Urban Outfitters, Inc. (NASDAQ: URBN)

November 01, 2010

Rating:	**HOLD**
Fair Price:	**$30.73**
Current Price:	**$30.31**
52 Week Range:	**$29.03 - $40.84**
Market Cap:	**$5.03B**
LTM P/E:	**19.8x**

Dil. EPS	2011	2012	2013
Q1	$0.30 (A)	-	-
Q2	$0.42 (A)	-	-
Q3	$0.38	-	-
Q4	$0.46	-	-
FY	**$1.56**	**$1.56**	**$1.69**

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INVESTMENT PHILOSOPHY

► Historically, sales/square foot of retail space has remained relatively flat. This suggests that the company has not been able to implement actions that improve the productivity of stores despite having reported consistent growth in comparable store sales. Because of this reason, we are not using management's comps store growth estimate of 7%.

► We don't believe the management team is doing an effective job. We see no reason for the firm to have invested or to continue to invest, in the Terrain store. We also do not believe that Leifsdottir is the type of brand that URBN should be developing. These concerns raise questions regarding the company's ability invest cash generated by its successful businesses for the best interest of shareholders.

► Visits to stores suggest that 2nd tier locations will not perform as well as 1st tier locations. As a result we believe that management's mid- and long-term growth expectations are too optimistic. Highest tier locations, Urban Outfitters and Anthropologie in NYC had nearly no items on sale, whereas Atlanta's mall location had 5-10% of the products on sale, and Atlanta non-mall in-town location and the New Haven campus location had roughly 10-15% of the store on sale.

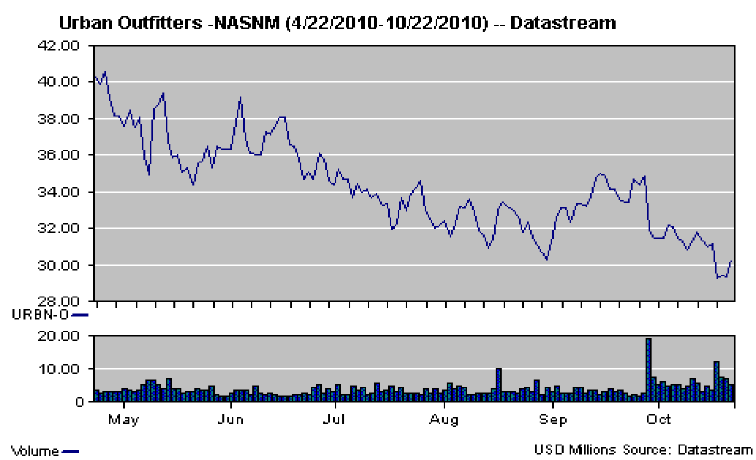

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Table of Contents

Why a Hold Recommendation?

While URBN has large upside potential there are significant risks to the upside. Furthermore, a systematic change in profitability (margins) can quickly destroy shareholder value. There is not a large enough margin of safety to warrant a Buy Rating. While we believe that there may be an opportunity to short this stock in the future (if trends indicate that the firm will face a difficult margin environment), the existence of a large upside make a short too risky of a proposition.

A hold recommendation should be interpreted as “do not own” in most situations. Exceptions made for investors with a short horizon period (less than 6 months), and ownership as part of a portfolio (although in such a case, a hold rating is equivalent to underweight).

Company Overview

Urban Outfitters is a leading lifestyle specialty apparel company that operates under three major brands. The Urban Outfitters brand targets young adults aged 18-30 with a range of offerings including women's and men's fashion apparel, footwear, and accessories, as well as apartment wares and gifts. The Anthropologie brand, targeted at women aged 30-45, sells a range of product assortment including casual apparel and accessories, home furnishings, and decorative items. The company's Free People brand offers merchandise such as casual apparel, accessories and gifts targeted at young women aged 25-30. As of Q2 2011, the company operated 160 Urban Outfitters, 145 Anthropologie, and 36 Free People stores in North America and Europe.

URBN Value Drivers

We believe that the following factors have a strong influence on the market valuation of Urban Outfitters, and thus, are the inputs manipulated in our valuation model.

- Margins across the firm
- Growth in store sales at existing locations
- Number of new stores
- Revenue generated at new stores

Initial Margin Analysis

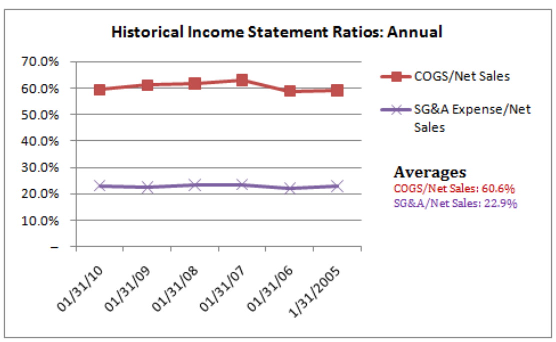

Figure 1: Source Thomson One and Analyst Calculations

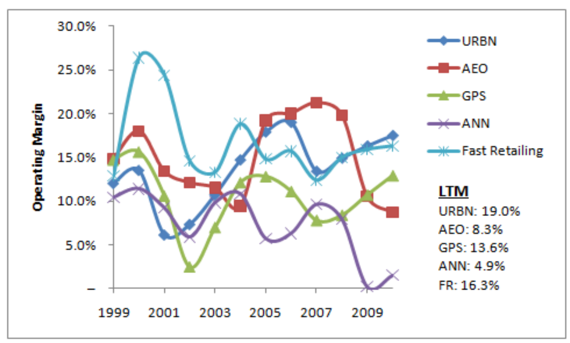

Figure 2: Source Capital IQ

As a starting point for forecasting margins, we considered the two most likely to be used indicators: company forecasts and historical averages. We examine the company value at COGS/Net Sales forecasts for both the company forecast of **57.1%**[1], historical average of **60.6%** in our model, and a long term trend from the current company forecast to the historical average. Given that SG&A/Net Sales has remained virtually flat since FY2005, we assume it will remain at the historic average of **22.9%**. We have also assumed that margins for the international business will be equivalent to those of the domestic business. While margins in the European retail business are currently tighter, the likely reasons for the discrepancy, lack of optimal scale and lack of an URBN owned distribution facility, are being addressed. The impact of assuming COGS/Revenues of 57.1%, as opposed to 60.6% used in the baseline model, is that the fundamental share price increases to $36.07 from the baseline scenario target of $30.73.

[1] 57.1% if backed out from the companies target of 20%+ operating margin

Clearly the margin assumption has a major impact on firm valuation. If the baseline scenario were adjusted so that COGS/Revenue going forward was 61.6%, the fundamental price per share would decline to $28.59.

Internally, we have assumed that gross margins will stay at historic averages, but have considered the fact that margins vary significantly between business segments. While the firm may be able to temporarily maintain the high margins achieved last quarter, there is no justification for these margins holding in the long run. As seen in Figure 2, 20% operating margins are rare within the industry, and URBN has never consistently generated such margins. Additionally, we believe significant domestic expansion plans could create additional margin pressure, because we believe 2nd tier locations require greater markdowns to clear inventory. (See Appendix: Evaluation of baseline assumptions for a description of 2nd tier locations.) Furthermore, achieving these above average returns for the next two quarters, while otherwise remaining at the baseline scenario, only raises the fundamental value by $0.80. Appendix: Sensitivity Analysis shows the impact of hitting 20% operating margins for 10 consecutive months, a scenario that we believe is highly unlikely. These margins have been estimated using the methodology described in Appendix: Estimate of COGS for Each Business Segment. Based on historical data the average segment cost of goods sold is as follows:

COGS/Revenue	
Retail Sales	*62.5%*
Direct-to-consumer	*49.2%*
Wholesale segment	*62.1%*

Figure 3: Source Public Filings and Analyst Calculations

Existing Store Sales Model

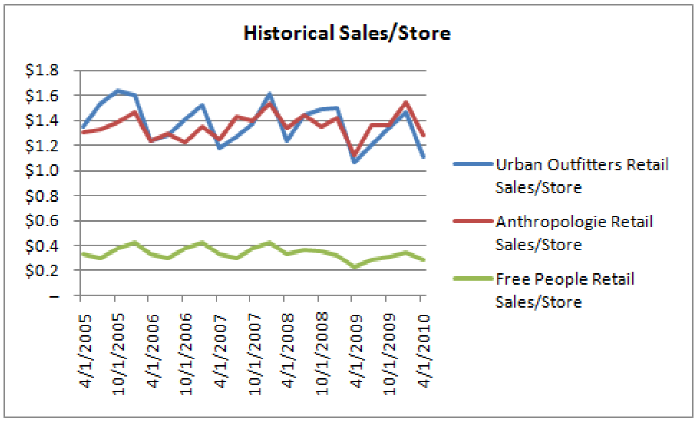

Figure 4: Source Public Filings and Analyst Calculations

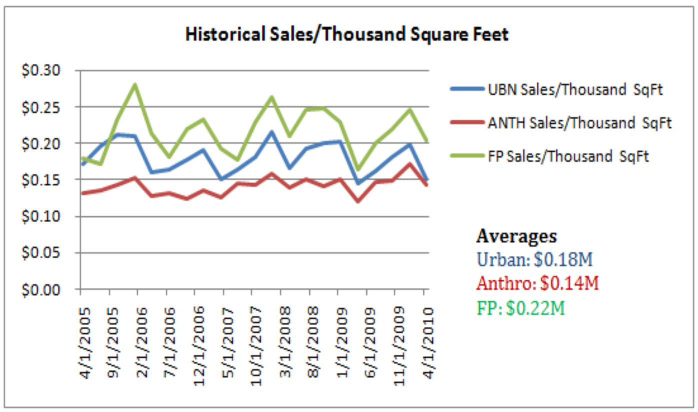

Figure 5: Source Public Filings and Analyst Calculations, averages exclude 4/1/2005

Over the past five years, sales per square foot has remained relatively flat across all retail business segments. However, markdowns do not hit the top line; rather, they are recognized in the cost of sales. This is why the top line does not take a large hit during periods of economic contraction, such as during the fourth quarter of FY 2009.[2]

There are two clear starting points from which we want to analyze the impact of existing store, per store, sales growth. **Option 1** is to assume that organic growth for existing stores meets the company's comparable store growth target of 7%, the previous 10 years average.[3] **Option 2** is to assume that sales from stores existing at the beginning of the forecast period remain constant adjusted for inflation. We assume that sales would grow at the historic inflation rate of 2.7%[4]. The impact of assuming same store growth of 7%, as opposed to 2.7%, is that the fundamental share price increases to $34.54 from the baseline scenario target of $30.73.

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[2] FY Q4 2009 Earnings Call
[3] FY Q4 2010 Earnings Call
[4] 90 year average calculated from http://www.usinflationcalculator.com/

Forecasts and Results

Because sales per square foot have remained relatively flat over the past several years, we believe that same stores should not be expected to generate revenue growth beyond inflation. **Thus, revenue growth from existing stores is forecast to grow at 2.7%.** In a more extreme case, if revenues were to remain flat through 2012, and then grow at 2.7%, the fundamental share price would be $30.06.

North American New Stores Sales Model

The key factors important in analyzing new stores sales are

1. The number of new stores
2. The sales per store generated from these new stores.

There are three ways to approach forecasting the sales from new stores for the projection period.

Method 1: Using historic averages

Hypothesis:

The growth of North American retail stores in the projection period will be similar to the growth achieved in the last five years. New stores opened will perform similar to existing stores in the past five years.

Figure 6: Source company 10-Ks

Under this assumption, we estimate **14, 16, and 6 new stores per year for Anthropologie, Urban Outfitters, and Free People,** respectively, through the projection period. The total number of Urban Outfitters, Anthropologie, and Free People stores at the end of the projection period will be 506. The **sales per store for the new stores is assumed to be equivalent to sales per store for existing stores**.

New Stores as on	2011	2012	2013	2014	2015
Urban Outfitters	16	32	48	64	80
Anthropologie	14	28	42	56	70
Free People	6	12	18	24	30
North American New Stores Opened	36	72	108	144	180

Figure 7

Method 2: Using management's growth strategy, long-term targets, combined with historical analysis

Hypothesis:

Management can accomplish their target growth plans in the North American retail stores.

Based on management guidance, Urban Outfitters expect to open 37-40 new stores in North America. This includes approximately 16 stores for Anthropologie, 14 for Urban Outfitters and 9 for Free People. For the subsequent years, we use the acceleration rate of expansion from the past five years. Under this hypothesis, we assume that since management has successfully accomplished this expansion in the past, using the same acceleration for the projection period is a good way to predict management's expansion plan. This is estimated as 2.5% for Urban Outfitters, 5% for Anthropologie, and 10% for Free People.

New Stores as on	2011	2012	2013	2014	2015
Urban Outfitters	14	28	42	56	70
Anthropologie	16	33	51	70	90
Free People	9	19	30	42	55
North American New Stores Opened	**39**	**80**	**123**	**168**	**215**

Figure 8

There is a potential for the gross margin of the new stores is be higher by 125 basis points, primarily driven by reduction in rent expense through reduced square footage of new stores (10%) and better site selection. Rent expense historically has been around 12.5% of COGS. **The average square footage per store for the new Urban Outfitters, Anthropologie, and Free People stores are 9000 Sq. Ft, 6500 Sq. Ft, and 1250 Sq. Ft respectively.** However, the sales per sq. ft. during this period remained flat. Hence, we are not incorporating the potential increase in gross margin into our model.

Method 3: New stores in second-tier cities are second-tier opportunities

Hypothesis:

Management will not be able to expand stores at the historic rate achieved in the past five years.

Under this assumption we model growth at a lower rate than achieved during the past five years. For the six months that ended Q2 2011, Urban Outfitters opened 8 Anthropologie, 5 Urban Outfitters, and 3 Free People stores respectively. Rapid growth would be required in the second half to meet the target store count of 37-40 stores reiterated in the earnings discussion for the fiscal year 2011. Based on the numbers for H1 2011 as baseline, subsequently, we model a decelerated expansion strategy as below.

New Stores as on	2011	2012	2013	2014	2015
Urban Outfitters	10	20	39	47	55
Anthropologie	16	31	45	58	70
Free People	6	12	18	24	30
North American New Stores	32	63	102	129	155

Figure 9

We strongly believe that management's domestic growth forecasts are overly optimistic. Visits to stores suggest that 2nd tier locations will not perform as well as 1st tier locations. As a result we believe that management's mid- and long-term growth expectations are too optimistic. Highest tier locations, Urban Outfitters and Anthropologie in NYC had nearly no items on sale, whereas Atlanta's mall location had 5-10% of the products on sale, and the Atlanta non-mall in-town location and the New Haven campus location had roughly 10-15% of the store on sale. Furthermore, that the company missed its 2010 expansion targets indicates that it faced significant headwinds during the last full fiscal year. Finally, we believe that the attitude of the firm is one of infallibility. Management speaks positively about all its ventures, and thus, management likely considers a high level of success its baseline when making expansion predictions.

Details of the new store growth opportunities are included in Appendix: Evaluation of baseline assumptions.

International New Store Sales Model

The number and the productivity of the stores opened are important factors to project the sales from new stores opened internationally. We modeled international expansion plans using the baseline guidance for 2011 from the management. Anthropologie's international expansion is modeled after the expansion Urban Outfitters accomplished from 2004 to present. We modeled the expansion of Urban Outfitters Europe according to its historic acceleration rate since we believe it is still in a growth phase.

The average revenue per EU store estimated from historic sales is $7.83M. The gross margins for international stores are believed to be slightly lower than in North American retail stores because of the dependence on third-party distribution centers. However, we expect international margins to match North American margins following the opening of a new distribution center in the UK in Q3 or Q4 2011.

As on	2011	2012	2013	2014	2015
Urban Outfitters	4	9	14	20	27
Anthropologie	2	4	6	9	13
International New Stores	6	13	20	29	40
Sales/Store (MM)	$7.83	$8.05	$8.28	$8.51	$8.75
Europe Inflation Rate	2.8%				

Figure 10

Direct-to-Consumer Segment

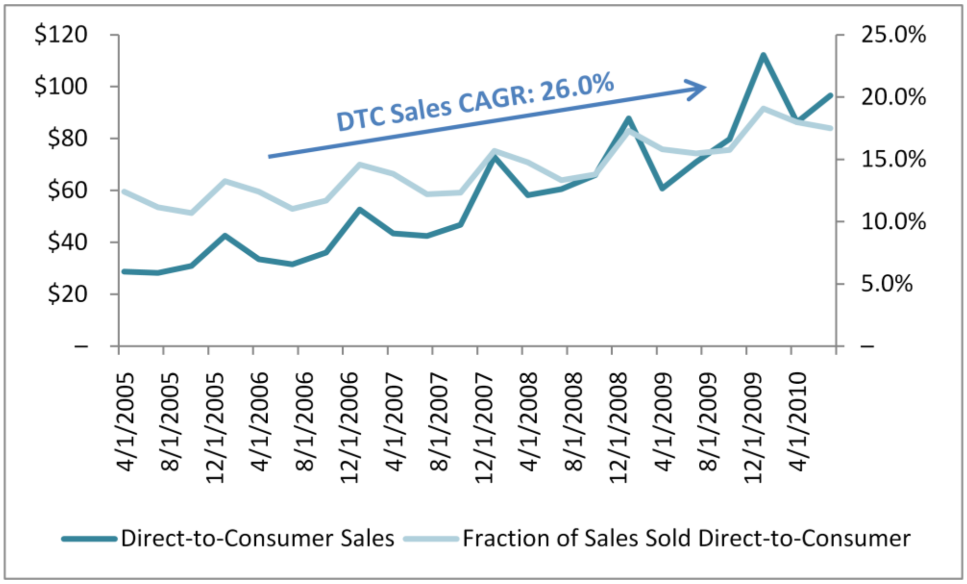


Figure 11: Source Public Filings and Analyst Calculations

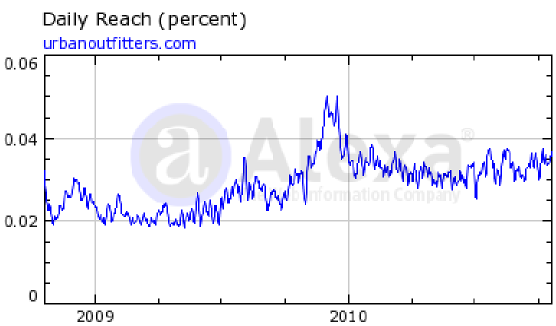


Figure 12: Source Alexa.com

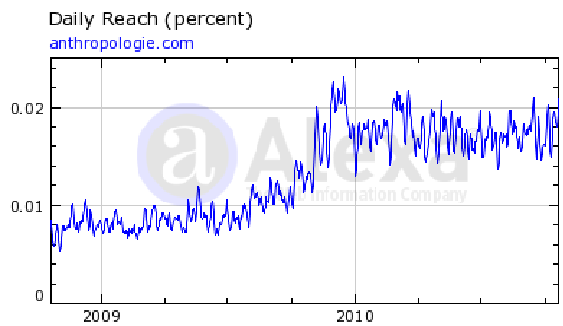


Figure 13: Source Alexa.com

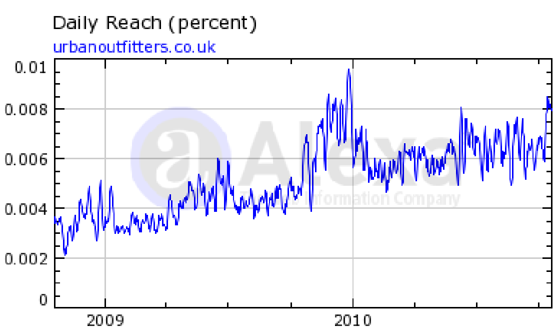


Figure 14: Source Alexa.com

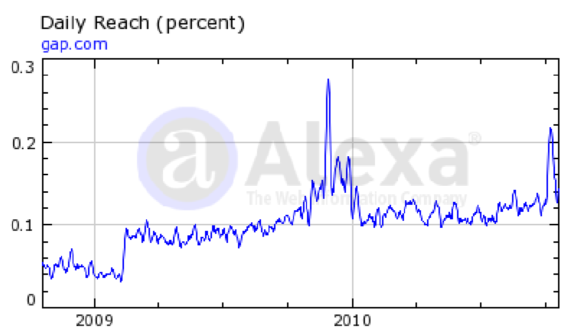


Figure 15: Source Alexa.com

How could the market view direct-to-consumer potential?

The direct-to-consumer segment is interpreted through the reach of the firm's ecommerce websites. This is necessary because the catalog sales and ecommerce segment sales are aggregated and it is not possible to determine the percentage of sales driven by each segment. However, we assume that the reach of the respective websites is correlated with the reach of marketing materials. The most obvious way that the market could be forecasting direct-to-consumer segment performance is to use a cap on penetration at a level that the company views as reasonable, 30% of total sales, and assume rate of growth declines from the most recent YoY rate of 36%[5] over time, we assumed a decline to 30% in FY2012, and 20% in the remaining years. This adjustment to the baseline model would result in 26% of revenues being generated by the direct-to-consumer segment by the end of the forecast period, and a fundamental share value of $36.47.

Forecasts and Results

There are two ways for URBN to grow direct-to-consumer revenues in excess of total industry growth (either total e-commerce traffic or total industry revenues). Either URBN can drive more traffic to the website than competitors, or it can increase sales generated per visit.

Because we have not yet seen growth in visits to *urbanoutfitters.com* we cannot draw the conclusion that sales from *urbanoutfitters.com* will grow faster than inflation + real industry growth. The same logic applies to *anthropologie.com*.

We made the simplified assumption that the growth of the .co.uk and .eu websites will have the same growth rate as their U.S. counterparts did over the previous five years (26% CAGR). However, because they make up a smaller portion of the business this will not result in 26% CAGR across the direct-to-consumer segment. If we assume that total revenues from the UK and US websites are correlated with reach, then EU direct-to-consumer sales would be expected to make up 10.6%[6] of total direct-to-consumer sales.

Based on alexa.com statistics, Urbanoutfitters.co.uk is showing some growth over the past three years. Anthropologie.eu, which was launched March 2010[7], is not yet popular enough to have data recorded on the alexa.com database. If we assume the relative reach of anthropologie.eu, as compared to urbanoutfitters.co.uk, will quickly reach the relative reach seen for the parallel U.S. websites, and that as a pair they grow at same CAGR as the direct-to-consumer segment as a whole since FY1Q2006 (because of the lack of resolution for the data, rough assumptions are made for these metrics from the graphs above), we can project forward European direct-to-consumer revenues. The U.S. direct-to-consumer revenue growth is assumed to slow from the high growth seen over the past five years until growth matches inflation. E.U. direct-to-consumer revenues are expected to jump during the current fiscal year due to the launch of Anthropologie.eu, and match the historic revenue CAGR throughout the remainder of the period.

[5] FY 2Q 2011 Earnings Call

[6] .0065/(.0175+.0375+.0065)=10.6% where .0065, .0175, and .0375 are estimates of reach for urbanoutfitters.co.uk, anthropologie.com, and urbanoutfitters.com, respectively

[7] 10-K FY 2010

Assumptions							
Starting % Of Sales In EU	*10.6%*						
Last Full Year (EO Jan)	2010						
Last Full FY DTC Revenues	$323.7						
Assumed U.S. Rev. Growth		*20.0%*	*10.0%*	*2.7%*	*2.7%*	*2.7%*	*2.7%*
Assumed E.U. Rev. Growth		*75.0%*	*26.0%*	*26.0%*	*26.0%*	*26.0%*	*26.0%*
Forecasts							
Year Ended	2010	2011	2012	2013	2014	2015	2016
U.S. Revenues	$289.4	$347.31	$382.04	$392.35	$402.95	$413.83	$425.00
E.U. Revenues	$34.3	$60.05	$75.67	$95.34	$120.13	$151.36	$190.72
Total	$323.7	$407.4	$457.7	$487.7	$523.1	$565.2	$615.7
Growth		*25.8%*	*12.4%*	*6.6%*	*7.3%*	*8.1%*	*8.9%*

Figure 16 Source: 10-K and analyst estimates

If the U.S. revenue growth rate did not decline as quickly as forecast above, the firms fundamental value would increase. If the baseline scenario were adjusted so that U.S. revenue growth from 2012-2016 was 10% the fundamental share value would rise to $31.93.

Wholesale Segment

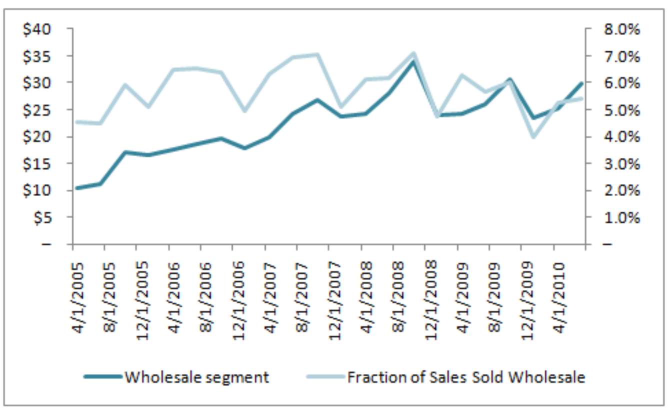


Figure 17 Source Public Filings and Analyst Calculations

The size of the wholesale segment has varied between 4% and 7% of URBNs revenues since 2005. Over the past four quarters wholesale sales made up 5.1% of total revenues. The absolute growth in wholesale sales has been powered by growth in the Free People brand.

While the development of the Free People brand was very successful, we believe that its success was dependant on three elements. One, it had a unique brand image and its introduction coincided with great growth in "hippie chic". Two, it was a brand that matched well with the Urban Outfitters image. Three, the firm got lucky.

We don't believe Leifsdottir has any of these elements, and thus, are unwilling to assign significant value to the brand. First, Leifsdottir produces sexy, sophisticated, and contemporary apparel sold through high end retail outlets. This segment is large and there is no indicator of accelerating growth in this segment, nor is there much room for the segment to grow. Second, Leifsdottir is not Anthropologie's Free People. The styles of Anthropologie and Leifsdottir do not align. This raises two issues: (1) why does marketing the product through Anthropologie make sense, and (2) why does the firm believe it has any competitive advantage in the segment given its lack of exposure. The segment is already highly developed, and contains many well branded competitors. Third, luck is random and rare. URBN has developed numerous private label brands, while none have developed consumer awareness close to Free People. There is no indication that URBN has a successful methodology to develop clothing brands.

Because we don't believe Leifsdottir will have a significant positive impact on the company's bottom line, we have modeled wholesale revenues as a constant fraction of total revenues. Management is yet to report the brand generating a profit for URBN.[8]

[8] Earnings Calls: FY2010 Q3 through FY2011 Q2

Appendix: Firm Valuation

Baseline Model

Metric	Assumption
COGS/Net Sales	Weighted average of segment margins
SG&A/Net Sales	22.9%
Same Store Sales Growth	Inflation (2.7%)
North American New Store Sales Growth	Method 3
International New Store Sales Growth	Figure 5
Direct-to-consumer Sales Growth	Figure 12
Wholesale Revenue	5.1% of Total Revenues

Discounted Cash Flow	(millions)										
	Year Ended 1/31/2009	**Year Ended 1/31/2010**	**Quarter End 4/30/2010**	**Quarter End 7/31/2010**	**Quarter End 10/31/2010**	**Quarter End 1/31/2011**	**Year Ended 1/31/2012**	**Year Ended 1/30/2013**	**Year Ended 1/30/2014**	**Year Ended 1/30/2015**	**Year Ended 1/30/2016**
NOPAT					$65.5	$79.2	$291.4	$327.6	$365.8	$401.6	$436.7
+ Depreciation and Amortization					22.5	22.8	91.9	98.4	107.1	117.6	129.7
- CapEx					25.0	25.0	120.0	140.0	140.0	160.0	180.0
- Change in Working Capital					(0.8)	(54.2)	66.3	31.6	32.6	32.6	31.8
Unlevered cash flow					$63.8	$131.1	$197.0	$254.5	$300.4	$326.6	$354.6
Discount Factor					0.977	0.954	0.828	0.754	0.686	0.624	0.568
PV of Unlevered Cash Flow					$62.3	$125.0	$163.1	$191.7	$206.0	$203.8	$201.4
PV of Terminal Value											$3,543.1
Excess Cash				94.9							
Marketable Securities				503.7							
Fundamental Value				**$5,295.17**							
Diluted Shares				***172.3***							
Price Target				**$30.73**							

Consolidated Statement of Income (millions)

	Year Ended 1/31/2009	Year Ended 1/31/2010	Quarter Ended 4/30/2010	Quarter Ended 7/31/2010	Quarter Ended 10/31/2010	Quarter Ended 1/31/2011	Year Ended 1/31/2011	Year Ended 1/31/2012	Year Ended 1/30/2013	Year Ended 1/30/2014	Year Ended 1/30/2015	Year Ended 1/30/2016
Net sales	$1,834.6	$1,937.8	$480.0	$552.2	$605.4	$714.6	$2,352.1	$2,647.3	$2,970.6	$3,311.3	$3,653.4	$3,981.2
Cost of sales	1,121.1	1,151.7	279.2	317.4	365.0	427.7	$1,161.2	$1,590.8	$1,788.6	$1,996.6	$2,204.4	$2,402.3
Gross profit	$713.5	$786.1	$200.8	$234.8	$240.5	$286.8	$962.9	$1,056.6	$1,182.0	$1,314.8	$1,449.0	$1,578.9
Selling, general and administrative expenses	414.0	447.2	118.6	127.9	138.6	163.6	$548.8	606.2	680.3	758.3	836.6	911.7
Income from operations	$299.4	$339.0	$82.2	$106.9	$101.8	$123.2	$414.1	$450.3	$501.8	$556.5	$612.3	$667.2
Interest income	11.5	6.3	0.4	0.6	0.5	0.5	$2.0	5.0	10.1	15.1	15.1	15.1
Other income	0.7	0.5			–	–	–	–	–	–	–	–
Other expenses	(2.1)	(1.3)					–					
Income before income taxes	$309.5	$344.4	$82.6	$107.5	$102.3	$123.7	$416.2	$455.4	$511.8	$571.6	$627.5	$682.3
Income tax expense	110.1	124.5	29.7	35.8	36.8	44.5	$146.9	163.9	184.3	205.8	225.9	245.6
Net income	$199.4	$219.9	$53.0	$71.7	$65.5	$79.2	$269.3	$291.4	$327.6	$365.8	$401.6	$436.7

Cash Flow Statement (millions)

	Year Ended 1/31/2009	Year Ended 1/31/2010	Quarter Ende 4/30/2010	Quarter Ende 7/31/2010	Quarter Ende 10/31/2010	Quarter Ende 1/31/2011	Year Ended 1/31/2011	Year Ended 1/31/2012	Year Ended 1/30/2013	Year Ended 1/30/2014	Year Ended 1/30/2015	Year Ended 1/30/2016
Cash flows from operating activities:												
Net Income	$199.4	$219.9	$53.0	$71.7	$65.5	$79.2	$269.3	$291.4	$327.6	$365.8	$401.6	$436.7
Adjustments to reconcile net income:												
Depreciation and amortization	81.9	92.4	24.3	24.7	22.5	22.8	94.3	91.9	98.4	107.1	117.6	129.7
Provision for deferred income taxes	(9.4)	2.2	(1.6)	(0.7)	(0.4)	(2.2)	(4.9)	1.1	(1.6)	(1.7)	(1.7)	(1.6)
Excess tax benefit on share-based compensation	(13.4)	(6.4)	(7.7)	(2.6)	–	–	(10.2)	–	–	–	–	–
Share-based compensation expense	3.6	4.8	2.2	2.3	–	–	4.5	–	–	–	–	–
Loss (gain) on disposition of property and equipment, net	0.1	0.3	(0.0)	0.1	–	–	0.0	–	–	–	–	–
Loss (gain) on sale of mktable securities					–	–	–	–	–	–	–	–
Change in assets and liabilities												
Receivables	(10.7)	(1.8)	3.2	(7.3)	(6.0)	(8.7)	(18.8)	4.2	(6.5)	(6.8)	(6.8)	(6.6)
Inventories	(0.3)	(15.5)	(36.3)	(20.8)	1.0	42.1	(14.1)	(46.1)	(30.1)	(31.7)	(31.8)	(30.5)
Prepaid expenses and other assets	9.2	(25.6)	6.3	(0.1)	(13.8)	(18.5)	(26.1)	(5.4)	(24.1)	(24.7)	(24.8)	(24.3)
Accounts payable, accrued expenses and other liabilities	(8.9)	55.3	8.8	5.0	19.5	39.3	72.6	(19.0)	29.1	30.7	30.8	29.5
Net cash provided by operating activities	$251.6	$325.4	$52.0	$72.3	$88.4	$153.9	$366.7	$318.1	$392.8	$438.7	$484.9	$532.9
Cash flows from investing activities:												
Cash rec from (paid for) property and equipment	($112.6)	($109.3)	($32.4)	(32.2)	(25.0)	(25.0)	(114.6)	(120.0)	(140.0)	(160.0)	(180.0)	(180.0)
Cash paid for marketable securities	(809.0)	(806.5)	(46.3)	(123.3)	–	–	(169.6)	–	–	–	–	–
Sales and maturities of marketable securities	864.7	421.0	116.4	131.3	0.00	0	248	0	0	0	0	0
Net cash used in investing activities	($56.9)	($494.8)	$37.7	($24.2)	(25.0)	(25.0)	(36.5)	(120.0)	(140.0)	(160.0)	(180.0)	(180.0)
Cash flows from financing activities:												
Exercise of stock options	$8.9	$3.3	$4.2	6.8	–	–	11.0	–	–	–	–	–
Excess tax benefit from stock option exercises	13.4	6.4	7.7	2.6	–	–	10.2	–	–	–	–	–
Share repurchases				(72.0)	–	–	(72.0)	–	–	–	–	–
Dividends					–	–	–	–	–	–	–	–
Net cash provided by financing activities	$22.3	$9.7	$11.9	($62.6)	–	–	(50.7)	–	–	–	–	–
Effect of FX rate changes on cash and cash equivalents	($6.2)	$2.7	($1.3)	0.2	–	–	(1.2)	–	–	–	–	–
(Decrease) increase in cash and cash equivalents	$210.8	($157.0)	$100.3	($14.4)	$63.4	$128.9	$278.3	$198.1	$252.8	$278.7	$304.9	$352.9
Cash and cash equivalents at beginning of period	$105.3	$316.0	$159.0	$259.3	$244.9	$308.4	$159.0	$437.3	$635.4	$888.2	$1,166.9	$1,471.8
Cash and cash equivalents at end of period	$316.0	$159.0	$259.3	$244.9	$308.4	$437.3	$437.3	$635.4	$888.2	$1,166.9	$1,471.8	1824.680143

Balance Sheet	(millions)											
	Year Ended 1/31/2009	Year Ended 1/31/2010	Quarter Ende 4/30/2010	Quarter Ende 7/31/2010	Quarter Ende 10/31/2010	Quarter Ende 1/31/2011	Year Ended 1/31/2011	Year Ended 1/31/2012	Year Ended 1/30/2013	Year Ended 1/30/2014	Year Ended 1/30/2015	Year Ended 1/30/2016
Assets												
Current Assets:												
Cash and cash equivalents	$316.0	$159.0	$259.3	$244.944	$308.4	437.3	437.3	$635.4	$888.2	$1,166.9	$1,471.8	$1,824.7
Marketable securities	49.9	342.5	323.9	$346.107	346.1	346.1	346.1	346.1	346.1	346.1	346.1	346.1
Accounts Receivable, net of allowance for do	36.4	38.4	35.5	$42.474	48.4	57.2	57.2	52.9	59.4	66.2	73.1	79.6
Inventories	169.7	186.1	222.0	$243.203	242.2	200.1	200.1	246.2	276.3	308.0	339.8	370.2
Prepaid expenses and other current assets	46.4	67.9	68.9	$74.125	84.8	100.0	100.0	92.7	104.0	115.9	127.9	139.3
Deferred taxes	5.9	12.3	10.9	$11.750	12.1	14.3	14.3	13.2	14.9	16.6	18.3	19.9
Total Current Assets	$624.4	$806.2	$920.6	$962.603	$1,042.0	$1,155.0	$1,155.0	$1,386.5	$1,688.8	$2,019.6	$2,376.8	$2,779.9
Property and equipment, net	505.4	540.0	548.6	559.9	565.6	571.1	571.1	612.0	666.4	732.0	807.2	870.3
Marketable securities	155.2	243.4	189.5	157.6	157.6	157.6	157.6	157.6	157.6	157.6	157.6	157.6
Deferred income taxes and other assets	44.0	46.5	49.6	46.9	46.9	46.9	46.9	46.9	46.9	46.9	46.9	46.9
Total Assets	$1,329.0	$1,636.1	$1,708.2	$1,727.1	$1,812.1	$1,930.6	$1,930.6	$2,203.0	$2,559.7	$2,956.2	$3,388.5	$3,854.7
Liabilities and Shareholders' Equity												
Current Liabilities:												
Accounts payable	$63.0	$78.0	$100.4	$92.2	$96.9	$114.3	$114.3	$105.9	$118.8	$132.5	$146.1	$159.2
Accrued compensation	12.0	21.9	17.3	19.0	24.2	28.6	28.6	26.5	29.7	33.1	36.5	39.8
Accrued expenses and other current liabilities	66.2	88.6	79.4	87.2	96.9	114.3	114.3	105.9	118.8	132.5	146.1	159.2
Total Current Liabilities	$141.2	$188.5	$197.2	$198.4	$218.0	$257.2	$257.2	$238.3	$267.4	$298.0	$328.8	$358.3
Deferred rent and other liabilities	134.1	150.8	150.9	155.4	155.4	155.4	155.4	155.4	155.4	155.4	155.4	155.4
Total Liabilities	$275.2	$339.3	$348.0	$353.8	$373.3	$412.6	$412.6	$393.6	$422.7	$453.4	$484.2	$513.7
Shareholders' Equity:												
Preferred shares	–	–	–	–	–	–	–	–	–	–	–	–
Common shares	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Additional paid-in capital	170.2	184.6	198.7	138.4	138.4	138.4	138.4	138.4	138.4	138.4	138.4	138.4
Retained earnings	901.3	1,121.2	1,174.2	1,245.8	1,311.3	1,390.5	1,390.5	1,682.0	2,009.5	2,375.4	2,776.9	3,213.6
Accumulated other comprehensive loss	(17.7)	(9.1)	(12.8)	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)	(11.0)
Total Shareholders' Equity	$1,053.8	$1,296.8	$1,360.1	$1,373.3	$1,438.8	$1,518.0	$1,518.0	$1,809.4	$2,137.0	$2,502.8	$2,904.4	$3,341.1
Total Liabilities and Shareholders' Equity	$1,329.0	$1,636.1	$1,708.2	$1,727.1	$1,812.1	$1,930.6	$1,930.6	$2,203.0	$2,559.7	$2,956.2	$3,388.6	$3,854.8

Appendix: Evaluation of baseline assumptions

New Store Growth (Method 3)

Site Selection

Urban Outfitters	2010	Notes 2010	2009	Notes 2009
California	29	2 in LA, 2 in SFO 2 in SD	26	2 in LA, 2 in SFO
New York	11	8 in NYC	10	8 in NYC
Illinois	8	4 in Chicago	8	4 in Chicago
Texas	7	2 in Dallas 2 in Houston	7	2 in Dallas 2 in Houston
Florida	7	-	7	-
Massachusetts	6	2 in Boston	4	2 in Boston
Pennsylvania	5	-	5	-

Anthropologie	2010	Notes 2010	2009	Notes 2009
California	28	2 in SD	28	2 in SD
Florida	10	-	9	-
Texas	9	2 in Dallas 2 in Houston	8	2 in Dallas
Illinois	8	3 in Chicago	6	2 in Chicago
New York	7	3 in NYC	6	3 in NYC
Massachusetts	5	-	4	-
Pennsylvania	4	-	4	-

Source: Company Reports

Currently, California and New York alone account for over 25% of the total stores of Urban Outfitters and Anthropologie. After studying the geographic location of the stores, we believe that the possible opportunities to expand are in the second tier cities in North-east and Mid-west. However, as discussed we believe that such locations will be less profitable, and thus expansion will likely meet more roadblocks than expected.

For this study, we used a flexible definition of 1st and 2nd tier locations, which are in part, defined by URBN's decisions to enter one before the other. We would expect the second location in a city to be considered less promising than the first location. However, we also use other metrics. For example, we expect URBN's stores, in particular the apartment dweller targeted Urban Outfitters, to be more successful in larger cities. If large cities are defined as those with populations of larger than 400,000, as of the 2007 American Community Survey, URBN opened 7 Urban Outfitters and Anthropologie stores in large cities in FY2005, while it opened 4 in such cities in FY2010.[9] Instead, in FY2010 URBN shifted its expansion towards areas with large universities (>20,000 students).

[9] URBN 10-Ks, Analyst Calculations, and U.S. Census Bureau <http://factfinder.census.gov/> (accessed 11/1/2010)

	2010 New Stores	
Urban Outfitters	Anthro	Free People
Roseville, CA	Miami, FL	Manhattan Beach, LA
Hillcrest, SD, CA	1120 State St, Chicago, IL	Highland Park, IL
Ventura, CA	Skokie, IL	Spring Street, NY
Allston, MA	Dedham, MA	Dedham, MA
Dedham, MA	St. Louis Park, MN	
Cherry Hill, NJ	Marlton, NJ	
Edison, NJ	Montclair, NJ	
Redbank, NJ	Victor, NY	
Ithaca, NY	Durham, NC	
Asheville, NC	Westheimer Road, Houston, TX	
Nashville, TN	Charlottesville, VA	
Charlottesville, VA	Bellevue, WA	

Source: Company reports

Store Venue

In 2010, the best performing stores for Urban Outfitters brand were located in Malls. This trend was observed in Q2 2011[10]. Anthropologie, however, seems to be performing well in all venues. In 2010, 5 of the 12[11] Urban Outfitters stores and 5 of 12 Anthropologie stores opened in North America were in Malls compared to Free Standing locations. In 2009, 5 of the 13 Anthropologie stores and 2 of the 12 Urban Outfitters stores were opened in Malls compared to Free Standing locations. There is a possibility that the rent expense is lower in Malls. However, opening stores in Malls puts Urban Outfitters brands in direct competition with other specialty apparel stores in the Mall. While this strategy allows the firm to generate larger in-store profits, it exposes the firm to additional competition from Specialty Apparel retails, and sacrifices some of the uniqueness that has defined the brand.

Store Design

The average selling square feet per store has decreased in the last five years through the remodeling of existing stores and the opening of smaller stores. The average size of a new Urban Outfitter store opened in 2010 was 8,000 Sq. Ft. compared to 9,000 Sq. Ft in 2006. The average new Anthropologie store footprint also fell, from 7,000 Sq. Ft to 6,500 Sq. Ft during the same time. Equivalently, the total average SKUs per store has increased during the period to maintain the same selling capacity. However, this strategy has not generated the expected benefits. The sales per Sq. Ft. remained flat during the period probably because of lower sales in the smaller stores.

[10] Earnings Discussion Q2 2011
[11] Company reports

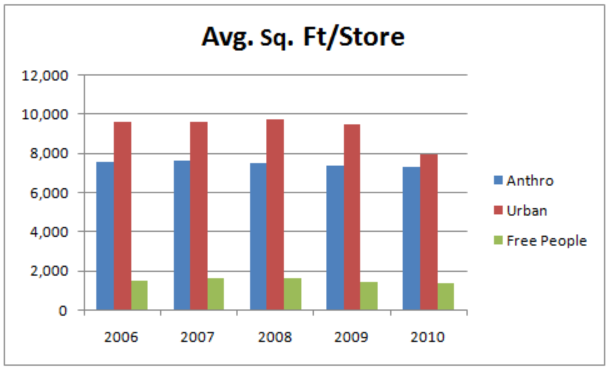


Figure 18: Source Public Filings (10-K)

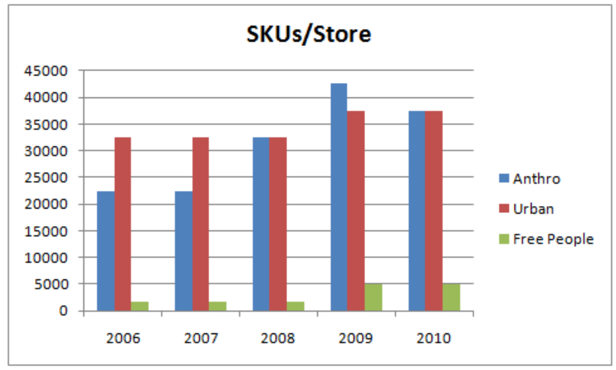


Figure 19: Source Public Filings (10-K)

New Retail Brand Opportunities

A new business in the wedding sector is to be launched as a part of Anthropologie in February 2011. This business is expected to offer wedding apparel with a price range between $750 and $5000. The potential sales model for this business could follow J. Crew's wedding business that started in 2004. Some of the current players already in the market are J. Crew ($300 - $3,000), Ann Taylor, Chico FAS (Under $500), and Limited (Under $300). The total size of the women's wedding apparel industry is $2.2 billion according to Wedding Report[12]. Management is aiming to open one store by the end of FY 2011 if the concept is successful.

The performance of Terrain and Leifsdottir has been poor and while Leifsdottir is still in early stages of development, Terrain has languished in unprofitability for years. We do not incorporate the potential sales from new brands into valuation because we are not confident in the growth potential of the developmental brands URBN's portfolio.

Urban Outfitters management was successful in opening the targeted stores until 2009. In FY 2010, however when sales slowed, management could open only 33 stores compared to the targeted 42[13] at the beginning of the year. For the FY 2011 Urban is targeting to open 45 stores for all three brands together. Only 13 new stores have been opened so far in the first half of the year.

[12] Something Old, Something from the Mall, WSJ, April 8, 2010 accessed October 24, 2010
[13] Company reports

International Expansion

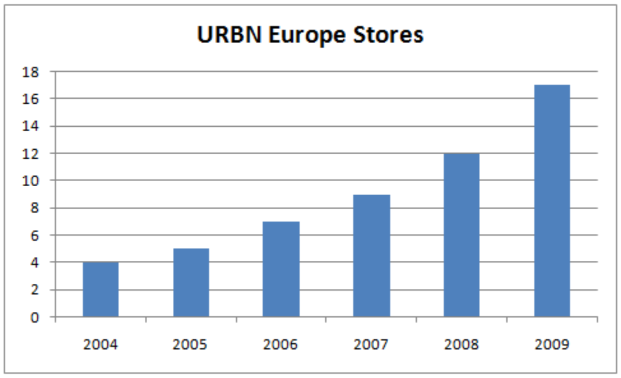


Figure 20: Source Public Filings (10-K)

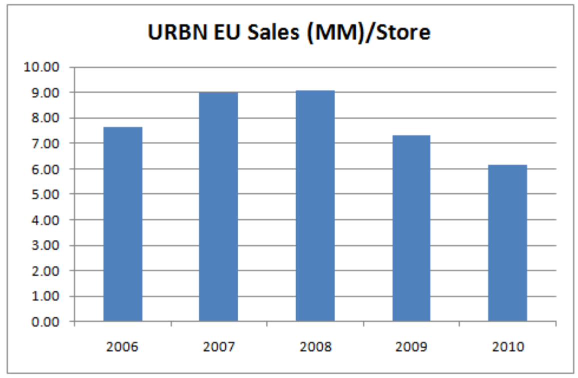


Figure 21: Source Public Filings (10-K)

Anthropologie:

For our model, we forecasted the international growth of Anthropologie based on the international expansion Urban Outfitters accomplished during its early phase in 2004. Anthropologie has many advantages as well. The presence of Urban Outfitters in Europe could also help achieve faster expansion. The assortment sold in Anthropologie Europe is 80% similar to Anthropologie North America unlike Urban with wide differences in assortments across continents. Urban Outfitters management is also evaluating options to open its first store into Tokyo in 2012 and Anthropologie is expected to take lead in the Far East. We believe that the management can pursue a similar international growth if not more aggressive with Anthropologie than it achieved with Urban.

Urban Outfitters:

Urban Outfitters International	
United Kindom	Other Europe
Brimigham	Copenhagen
Briston	Antwerp
Leeds	Stockholm
Liverpool	Hamburg
London (4)	
Manchester	
Dublin (2)	
Belfast	
Edinburgh	
Glasgow	

Figure 22: Source Public Filings

As ofQ2 2011, Urban Outfitters only operates 18 stores internationally with 14 in the United Kingdom. In the Q2 2011 earnings discussion, management announced their intention to continue expansion in UK and Germany in the next 12-18 months. A distribution center in UK is scheduled to be opened in Q3 or Q4 2011. We believe that there are opportunities to expand into cities such as Frankfurt and Berlin in Germany in 2011 to accomplish the targeted international growth.

Appendix: Estimate of COGS for Each Business Segment

Quarterly data beginning with FY1Q2006 was regressed according to the following equation:

$$COGS_{Firm} = \left(\frac{COGS}{REVENUE}\right) Retail \ * REVENUE_{Retail} + \left(\frac{COGS}{REVENUE}\right)_{DTC} * REVENUE_{DTC} + \left(\frac{COGS}{REVENUE}\right)_{Wholesale} * REVENUE_{Wholesale}$$

SUMMARY OUTPUT

Regression Statistics	
Multiple R	0.999202
R Square	0.998404
Adjusted R Square	0.942671
Standard Error	10.36408
Observations	21

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	3	1209268.928	403089.6	3752.667689	3.55743E-24
Residual	18	1933.454856	107.4142		
Total	21	1211202.383			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*
Intercept	0	#N/A	#N/A	#N/A	#N/A	#N/A
Combined Retail Sales	0.625127	0.087361244	7.15566	1.15515E-06	0.441588224	0.808666551
Direct-to-consumer	0.491736	0.247658747	1.985538	0.062533945	-0.02857575	1.012047694
Wholesale segment	0.621119	0.744956537	0.833766	0.415340657	-0.94397616	2.186215049

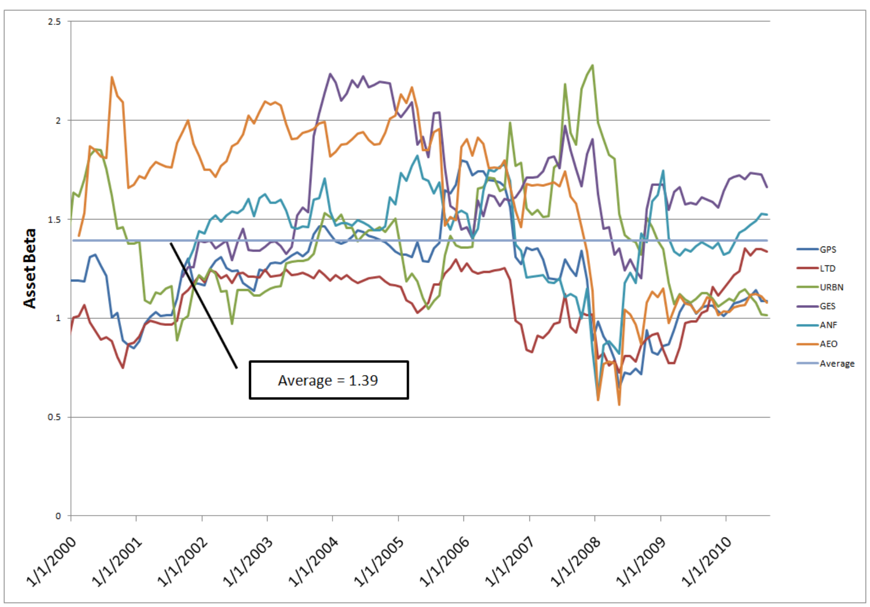
Given that 2010 rent expense is $129M, and total retail sales were $1,510M, rent expense alone would reduce margins of the retail segment (vs. direct to consumer) by 850 basis points. Thus, because of additionally complexity and staffing needs for a retail business (and less economies of scale) we believe that our regression gives us reasonable result.)

Appendix: Cost of Capital Calculation and Estimates of Beta

We are using the industry asset beta of 1.39 to value Urban Outfitters. The cost capital estimation is tabulated below. The market risk premium is assumed to be the historic average value of 7%. The risk free rate is the yield on one month T-bill. We used one month t-month as our risk free rate since it is a good representation of the return investors can earn immediately. The WACC estimated for Urban Outfitters is in line with the WACC of the industry, 9.83%.

Cost of Equity	Value
Beta	1.39
Risk-free Rate	0.14%
Market Risk Premium	7%
Cost of Equity	9.9%
Debt/Equity	0.0%
WACC	9.9%

The beta used for calculating the discount rate is the average rolling asset beta for the six largest comparable firms (by market cap).



Source: Bloomberg, CSRP, Analyst Estimates

Appendix: Sensitivity Analysis

Margins	New Store Growth	Direct-to-Consumer	Share Price
20% Operating Margins	Management Guidance	Strong U.S. Growth	$39.15
Historical Weighted Average	Management Guidance	Strong U.S. Growth	$33.61
20% Operating Margins	Baseline Scenario	Strong U.S. Growth	$37.26
Historical Weighted Average	Baseline Scenario	Quick Decline in U.S. Growth	$30.73
Next 10 mo: 20% Rest: Hist. Wtd.	Baseline Scenario	Strong U.S. Growth	$32.86
Next 10 mo: 20% Rest: Hist. Wtd.	Management Guidance	Strong U.S. Growth	$34.83

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