

L Brands, Inc. (LB)

\$21.66 (As of 02/28/20)

Price Target (6-12 Months): **\$18.00**

Long Term: 6-12 Months

Zacks Recommendation: Underperform

(Since: 01/10/20)

Prior Recommendation: Neutral

Short Term: 1-3 Months

Zacks Rank: (1-5)

4-Sell

Zacks Style Scores:

VGM:F

Value: B

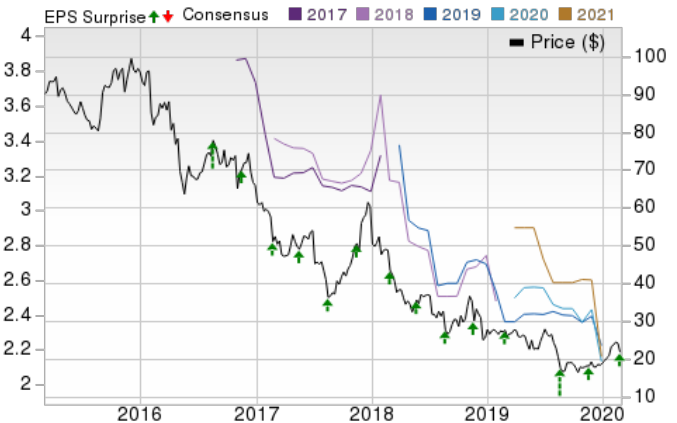
Growth: F

Momentum: F

Summary

Continued sluggishness in Victoria's Secret brand has been taking a toll on L Brands, whose shares have declined sharply in a year. Although, the company is divesting its majority stake in the brand to focus on profitable zones, its fourth-quarter fiscal 2019 has still borne the impact of the same. Both top and bottom lines continued to decline year over year with net sales missing the Zacks Consensus Mark for the third quarter in row. Nonetheless, solid performance at Bath & Body Works brand did provide some cushion. But this did not restrain management to provide soft first-quarter fiscal 2020 bottom-line view. L Brands also forecasts low-single digit decline in comps with gross margin expected to be almost flat. Additionally, SG&A expense rate is anticipated to increase considerably. This is likely to show on operating margin.

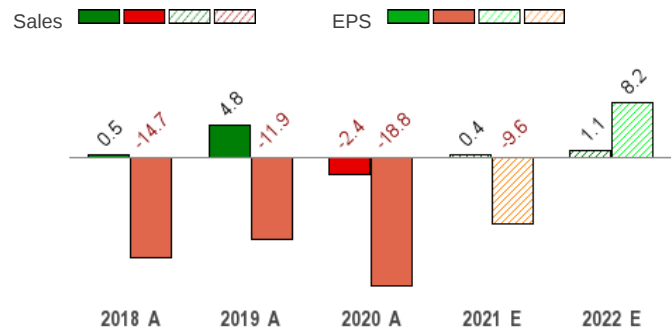
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$29.02 - \$15.80
20 Day Average Volume (sh)	10,269,897
Market Cap	\$6.0 B
YTD Price Change	19.5%
Beta	0.76
Dividend / Div Yld	\$1.20 / 5.5%
Industry	Retail - Apparel and Shoes
Zacks Industry Rank	Top 25% (63 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	1.1%
Last Sales Surprise	-0.1%
EPS F1 Est- 4 week change	-3.6%
Expected Report Date	NA
Earnings ESP	-147.1%
P/E TTM	9.5
P/E F1	10.5
PEG F1	1.0
P/S TTM	0.5

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2022					13,112 E
2021	2,638 E	2,959 E	2,737 E	4,855 E	12,964 E
2020	2,629 A	2,902 A	2,677 A	4,707 A	12,914 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2022					\$2.24 E
2021	\$0.04 E	\$0.21 E	\$0.06 E	\$1.92 E	\$2.07 E
2020	\$0.14 A	\$0.24 A	\$0.02 A	\$1.88 A	\$2.29 A

*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 02/28/2020. The reports text is as of 03/02/2020.

Overview

L Brands evolved from an apparel-based specialty retailer to a segment leader focused on women's intimate and other apparel, personal care, beauty and home fragrance products. But since past few years, the company has been struggling for a while due to sluggishness in the Victoria's Secret brand. As result, L Brands decided to take its lingerie business private.

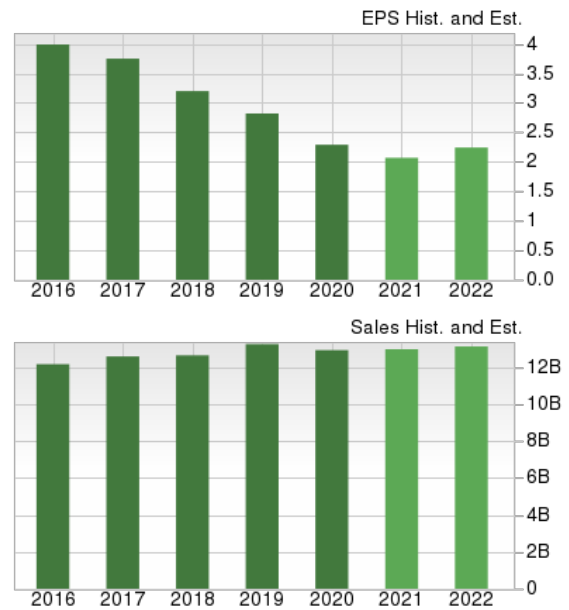
The company has entered into a deal to sell 55% stake in Victoria's Secret brand to private equity firm Sycamore Partners. The transaction is expected to close during the second quarter of fiscal 2020. This will help simplify the company's organizational structure and focus on Bath & Body Works, one of the leading specialty retailers of body care, home fragrance products, soaps and sanitizers.

The Columbus, OH-based company sells its merchandise through specialty retail stores in the e United States, Canada, the United Kingdom, Ireland and Greater China (China and Hong Kong), which are primarily mall-based, and through its websites, catalogue and other channels. The company conducts its business primarily through three reportable segments –

The Victoria's Secret segment (53% of FY19 Net Sales), Bath & Body Works segment (40% of Net Sales), Victoria's Secret and Bath & Body Works International segment (5% of Net Sales) includes company-owned and partner-operated outlets located outside of the U.S. and Canada. Other segment is 2% of Net Sales.

As of Feb 1, 2020, company-owned stores were 2,920 including 1,091 Victoria's Secret stores, 1,739 Bath & Body Works, 21 Victoria's Secret U.K./Ireland, five PINK U.K., 41 Victoria's Secret Beauty and Accessories and 23 Victoria's Secret China.

Total non-company-owned stores were 722, including 207 Victoria's Secret Beauty & Accessories, 72 Victoria's Secret, 12 Pink and 262 Bath & Body Works stores. Further, non-company-owned stores comprised 153 and 16 Travel Retail stores of Victoria's Secret Beauty & Accessories and Bath & Body Works, respectively.



Reasons To Sell:

- ▼ **Soft Victoria's Secret Performance:** Shares of L Brands have slid 19.2% compared with the industry's decline of 38.4% in a year. The company has been witnessing softness in its Victoria's Secret brand for quite some time now, owing to stiff competition and consumers' changing preferences. Investors have pointed out that wrong merchandising actions and the company's inability to keep up with its strong brand image have led to Victoria's Secret's failure. During the fourth quarter of fiscal 2019, total Victoria's Secret sales fell 10% to \$2,275.8 million. Comparable sales fell 10% while comparable store sales declined by an equivalent rate owing to lower traffic and average unit retail. Further, total digital sales registered a decline of 8%. Comps were down mid-teens in both the lingerie business and at PINK. Segment gross margin rate fell sharply due to significant decline in the merchandise margin rate and buying and occupancy expense deleverage. Merchandise margin dollars decreased in the high-teens.
- ▼ **First-Quarter FY20 View Disappointing:** L Brands envisions adjusted loss of 5 cents a share for first-quarter fiscal 2020, which came sharply below analysts' expectations. The company had reported earnings of 14 cents in the year-ago period. Management expects continued challenges at Victoria's Secret with flat to modest improvement in operating income at Bath & Body Works due to occupancy and supply chain pressures. The company's projection also takes into account an adverse impact of approximately 3 cents on account store closures in China due to the coronavirus outbreak. Management forecasts low-single digit decline in first-quarter comps.
- ▼ **Margins a Concern:** Gross margin, an important financial metric that gives an indication about the company's health, has been contracting year over year for the past few quarters. In the fourth quarter of fiscal 2019, L Brands' adjusted gross profit declined 7% to \$1,829.1 million during the quarter. We note that gross margin contracted 170 bps to 38.9% on account of decline in the merchandise margin rate. This follows a contraction of 110, 160 and 40 basis points during the third, second and first quarters. During the fourth quarter, adjusted operating income fell 10% from the year-ago period to \$806.7 million, while operating margin shrank 140 bps to 17.1%. This follows a contraction of 200 bps in the preceding quarter.
- Further, management expects first-quarter fiscal 2020 gross margin to be almost flat year over year with deleverage in buying and occupancy to be offset by an improvement in the merchandise margin rate. SG&A expense rate is anticipated to increase considerably. Again, management has hinted that at Bath & Body Works brand occupancy costs are likely to be under pressure in fiscal 2020 due to real estate initiative and expansion of direct channel capacity and capability. Further, the company expects margin to remain strained due to ongoing supply chain impacts related to global trade tariffs and sourcing costs.
- ▼ **Fashion Obsolescence A Threat:** Fashion obsolescence remains the main concern for L Brands' business model, which involves a sustained focus on product and design innovation. The company's pioneering position may be compromised by delays in its product launches. The company operates in the highly competitive apparel segment, and faces stiff competition from chain specialty stores, department stores and discount retailers on attributes such as, marketing, design, price, service, quality, and brand image, which may weigh upon its results.
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L Brands has been witnessing softness in its Victoria's Secret brand for quite some time now, owing to stiff competition and consumers' changing preferences.

Risks

- **Growth Catalyst:** We believe that L Brands' sustained focus on cost containment, inventory management, merchandise and speed-to-market initiatives has kept it afloat in a competitive environment. Additionally, L Brands' operational efficiencies together with its new and innovative collections, bode well. Furthermore, the company's focus on tapping international markets is likely to provide long-term growth opportunities and generate increased sales volumes. Notably, the company has entered into a deal to sell 55% stake in Victoria's Secret brand to private equity firm Sycamore Partners for roughly \$525 million. This will help simplify the company's organizational structure and focus on Bath & Body Works brand that sustained its impressive performance during the fourth quarter of fiscal 2019. The company will utilize the proceeds from the sale to lower debt burden.
 - **Strength in Bath & Body Works Brand:** L Brands has been benefitting from strength of its Bath & Body Works, which formed more than 46% of the company's net sales in the fourth quarter of fiscal 2019. During the quarter, Bath & Body Works delivered a solid show. Total sales grew 11% to \$2,174.8 million, with 10% rise in comparable sales and 5% improvement in comparable store sales. Management stated that the segment benefited from growth across main categories body care, home fragrance and soaps. Bath & Body Works direct channel remained sturdy, with sales up 33%. Operating income came in at \$660.6 million, up 9% from the year-ago period. Further, industry experts believe that Bath & Body Works brand is likely to experience another solid year. We expect the trend to continue and aid the top line in the forthcoming periods. Even analysts pointed that due to the outbreak of coronavirus there could a surge in demand for soaps and hand sanitizers, and Bath & Body Works being one of the prominent retailers of the product is likely to benefit from the same.
 - **Revamping and Repositioning Business:** L Brands continues to revamp its business by improving store experience, localizing assortments and enhancing its direct business. We believe these measures will facilitate it to generate incremental sales and increase store transactions through higher conversion rate. Looking ahead, the company remains committed to improve performance by staying customer-focused, enriching assortments, and enhancing store and online experiences. Moreover, to drive growth the company seeks to expand in the adjacent categories. We believe that the company's innovation in merchandise and exclusive assortments remain popular among consumers and sets it apart from peers. The company with its operational efficiencies, new and innovative assortments remains well positioned to capitalize on the same. L Brands expects new product launches in Lingerie, PINK and Beauty throughout the Spring.
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Last Earnings Report

L Brands Beats on Q4 Earnings, Victoria's Secret a Drag

L Brands, Inc.'s fourth-quarter fiscal 2019 earnings beat the Zacks Consensus Estimate but net sales fell short of the same for the third straight quarter. Again, both the top and bottom lines continued to decline year over year.

Management highlighted that better-than-expected results at Bath & Body Works were more than offset by dismal performance at Victoria's Secret business. Further, the company provided a disappointing bottom-line view for first-quarter fiscal 2020.

Weakness in the Victoria's Secret brand, which once dominated the U.S. lingerie market, has been marring the company's overall performance. L Brands is struggling to make a comeback in the wake of rising competition from intimate apparel brands like ThirdLove and Aerie.

Notably, the company has entered into a deal to sell 55% stake in the business to private equity firm Sycamore Partners for roughly \$525 million. This will help simplify the company's organizational structure and focus on Bath & Body Works brand that sustained its impressive performance in the quarter under review. The company will utilize the proceeds from the sale to lower debt burden.

Quarter Ending 01/2020

Report Date	Feb 26, 2020
Sales Surprise	-0.05%
EPS Surprise	1.08%
Quarterly EPS	1.88
Annual EPS (TTM)	2.28

Detailed Quarterly Discussion

L Brands reported adjusted earnings of \$1.88 per share that beat the Zacks Consensus Estimate by a couple of cents. However, the bottom line declined 12% from \$2.14 reported in the prior-year period. We note that lower net sales and contraction in margins hurt the bottom line.

Net sales came in at \$4,707.1 million, down 3% from \$4,852.3 million reported in the prior-year period. The top line also missed the Zacks Consensus Estimate \$4,709.5 million. Comparable sales declined 2% against the prior-year quarter's growth of 3%.

Total **Victoria's Secret** sales declined 10% to \$2,275.8 million. Comparable sales fell 10% while comparable store sales declined by an equivalent rate owing to lower traffic and average unit retails. Further, total digital sales registered a decline of 8%. Comps were down mid-teens in both the lingerie business and at PINK. Victoria's Secret Beauty comps improved in the low-single digit range. We note that the segment's merchandise margin rate declined significantly.

Meanwhile, **Bath & Body Works** put up a stellar show. Total sales grew 11% to \$2,174.8 million, with 10% rise in comparable sales and 5% improvement in comparable store sales. Management stated that the segment benefited from growth across main categories body care, home fragrance and soaps. Bath & Body Works direct channel remained sturdy, with sales up 33%. Further, merchandise margin rate declined on account of impact of tariffs and other production and sourcing pressures.

We note that L Brands' **International** sales came in at \$177.1 million, down 7% year over year. The Bath & Body Works franchise business sustained the impressive run. However, performance at the Victoria's Secret company-owned outlets in the U.K. and China remains challenging.

L Brands' adjusted gross profit declined 7% to \$1,829.1 million during the quarter. We note that gross margin contracted 170 bps to 38.9% on account of decline in the merchandise margin rate. Adjusted operating income fell 10% from the year-ago period to \$806.7 million, while operating margin shriveled 140 bps to 17.1%.

SG&A expenses declined 4% to \$1,022.4 million due to fall in store selling and marketing expense at Victoria's Secret and the absence of the Henri Bendel and La Senza businesses. As a percentage of net sales, SG&A expenses decreased 30 bps to 21.7%.

Store Update

As of Feb 1, 2020, company-owned stores were 2,920 including 1,091 Victoria's Secret stores, 1,739 Bath & Body Works, 21 Victoria's Secret U.K./Ireland, five PINK U.K., 41 Victoria's Secret Beauty and Accessories and 23 Victoria's Secret China.

Total non-company-owned stores were 722, including 207 Victoria's Secret Beauty & Accessories, 72 Victoria's Secret, 12 Pink and 262 Bath & Body Works stores. Further, non company-owned stores comprised 153 and 16 Travel Retail stores of Victoria's Secret Beauty & Accessories and Bath & Body Works, respectively.

Other Financial Details

L Brands ended the quarter with cash and cash equivalents of \$1,498.7 million, up from the prior-year quarter's figure of \$1,413.5 million. Long-term debt decreased to \$5,486.9 million from \$5,739.4 million a year ago. Shareholders' deficit was \$1,495 million. Management incurred capital expenditures of \$66.7 million in the quarter under review.

Outlook

L Brands envisions adjusted loss of 5 cents a share for first-quarter fiscal 2020. The company had reported earnings of 14 cents in the year-ago period. Management expects continued challenges at Victoria's Secret with flat to modest improvement in operating income at Bath & Body Works due to occupancy and supply chain pressures. The company's projection also takes into account an adverse impact of approximately 3 cents on account store closures in China due to the coronavirus outbreak.

Management forecasts low-single digit decline in first-quarter comps. Further, gross margin is expected to be almost flat year over year with deleverage in buying and occupancy to be offset by an improvement in the merchandise margin rate. SG&A expense rate is anticipated to increase considerably.

L Brands expects new product launches in Lingerie, PINK and Beauty throughout the Spring. Further, industry experts believe that Bath & Body

Works brand is likely to experience another solid year. However, management has hinted that occupancy costs are likely to be under pressure in fiscal 2020 due to real estate initiative and expansion of direct channel capacity and capability. Further, the company expects margin to remain strained due to ongoing supply chain impacts related to global trade tariffs and sourcing costs.

Recent News

L Brands Posts Soft Holiday Sales – January 9, 2020

L Brands disappointed with its holiday season performance. The company posted net sales of \$3.906 billion for the nine weeks ended Jan 4, 2020, reflecting year-over-year decline of 4.1%. Comparable sales fell 3% during the aforementioned time frame. The company has been grappling with softness at the Victoria's Secret brand. The segment's comparable sales dropped 12% during the November and December period. Nonetheless, Bath & Body Works brand put up a stellar show with 9% jump in comparable sales. But this was not enough to stop L Brands from slashing its earnings per share view for the final quarter of fiscal 2019. The company now envisions earnings to be \$1.85, down from the prior estimate of \$2.00.

Valuation

L Brands shares are up 19.6% in the year-to-date period but down nearly 19.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and the Zacks Retail-Wholesale sector are down 13.6% and 5%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry is down 38.4% but the sector is up 4.6%.

The S&P 500 index is down 8.2% in the year-to-date period but up 4.9% in the past year.

The stock is currently trading at 10.56X forward 12-month earnings, which compares to 10.79X for the Zacks sub-industry, 23.39X for the Zacks sector and 16.87X for the S&P 500 index.

Over the past five years, the stock has traded as high as 25.19X and as low as 6.49X, with a 5-year median of 14.91X. Our Underperform recommendation indicates that the stock will perform worse than the market. Our \$18 price target reflects 8.98X forward 12-month earnings.

The table below shows summary valuation data for LB

Valuation Multiples - LB					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	10.56	10.79	23.39	16.87
	5-Year High	25.19	18.38	26.19	19.34
	5-Year Low	6.49	10.23	19.06	15.18
	5-Year Median	14.91	14.22	23.08	17.44
P/S F12M	Current	0.46	0.53	0.98	3.12
	5-Year High	2.32	1.34	1.11	3.43
	5-Year Low	0.33	0.53	0.8	2.54
	5-Year Median	1.09	0.81	0.92	3.01
EV/EBITDA TTM	Current	8.03	7.99	14.45	10.93
	5-Year High	13.83	8.9	15.92	12.88
	5-Year Low	5.9	4.71	10.8	8.49
	5-Year Median	8.08	6.76	12.48	10.79

As of 02/28/2020

Industry Analysis Zacks Industry Rank: Top 25% (63 out of 254)



Top Peers

Zumiez Inc. (ZUMZ)	Outperform
American Eagle Outfitters, Inc. (AEO)	Neutral
Abercrombie & Fitch Company (ANF)	Neutral
Guess?, Inc. (GES)	Neutral
The Gap, Inc. (GPS)	Neutral
The Childrens Place, Inc. (PLCE)	Neutral
Urban Outfitters, Inc. (URBN)	Neutral
Vera Bradley, Inc. (VRA)	Neutral

Industry Comparison Industry: Retail - Apparel And Shoes				Industry Peers		
	LB Underperform	X Industry	S&P 500	ANF Neutral	GPS Neutral	URBN Neutral
VGM Score	F	-	-	C	D	B
Market Cap	5.99 B	684.55 M	21.48 B	823.88 M	5.35 B	2.30 B
# of Analysts	10	3	13	11	8	13
Dividend Yield	5.54%	0.00%	2.07%	6.09%	6.77%	0.00%
Value Score	B	-	-	A	A	A
Cash/Price	0.05	0.13	0.04	0.40	0.17	0.12
EV/EBITDA	7.96	7.16	12.57	6.65	5.84	6.13
PEG Ratio	0.95	1.11	1.84	0.71	0.94	1.00
Price/Book (P/B)	NA	1.41	2.88	0.83	1.47	1.61
Price/Cash Flow (P/CF)	4.41	5.58	11.58	3.66	3.60	6.03
P/E (F1)	10.42	10.67	16.87	10.82	8.44	10.26
Price/Sales (P/S)	0.46	0.46	2.34	0.23	0.33	0.58
Earnings Yield	9.56%	8.96%	5.91%	9.22%	11.86%	9.74%
Debt/Equity	-6.93	0.93	0.70	1.48	1.90	0.78
Cash Flow (\$/share)	4.91	1.51	6.94	3.59	3.98	3.90
Growth Score	F	-	-	F	F	C
Hist. EPS Growth (3-5 yrs)	-8.16%	-0.69%	10.85%	-3.52%	-2.48%	9.20%
Proj. EPS Growth (F1/F0)	-9.65%	7.62%	6.79%	79.67%	-6.24%	9.09%
Curr. Cash Flow Growth	1.77%	9.92%	5.92%	8.78%	13.35%	33.74%
Hist. Cash Flow Growth (3-5 yrs)	0.97%	-0.29%	8.38%	-7.00%	-2.78%	0.23%
Current Ratio	1.15	1.50	1.23	1.41	1.43	1.57
Debt/Capital	NA%	51.30%	42.53%	59.75%	65.50%	43.91%
Net Margin	-2.84%	2.55%	11.57%	1.52%	4.97%	5.96%
Return on Equity	-62.38%	10.96%	16.80%	5.30%	22.33%	16.67%
Sales/Assets	1.20	1.32	0.54	1.13	1.31	1.33
Proj. Sales Growth (F1/F0)	0.39%	2.01%	4.07%	1.93%	0.33%	4.17%
Momentum Score	F	-	-	D	D	C
Daily Price Chg	-6.03%	0.00%	-1.44%	-0.38%	0.99%	-3.21%
1 Week Price Chg	-1.11%	-0.13%	-0.94%	-5.42%	-5.95%	1.27%
4 Week Price Chg	-7.48%	-11.97%	-10.98%	-21.14%	-20.92%	-11.22%
12 Week Price Chg	19.87%	-12.09%	-7.84%	-21.28%	-12.09%	-7.33%
52 Week Price Chg	-17.14%	-25.20%	1.20%	-40.18%	-43.58%	-23.79%
20 Day Average Volume	10,269,897	297,720	2,169,477	2,027,762	5,366,478	1,416,270
(F1) EPS Est 1 week change	-2.61%	0.00%	0.00%	-1.25%	-0.05%	0.77%
(F1) EPS Est 4 week change	-3.56%	0.00%	-0.09%	-0.68%	-0.11%	-0.58%
(F1) EPS Est 12 week change	-11.70%	0.00%	-0.24%	0.72%	1.69%	-5.76%
(Q1) EPS Est Mthly Chg	-8.33%	-1.37%	-0.72%	-0.32%	-5.12%	-5.67%

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	B
Growth Score	F
Momentum Score	F
VGM Score	F

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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