**Ulta Beauty (NASDAQ: ULTA)**

**Brock Schauer and Kyle Kolb Consumer Discretionary B**

**Introduction**

Ulta Beauty is the largest beauty retailer in the United States, providing cosmetics, fragrances, skin care products, hair products, and salon services. Ulta is a fairly new company, with the first store being opened in 1990 and issuing their IPO in October, 2007. They have experienced rapid growth and success shown by the 1,074 retail stores located across 48 states and the District of Columbia as of February 3rd, 2018. The company has a strategy to acquire new guests and deepen loyalty with existing customers, differentiate with personalized experiences, offer relevant products, and focus on growth initiatives in the long run. They place emphasis on exceptional service in the industry and developing a winning corporate culture.

**Recommendation**

We recommend a BUY for Ulta Beauty with a potential upside of 47.9%. Ulta Beauty has experienced a 5-year CAGR of 22%, 28%, and 17% for revenue, net income, and store count, respectively. We see these trends to continue in the future, truly making Ulta a growth company within a growing industry. As of 2017 the U.S. beauty products and salon services industry had sales of $134 billion showing the room to capture more market share within the industry, as the industry expands, leading to significant growth opportunities for Ulta Beauty. The stock has traded as high as $313.73 over the past year, but this was negatively affected by the hurricanes in Florida and Texas where 161 of their stores are located, as well as not meeting consensus earnings estimates from Wall Street. On Tuesday April 10th the stock jumped approximately 4% when a Piper Jaffray analyst upgraded ULTA from a “neutral” to “buy” rating. This is one of the several upgrades from analysts over the past couple months.

**Investment Thesis**

Ulta Beauty is experiencing positive metrics across the board, increasing revenue, dramatic same store sales increases, better EPS, as well as many other metrics company wide. One of the few negative financial indicators was the reduction in gross margin by 40 basis points, which came from the company strategy of deleveraging merchandise margins and a bonus to employees showing the commitment to a fulfilling company culture. While this represents an outstanding prior performance by Ulta and the management team, we believe that these results are already priced into the stock, and alone will not provide the desired future performance. Based on team analysis we believe that managements forward looking projections of same store growth of 6-8% and EPS growth of 20 basis points to be conservative, and will likely be beat, driving our one-year target price of the stock to $345.48. The drivers behind our recommendation are changes in consumer preferences, Ulta rewards program, and the diverse demographics of their consumer base.

Change in consumer preferences – Consumer purchasing habits are changing, traditionally fragrances as well as other beauty products were primarily purchased in department store, millennials as well as younger generations prefer to do their shopping at beauty specialty stores.

Ulta Rewards Program – Ulta Beauty has the best rewards program in the industry exemplifying customer lifetime value and the importance of good relationships with customers.

Diverse Customer Base – Ulta Beauty offers the most diverse product line for beauty consumers to choose from. Their products vary from high-end makeup lines to drug-store affordable brands. Ulta Beauty also provides their customers with the availability to purchase general hygienic products like razors, soap, and much more.

**Valuation**

Ulta Beauty has a strong cash flow, but the true performance of the cash flow has been concealed due to the expansion of Ulta Beauty. Ulta is positioning themselves for success in the long run shown by significant expenditures in the investing and financing sections of cash flows, primarily composed of purchases of short term investments, increases in PPE, and common stock repurchases. To value Ulta Beauty we utilized a 70/30 split between a 5-year DCF model, which reflects our core cash flow assumptions, and a forward P/E multiple to reflect our increased earnings expectations of Ulta and allowed us to compare them to peers. The higher weight was given to the DCF model due to the model’s ability to find a true intrinsic value based on future cash flow projections. We arrived at a one-year target price of $345.48 which represents a 47.9% upside potential from the closing price of $233.59 on April 17th.

**Risks**

M1: Economic Condition (Probability: Moderate Impact: Moderate) A downturn in the economy could affect consumer discretionary purchases in a negative way.

M2: Competition (Probability: High Impact: Low) Ulta Beauty competes in are highly competitive, and new players are always entering with new operational strategies.

OP1: Consumer Trends (Probability: Low Impact: High) Failure of management to predict and adopt beauty trends of consumers could adversely affect sales.

OP2: Company Relations (Probability: Low Impact: Moderate) Manufacturers may choose to supply products only sold to Ulta to other beauty retailers taking away the exclusiveness that give Ulta Beauty a competitive advantage.

F1: Inventory Management (Probability: Low Impact: Moderate) If Ulta Beauty is unable to effectively maintain inventory levels and deliver products to consumers effectively, the company’s financial conditions may be affected.

F2: E-Commerce (Probability: Low Impact: High) If Ulta Beauty is unable to effectively utilize their e-commerce to increase sales from customers, a significant decrease it sales could be present.

**Management**

Mary Dillion, leads Ulta Beauty as their CEO since 2013 and has a plethora of business experience. She has previously held the position of CEO of U.S. Cellular, Global CMO for McDonalds Corporation, and multiple management positions within PepsiCo. Mary seeks to constantly develop herself as a professional and always bring new ideas to the company, she shows this by sitting on the Board of Directors for Starbucks Corporation, and, until 2013 on the Board of Directors with Target Corporation. She brings with her a positive corporate culture, encouraging employees to think differently, try new things, investing in growth platforms and becoming a more competitive employer.

**Peer Analysis**

Ulta Beauty has a unique peer analysis. When looking at the peer group analysis from accredited financial sources it was clear to us that they did not have the same growth potential that Ulta did. To quantify this into our P/E analysis we needed to select an alternative peer group - our solution, compare Ulta to other high growth peers, as well as those in similar markets. In order to get an accurate P/E analysis we needed to base the P/E off of implicit metrics. We selected 5-year revenue CAGR, and 5-year average operating margin as metrics to base our adjustments of the P/E ratio. Our final peer group analysis consisted of 15 companies who either competed in specialty retail or had similar growth rates to Ulta Beauty.

**Ownership of Shares**