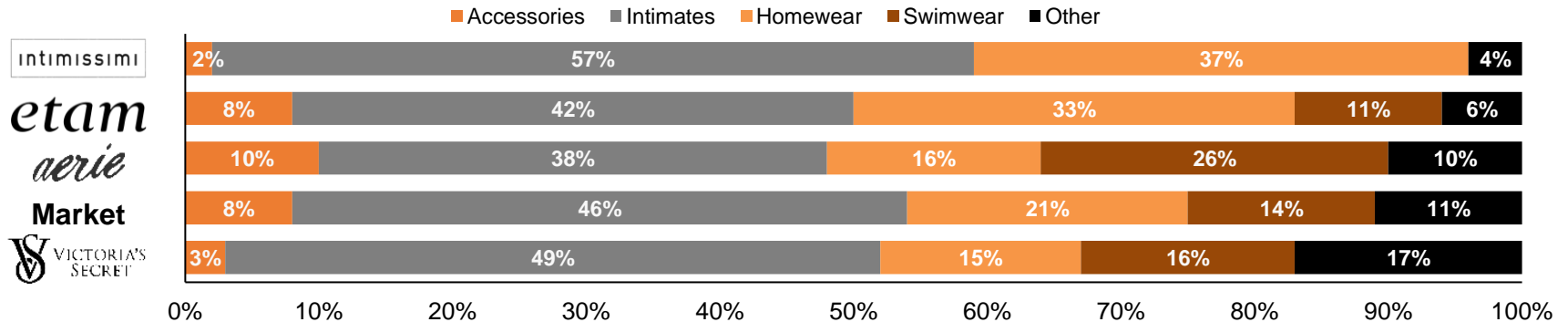
Involved Customers Are Loyal to Preferred Brands

- VSCO's differentiated product offering mix has led to the company amassing a completely allegiant breed of customer; the purchasing process is highly involved
 - VSCO has commanded brand awareness and, as a specialty retailer, has fostered a sizeable repurchasing culture
 - VSCO prioritizes innovation and STM¹; customers often simultaneously purchase their preferred 'basics' and observe fresh products
- Store volumes have rebounded since the company's missteps and the onset of the pandemic; notable sales recapture from closed stores mark a change to customer sentiment and recapturing of loyal customers

How Often Do Customers Purchase Intimates?



Differentiated Product Offering Mix is Constantly Refreshed



The intimates industry is a highly competitive market, wherein differentiation translates to incentive for customers to favour a specific brand; VSCO's incredible bandwidth allows the company to offer products with a high degree of differentiation

INVESTMENT THESIS II

PINK Synergies

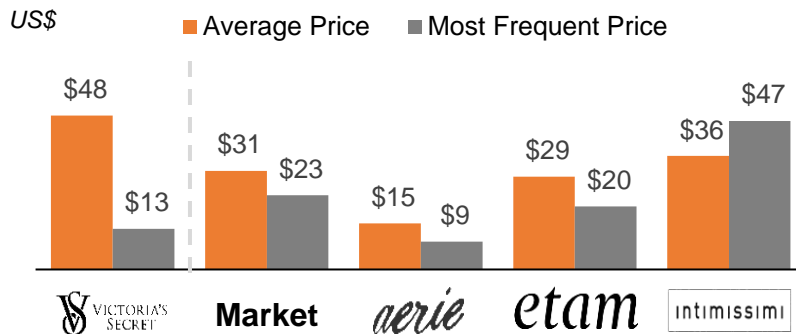
Lower Prices

- PINK has more basic styles of lingerie and clothing items compared to VSCO (ie. plain style bras compared to VS' more complex styles like laces etc.)
- PINK also has a successful loungewear segment, and these types of products have lower margins than the lingerie sold at VSCO
- The quality of clothing at PINK is identical to the quality of clothing sold at VSCO; however there is a different target customer in mind (ages 13 - 22)

Dominant Market Share

- PINK holds dominant share within intimates industry for the pre-teen age group category
 - When customers reach the age to upgrade to VSCO, it is a smooth transition given brand familiarity
- VSCO has relatively higher gross profit margins compared to competitors like Urban Outfitters and American Eagle, owing to its higher pricing

Price Comparisons



VSCO's prices align with the market's largest demand segment

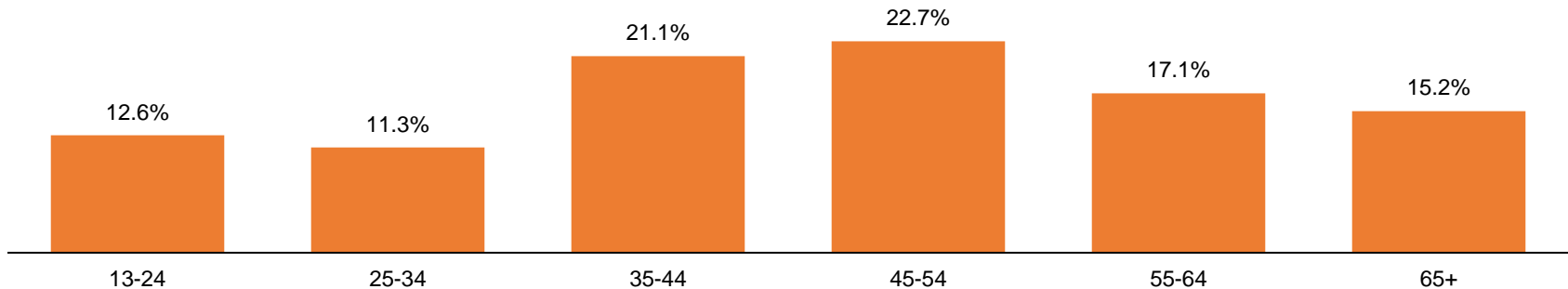
Performance

- All three pillars are performing well (lingerie, logo, and active wear)
- PINK Friday initiatives and mental health awareness programs resonated well with customers
- PINK is also realizing a brand turnaround focused on size expansion and a gender free product line
 - This provides consistency across the two brands as customers acclimatize to the inclusive PINK brand in their youth

VSCO has Cultivated a Recurring Customer Base

Progression of Customers from PINK to VSCO

Age Distribution of PINK & VSCO Target Customers



The transition of customers from PINK to VSCO typically occurs between ages 18-21; customers realize their preferred products throughout their switch to VSCO, which results in an even distribution of customers between Lines of Business and age demographics

Intricacy of Intimates Purchasing Process

- Brand loyal customers are more likely to enjoy a less extensive intimates purchasing process; within the loyalty loop, active evaluation is a very small component relative to other industries
- Contrary to the regular apparel purchasing process, intimates customers rarely stray from their preferred brand and style; however, occasionally making larger one-time purchases of single items is not uncommon
 - VSCO's ability to capitalize on the lack of differentiation in the intimate's market – while continuing best-seller lines – has allowed the company to ease the intimates purchasing process and nurture customer relationships

Brand Affinity & Differentiation Drives VS Loyalty

| | | |
|---|--|---|
| ~27M Total active customers in North America | ~57% of active customers have shopped online in the LTM | ~45% of customers shop across multiple Lines of Business |
| 6.2M Active VS app customers | 5.5M Active PINK Nation customers | 6.3M Active VS credit card holders |

Customer loyalty extends across all VSCO Lines of Business; repeat purchases are a direct outcome of brand affinity, VSCO's constant innovation, and product differentiation strategy

Tangible Pathways to Realize Further Upside

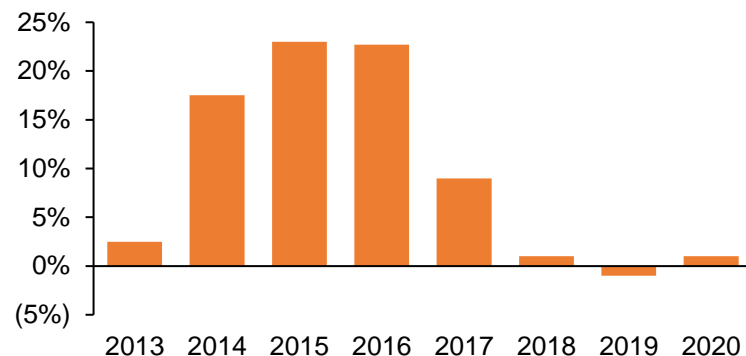
International Opportunity

- As of Q1 2021, the Company currently attributes 7% of sales towards its international platform, 25% of which are online
- We see this as an opportunity for material growth for VSCO as a pre-existent leader in a stable industry
- Prior to its execution mishaps, the business saw outsized operating margins in the mid-2010s
- Thus, there is potential for margin expansion as the Company looks to expand internationally
 - The Company has formed a JV in the UK, and a partnership program in China is in progress

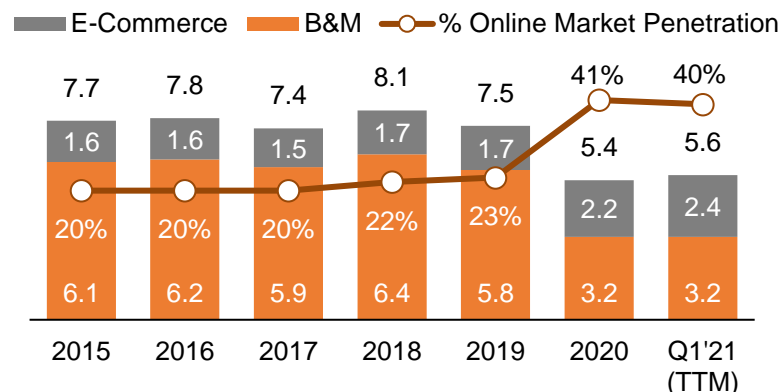
E-Commerce

- Margins have seen a significant upshoot, likely owing to e-commerce as well as the general turnaround
- Attractive Components: Scalability, lower capital expenditures, and likely much higher sales per square foot (factory versus a full brick-and-mortar store)
- Estimates believe online penetration to be ~50% of TAM long-term (currently at 43% as at Q1 2021)
- VSCO attributes ~40% of its LTM sales to online, much higher than the 2021 estimate industry average of ~12%

International Sales Operating Margins



US\$ bn E-Commerce a % of Sales

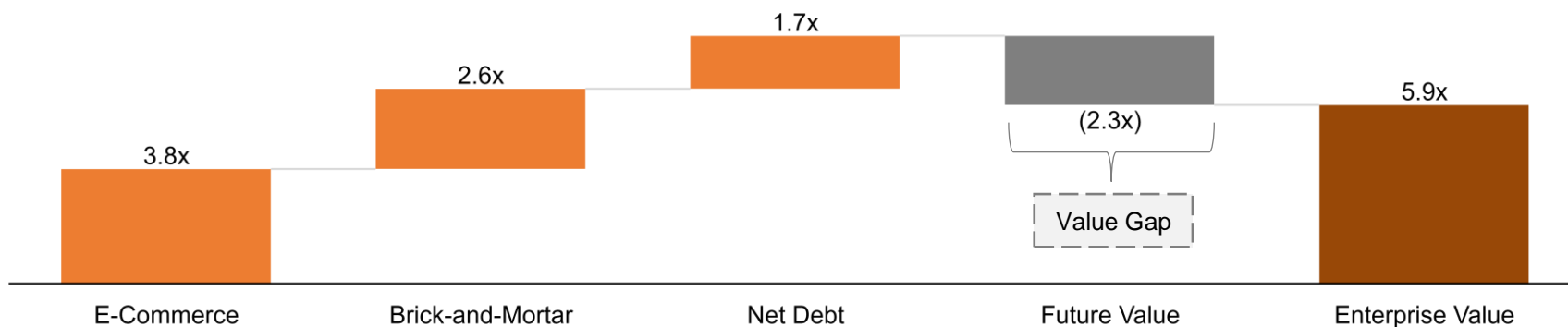


Tangible Pathways to Realize Further Upside

E-Commerce Opportunity Presents Upside in Multiples¹

| Base Case | | | | Bear Case | | | | Bull Case | | | |
|----------------------------|-----------------|-------------|---------------------|----------------------------|----------------|-------------|---------------------|----------------------------|-----------------|-------------|---------------------|
| | | % of EV | x Adj. 2021E EBITDA | | | % of EV | x Adj. 2021E EBITDA | | | % of EV | x Adj. 2021E EBITDA |
| E-Commerce | | | | E-Commerce | | | | E-Commerce | | | |
| % of Revenue | 43% | | | % of Revenue | 43% | | | % of Revenue | 43% | | |
| EBITDA Margin | 20% | | | EBITDA Margin | 20% | | | EBITDA Margin | 20% | | |
| EBITDA | \$589 | | | EBITDA | \$589 | | | EBITDA | \$589 | | |
| E-Commerce Multiple | 8.0x | | | E-Commerce Multiple | 6.0x | | | E-Commerce Multiple | 10.0x | | |
| Implied Value | \$4,709 | 64% | 3.8x | Implied Value | \$3,531 | 48% | 2.8x | Implied Value | \$5,886 | 80% | 4.7x |
| Brick-and-Mortar | | | | Brick-and-Mortar | | | | Brick-and-Mortar | | | |
| % of Revenue | 57% | | | % of Revenue | 57% | | | % of Revenue | 57% | | |
| EBITDA Margin | 17% | | | EBITDA Margin | 17% | | | EBITDA Margin | 17% | | |
| EBITDA | \$660 | | | EBITDA | \$660 | | | EBITDA | \$660 | | |
| Brick-and-Mortar Multiple | 5.0x | | | Brick-and-Mortar Multiple | 5.0x | | | Brick-and-Mortar Multiple | 5.0x | | |
| Implied Value | \$3,298 | 45% | 2.6x | Implied Value | \$3,298 | 45% | 2.6x | Implied Value | \$3,298 | 45% | 2.6x |
| Add: Net Debt | \$2,183 | 30% | 1.7x | Add: Net Debt | \$2,183 | 30% | 1.7x | Add: Net Debt | \$2,183 | 30% | 1.7x |
| Implied Total Value | \$10,190 | 139% | 8.1x | Implied Total Value | \$9,013 | 123% | 7.2x | Implied Total Value | \$11,367 | 155% | 9.1x |
| Less: Future Value | (\$2,849) | (39%) | (2.3x) | Future Value | (\$1,672) | (23%) | (1.3x) | Future Value | (\$4,026) | (55%) | (3.2x) |
| Enterprise Value | \$7,341 | 100% | 5.9x | Enterprise Value | \$7,341 | 100% | 5.9x | Enterprise Value | \$7,341 | 100% | 5.9x |

Base Case Value Bridge



Agenda



1 Company Overview

2 Industry Outlook

3 Investment Thesis

4 Valuation

5 Risks & Mitigants

6 Recommendation

Summary of Valuation Methodologies

| | |
|--|--|
| 1 Comparable Trading Analysis | <ul style="list-style-type: none">▪ EV / EBITDA, Price / Earnings, and EV / Revenue for 2021E and 2022E▪ Two universes: In-Mall Premium Apparel Retailers and In-Mall Apparel Retailers▪ Peer companies sell products related to a specific lifestyle or category; mirroring VSCO's current business and revenue model▪ Peers all operate in the U.S. primarily |
| 2 Precedent Transactions Analysis | <ul style="list-style-type: none">▪ TEV / LTM EBITDA and TEV / LTM Revenue for relevant apparel acquisitions▪ Broader company selections within apparel retail, owing to fewer data points and public information |
| 3 Discounted Cash Flow (DCF) | <ul style="list-style-type: none">▪ 5.5-year forecast period using unlevered free cash flows and exit multiples method▪ Exit multiple of 7.5x of 2026E Adj. EBITDA based on multiple ranges indicated by comparable companies▪ WACC based on estimated target capital structure based on comparables, Duff & Phelps Cost of Capital 2021 reports, and 3-year and 5-year average statistics of peer group to calculate implied beta |

Comparable Companies Analysis

Comparable Companies Output

| US\$ mm | | | P/E | | | EV/EBITDA | | | EV/Revenue | | | Revenue Growth | | EBITDA Margin | |
|---------------------------------------|--------------|------------------|-------|-------|-------|-----------|-------|-------|------------|-------|-------|----------------|--------|---------------|-------|
| | Equity Value | Enterprise Value | LTM | 2021E | 2022E | LTM | 2021E | 2022E | LTM | 2021E | 2022E | 2021E | 2022E | 2021E | 2022E |
| In-Mall Premium Apparel Retail | | | | | | | | | | | | | | | |
| Lululemon Athletica Inc. | \$53,491 | \$53,116 | 64.9x | 54.8x | 45.7x | 39.4x | 33.9x | 28.8x | 9.6x | 8.5x | 7.3x | 42.4% | 15.8% | 25.0% | 25.4% |
| Aritzia Inc. | \$3,714 | \$4,043 | 73.2x | 42.1x | 30.8x | 33.3x | 18.3x | 14.3x | 5.1x | 4.3x | 3.7x | 36.2% | 17.6% | 23.6% | 25.8% |
| Hugo Boss AG | \$4,166 | \$5,297 | nmf | 35.8x | 22.8x | nmf | 8.5x | 7.0x | 2.0x | 1.8x | 1.6x | 30.3% | 12.5% | 20.6% | 22.4% |
| Average | | | 69.0x | 48.4x | 38.3x | 36.4x | 26.1x | 21.6x | 7.4x | 6.4x | 5.5x | 39.3% | 16.7% | 24.3% | 25.6% |
| Median | | | 69.0x | 48.4x | 38.3x | 36.4x | 26.1x | 21.6x | 7.4x | 6.4x | 5.5x | 39.3% | 16.7% | 24.3% | 25.6% |
| In-Mall Apparel Retail | | | | | | | | | | | | | | | |
| Ralph Lauren Corporation | \$8,639 | \$9,207 | 50.6x | 20.6x | 14.9x | 10.9x | 10.1x | 8.6x | 1.7x | 1.7x | 1.5x | 18.5% | 7.9% | 16.5% | 17.9% |
| Urban Outfitters, Inc. | \$3,126 | \$3,778 | 10.9x | 9.5x | 10.1x | 7.7x | 6.8x | 7.0x | 0.9x | 0.8x | 0.8x | 30.3% | 5.0% | 12.4% | 11.4% |
| American Eagle Outfitters, Inc. | \$5,180 | \$6,071 | 18.5x | 12.4x | 11.4x | 9.0x | 7.8x | 7.4x | 1.3x | 1.2x | 1.1x | 31.7% | 7.3% | 15.7% | 15.5% |
| Abercrombie & Fitch Co. | \$2,468 | \$2,871 | 9.4x | 9.2x | 10.8x | 6.1x | 5.3x | 5.6x | 0.8x | 0.8x | 0.7x | 20.4% | 2.1% | 14.4% | 13.3% |
| The Gap, Inc. | \$9,381 | \$14,026 | 12.5x | 11.4x | 9.9x | 10.4x | 7.6x | 7.0x | 0.8x | 0.8x | 0.8x | 28.4% | 2.3% | 10.4% | 11.0% |
| The Children's Place, Inc. | \$1,262 | \$1,757 | 13.9x | 7.6x | 8.9x | 13.0x | 5.7x | 6.8x | 1.0x | 0.9x | 0.9x | 26.4% | (0.6%) | 16.1% | 13.4% |
| The Buckle, Inc. | \$2,152 | \$2,028 | 10.0x | 10.2x | 10.8x | 6.7x | 6.7x | 6.8x | 1.7x | 1.7x | 1.9x | 32.6% | (8.9%) | 25.2% | 27.3% |
| Zumiez Inc. | \$1,107 | \$984 | 9.0x | 9.2x | 10.3x | 5.3x | 5.5x | 6.2x | 0.9x | 0.8x | 0.8x | 20.0% | 0.7% | 14.9% | 13.2% |
| Guess?, Inc. | \$1,484 | \$2,255 | 8.6x | 8.3x | 7.3x | 8.1x | 7.0x | 6.4x | 1.0x | 0.9x | 0.8x | 35.4% | 6.4% | 12.6% | 13.0% |
| Average | | | 15.9x | 10.9x | 10.5x | 8.6x | 7.0x | 6.9x | 1.1x | 1.1x | 1.0x | 27.1% | 2.5% | 15.3% | 15.1% |
| Median | | | 10.9x | 9.5x | 10.3x | 8.1x | 6.8x | 6.8x | 1.0x | 0.9x | 0.8x | 28.4% | 2.3% | 14.9% | 13.3% |
| Overall Average | | | 25.6x | 17.7x | 15.5x | 13.6x | 10.4x | 9.5x | 2.3x | 2.0x | 1.9x | 29.3% | 5.1% | 17.0% | 17.0% |
| Overall Median | | | 12.5x | 10.2x | 10.8x | 9.0x | 7.0x | 7.0x | 1.0x | 0.9x | 0.9x | 30.3% | 5.0% | 15.7% | 13.4% |
| Victoria's Secret & Co. | \$5,158 | \$7,341 | 6.6x | 7.7x | 7.3x | 5.6x | 5.9x | 5.4x | 1.1x | 1.1x | 1.0x | 26.4% | 7.6% | 18.3% | 18.6% |

Commentary

- We believe VSCO's operating profile aligns with premium in-mall apparel retailers given its pricing power and market leadership; however, this universe also has superior growth reflected in the multiples
 - We do not anticipate the same growth profile for VSCO in near-term as it continues to restructure
 - VSCO's lower revenue estimates are due to the closure of new stores forecasted in 2021E
- We anticipate VSCO to trade near the top of its in-mall apparel retail peers at 7.0x – 9.0x 2021E EBITDA and 10.0x – 12.0x 2021E EPS

Precedent Transactions Analysis

Selected Precedent Transactions - Revalent Apparel Acquisitions (in USD millions)

| Date Announced | Target | Acquiror | TEV | TEV / LTM | |
|----------------|----------------------|-----------------------|---------|-------------|--------------|
| | | | | Revenue | EBITDA |
| 12-Feb-20 | Golden Goose | Permira | \$1,196 | na | na |
| 13-Dec-18 | La Senza | Regent | na | na | na |
| 22-Oct-18 | Perry Ellis | Legion Partners | na | na | na |
| 26-Mar-18 | Finish Line | JD Sports | \$558 | 0.3x | 6.9x |
| 3-Oct-17 | Citizens of Humanity | Berkshire | na | na | na |
| 13-Oct-17 | Alternative Apparel | Hanesbrands | \$60 | na | na |
| 14-Sep-17 | Paige Premium Denim | Lion Capital | na | na | na |
| 1-Aug-17 | BCBG Max Azria | Marquee Brands | \$108 | na | na |
| 25-Jul-17 | Jimmy Choo | Capri Holdings | \$1,390 | 3.5x | 24.4x |
| 16-Jun-17 | Bonobos | Walmart | \$310 | na | na |
| 8-May-17 | Kate Spade | Tapestry | \$2,776 | 2.0x | 11.7x |
| 2-Mar-17 | Agent Provocateur | Four Holdings | na | na | na |
| 1-Jul-16 | Pacific Brands | Hanesbrands | \$600 | 0.7x | 7.4x |
| 15-Jan-16 | Phase Eight | Foschini Group | \$170 | na | na |
| 18-May-15 | ANN Inc | Sycamore Partners | \$2,150 | 0.9x | 8.9x |
| 9-Dec-13 | Nine West Holdings | Sycamore Partners | \$2,229 | 0.6x | 10.8x |
| 25-Oct-13 | Neiman Marcus | CPP Investment / Ares | \$6,000 | 1.3x | 9.3x |
| 24-Jul-13 | Maidenform Brands | Hanesbrands | \$583 | 1.0x | 13.4x |
| 29-Jun-13 | Saks Fifth Avenue | Hudson's Bay | \$2,900 | na | na |
| 10-May-13 | True Religion | Towerbrook Capital | \$835 | 1.7x | 9.7x |
| 7-Mar-13 | Hot Topic | Sycamore Partners | \$600 | 0.8x | 9.5x |
| 31-May-12 | The Talbots | Sycamore Partners | \$378 | 0.3x | nmf |
| 26-Jul-07 | 7 For All Mankind | VF Corporation | \$775 | na | na |
| Average | | | | 1.2x | 11.2x |
| Median | | | | 0.9x | 9.6x |

Commentary

- Transactions were broadly selected based on majority-stake purchases within the apparel industry
- The higher multiples relative to comparables is owed to control premiums paid
- While there is greater variance in multiples, we believe that the precedents also suggest a multiples range of 7.0x – 9.0x 2021E EBITDA
- Variance is likely due to the differences in size, acquisition rationale, and timing

VALUATION

Discounted Cash Flow Analysis – Base Case

US\$ mm

| | Forecast Period | | | | | | | | | | | |
|-----------------------------------|-----------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | 2018A | 2019A | 2020A | Q1'21A | Q2'21A | Q3'21E | Q4'21E | 2022E | 2023E | 2024E | 2025E | 2026E |
| Revenue | 8,103 | 7,509 | 5,413 | 1,554 | 1,614 | 1,742 | 1,934 | 7,362 | 7,846 | 8,297 | 8,697 | 9,007 |
| % Growth (Live) | - | (7.3%) | (27.9%) | (71.3%) | 3.8% | 8.0% | 11.0% | 7.6% | 6.6% | 5.8% | 4.8% | 3.6% |
| Adjusted EBITDA | 919 | 503 | 414 | 306 | 280 | 279 | 387 | 1,370 | 1,485 | 1,597 | 1,702 | 1,846 |
| % Margin (Live) | 11.3% | 6.7% | 7.6% | 19.7% | 17.4% | 16.0% | 20.0% | 18.6% | 18.9% | 19.2% | 19.6% | 20.5% |
| (-) Depreciation & Amortization | (425) | (411) | (326) | (80) | (78) | (18) | (22) | (133) | (141) | (149) | (157) | (162) |
| Adjusted EBIT | 494 | 92 | 87 | 226 | 202 | 260 | 365 | 1,237 | 1,344 | 1,448 | 1,546 | 1,684 |
| % Margin | 6.1% | 1.2% | 1.6% | 14.5% | 12.5% | 15.0% | 18.9% | 16.8% | 17.1% | 17.4% | 17.8% | 18.7% |
| (-) Cash Taxes | (140) | 2 | 34 | (51) | (48) | (74) | (103) | (350) | (380) | (409) | (437) | (476) |
| Tax rate (%) | 28.4% | (2.2%) | (38.9%) | 22.4% | 23.7% | 28.3% | 28.3% | 28.3% | 28.3% | 28.3% | 28.3% | 28.3% |
| NOPAT | 354 | 94 | 121 | 175 | 154 | 187 | 262 | 888 | 964 | 1,039 | 1,109 | 1,208 |
| (+) Depreciation & Amortization | 425 | 411 | 326 | 80 | 78 | 18 | 22 | 133 | 141 | 149 | 157 | 162 |
| (-) CapEx | (341) | (225) | (127) | (19) | (47) | (20) | (24) | (147) | (157) | (166) | (174) | (180) |
| % of Revenue | 4.2% | 3.0% | 2.3% | 1.2% | 2.9% | 1.2% | 1.2% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |
| (-) Change in Net Working Capital | (54) | (190) | 298 | (193) | 25 | 11 | 14 | (45) | (36) | (27) | (19) | (6) |
| % of Change in Revenue | 0.7% | (32.0%) | 14.2% | (5.0%) | (41.9%) | (8.7%) | (7.3%) | 8.7% | 7.3% | 6.0% | 4.7% | 2.0% |
| (+/-) Adjustments | (27) | (10) | (62) | 41 | 30 | - | - | - | - | - | - | - |
| UFCF | 357 | 80 | 557 | 84 | 241 | 196 | 274 | 828 | 913 | 995 | 1,073 | 1,184 |
| % Conversion | 39% | 16% | 135% | 27% | 86% | 70% | 71% | 60% | 61% | 62% | 63% | 64% |

| | |
|---|-----------------|
| Cumulative PV of Free Cash Flow | 4,113 |
| % of Enterprise Value | 32.6% |
| Exit Multiple | 7.5x |
| Terminal Value | 13,848 |
| Implied EV / UFCF Multiple | 12.2x |
| PV of Terminal Value | 8,501 |
| % of Enterprise Value | 67.4% |
| Enterprise Value | 12,614 |
| Equity Value | 10,431 |
| Fully Diluted Shares Outstanding | 88.36 |
| Implied Share Price | \$118.06 |
| Current Share Price | \$58.37 |
| Premium to Current Share Price | 102.3% |

Sensitivity Analysis

| Discount Rate | Exit Multiple | | | | |
|---------------|---------------|-------|--------|--------|--------|
| | 5.5x | 6.5x | 7.5x | 8.5x | 9.5x |
| 7.6% | 75.3% | 99.6% | 123.8% | 148.1% | 172.3% |
| 8.6% | 66.6% | 89.7% | 112.7% | 135.8% | 158.9% |
| 9.6% | 58.3% | 80.3% | 102.3% | 124.2% | 146.2% |
| 10.6% | 50.5% | 71.4% | 92.3% | 113.3% | 134.2% |
| 11.6% | 43.0% | 63.0% | 82.9% | 102.9% | 122.8% |

Commentary

- Both the sensitized discount rate and WACC showcase significant returns for the VSCO
- Cash flows are difficult to forecast in light of restructuring and store closures, requiring various scenarios

VALUATION

Discounted Cash Flow Analysis – Stress Case

US\$ mm

| | Forecast Period | | | | | | | | | | | |
|-----------------------------------|-----------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| | 2018A | 2019A | 2020A | Q1'21A | Q2'21A | Q3'21E | Q4'21E | 2022E | 2023E | 2024E | 2025E | 2026E |
| Revenue | 8,103 | 7,509 | 5,413 | 1,554 | 1,614 | 1,742 | 1,934 | 7,251 | 7,620 | 7,951 | 8,226 | 8,286 |
| % Growth (Live) | - | (7.3%) | (27.9%) | (71.3%) | 3.8% | 8.0% | 11.0% | 5.9% | 5.1% | 4.3% | 3.5% | 0.7% |
| Adjusted EBITDA | 919 | 503 | 414 | 306 | 280 | 279 | 387 | 1,321 | 1,382 | 1,437 | 1,481 | 1,492 |
| % Margin (Live) | 11.3% | 6.7% | 7.6% | 19.7% | 17.4% | 16.0% | 20.0% | 18.2% | 18.1% | 18.1% | 18.0% | 18.0% |
| (-) Depreciation & Amortization | (425) | (411) | (326) | (80) | (78) | (18) | (22) | (131) | (137) | (143) | (148) | (149) |
| Adjusted EBIT | 494 | 92 | 87 | 226 | 202 | 260 | 365 | 1,190 | 1,245 | 1,294 | 1,333 | 1,342 |
| % Margin | 6.1% | 1.2% | 1.6% | 14.5% | 12.5% | 15.0% | 18.9% | 16.4% | 16.3% | 16.3% | 16.2% | 16.2% |
| (-) Cash Taxes | (140) | 2 | 34 | (51) | (48) | (74) | (103) | (336) | (352) | (365) | (376) | (379) |
| Tax rate (%) | 28.4% | (2.2%) | (38.9%) | 22.4% | 23.7% | 28.3% | 28.3% | 28.3% | 28.3% | 28.3% | 28.3% | 28.3% |
| NOPAT | 354 | 94 | 121 | 175 | 154 | 187 | 262 | 854 | 893 | 928 | 956 | 963 |
| (+) Depreciation & Amortization | 425 | 411 | 326 | 80 | 78 | 18 | 22 | 131 | 137 | 143 | 148 | 149 |
| (-) CapEx | (341) | (225) | (127) | (19) | (47) | (20) | (24) | (145) | (152) | (159) | (165) | (166) |
| % of Revenue | 4.2% | 3.0% | 2.3% | 1.2% | 2.9% | 1.2% | 1.2% | 2.0% | 2.0% | 2.0% | 2.0% | 2.0% |
| (-) Change in Net Working Capital | (54) | (190) | 298 | (193) | 25 | 11 | 14 | (35) | (27) | (20) | (13) | (1) |
| % of Change in Revenue | 0.7% | (32.0%) | 14.2% | (5.0%) | (41.9%) | (8.7%) | (7.3%) | 8.7% | 7.3% | 6.0% | 4.7% | 2.0% |
| (+/-) Adjustments | (27) | (10) | (62) | 41 | 30 | - | - | - | - | - | - | - |
| UFCF | 357 | 80 | 557 | 84 | 241 | 196 | 274 | 804 | 851 | 892 | 927 | 945 |
| % Conversion | 39% | 16% | 135% | 27% | 86% | 70% | 71% | 61% | 62% | 62% | 63% | 63% |

| | |
|--|----------------|
| Cumulative PV of Free Cash Flow | 3,980 |
| % of Enterprise Value | 45.6% |
| Exit Multiple | 5.5x |
| Terminal Value | 7,748 |
| Implied EV / UFCF Multiple | 9.2x |
| PV of Terminal Value | 4,749 |
| % of Enterprise Value | 54.4% |
| Enterprise Value | 8,728 |
| Equity Value | 6,545 |
| Fully Diluted Shares Outstanding | 88.36 |
| Implied Share Price | \$74.08 |
| Current Share Price | \$58.37 |
| Premium to Current Share Price | 26.9% |

Sensitivity Analysis

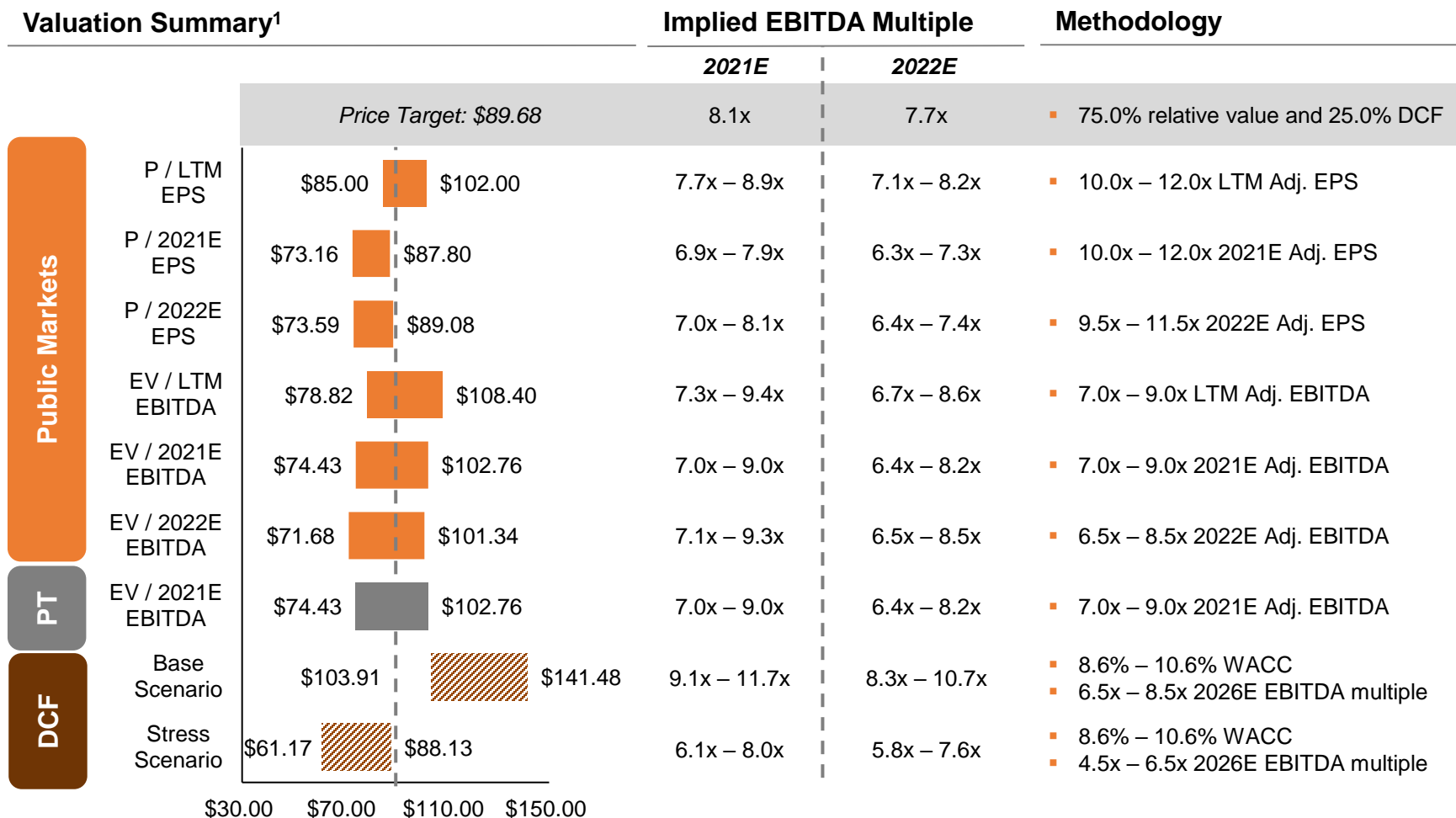
| Discount Rate | Exit Multiple | | | | |
|---------------|---------------|--------|-------|-------|-------|
| | 3.5x | 4.5x | 5.5x | 6.5x | 7.5x |
| 7.6% | 3.3% | 21.8% | 40.3% | 58.7% | 77.2% |
| 8.6% | (1.8%) | 15.8% | 33.4% | 51.0% | 68.6% |
| 9.6% | (6.6%) | 10.2% | 26.9% | 43.6% | 60.4% |
| 10.6% | (11.1%) | 4.8% | 20.8% | 36.7% | 52.6% |
| 11.6% | (15.5%) | (0.3%) | 14.9% | 30.1% | 45.3% |

Commentary

- Even under a highly stressed scenario (no openings, 40% e-commerce penetration at terminal year, and 5.5x exit), an investment in VSCO meets an attractive hurdle rate of 25.0%

Summary of Value Analysis

- Our value analysis indicates an implied price target of \$89.68, representing a substantial margin of safety of 53.6%; in our view, this well compensates the execution risk of VSCO's continued turnaround strategy



Agenda



1 Company Overview

2 Industry Outlook

3 Investment Thesis

4 Valuation

5 Risks & Mitigants

6 Recommendation

Turnaround Execution Risk Mitigated by Track Record

| Risk | | Mitigant |
|---|---|--|
| <p>1 Brand Turnaround</p> | <ul style="list-style-type: none"> Turnarounds are often deemed speculative due to the complexities of restructuring assets and acquiring customer demand | <ul style="list-style-type: none"> The Company has produced proven financial results throughout COVID-19 Took advantage of the e-commerce opportunity and restructuring stores during the lockdown Demonstrates management competency and comfort in strategy going forward |
| <p>2 Carve-Out Risk</p> | <ul style="list-style-type: none"> VSCO has never operated as a standalone entity, creating risk for operational mishaps The Company is effectively less diversified as a standalone entity, concentrating on a specific apparel market versus a generalist model | <ul style="list-style-type: none"> L Brands and VSCO maintain a relationship both operationally and financially, pooling resources together as the Company emerges L Brands also offers a credit facility to VSCO, which remains undrawn currently Proven financial track record in recent quarters |
| <p>3 Cultural Differences Abroad</p> | <ul style="list-style-type: none"> There is risk in selling lingerie apparel to different cultures; conservative populations may not resonate well with VSCO's products and marketing approach | <ul style="list-style-type: none"> Foreign JV and partnerships methods used (i.e., China and the UK) to ensure cultural expertise before new market entry Brand name and turnaround engenders a wholesome / inclusive approach that is important for conservative nations |
| <p>4 Supply Chain Headwinds</p> | <ul style="list-style-type: none"> Management has expressed that supply chain will be a bottleneck for demand, particularly in the coming Q3 2021 results | <ul style="list-style-type: none"> We view this as an inevitable consequence of COVID and the restructuring, but ultimately transitional |

Agenda



1 Company Overview

2 Industry Outlook

3 Investment Thesis

4 Valuation

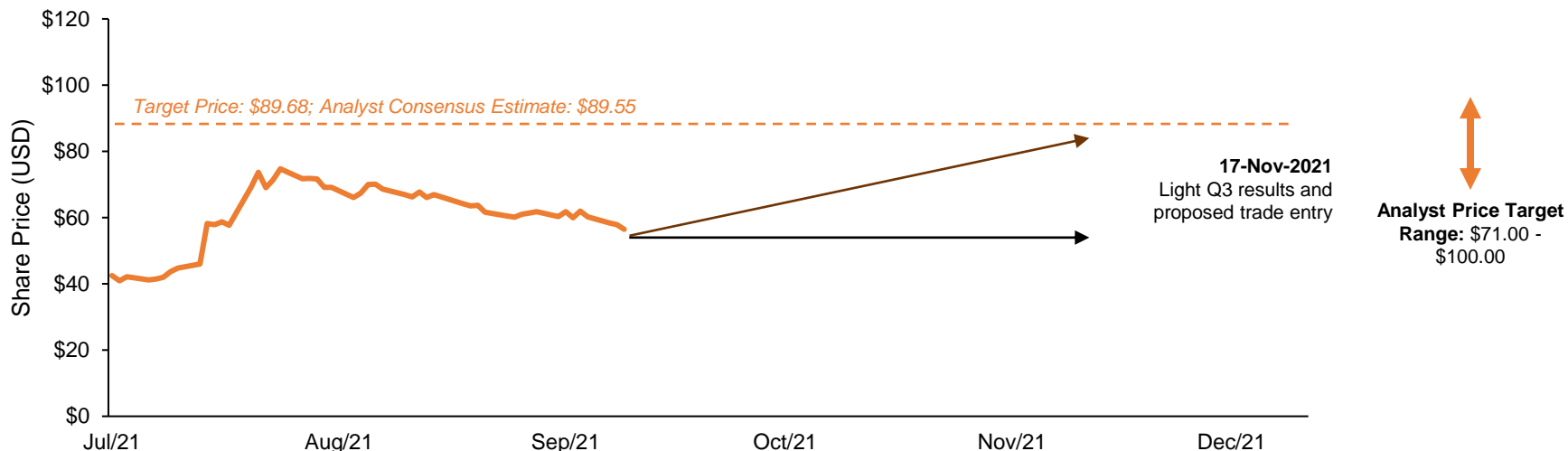
5 Risks & Mitigants

6 Recommendation

RECOMMENDATION

Long with 53.6% Expected Return

Proposed Timeline



Key Catalysts

- Q3 Earnings**
 - Management guides a “light” Q3 given seasonality and restraints in supply chain; we believe this to be a transitional factor for all businesses
 - The potential fall in share price may provide an additional cushion to our outsized margin of safety
- Q4 Earnings**
 - A surge in Q4 2021 earnings due to seasonality is expected; jump in financials for year-end should demonstrate turnaround success to investors
 - Expect appreciation for e-commerce platform, increased analyst coverage, and overall trading volume
- Analyst Coverage**
 - Throughout his short lifetime as a public company, analysts have repeated increased their price targets for the business (Jefferies initiated at \$58.23 and has increased to \$71.09 as of August 19, 2021)
 - Street consensus is pegged at \$89.55 average, highest being JPM at \$100

Appendix



Intrinsic Valuation: Forecast Assumptions

| | | |
|--------------------------------|---------------------------|--|
| Revenue | Same-Store Sales | <ul style="list-style-type: none"> 2022E same-store sales growth of 10.0% tapered to 2.0% in terminal year |
| | Store Growth | <ul style="list-style-type: none"> Net store closures of unprofitable locations forecasted until 2023E Steady growth in net store additions anticipated for 2024E and beyond |
| | E-Commerce | <ul style="list-style-type: none"> E-commerce market penetration forecasted to grow from 43% to 50% by 2026E driven by state-of-the-art distribution centers and use of AI to support e-commerce Global intimates and lingerie industry forecasted to grow 2.0% annually |
| EBITDA Margin | Gross Profit Margin | <ul style="list-style-type: none"> VSCO's position as a market leader grants them superior pricing power, which enables them to realize strong margins Reduced sales discounts and promotions support this recent margin appreciation |
| | Sales, General, and Admin | <ul style="list-style-type: none"> Management forecasts SG&A to increase by ~7%, driven by higher store selling costs and marketing investments SG&A figures account for marketing expense anticipated to reach 5% of revenue |
| Capital Expenditures and D&A | | <ul style="list-style-type: none"> Steady capex at 2.0% of revenue from 3Q21 onwards Forecasted based on historical results and management guidance |
| Terminal Exit Multiples Method | | <ul style="list-style-type: none"> Exit multiple method used to due volatility of future cash flows as a result of sporadic store openings / closures 7.5x 2026E Adj. EBITDA multiple based on comparable companies analysis |
| Stress Case | | <ul style="list-style-type: none"> 5.5x 2026E Adj. EBITDA exit multiple, reflecting of current trading ranges for VSCO Net store additions of 0 beyond 2023E E-commerce market penetration forecasted to retract to 40.0% in 2026E |

Takeaways from Management Calls

Earnings and Investor Meeting Commentary

| Release | Key Commentary | Questions |
|---|---|---|
| Virtual Investor Meeting (July 19, 2021) | <ul style="list-style-type: none"> Victoria Secret had major missteps from 2016-2019 but has since learned from them and set a new trajectory for the business Very strong customer base with 27 million active customers in North America, 700 million websites visits per year, and 77 million Instagram followers Victoria Secret as physical presence in over 70 countries and ships to over 200 94% of their 867 stores are cashflow positive and on average are turning \$900,000 of profit Victoria's Secret Beauty is America's #1 fragrance brand selling more unites than any other fragrance in America Pink has been focused on size expansion and gender free product line | <ul style="list-style-type: none"> As you are looking to grow your business by having new bra launches each year do you ensure that you don't get over inventoried again? The strategy around the sport and lounge business has changed a few times over the years, how big was it at its peak and how will you ensure that it does not overlap with Pink's lounge wear? Is Capex going to be a straight-line margin or could it bounce around a little bit over the next couple of years? Who are you competing against? |
| Q2 Earnings Release (August 18, 2021) | <ul style="list-style-type: none"> Very strong results and exceeding expectations – best Spring season performance in 5 years EPS stands at \$1.71 compared to an adjusted loss of \$0.97 per share last year Sales growth at 51% combined with significant growth in merchandise margin and disciplined expense management drove these results Given closure of 240 stores since 2019, sales have been down 10%, however comparable sales have been up 5% | <ul style="list-style-type: none"> Where do you see AUR expansion going and do you see merchandise margins being sustainable? Are SG&A investments going to be linear over the next 3-5 years? Can you provide an update on the brand evolution and explain how it is resonating with customer? How needle moving are the new product lines and categories? |

Supply Chain Framework

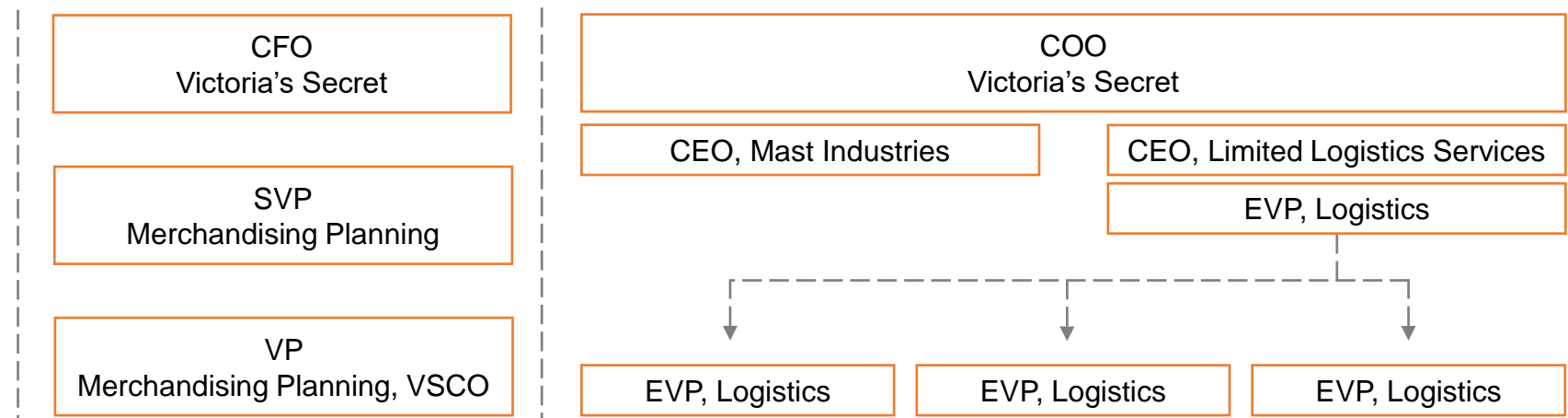
Overview of Flow Model

- As VSCO operates in a highly competitive market, women’s apparel, the company’s general flow model can best be described as the *efficient chain model*
 - Commodity pricing, inventory management, and a successful e-commerce platform are crucial entities in VSCO’s supply chain model
- VSCO’s aims to deliver an assortment of innovative fashion products and ‘less risky’ basic products
 - VSCO has fostered a sizable repurchasing culture through simultaneously offering preferred ‘basics’ as well as fresh and innovative products

Operational Competitive Advantages

1. **Company-wide Open Innovation**
 - a. Multiple pathways for product innovation stem from a decentralized design culture and inter-company operating tactics
2. **Sourcing Model**
 - a. Wholly-owned subsidiary of VSCO, Mast Industries, Inc. works along side Victoria’s Secret product innovation teams to manufacture unique and irreplicable products
3. **Limited Logistics Service (“LLS”)**
 - a. VSCO employs LLS as a shared service model to constantly re-evaluate its supply chain process and compare it to competitors

Victoria’s Secret Innovation & Supply Chain Overview



Sources: Company Filings, MIT Supply Chain Reports

Irreplicable Advantage

Mast Industries & VSCO's Sourcing Model

- Mast works in tandem with vertically integrated factories and raw material suppliers to collaborate with VSCO on unique and irreplicable products
- Mast allows for greater manufacturing efficiency and increased speed of product development, aiding VSCO's ability to pivot on market sentiment
- Example: Mast, VSCO & expert foam manufactures
 - The companies worked to innovate a padded bra suitable for air-shipping at lower costs per unit; Mast thinks ahead of solely the manufacturing process of products

Operational Performance Objectives & LLS

- LLS's role in bringing products to market is indispensable; LLS's ability to facilitate VSCO's logistics stems from the *Service Level Agreement*
- The SLA is responsible for outlining detailed performance metrics and reports, evaluating competitors' performance, and defining roles and timelines for getting products from concept-to-shelf
 - LLS's frequent reporting allows VSCO to be uber responsive to changing customer wants
- LLS is responsible for all customer-facing, efficiency-based, and asset utilization-based performance metrics from manufacturing to stores

LLS: Importance of Reporting & Responsibilities

| Basic Intimate Apparel | Fashion Intimate Apparel ¹ |
|--|--|
| Efficiency-Based: auditing, network productivity, DC metrics, DC & store throughput | Efficiency-Based: auditing, network productivity, DC metrics, DC & store throughput |
| Customer-Facing: responsiveness, store layout, business priorities, new stores, air shipments, value added services | Customer-Facing: responsiveness, store layout, business priorities, new stores, air shipments, value added services |
| Asset-Utilization: capacity utilization, inventory turns | Asset-Utilization: capacity utilization, inventory turns |

Case Study: Brand Bounce-Backs

American Apparel

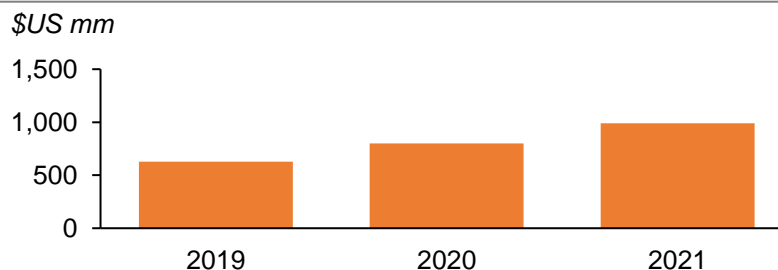
- At the height of the brand's popularity in 2007, American Apparel campaigns often conveyed sexualised images of young women
- Under Dov Charney's (Ex-CEO) leadership the brand had not turned a profit between 2009-2014, due to poor management and controversial advertising
- Charney was removed from the company in 2014 and the new management team filed for bankruptcy in 2016 and 2017 due to crippling debt obligations
- Gildan Activewear bought American Apparel at auction for \$88mm in 2017, now the brand stands to support the message of empowerment and body positivity
 - They have since expanded sizes up to 3XL
- In 2018, Gildan stated that they expected American Apparel's revenue to double from \$50mm to \$100mm



Aerie

- Aerie launched in 2014 with a brand ethos centered around body positivity and inclusion
- The “Real” marketing campaign features models and photo unaltered by photoshop techniques used by rival companies promoting “perfect” bodies
- In 2019, comparable sales for Aerie were up 20% and the brand has delivered 21 straight quarters of double-digit growth
- Aerie has also seen impressive store count growth expanding by 30 stores annually in 2019 and 2020, up from only 6 stores in 2018

Aerie Revenue Growth



Management expects Aerie's revenue to double reaching \$2 bn in the near future which outlines a 102% increase

Brands that transition to promote body positivity will realize sustainable revenue growth. Since, Victoria Secret is in very early stages of their brand revolution they are poised to realize similar revenue growth

Credit Analysis

Capital Structure Analysis

| US\$ mm | 2018A | 2019A | 2020A | 1Q'21A | 2Q'21A | LTM |
|--|--------------|--------------|--------------|--------------|--------------|--------------|
| Current Debt | - | 61 | - | - | - | - |
| 4.625% Notes (July 2029) | - | 92 | - | - | 591 | 591 |
| Debt due to Related Party (Sept. 2025) | 1 | - | 97 | 97 | 97 | 97 |
| Total Secured Debt | - | 153 | 97 | 97 | 688 | 688 |
| (+) Lease Liabilities | - | 2,676 | 2,087 | 2,010 | 1,912 | 1,912 |
| Total Debt | - | 2,829 | 2,184 | 2,107 | 2,600 | 2,600 |
| (-) Cash | (369) | (245) | (335) | (332) | (293) | (293) |
| Net Debt | (369) | 2,584 | 1,849 | 1,775 | 2,307 | 2,307 |
| Credit Ratios | | | | | | |
| Total Secured Debt / LTM Adj. EBITDA | nmf | 0.3x | 0.2x | 0.1x | 0.5x | 0.5x |
| Total Debt / LTM Adj. EBITDA | nmf | 5.6x | 5.3x | 2.3x | 2.0x | 2.0x |
| Net Debt / LTM Adj. EBITDA | 2 | nmf | 5.1x | 4.5x | 2.0x | 1.8x |
| Total Secured Debt / LTM UFCF | nmf | 1.9x | 0.2x | 0.1x | 0.6x | 0.6x |
| Total Debt / LTM UFCF | nmf | 35.1x | 3.9x | 2.2x | 2.4x | 2.4x |
| Net Debt / LTM UFCF | nmf | 32.1x | 3.3x | 1.8x | 2.1x | 2.1x |

Commentary

- VSCO has steadily built a straightforward capital structure with minimal leverage
- 1 VSCO has a small portion of secured debt outstanding to L Brands, previously Parent Co. which is no longer required to be repaid
- 2 Recent recovery has enabled VSCO to maintain a strong credit profile with sufficient cashflows to service future debt obligations
- We anticipate that VSCO's credit rating will exceed their current "BB-" rating in the coming months, allowing for market optimism

APPENDIX

WACC Analysis

| US\$ mm | Market Capitalization | | | Net Debt | | Levered Beta | | Tax Rate | | Debt-to-Equity | | Unlevered Beta | |
|---------------------------------------|-----------------------|----------|----------|----------|---------|--------------|--------|----------|--------|----------------|---------------|----------------|--------|
| | Current | 3-Year | 5-Year | 3-Year | 5-Year | 3-Year | 5-Year | 3-Year | 5-Year | 3-Year | 5-Year | 3-Year | 5-Year |
| In-Mall Premium Apparel Retail | | | | | | | | | | | | | |
| Lululemon Athletica Inc. | \$54,054 | \$33,249 | \$24,178 | (\$280) | (\$422) | 1.46 | 1.36 | 21.0% | 24.6% | neg | neg | 1.46 | 1.36 |
| Aritzia Inc. | \$3,821 | \$2,443 | \$2,113 | \$306 | \$228 | 1.72 | 1.69 | 21.0% | 24.6% | 0.13x | 0.11x | 1.57 | 1.56 |
| Hugo Boss AG | \$4,179 | \$2,934 | \$3,649 | \$810 | \$564 | 1.83 | 1.68 | 21.0% | 24.6% | 0.28x | 0.15x | 1.50 | 1.51 |
| Average | | | | | | | | | | | | 1.51 | 1.48 |
| Median | | | | | | | | | | | | 1.50 | 1.51 |
| In-Mall Apparel Retail | | | | | | | | | | | | | |
| Ralph Lauren Corporation | \$8,796 | \$7,877 | \$7,965 | \$238 | (\$11) | 1.60 | 1.51 | 21.0% | 24.6% | 0.03x | neg | 1.56 | 1.51 |
| Urban Outfitters, Inc. | \$3,155 | \$2,832 | \$3,093 | \$73 | (\$49) | 1.72 | 1.57 | 21.0% | 24.6% | 0.03x | neg | 1.69 | 1.57 |
| American Eagle Outfitters, Inc. | \$5,246 | \$3,336 | \$3,230 | \$731 | \$363 | 1.56 | 1.44 | 21.0% | 24.6% | 0.22x | 0.11x | 1.33 | 1.32 |
| Abercrombie & Fitch Co. | \$2,446 | \$1,361 | \$1,282 | \$570 | \$300 | 2.03 | 1.85 | 21.0% | 24.6% | 0.42x | 0.23x | 1.52 | 1.58 |
| The Gap, Inc. | \$9,351 | \$8,001 | \$9,130 | \$4,153 | \$2,596 | 1.80 | 1.61 | 21.0% | 24.6% | 0.52x | 0.28x | 1.28 | 1.33 |
| The Children's Place, Inc. | \$1,256 | \$1,124 | \$1,484 | \$400 | \$177 | 2.26 | 2.26 | 21.0% | 24.6% | 0.36x | 0.12x | 1.76 | 2.07 |
| The Buckle, Inc. | \$2,154 | \$1,231 | \$1,142 | (\$28) | (\$102) | 1.13 | 1.07 | 21.0% | 24.6% | neg | neg | 1.13 | 1.07 |
| Zumiez Inc. | \$1,112 | \$787 | \$678 | (\$3) | (\$28) | 1.87 | 1.72 | 21.0% | 24.6% | neg | neg | 1.87 | 1.72 |
| Guess?, Inc. | \$1,518 | \$1,289 | \$1,310 | \$637 | \$288 | 2.45 | 2.26 | 21.0% | 24.6% | 0.49x | 0.22x | 1.76 | 1.94 |
| Average | | | | | | | | | | | | 1.55 | 1.57 |
| Median | | | | | | | | | | | | 1.56 | 1.57 |
| Overall Average | | | | | | | | | | | | 1.53 | 1.54 |
| Overall Median | | | | | | | | | | | | 1.54 | 1.54 |
| | | | | | | | | | | 3-Year | 5-Year | | |
| Unlevered Beta | | | | | | | | | | 1.53 | 1.54 | | |
| Target Debt-to-Equity | | | | | | | | | | 0.10x | 0.10x | | |
| Tax Rate | | | | | | | | | | 28.3% | 28.3% | | |
| Relevered Beta | | | | | | | | | | 1.64 | 1.65 | | |
| Risk-Free Rate | | | | | | | | | | 2.5% | 2.5% | | |
| Equity Risk Premium | | | | | | | | | | 4.7% | 4.7% | | |
| Cost of Equity | | | | | | | | | | 10.3% | 10.3% | | |
| Cost of Debt | | | | | | | | | | 4.5% | 4.5% | | |
| Tax Rate | | | | | | | | | | 28.3% | 28.3% | | |
| After-Tax Cost of Debt | | | | | | | | | | 3.2% | 3.2% | | |
| WACC | | | | | | | | | | 9.55% | 9.57% | | |