Burlington Stores Inc. (NYSE: BURL)

Recommendation: **Buy**
Price as of Feb 23rd, 2022: **$210.00**
Target Price: **$289.47**
Implied Upside: **37.8%**
Investment Horizon: 3-5 **Years**

Culverhouse Investment Management Group **|** Point72 2022 Case Competition

CULVERHOUSE
INVESTMENT MANAGEMENT GROUP


Matthew Gaines


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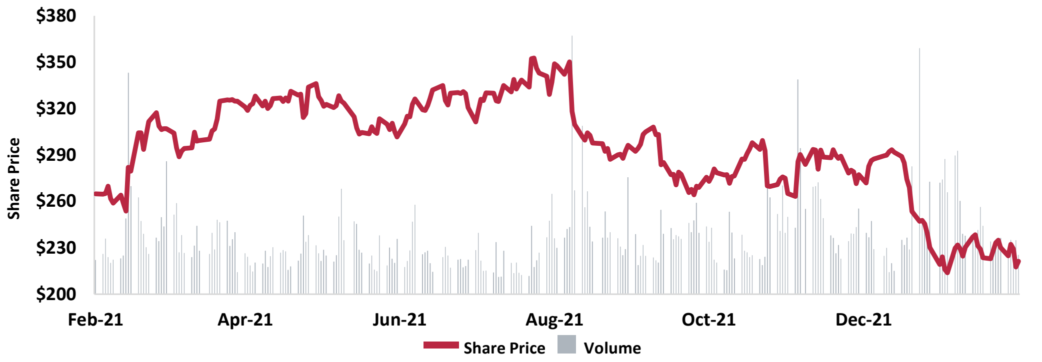
Burlington 2.0

Burlington's TTM – 40% Off All Time High[1]



Short Term Headwinds Overshadow Long-Term Plans

Short-Term Headwinds

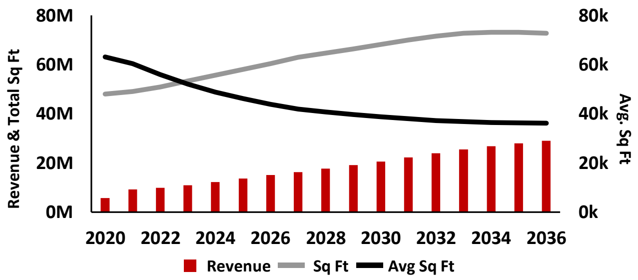
- Management guidance of negative comparable SSS for FY 2022
- Latest CPI print at over 7.5%
  - Largest 12-month increase since February 1982
- Supply chain issues
  - Significant impact on GM
  - Exposure to spot transportation rates

Long-Term Plan

- Smaller Store prototypes
  - ~25k sq ft long term target
- Better Inventory management
  - Higher quality
  - Faster turns
- Better Locations
  - For new stores and relocating existing stores

Changing Store Economics

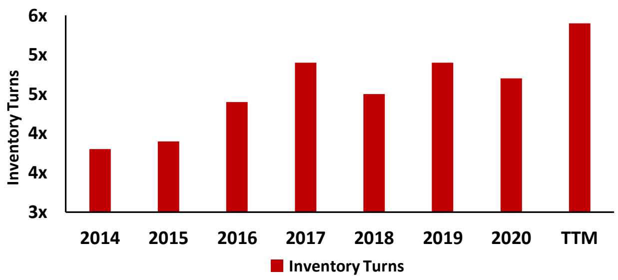
Decreasing store size and moving locations leading to higher store productivity, and improving sq. ft operating metrics



Nimble Inventory

Burlington's focus on smaller ticket items that increase inventory turnover to help improve margins and reduce write-downs

"Even though you build up strategies six months in advance, there's a lot of flexibility in the model. You need to be nimble"
– Former Director of Store Initiatives at Burlington[2]



Hedged Against ST Uncertainty

Off-price is significantly hedged against macro-uncertainty, with Burlington best positioned to handle inflationary pressure

More Inflation

- Drives customers down the value chain to BURL
- Creates attractive sourcing opportunities
- Enables BURL to pull price lever

Less Inflation

- Sourcing costs subside
- Accelerates closures at full price retail
- Creates real estate leverage for BURL

(1) CapIQ (2) Tegus

Burlington is the Next Ross

Why we Love Off Price Retail

Flexible Inventory[1]

When consumers shop at off-price retailers..

…They expect low prices

If the item is out of style, the consumer will still purchase as low price is the value provided

Protection from Ecommerce

Full-price retailers must charge higher prices to achieve a similar margin profile as off-price

Full Price
0% Discount

macy's Dillard's

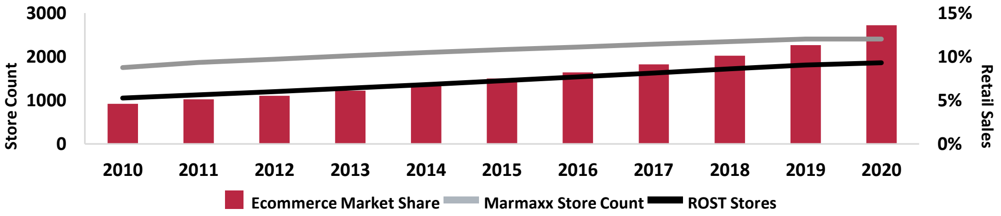
Off-Price
20-60% Discount[2]

Burlington
TJ·maxx ROSS DRESS FOR LESS

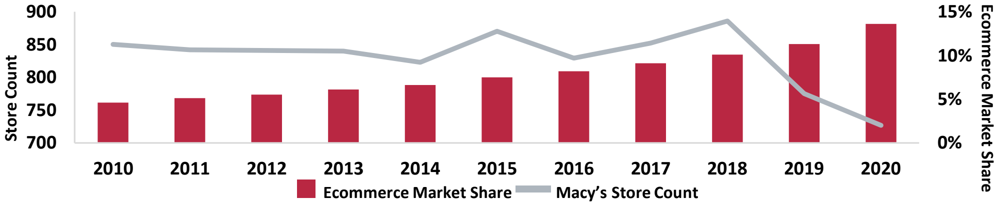
Full-Price brands do not allow online advertising due to the brands wanting to maintain pricing power

PUMA
adidas
RALPH LAUREN
Calvin Klein

Off-Price has Grown with Ecommerce… [3]



…While Full-Price has Fallen Apart [3]



Burlington is Closing the Gap on Their Closest Competitor

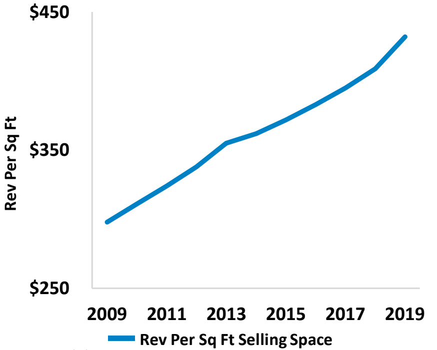
Ross Stores vs. Burlington EBIT Margin [4]

Burlington is Led by Proven Operator

CEO Michael B O'Sullivan

O'Sullivan has been at Burlington since September 2019. He previously worked with Ross for 16 years and served as the COO. Prior to this he worked for Bain & Company as a partner for 12 years

Who Transformed Ross [5]



(1) Price and Quality Value Influences on Discount Retail Customer Satisfaction and Loyalty UAB (2) Burlington Company Website (3) Company Reports & US Census Bureau: US Department of Commerce (4) Company Reports (5) Company Reports

Burlington's Strategy

Changing Store Economics Will Boost Long-Term Margin Expansion

Shift in Store Demographics(1)

Decrease Store Prototype Size

- Burlington is moving away from the traditional 100,000 Sq Ft store
- Opening stores with an average Sq Ft between 25,000-30,000

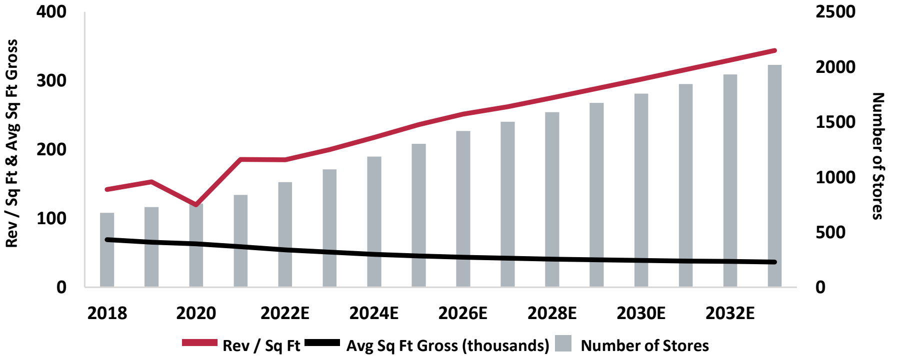
Leaner Inventory Strategy

- Smaller stores allow for more strategic buying based off consumer trends, increasing inventory turns
- Leads to decreased markdowns, creating gross margin expansion

Relocation and Long-Term Store Target

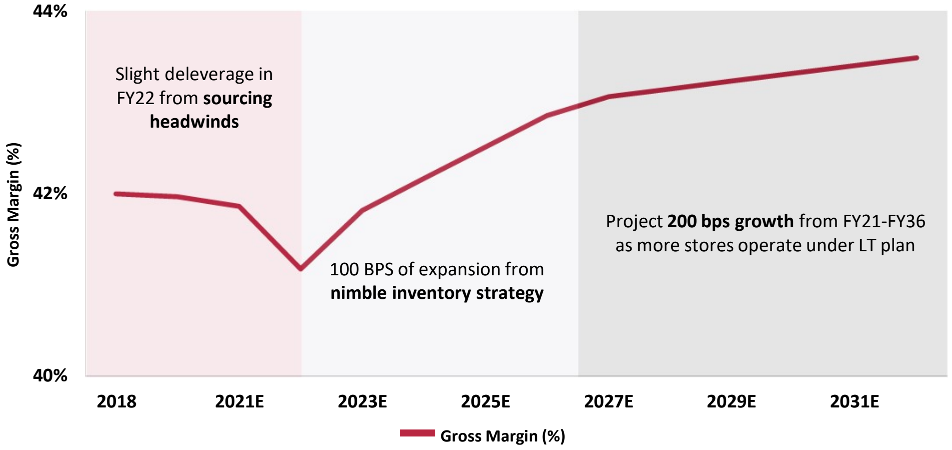
- Burlington's long-term goal is **2,000** stores. Achieved by opening ~150 gross new stores / year, inclusive of ~30 relocations of stores that are oversized, in poor locations
- This will lead to 300 BPS of **operating margin expansion** in the next 5 years from lower SG&A expenses and higher revenue/Sq Ft

Will Drive Store Efficiency Higher



Accelerating Margin Expansion after 1H 22

Gross Margins

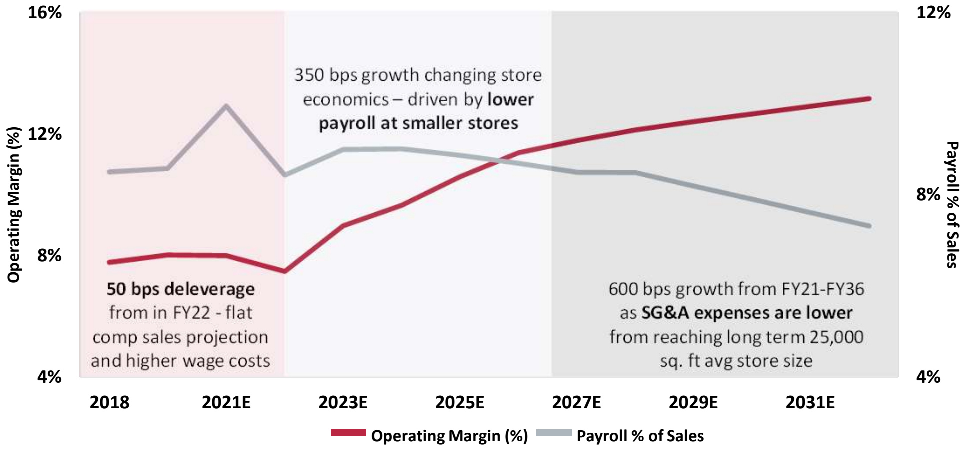


Slight deleverage in FY22 from **sourcing headwinds**

100 BPS of expansion from **nimble inventory strategy**

Project **200 bps growth** from FY21-FY36 as more stores operate under LT plan

Operating Margins



350 bps growth changing store economics – driven by **lower payroll at smaller stores**

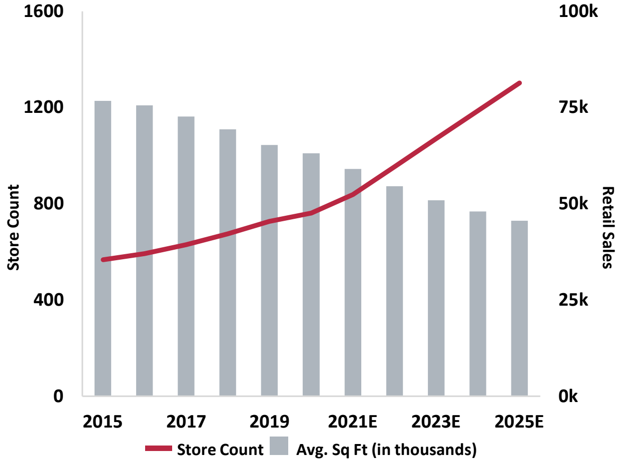
50 bps deleverage from in FY22 - flat comp sales projection and higher wage costs

600 bps growth from FY21-FY36 as **SG&A expenses are lower** from reaching long term 25,000 sq. ft avg store size

(1) Company Reports

Margin Expansion is Driven by Nimble Inventory Strategy at Smaller Stores

Decreasing Avg. Store Size(1)

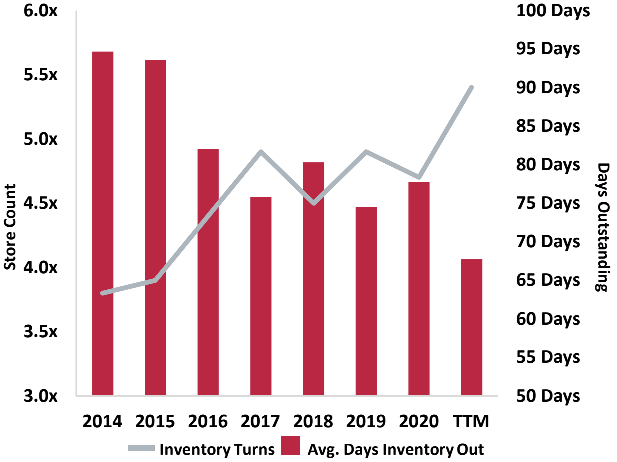


Requires Higher Sourcing Discipline

> "Burlington can **afford to do luggage when they were in 50,000 square foot stores** or bigger. You'll notice if you've been in any of the newer Burlington's where they're getting down to **35,000 square feet, it's no longer big suitcases**"
> **– Former Senior Director of Customer Strategy Burlington(2)**

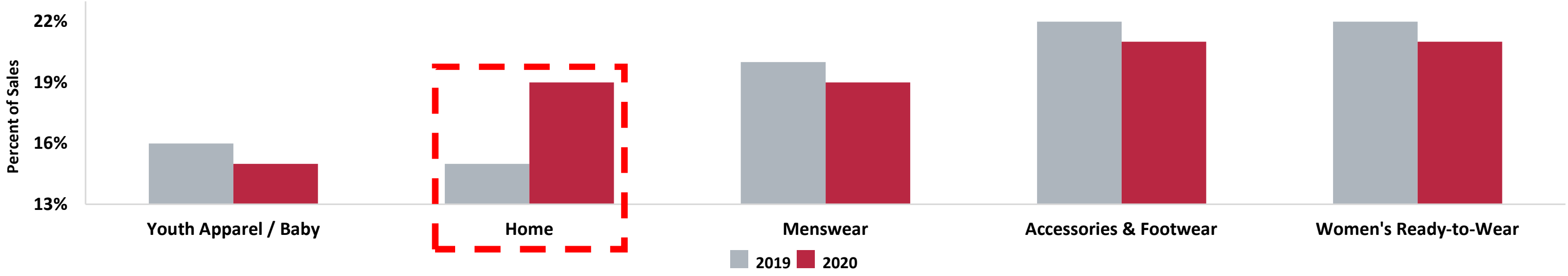
+50,000 Sq Ft	-35,000 Sq Ft
Stock larger, higher price items that turnover slowly due to excess space	Can **stock a small, low-price item in smaller store** that will turnover quickly
=	=
This inflates fixed costs and increases markdowns, lowering AUR	Leads to lower markdowns, driving higher AUR and Gross Margin Improvement

Which Increases Inventory Turns (3)



Burlington Monitors Consumer Preference and Shifts Inventory to Match

> "We're not dependent on a single category or brand. We're very good at moving money from businesses where there's either a **weak trend or poor supply** to businesses where there's **strong sales and good supply opportunity**" **– Michael B O'Sullivan CEO, Burlington(4)**



Lower Inventory Risk

Matching Consumer Taste

Which allows quicker turnover to inventory matching consumer demand

Lower Write-down Risk

Ensures inventory has high turnover & increases rev per sq ft of stores

(1) Company Reports (2) Tegus (3) Company Reports (3) Burlington Q3 2021 Q3 Earnings Call

Thesis – More Inflation

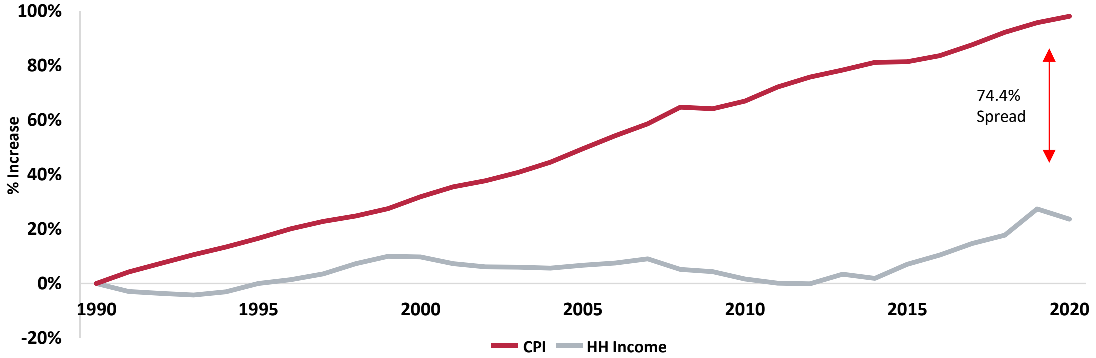
Leads to a SSS Beat as their Value Proposition Increases and Inventory is Abundant

Consumers Continue to Lose Spending Power

Household Income historically **lags** CPI, causing consumers to be more **price sensitive**

Discretionary items hit **most** by this trend as consumers seek to **save money**

CPI vs HHI 1990-2020 (1)



Increasing Burlington's Value Proposition

"The delta between the price of an item at Burlington and the price of a like item at a full price store has never been greater."
– **Michael O'Sullivan, Burlington CEO**(2)

Which Allows Burlington to Take Share

Full-price customers become more price sensitive, **pricing down** to off-price to save

Leading to a **SSS beat** for FY22

Inflation Also Creates Sourcing Opportunities

Supply chain delays cause full-price retailers to **cancel orders.** Suppliers sell this inventory to Burlington at **a large discount**, keeping cost-basis low

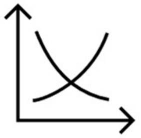
Allowing Burlington to…

Push relevant inventory into stores to meet the rising demand, or **pack away irrelevant inventory** in warehouses until the appropriate season or demand arises

And Forcing Full-Price to Operate in an Environment of…

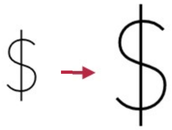
Artificially high sourcing discipline which leads to lower inventory levels. This creates a **less promotional** pricing environment and higher AUR at full price retailers, further driving the value proposition of off-price

And Provides a Lever to Offset Margin Headwinds



"We are the third-largest off-price retailer. So clearly, it wouldn't make sense for us to take the lead on raising retail prices, but we're not proud. If we see something and we believe something is working. There's really nothing to stop us from evolving."
–Michael O'Sullivan, Burlington CEO(3)

TJX Already Making a Move



"We're very optimistic about the margin opportunity from our strategy to surgically adjust retails while maintaining our value proposition for customers"
–Ernie Herrman, TJX CEO(4)

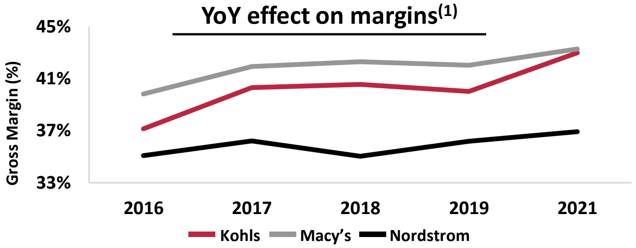
(1) Federal Reserve Bank of Minneapolis & (2) Burlington 2021 Q3 Earnings Call (3) Burlington 2021 Q3 Earnings Call (4) TJ Maxx 2021 3Q Earnings Call

Thesis – Less Inflation

Leads to Lower Sourcing Costs and Increased Real Estate Leverage From Closures

Inflation Props Up Full-Price Profitability

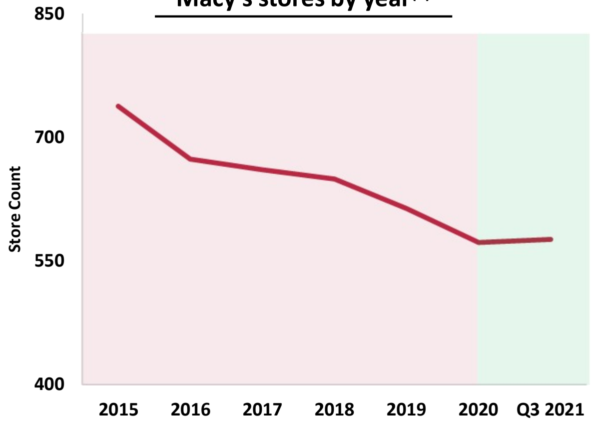
YoY effect on margins[1]



"Gross Margin for the quarter improved by approximately 100 basis points, **driven by stronger price selling, fewer markdowns due to leaner inventories and a number of pricing promotion initiatives**"
– Jeffrey Gennette, Macy's CEO[2]

Halting the Trend of Store Closures

Macy's stores by year[3]



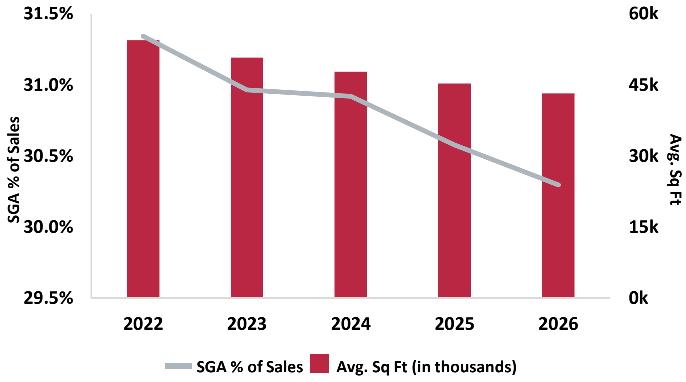
Less Inflation Will Normalize Closures

Large retail chains have been able to **stop** closing stores and even open new stores recently as margins have strengthened from **less markdowns**. As inflation subsides, we expect to see the **closure trend continue**

Creating Whitespace and Prevents Cannibalization

"[Burlington can] squeeze their square footage down even more because **it opens up a lot more possibilities in terms of available locations.** And that real estate, given the state of brick-and mortar right now, it should be pretty affordable"
– Former Burlington Director of Store Initiatives [4]

Closures Accelerate Changing Store Economics



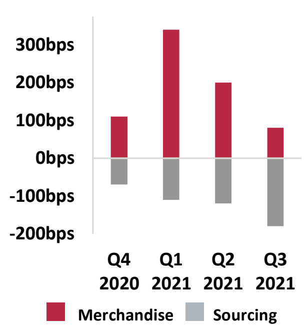
Consistent floor plans allow for more efficient inv. management[2]

Fewer employees required per Store

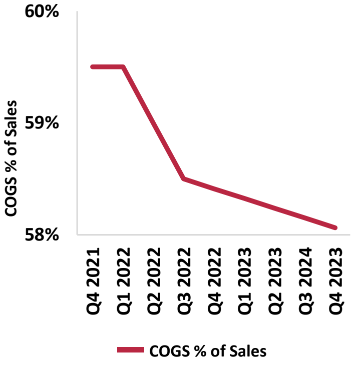
Cheaper leases on a per Store Basis[2]

Merchandise Margin Expansion Will Show up After 1H 22

Effects on Gross Margin[5]



"Freight and supply chain expenses [should] remain at their current levels through mid-2022 and then begin to moderate" **– John B. Crimmins CFO, Burlington** [6]



(1) Company Filings of Kohls, Macy's and Nordstrom (2) Macy's Q3 2021 Earnings Call (3) Company Reports (4) Tegus (5) Burlington Q4 2020, Q1-Q3 2021 Earnings Call (6) Burlington Q3 2021 Earnings Call

Valuation

Overview

DCF – Three Statement Model

Discount Rate	10%
LTGR	2.5%
Sum of PV	$12,153,238
Terminal Value	$10,464,940
EV	$22,618,178
(+) Cash	$1,185,383
(-) Debt	$4,535,699
Equity Value	$19,267,862
Diluted Shares Out	68,205
Implied Value	$282.50
Current Price	$227.00
V/P	1.24
Upside	24.4%

Store Projections

Our three-statement based model projects retirement of old stores and building of new stores using a store build waterfall. We assume stores closed are a slightly higher % of the current avg sq foot/store

Revenue Projections

We then calculate our revenue by multiplying a rev per sq ft by the total sq ft and assume that new stores operate at a fraction of the revenue an existing store comps at until they reach their second year of operation

Expense Projections

COGS and SG&A ex payroll are driven by our thesis + management models for the implication of certain growth expectations, then adjusted for seasonality. Payroll on a per store basis

Depreciation and Capex

Capex was calculated using FY21 as a base year, calculating the average cost per store opened and then applying 3% increase per year to account for inflation. Depreciation is based on a waterfall built from current and previous stores

WACC Calculation

Risk Free Rate	1.94%
Market Return	10.0%
Equity Beta	1.30
Interest Rate	4.02%
Tax Rate	21%
Current Price	$227
Basic Share Count	66,740
Cost of Equity	12.03%
Cost of Debt	4.02%
Equity Amount ($)	$15,149,980
Debt Amount ($)	$4,535,699
Total	$19,685,679
WACC	10.0%

Sensitivity Analysis

Long-Term Growth Rate

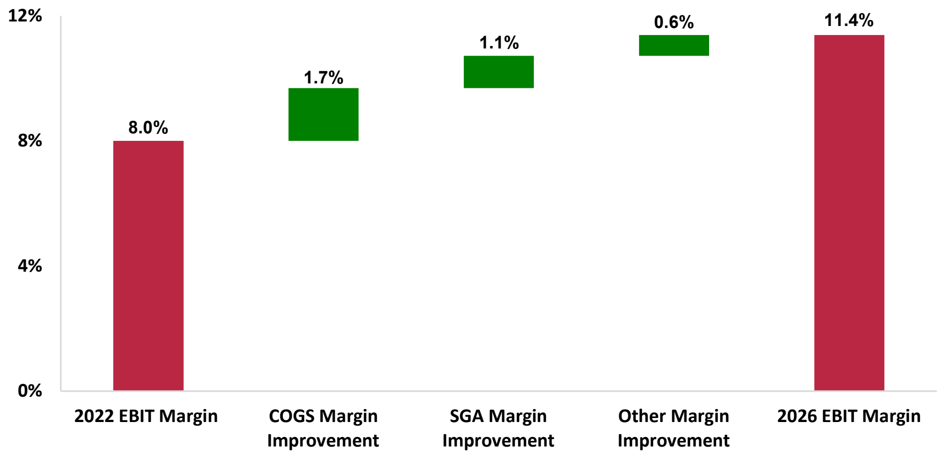
Discount Rate	2.00%	2.25%	2.50%	2.75%	3.00%
9.50%	$298.78	$304.82	$311.29	$318.24	$325.73
10.00%	$271.59	$276.55	$281.85	$287.51	$293.57
10.50%	$247.84	$251.95	$256.32	$260.97	$265.94
11.00%	$226.94	$230.37	$234.01	$237.87	$241.97
11.50%	$208.43	$211.32	$214.37	$217.59	$221.00

# of New Stores (Gross) / Quarter

New Stores Comp Growth	25	30	36	40	45
4.0%	$236.10	$262.27	$293.45	$314.14	$339.90
3.0%	$228.47	$253.13	$282.50	$301.98	$326.23
2.0%	$221.02	$244.21	$271.82	$290.12	$312.90
1.0%	$213.76	$235.51	$261.40	$278.55	$299.89
0.0%	$206.68	$227.03	$251.24	$267.27	$287.22

Drivers of Model and Key Assumptions

DCF – Three Statement Model



Gross Margin Assumptions

Sourcing Costs

Alleviate in late 2022 and stay normalized with no future big issues seen

Merchandising Margin

Continued Improvements in margins from smaller stores, quicker turns

Gross Margin

Combination sees gross margin improving ~100 bps by 2026 and another ~100 at terminal year

SGA Margins

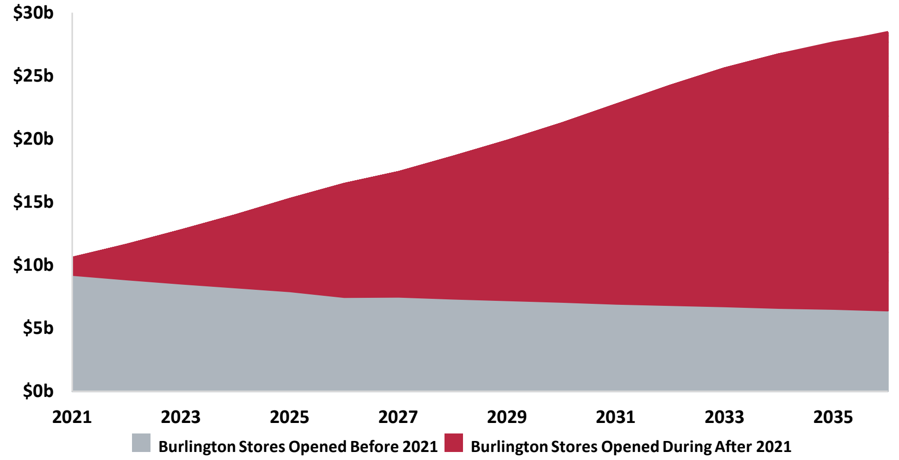
SGA Margins

- Payroll expense / store decreasing ex inflation by 200 bps / year starting in 2023
- SGA ex payroll constant based on historical averages, adjusted for seasonality

Changing Store Economics

- **Distribution system** is leveraged as store count and sales increase
- Less overhead per store (rent, employees)
- **Simplification** of stores equals efficiency

Revenue Breakdown



Store Count

New Stores

- **~140** gross new stores opened(including relocations) through **2026**, then slowing.
- Avg Sq Ft decreases by 1% quarterly until **25k** target reached

Closed Stores

- ~**25-30** Projected store closures / year including relocations.
- Avg Sq Ft projected as **125%** of previous year gross average

Revenue Projections

Existing Stores

On a Sq Ft basis, comping **flat through 2023** and growing at **~2-3%** thereafter, driven by closure of larger stores

New Stores

Revenue of **~75% in 1st year**. **Flat comps** through 2022 and growing at 3-4% thereafter. Smaller stores in better locations provide more opportunity

Catalysts

What Moves the Needle?

Looking Ahead to the Next Two Years – Where is our Value?

March 2nd, 2022

1st Half of 2022

2022

2023

2021 Q4 Earnings

- Management consistently states their methodology of **projecting low and chasing the trend**
    - Some of retail sales decline driven by shortages
    - Burlington's pack-and-hold inventory helps alleviate this issue
- Consumer confidence **pulling back is beneficial for off-price** as consumers budget appropriately
    - Drives comparable store sales
    - Helps SGA margin

Price Lever is Pulled

- TJ Maxx continues to **raise prices; surgical price** increases began in 2021 Q3 and are expected to become more widespread
- Ross Stores also has begun to **surgically raise prices and has noted slight increase in AURs**
- Burlington follows the market leaders and raises prices enabling them to:
    - Expand gross margins
    - Better deal with increasing supply chain costs
    - Grow top line revenue

Fiscal Year 2022 Comp Beat

- **Full Price inventory stays leaner in 1H 22**, continuing to allow Burlington to purchase better inventory
    - Fits into existing strategy of strategic price raises based on demand
    - Keeps markdown activity low, serving as a lever for gross margins
- Economy wide inflation continues through 1H 22, **pushing consumers down the value chain**
- New Stores in 2nd year or on continue to outperform on comps, pushing rev/store up

Market Aligns with Changing Economics

- Store economics have changed in a meaningful way
    - Average gross square footage has **decreased below of 30,000 sq ft** per store
    - **Revenue per gross square foot continues** increasing
    - **Large, underperforming stores have been closed** and replaced with the new store prototype
    - Burlington better understands the placement of the stores and can look at expanding store target
    - Cost cutting strategies on sourcing inventory expenses and SG&A are beginning to play out

Bear Case

Risks to Our Thesis

The Bear Case

Inflationary Environment Subsists

- Inflation continues to spread across the economy, driving up prices of goods other than retail
- Leads to permanently higher wage expenses for BURL associates and sourcing costs stay high into the 2H of 22(1)
- Leads to a continuation of suppressed Gross Margin from elevated sourcing costs and freight expenses(1)

Consumers React Negatively to Retail Increases

- Burlington's price increases could lead to less consumer spending at off-price or a shift down the value chain
- Leads to less market share gains and more margin deleveraging

New Store Performance Falls Short

- New stores are projected to comp above existing stores and competitors
- Would not offset projected FY22 -5% projected comps decline and lead to a miss on projected double digit topline increases

Supply Chain Complications Make Inventory Unavailable

- Inventory does not show up at ports and Burlington is unable to meet high demand
- Would lead to lower SSS, possibly lower than managements -5% guidance

Our View

Continued increase in orders cancelled by department stores will give Burlington more opportunities to purchase high quality inventory. This results in…

1. Higher realized prices **shift to higher long-term prices** as department stores inventory stays lean and inflation pushes up item prices
2. Value proposition increases as consumers become more price-sensitive, driving sales
3. Burlington **can raise prices** in line with competitors, creating margin accretion(1)

Burlington's Strategy
Based on demand, extremely conservative, and will follow competitors

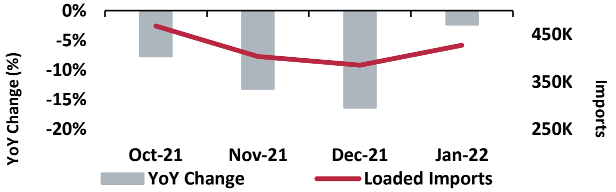
TJX's Surveys
Already raised some retail prices and shown no sign of consumer resistance in surveys

Value Proposition
Delta between FP and OP has never been wider

Proof of Concept
New stores in their 2nd year of operations or later already outperform old stores(1)

Trust in Management
O'Sullivan's track record at Ross provides conviction on ability to execute higher rev sq ft

LA Port data shows signs of recovering imports (2)



Pack and Hold Hedge
Q3 historically drains reserve inventory. Q3 21 Saw an increase 174% vs. Q319, providing ample inventory should the imports decay

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(1) Burlington Q3 2021 Earnings Call (2) Los Angeles Port Authority Data