

# Ulta Beauty (NASDAQ: ULTA)

## Recommend Buy at 2.5% | PT: \$520.15

September 15, 2023



CIMG Investment Research

## Unlocking the Ulta-Mate Potential in the Beauty Business

Ulta Beauty is the largest beauty retailer in the U.S. with 1,350 locations offering both prestige and mass products to “The Beauty Enthusiast”. The unique product offering in a one stop shop has led Ulta to make a splash in the \$172B market that is beauty and salon services. In the short term Ulta has faced business pressures from a heightened promotional environment, shrinkage issues, and a price conscious consumer. We believe Ulta is well positioned to continue growing in the segment, drive pre-covid level comps store sales, take advantage of their omnichannel presence, and improve margins with a best-in-class customer loyalty program (95% of sales).

## Investment Thesis

**Ulta Has Faced Margin Pressure Which Has Led to Investor Concern, But There is a Road to Expansion.** On the Q2 earnings call, management called out gross margin headwinds are normalizing (but still below historical) driven by a higher promotional environment, elevated shrink, and supply chain investments. Looking ahead, Ulta expects further gross margin pressure in Q3 as they encounter significant pricing benefits from last year. Though margins are compressing in the near term, Ulta's competitive advantages should enable it to navigate through headwinds. With its unique mix of prestige and mass beauty products, Ulta is able to flex its assortment to meet consumer demand. The loyalty program drives significant consumer loyalty, with members accounting for 95% of sales. As management works through the near-term margin pressures, Ulta's distinct positioning in the attractive beauty category leaves it well-positioned to deliver healthy long-term growth.

**Streamlining E-Commerce will Drive Traffic In and Out of Stores.** In recent years, Ulta has been investing in its e-commerce infrastructure and that investment paid off during COVID-19. Ulta had triple-digit e-commerce growth in 2020 with strong growth in 2021 as well. Ulta's e-commerce sales grew by a 27% CAGR from 2018 to 2022. With this growth, Ulta is better positioned than other retailers to support the shift to a more e-commerce-reliant consumer post-COVID with e-commerce projected to make up a quarter of the beauty market by 2027. This also supports an omnichannel approach where 31% of online orders were fulfilled through buy online, pick up in store (BOPIS) and ship from store in 2022 for Ulta. As in-store traffic increases from those shopping online and in person, Ulta is expanding its brick-and-mortar presence. Ulta plans on opening 25-30 stores in FY23 to add to its 1,300+ stand-alone stores. Ulta can also leverage the Target partnership of "shop in shops" where Ultas are in 300+ Target stores with management's long-term goal of Ulta Beauty in 800 Target locations. Overall, we see the combination of e-commerce and brick-and-mortar growth for Ulta resulting in margin improvement as well as top-line growth.

**Taking Action to Address Decelerating Operating Margins:** From 2016 to 2019 there was a decline in operating margin that prompted the company to re-evaluate its capital expenditure. Total capital expenditure for 2022 to 2024 is \$1.1 to \$1.4 billion with increased focus in IT and digital experiences, fleet investments, and supply chain. From 2017 to 2019 Ulta allocated 39% of their CapEx to new stores, but now moving forward from 2022 to 2024 new stores only makes up 21% of total CapEx allowing more capital to improve fulfillment and inventory management. The objective of these investments in innovation and technology is to reduce cycle time, increase simplicity for end user, maximize use of existing assets, and increase automation. These will result in the benefits of quality improvement, indirect hour savings, improved space and resource utilization, cycle time reduction, and bottleneck reduction. After talking with a research analyst, he sees these internal investments in fulfillment and inventory management as a crucial step for Ulta and believes these improvements will be realized within the next year. As a result, we see structural change in the business as a key area operating margin will improve in the future.

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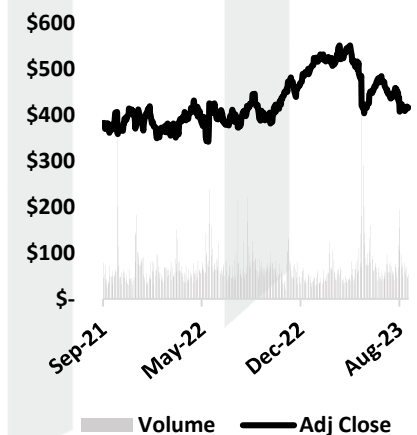
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Figure 1: ULTA 2-Year Stock Chart



Price	\$413.57
Price Target	\$520.15
Upside	25.58%
52-Week Range	\$373.80 – \$556.60
Dil Shrs Outstand	49.8m
Mkt Cap	\$20.36B
NTM EV/EBITDA	11.39x
NTM P/E	15.80x
TTM Revenue	\$10.73b

## Valuation

In our valuation of ULTA we built out a comparable store sales build and an efficiency rate for sales of new stores. We projected out COGS and SG&A as a % of revenue and used a blended valuation to reach our price target of \$520.15. We used a 11.5x terminal EBITDA multiple, a DCF with a discount rate of 10% and a LTGR of 2.5%, a 12x EV/EBITDA multiple on 2024E which is a discount to its 4-year average and in line with its beauty comps, and a 19x P/E multiple on our 2024E which has the same discount. We believe blended together represents the true value of ULTA to investors.

## Company Overview

Ulta Beauty is the largest specialty beauty retailer in the United States and the premier beauty destination for all beauty services. Ulta has over +25,000 products from more than 600 well-established beauty brands which includes Covergirl, CeraVe, Dior, and Morphe. The company operates more than 1,350 stores predominantly located in convenient, high-traffic locations and 350 free standing in Targets across the country. Their best-in-class loyalty program, Ultimate Rewards, enables members to earn points for every dollar spent on products and beauty services at Ulta Beauty, which accounts for 95% of revenue. The company operates in 6 segments: Cosmetics, Haircare and Salon, Skincare, Fragrance and Bath, Accessories and Service. With a well-established omnichannel presence Ulta targets its primary customer “The Beauty Enthusiast” which accounts for more than 65% of shoppers.

## Industry Overview

Ulta competes in a large and fragmented market. Defined as skincare, fragrance, makeup and haircare - the beauty market generated \$430 billion in revenue in 2022. Today, beauty is on an upward trajectory across all segments. The industry has reshaped itself from a department store business model into one of “premiumization,” with the role of influencers and key opinion leaders stressing the idea that beauty is becoming self-care. In addition, E-commerce in beauty has nearly quadrupled between 2015 and 2022, as consumers have drifted away from conventional, department stores and capitalized upon the digital sophistication of direct-to-consumer players. As the beauty landscape expands, the competitiveness within the industry is expected to become more intense worldwide. Individual brands have the opportunity to capitalize on both prestige and mass markets alike. Geographic diversification beyond China and the United States is predicted to create long term growth worldwide in a resilient industry.