

Current Share Price: \$10.79 (close of market on 12/2/16)

Target Price: \$13.17-\$16.43

Expected Upside: 22%-52%



Express is an American fashion retailer who sells apparel and accessories. They have stores open in the United States, Canada, and Puerto Rico. They sell to both young men and women with their target market in the range of teenagers from around 16 to young adults at the age of 30.

Disclosure: I am long Express (EXPR).

Elevator Pitch

Apparel is a cyclical industry and Express reported a lackluster 3rd quarter and lower guidance for the 4th quarter. Net income for 2016 is expected to be between \$55M-\$58M which gives the company a 2016 PE ratio of 15 which isn't too high. Express is improving their brand image after bringing on two popular athletes, MLB MVP Kris Bryant and NBA MVP Steph Curry, over the past two years. I shop at Express and see other customers shopping there as well when I go. Checkout lines aren't out the door but they are present. I don't see the fundamentals of the business deteriorating and the taste in the clothing style disappearing over the next five years.

The company has \$101 million in cash and cash equivalents with no long term or short term debt, so the financial position is very good. Lease agreements aren't capitalized but will be \$200M in 2017, \$184M in 2018, \$167M in 2019, and \$157M in 2020. Express has been profitable in the past based on net income and free cash flow, and I don't see the company's clothing line being so out of favor over the next five years that these leases become an issue.

The current market cap at the close of the market on December 3, 2016 is \$846 million and free cash flow over the past 12 months is \$56M which is a multiple of 15. Express has earned an average of \$125M of free cash flow over the past 7 years and I expect the \$56M to revert to \$100M over the next 5 years due to increased brand awareness, higher e-commerce sales, and management's ability to continue to design fashionable clothing to bring in existing and new shoppers. I think the current fears will subside in 2017 and the stock price will appreciate to around \$13-\$16 a share, resulting in an annual return between 22%-52%.

Business Background

Express is an American fashion retailer who sells apparel and accessories. They have stores open in the United States, Canada, and Puerto Rico. They sell to both young men and women with their target market normally in the range of teenagers from around 16 to young adults at the age of 30. The first Express store opened in 1980 when they were owned by Limited Brands. In 2007, a 67% ownership stake was sold to the private equity firm Golden Gate Capital Partners who then took the company public in May 2010 for \$17 a share.

At the beginning of 2016, there were 653 stores across the US, Canada, and Puerto Rico including 81 outlet stores. Express also has franchise agreements with franchisees who operate stores in Latin America, the Middle East, and South Africa. Below is a breakdown of where the stores are located as of January 30, 2016:

Location	Count	Location	Count	Location	Count
Alabama	6	Louisiana	9	Ohio	20
Arizona	11	Maine	2	Oklahoma	5
Arkansas	4	Maryland	12	Oregon	4
California	79	Massachusetts	18	Pennsylvania	27
Colorado	10	Michigan	22	Puerto Rico	4
Connecticut	11	Minnesota	14	Rhode Island	3
Delaware	2	Mississippi	3	South Carolina	9
Florida	51	Missouri	12	South Dakota	1
Georgia	17	Nebraska	4	Tennessee	10
Hawaii	2	Nevada	9	Texas	52
Idaho	1	New Hampshire	4	Utah	6
Illinois	32	New Jersey	22	Vermont	1
Indiana	12	New Mexico	3	Virginia	16
Iowa	8	New York	46	Washington	10
Kansas	5	North Carolina	16	West Virginia	2
Kentucky	6	North Dakota	1	Wisconsin	12
				Total	636

Source: Express 2015 Annual Report; US Locations

Location	Count
Alberta	4
British Columbia	2
Ontario	11
Total	17

Source: Express 2015 Annual Report; Canada Locations

The majority of sales come from apparel, but they also have sales from accessories such as watches, wallets, and shoes. Other revenue in the sales chart below consists of revenue from franchise agreements, shipping and handling, and the selling-off of old inventory to third parties.

	2015		2014		2013	
Apparel	\$ 2,062,235.00	88%	\$ 1,883,641.00	87%	\$ 1,922,868.00	87%
Accessories and other	\$ 242,408.00	10%	\$ 240,052.00	11%	\$ 254,426.00	11%
Other Revenue	\$ 45,486.00	2%	\$ 41,788.00	2%	\$ 41,831.00	2%
Total Net Sales	\$ 2,350,129.00	100%	\$ 2,165,481.00	100%	\$ 2,219,125.00	100%

	2015		2014		2013	
Stores	\$ 1,911,923.00	81%	\$ 1,769,478.00	82%	\$ 1,836,704.00	83%
E-commerce	\$ 392,720.00	17%	\$ 354,215.00	16%	\$ 340,590.00	15%
Other Revenue	\$ 45,486.00	2%	\$ 41,788.00	2%	\$ 41,831.00	2%
Total Net Sales	\$ 2,350,129.00	100%	\$ 2,165,481.00	100%	\$ 2,219,125.00	100%

Management

Michael Weiss was the CEO from 2007 until January 30, 2015 when he decided to step down and pass the reins to David Kornberg, who was the president at the time. Michael Weiss was with Express since it was owned by Limited Brands in 1980, minus a brief retirement in 2004 and then returning in 2007 when it was acquired by Golden Gate Private Equity. In 1980, he started as a Merchandise Manager when Express was an eight-store experiment of Limited Brands. Michael currently is the Chairman Emeritus. He owns 1,541,972 shares, valued at \$16,406,582, and 155,158 options that are valued at \$1,650,881 based on the close of the market on December 2, 2016. He has been a very important contributor to Express's success since he took the company from a money losing company in 2007 when he first became CEO, to a profitable company when he retired at the end of January 2015. His performance has been good, but has also been a little inconsistent due to the cyclical nature of the industry, and the high growth that companies have in their early years of going public.

In percentages	Jan-08	Jan-09	Jan-10	Jan-11	Jan-12	Jan-13	Jan-14	Jan-15
Return on Equity	-1.7	-8.15	80.78	116.06	68.41	42.7	27.56	13.26
Return on Invested Capital	-1.26	0.6	23.14	36.13	33.6	28.77	18.74	9.56
Return on Assets	-1.02	-3.08	8.71	14.71	16.31	14.8	10.59	5.55
Profit Margin	-0.58	-1.67	4.38	6.68	6.79	6.48	5.25	3.16

Source: Morningstar

David Kornberg has been the CEO since January 2015. He is also the President and has been a member of the Board since January 2015. He joined Express in 1999 and has held roles with the company through his tenure such as Executive Vice President of Men's Merchandising and Design, and General Merchandising Manager of Men's business. David owns 367,614 shares of Express stock and 78,947 options which are valued at \$3,911,412 and \$839,996 at the close of the market on December 2nd. He has a 73% approval rating according to Glassdoor which is a pretty favorable rating.

In percentages	Jan-16
Return on Equity	19.84
Return on Invested Capital	16.96
Return on Assets	9.49
Profit Margin	4.96

Source: Morningstar

Investment Thesis

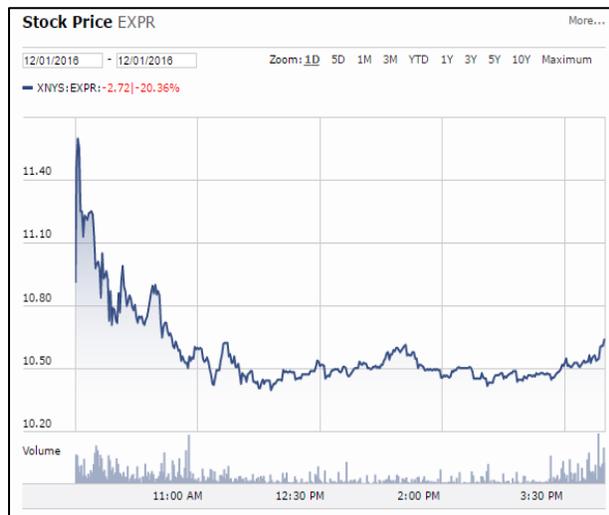
The reason for this buying opportunity:

Investors have an opportunity to acquire a position after the 20% drop based on a lackluster 3rd quarter, lower same store sales, and downward revisions for 2016 results. The President of Express, David Kornberg, also sent fear to investors and traders with the following remarks on the Q3 conference call:

“We expect the holiday season to remain challenging as mall traffic and a highly promotional retail environment continue to be headwinds.”

The stock price dropped 20% on December 1, 2016 to close at \$10.64 a share which brings the price down to its all-time low, which is where it was trading during the middle of November 2012.

Stock Price Chart on December 1, 2016



Stock Price Chart Since IPO



Sources: Morningstar

In the 3rd quarter, net sales declined 7% from last year and comparable sales declined 8% which is bad news, but management has focused on cutting costs as well. Buying and occupancy expenses were lower by \$2.4 million, SG&A was \$10 million lower than last year, and management continues to plan for \$44 to \$54 million of annualized cost savings over the next few years, with the majority coming from lower spending on selling, general, and administrative costs. Management has stated that they are

committed to cost savings and if they deliver, this will help cushion the lower sales that they are expecting for 2016.

In addition to the cost savings, e-commerce sales have also been a positive for Express. Here is what David mentioned about them on the Q3 conference call:

“E-commerce was a bright spot in the quarter delivering 15% growth as we capitalized on the increasing preference of our customer demographic towards this channel with a strong and clear marketing and merchandizing message.”

Opportunity Going Forward:

Despite the fears of a recession, slow holiday shopping season, pullback in spending from consumers on retail, etc., I believe that the reward is on investor’s side with an entry position at the current low price because I think the market overreacted. The brand is growing more popular due to their successful marketing campaign to date. They have seen an increase in Instagram followers which is very important to young shoppers, as well as signing Kris Bryant (MLB baseball player) and Steph Curry (NBA Basketball player) to marketing partnerships over the past two years. Both were the most valuable players in their respective sports in their previous seasons.

To give an example of the impact that Kris Bryant’s MVP season has had for Express’ brand image, the CEO, David Kornberg, mentioned on the 2016 Q3 conference call that Kris Bryant’s video campaign on YouTube drove more than 2 million views and resulted in their best performing video campaign to date.



Source: prnewswire.com



Source: Express

Although clothing is an industry that goes in and out of favor, I don’t see shoppers currently abandoning the brand. I researched Express clothing on Yelp.com and the ratings of most of the stores that I found were consistently from 3 to 4 stars. These locations were scattered in major metropolitan areas like Los Angeles, Miami, Philadelphia, and New York. There were ratings that were below 3 stars but these were mostly due to poor customer service and weren’t tied to the product.

Financial Position

Express is currently in a stable financial position with no short term or long term debt on the balance sheet and \$101 million of cash and cash equivalents. They do have a total of \$1,496,667,000 in

noncancelable lease commitments from 2016 and beyond which are expensed, but these have been adequately funded in the past from sales and will be going forward in my opinion.

Minimum rent commitments under noncancelable operating leases are as follows (in thousands):		
2016	\$	227,799
2017		197,826
2018		183,520
2019		167,318
2020		157,149
Thereafter		563,055
Total	\$	1,496,667

Source: Express 2015 Annual Report

Relative Valuation

	Market Cap	TTM P/E	P/FCF (TTM)	P/S (TTM)	P/B	ROE (TTM)	Debt/Equity (TTM)
Express	0.834B	9.72	14.89	0.36	1.36	15%	0%
GAP	10B	14.55	5.62	0.65	3.67	25%	64%
Guess	1.2B	16.99	Negative	0.57	1.20	7%	3%
Urban Outfitters	3.7B	16.49	7.06*	1.06	2.96	18%	0%
Abercrombie	0.965B	74.74	Negative*	0.28	0.80	1%	28%
Ralph Lauren	8.69B	44.56	6.45	1.21	2.42	5%	27%
Industry Average	N/A	21.87	N/A	1.49	12.38	41%	132%

*Excludes Q3 2016 free cash flow because cash flow statements were released.

Source: Fidelity/S&P Capital IQ and my calculations

The chart above shows how Express is being priced at compared to its competitors. They are in the best position based on debt/equity along with Urban Outfitters, since both companies have zero debt on the balance sheet (doesn't include leases). They have the lowest TTM P/E ratio following the 20% drop on December 1st which I think will trend higher during 2017 as investors digest the overreaction to one quarter in a cyclical industry.

The P/B ratio of 1.36 is below most competitors except for Guess and Abercrombie, which is encouraging because Express has been able to grow their book value from \$483M in April 2014 to \$610,694 in October 2016 with most of this growth coming from retained earnings. The growth in book value is reflected in their return on equity which was 15% over the past twelve months and has been above 12% since 2010.

Intrinsic Valuation

Express has a market cap of \$846M and TTM free cash flow of \$56M as of October 31, 2016, which translates into a multiple of 15. I estimate a 7.5% growth rate over the next five years which would bring free cash flow to \$81 million in 2022. I believe this is reasonable since free cash flow has averaged

Intrinsic Value Scenarios

	Bear Case	Bear Case	Base Case	Bull Case	Bull Case
5 yr growth rate	5%	7.5%	7.5%	7.5%	10%
Required Rate of Return	15%	15%	10%	10%	10%
Terminal Value growth rate	3%	3%	3%	3%	3%
Sum of Discounted FCFs	214,891.95	229,754.10	261,477.83	261,477.83	280,000.00
FCF in Terminal Value Year	73,615.92	82,807.10	82,807.10	82,807.10	92,894.22
P/FCF Multiple	10	15	15	20	20
Terminal Value	736,159.21	1,219,926.02	1,242,106.49	1,656,141.99	1,857,884.34
Discount rate at year 5	0.50	0.50	0.62	0.62	0.62
Discounted Terminal Value	366,001.23	617,546.45	771,250.41	1,028,333.88	115,360.00
Sum of discounted FCF plus Disc. Terminal Value	580,893.18	847,300.55	1,032,728.24	1,289,811.71	1,433,600.00
Shares outstanding	78,410.00	78,410.00	78,410.00	78,410.00	78,410.00
Value Per Share	\$7.41	\$10.81	\$13.17	\$16.45	\$18.28
Price Per Share (Market Close 12/2)	\$10.79	\$10.79	\$10.79	\$10.79	\$10.79
Upside (Downside)	-31%	0%	22%	52%	69%

Financial data is in thousands except for multiples, per share numbers, and percentages.

Catalysts

Earnings surprise – Management has revised their 2016 outlook downward to reflect a more cautious viewpoint. This outlook seemed like it was mostly based on Black Friday sales being lower than initially anticipated. There are still another 20 days of shopping for Christmas and with the unemployment rate at a 9-year low, along with a healthy economy, there is still the possibility that earnings for the 4th quarter surprise analysts. The 5-year chart of the stock price on Page 5 shows the price activity each year going back to the company's IPO. Each year, the stock has gone down on pessimism towards the end of the year, but then picks back up at the beginning of the new year as fears subside. This may signify management taming Wall St. expectations to beat year-end estimates or over-expectation for holiday sales by analysts. Although history doesn't represent the future, it is something to keep in mind.

I/B/E/S Estimates vs Adjusted Actual (Fiscal Year)			
	I/B/E/S Estimates vs Adjusted Actual		
	Consensus Est. EPS (\$)	Adjusted Actual EPS (\$)	Est. Low / High Range (\$)
Previous Year (Ends 01/31/16)	1.42 (16 Analysts)	1.45	1.41 / 1.44
Current Year (Ends 01/31/17)	0.85 (10 Analysts)	--	0.80 / 0.99
Next Year (Ends 01/31/18)	0.95 (15 Analysts)	--	0.66 / 1.08

Source: Fidelity

Possible Share Repurchase - Express spent \$51,538,000 in the previous quarter repurchasing shares and the same amount in the second quarter. Repurchases have come from excess cash from business operations. If management continues to repurchase shares, then this could give a boost to the share price. Express hasn't been repurchasing shares at the most convenient time, but now would be an opportune time to do so in my opinion. The last quarter was their best price that they were repurchasing at, which was around \$11-\$13 a share, but before that, share repurchases were around \$15-\$17 a share.

Risks

The apparel industry is cyclical which can have a material effect on earnings and cash flows. Some other apparel companies like Abercrombie and Aeropostale have already seen some of these effects recently. The 20% drop in Express stock price is very likely the market factoring in a recession after eight years into the current economic cycle, accompanied by record low interest rates which are likely to rise in December. A recession would lead to a drop-in consumer spending which would lead to lower sales.

Lack of a moat and durable competitive advantage opens the company to competition. There are no high barriers to entry in the retail industry. Express started out as a 5-store experiment from Limited Brands and there is not much stopping another clothing chain from doing the same thing.

Conclusion

I don't believe Express' clothing lines are out of style and their business is in jeopardy of falling apart. They didn't report a great 3rd quarter, but they have bounced back from previous poor quarters before which have been tied to Wall Street expectations, rather than business fundamentals. It is no secret that the retail industry will have its ups and downs due to the cyclical nature of the business. Express has zero debt on the balance sheet and \$101M in cash. They have consistently provided positive free cash flow for investors and earned double digit returns on equity. I see the 20% drop on December 1st as a buying opportunity as the company rebounds in 2017 and investors realize their overreaction.

Cash Flow Statement

In Thousands	TTM	Oct-16	16-Jul	Apr-16	16-Jan
Cash Flows from Operating Activities:					
Net income	187,643.00	34,643.00	23,000.00	13,000.00	117,000.00
Depreciation and amortization	186,960.00	58,960.00	36,000.00	17,000.00	75,000.00
Loss on disposal of property and equipment	3,907.00	907.00	1,000.00	-	2,000.00
Impairment charge	829.00	829.00	-	-	-
Amortization of lease financing obligation discount	17,354.00	11,354.00	(3,000.00)	9,000.00	-
Share-based compensation	17,783.00	10,783.00	3,000.00	4,000.00	-
Deferred taxes	(11,385.00)	(385.00)	-	-	(11,000.00)
Landlord allowance amortization	(8,345.00)	(8,345.00)	-	-	-
Receivables, net	19,883.00	5,883.00	7,000.00	6,000.00	1,000.00
Inventories	(128,468.00)	(86,468.00)	(1,000.00)	(26,000.00)	(15,000.00)
Accounts payable, deferred revenue, and accrued expenses	28,749.00	28,749.00	-	-	-
Other assets and liabilities	5,954.00	2,954.00	(19,000.00)	(39,000.00)	61,000.00
Net cash provided by operating activities	319,864.00	59,864.00	46,000.00	(16,000.00)	230,000.00
CASH FLOWS FROM INVESTING ACTIVITIES:					
Capital expenditures	(263,900.00)	(80,900.00)	(50,000.00)	(18,000.00)	(115,000.00)
Purchase of intangible assets	(21.00)	(21.00)	-	-	-
Investment in equity interests	(10,133.00)	(10,133.00)	-	-	-
Net cash used in investing activities	102,946.00	(91,054.00)	61,000.00	18,000.00	115,000.00
CASH FLOWS FROM FINANCING ACTIVITIES:					
Repayment of long-term debt	201,000.00	-	1,000.00	-	200,000.00
Payments on lease financing obligations	(1,186.00)	(1,186.00)	-	-	-
Proceeds from exercise of stock options	2,735.00	2,735.00	-	-	-
Repurchase of common stock under share repurchase program	123,462.00	(51,538.00)	56,000.00	46,000.00	73,000.00
Repurchase of shares for tax withholding obligations	(4,498.00)	(4,498.00)	-	-	-
Other	(73,000.00)	-	-	-	(73,000.00)
Net cash used in financing activities	(424,487.00)	(54,487.00)	(54,000.00)	(44,000.00)	(272,000.00)
Effect of Exchange Rate on Cash	4,629.00	629.00	1,000.00	2,000.00	1,000.00
Cash flow from Operating Activities	319,864.00	59,864.00	46,000.00	(16,000.00)	230,000.00
Capital Expenditures	(263,900.00)	(80,900.00)	(50,000.00)	(18,000.00)	(115,000.00)
Free Cash Flow	55,964.00	(21,036.00)	(4,000.00)	(34,000.00)	115,000.00

Source: Express Q3 2016 News Release; Fidelity