

# Deep Dive: Finance

Board Education Program

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# Investment Overview

## Company Description

- Design, markets, and sell jeans, casual apparel, footwear, and related accessories
- Sold in 110 countries, 50,000+ retail stores in Americas, Asia, Europe
- Strong commitments to sustainability and ethics
- Founded in 1853, headquartered in San Francisco, CA

## Thesis Highlights

- Well positioned for post-pandemic recovery
- Increased digital presence, international, and DTC sales present strong opportunities for long term growth and increased margins
- The appeal of Levi's cutting edge innovation in jeanswear, community involvement, and sustainable brand to the modern consumer is underestimated
- Renewed focus on cutting costs -> better margins

## Financials

LEVI	
Stock Price	\$15.83
Market Cap	\$6.29B
Debt	\$1.01B
Preferred & Other	10M shares
Cash	\$934M
Enterprise Value	\$6.37B
EV/EBITDA	8.67
EV/EBIT	10.43
P/E	16.32
Gross Margin	53.82%
Operating Margin	9.56%

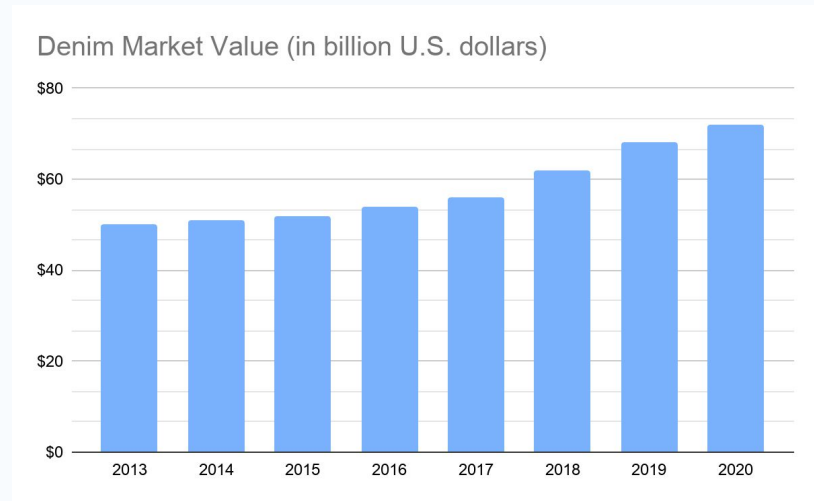
# Drivers of Denim Market Growth

## Market Overview

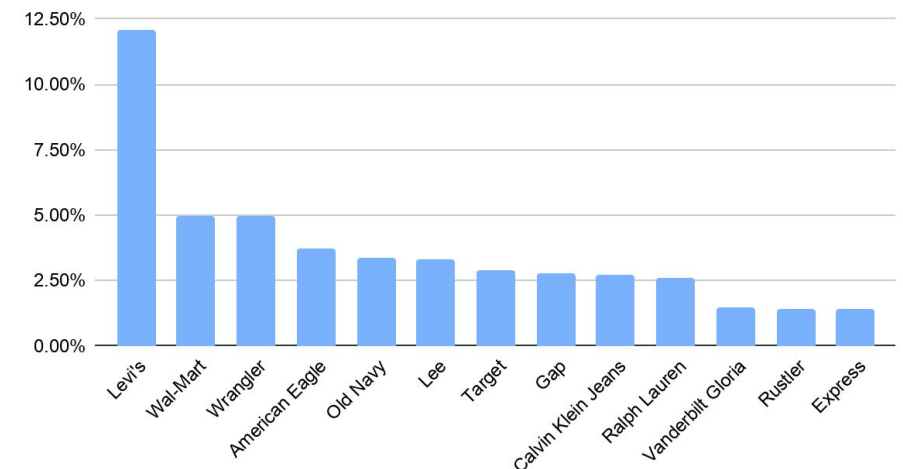
- Current market size (\$72B), CAGR (6.81%)
- Growing e-commerce market
  - Levi's ecommerce CAGR (10%)
- Saturated and highly competitive
  - Many submarkets
- China is leading exporter of denim fabric

## Trends

- Resale market outperforming the overall retail market in the U.S. in the past 5 years
  - Frugal, environmentally conscious, craving vintage fashion
- Athleisure trends
  - U.S. imports of elastic knit pants outpaced those of blue jeans for the first time in 2017
  - Athleisure brands are diversifying as growth slows CAGR (1.9%)
- Black jeans - 3rd fastest growing clothing item in 2020 (search growth increased 49%)



Market Share - U.S. Jean Market



# Company Overview

## An innovative, values-driven company

- Eureka Innovation Lab - established 2013
  - Project F.L.X
    - Digitized denim design and finishing
      - Radically reduces time to market
      - eliminates thousands of chemical from jean finishing
      - Laser finishing locally and in a thousand different way
- Sustainability
  - Wellthread line - 100% recyclable
  - Cottonized Hemp
  - Water<Less finishing process
    - reduced water usage by 96%
- Worker-Well being Facilities
  - implements health, financial literacy and gender equity programs
- Levi's Strauss Foundation
  - philanthropic arm with the mission of advancing human rights
  - spoken out on systematic racism, police brutality, gun violence, etc.
- Can lead to 18% higher ROI



# Business Overview

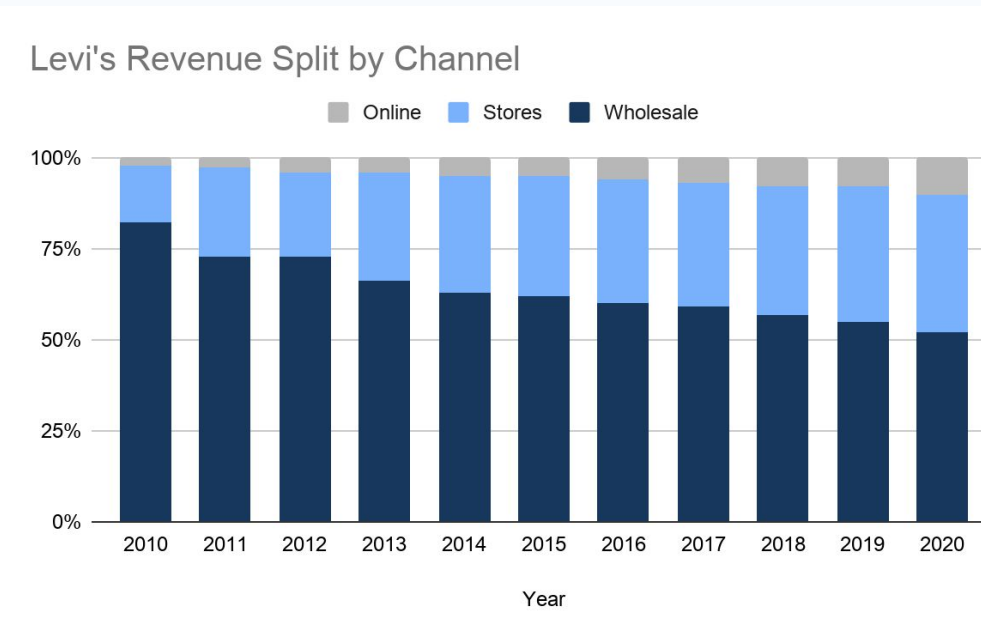
## Robust, Diversified business model

- **Levi's** (\$60-100), Dockers (\$30-100) , Signature by Levi Strauss & Co. (Walmart - \$20), and Denizen® brands (Target - \$25)
  - **Levi's** brand represents 87% of total revenue
  - Good-better-best price-tier strategy caters to diverse customer base
- Expanding into the luxury market
  - Collaboration with Valentino drops in 2021
  - Vintage Clothing and Made & Crafted lines feature premium materials at premium prices
- Emphasis on value at each price point
  - Denim improves with wear so people are more likely to invest in good denim
- Diversified Supply-Chain
  - source apparel from independent contractors in 23 countries
    - No single country accounts for >20% of their sourcing

# Business Segment Breakdown

## Shift from U.S. Wholesale to DTC and International Sales

- Revenue Breakdown
  - Bottoms (72%), tops (21%), footwear and accessories (7%)
    - Bottoms were 82% of revenue in 2015
  - Americas (55%), Europe (36%), Asia (16%)
    - America comprised 69% of revenue in 2015
  - DTC (40%), wholesale (60%)
    - No customer represents more than 10% of their revenues
- Ecommerce
  - Launched a new site and app in August
    - Conversion ratio increased 7% while product views increased 20% within a few days
  - Fastest growing business segment
    - Grew 52% in last quarter
    - Makes 22% of DTC revenue compared to 13% in 2019



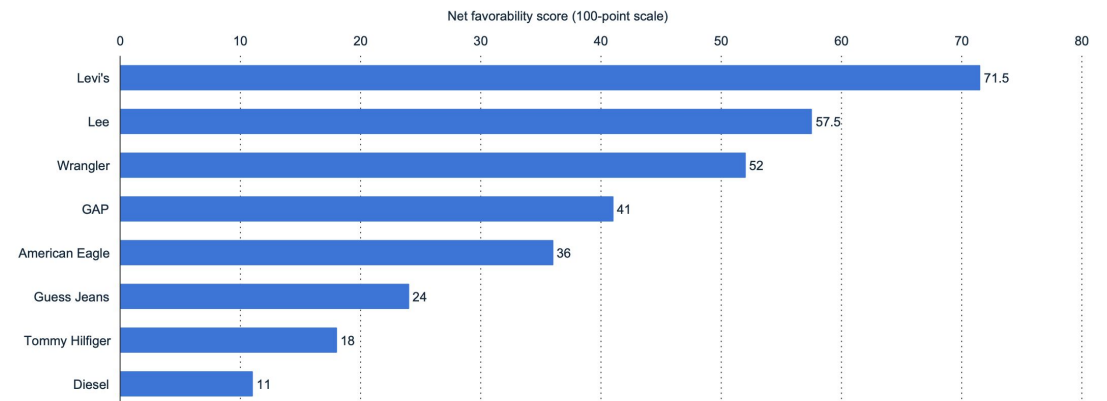
# Economic Moat Analysis

- Levi Strauss invented jeans in the 1870s; fixture in American fashion
  - Strong Partnerships - naming rights for San Francisco 49ers stadium
  - Social Media Influence - 7.2M Instagram followers, Kanye West wears Levi's vintage trucker jacket, the Kardashians sports Levi's jeans in photo ops
  - Global Ad Campaigns - "Circles" ad has over 26 million YouTube views and won the 2017 Cannes Lions Silver Award, most prestigious brand communications award



## Consumers most loved denim brands in the United States in 2018 (net favorability score)

Net favorability of denim brands in the United States in 2018



Note: United States; January 1 to April 7, 2018; 18 years and older  
Further information regarding this statistic can be found on [page 51](#).  
Source(s): Statista estimates; Morning Consult; ID 995843

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U.S. market

# Porter's 5 Forces Analysis

- **Bargaining Power of Buyers: Medium**

- Robust online marketplace creates low barrier to entry for competitors and low switching costs for consumers if they stumble across an attractive new product
- On the flip side, buyers in this industry value quality and Levi's brand has a high reputation that discourages consumers from spending dollars elsewhere

- **Bargaining Power of Suppliers: Low**

- Large number of suppliers compared to buyers means less control over pricing
- Product is standardized so it is easy and cheap for Levi Strauss to switch suppliers

- **Threat of New Entrants: Low**

- Economies of scale benefit Levi Strauss and make production costlier for new entrants
- High product differentiation in the industry and high initial costs

- **Threat of Substitutes: Low**

- Levi Strauss has great brand reputation and quality over substitute products
- Few products similar in quality but much higher in price

- **Industry Competition: Strong**

- Few behemoths control majority of market and have considerable spending power



# SWOT Analysis

## Strengths

- **Iconic brand with deep heritage:**
  - Birthplace of denim- blue jeans were invented by Levi Strauss back in 1873
  - #1 jeanswear brand measured by total retail sales (\$5.6 billion in 2019)
  - Leading presence through cultural events, strategic collaborations, ad campaigns
- **Driving sustainability and improved operations via Eureka Innovation Lab**
  - Open sourced all of their water-saving practices with competitors
  - Pursuing new imaging tool to cut development time in half
  - Plan to scale laser technology across entire supply chain to drastically reduce labor
- **Diversified in terms of sourcing, distribution, sales:**
  - Sourcing from 25 countries, with none representing > 20% of Levi's sourcing
  - Wholesale distribution channels and D2C (department, e-commerce. retail, etc.)
  - Products sold in 110 countries, over 50,000 retail stores worldwide
- **Strong management team with years of experience:**
  - CEO Chip Bergh was P&G Grooming Division's President, led creation of Swiffer, led turnaround for Old Spice
  - CFO Harmit Singh: 30 yrs. of experience for global consumer brands. Previously CFO at Hyatt Hotels

# SWOT Analysis

## Weaknesses

- **Dependent on Wholesale Customers**
  - 10 wholesalers account for 31% of net revenues (2020 10-K)
- **Dependent on Contract Manufacturers**
  - 99% of products are from independent product manufacturers (2020 10-K)
- **Trends**
  - Trends and styles dictate how many consumers spend their dollars, however, blue jeans are a staple clothing item in many people's closets and are somewhat insulated from this



# SWOT Analysis

## Opportunities

- Repair Levi's image as the “American” brand-- fell out of public eye in the 1980s
- Growth in global markets-- increase revenue in Asia and Europe
- Innovation & business opportunities in sustainability
- Enter and expand into other categories (footwear, top, outerwear, etc.)
- Partnering with more influencers, more aggressive social media campaigns
- Restructuring initiatives to reduce costs from COVID-19
- More penetration in e-commerce



# SWOT Analysis

## Threats

- **Clothing startups and Fast Fashion**
  - New companies with new fabric technologies (Ministry of Supply, Public Rec, etc.) can easily enter the market and reach millions of people worldwide
- **Pandemic**
  - Reduced foot traffic through stores means a more competitive online marketplace
  - Losses associated with operating brick and mortar stores
- **Foreign Exchange Risk**
  - Global business means the company is exposed to currency fluctuation risks
  - Changing value of costs and prices must be offset to prevent losses (Levi's has foreign risk management team)



# Investment Thesis

## Levi Strauss positioned for growth as pandemic ends

- **Swift Recovery From Pandemic**

- Revenue is recovering, losses went from 60% Q2 (year over year) to 27% in Q3
- Though brick and mortar retail prospects are generally negative, we believe Levi's experiential stores will outperform expectations
- Consumer spending is 6% below pre-pandemic levels, Levi revenues will grow as this corrects back to normal

- **Increased Digital Presence**

- E-commerce revenues rose 52% in Q3, we believe this trend will continue post pandemic

- **Competitive Margins**

- Gross margins expanded 60% (YOY) and according to management have room to grow as prices increase, paired with increased digital, international, and direct to consumer sales, this is likely to increase future profits

- **Strong Brand Name**

- We believe that Levi's powerful name will accelerate its recovery from the pandemic and share prices will continue increasing in the near future

# Analysis of Financials

## Levis had healthy pre-pandemic financials

- **Revenue** increased an average of 8.26% three years pre-pandemic
- **Profit Margin** has stayed around 12% for the three years pre-pandemic
- **Leverage Ratio** stayed under 0.8 in 2019 but spiked to 1.3 during the pandemic

### Future

- Customers shifting to online shopping and improved operational technology means **lower operating costs**
- Increased demand for eco-friendly apparel and brands that identify with consumer values will lead to increased **revenue**
- Management initiatives for geographic and product diversification into expanding markets will increase **margins**

# Comps Analysis

Comparable Company Analysis (in Mill)		All figures except margins and share price in millions of dollars								
	Ticker	Share Price (11/07)	Market Cap	Enterprise Value	EV/Revenue	EV/EBIT	EV/EBITDA	Operating Margin	P/E	
Levi Strauss	LEVI	\$15.56	6,177	7,462	1.61	43.18	24.17	-0.98%	-69.79	
Kontoor Brands	KTB	\$33.64	1,917	2,746	1.31	19.07	15.59	6.89%	35.77	
Gap	GPS	\$21.43	8,015	9,668	0.69	-45.60	29.84	-1.51%	-7.72	
Urban Outfitters	URBN	\$23.73	2,320	3,357	1.56	-30.45	30.80	-5.11%	-80.43	
Mean		\$23.59	4,608	5,808	1.29	-3.45	25.10	-0.18%	-30.54	
Median		\$22.58	4,249	5,410	1	-6	27			

- Comparables are larger retail brands with similar brick and mortar presence to Levi Strauss
- Metrics are struggling because of COVID but valuing based on EV/EBITDA provides a fairer valuation
- Levi Strauss revenues are recovering from pandemic along with increasing margins, which should increase its valuation in the future
- Not all comps have the brand recognition Levi Strauss does and a couple have more diverse products

# Comps Valuation

Implied Pricing:	Bear
EV/EBITDA	23.0
EBITDA	\$309
Implied EV	\$7,102
Cash	\$1,353
Debt	\$2,638
Market Cap	\$5,817
Weighted Avg Diluted Shares	397,010,522
<b>Implied Price</b>	<b>\$14.65</b>
ROI	-5.83%

Implied Pricing:	Neutral
EV/EBITDA	27
EBITDA	\$309
Implied EV	\$8,337
Cash	\$1,353
Debt	\$2,638
Market Cap	\$7,053
Weighted Avg Diluted Shares	397,010,522
<b>Implied Price</b>	<b>\$17.76</b>
ROI	14.16%

Implied Pricing:	Bull
EV/EBITDA	31.1
EBITDA	\$309
Implied EV	\$9,603
Cash	\$1,353
Debt	\$2,638
Market Cap	\$8,319
Weighted Avg Diluted Shares	397,010,522
<b>Implied Price</b>	<b>\$20.95</b>
ROI	34.66%

- Good opportunity for Return on Investment: neutral and bull cases indicative of trends in revenue and margins in Q3 that we believe will continue to exceed expectations
- Multiples
  - Bear: 23.0x (Slightly lower than industry median)
  - Base: 27.0x (Median of the comps)
  - Bull: 31.1x (Slightly higher than industry median - same as highest comp)



# Catalysts and Risks

## Risks

- COVID resurgences/lockdown measures may keep brick and mortar stores closed
- Market trends to athleisure may move consumers away from denim and decrease revenues
- Industry with heavily capitalized competitors that have a variety of similar products
- Heavy investment into their own R&D might not give fruitful returns

## Mitigants

- We believe that as consumer spending corrects to pre-pandemic levels, Levi's stock will as well
  - Expect massive uptick in revenue at brick-and-mortar stores after COVID vaccine-- within a year's timeline
- Levi's can use brand name to expand into other products/clothing categories
- Levi's can keep pushing into e-commerce and direct to consumer development
- Levi's can partner with cutting-edge technology companies to improve quality of product
  - Ex. Google with their smart trucker jacket

# Recommendation: Target Price: \$16.61

## Thesis Summary

- Well positioned for post-pandemic growth
- Strategic expansion into e-commerce & international markets
- Developing cutting edge innovation to improve design and operations
- Sustainability measures are often overlooked by investors

## Investment Support

- Strong Q3 Results
  - E-commerce sales ↑ 52%
- Heavy R&D investment in their innovation lab
  - Improve operational efficiency
  - Leading water sustainability efforts in denim industry
- Marketing and Sales
  - Celebrity and brand partnerships
  - Launching ad-campaigns