

Ulta Beauty Inc. (ULTA)

\$263.50 (As of 01/09/20)

Price Target (6-12 Months): **\$279.00**

Long Term: 6-12 Months

Zacks Recommendation:

Neutral

(Since: 10/29/19)

Prior Recommendation: Underperform

Short Term: 1-3 Months

Zacks Rank: (1-5)

3-Hold

Zacks Style Scores:

VGM:B

Value: C

Growth: B

Momentum: C

Summary

Ulta Beauty's shares have outpaced the industry in the past three months. The stock got a boost following the company's third-quarter fiscal 2019 results, wherein the top and the bottom lines improved year over year. Also, the top line beat the Zacks Consensus Estimate. Results were backed by rise in ticket and transactions, as well as enhanced gross margin. Moreover, the company's loyalty programs are yielding results. Also, the company is strengthening e-commerce channels, which is expected to grow 20-30% in fiscal 2019. However, the company has been grappling with high SG&A expenses, which continued to hurt operating margin during the quarter. Also, soft makeup business in the United States is a concern. Consequently, management squeezed its guidance range for fiscal 2019 for sales, comparable sales and earnings.

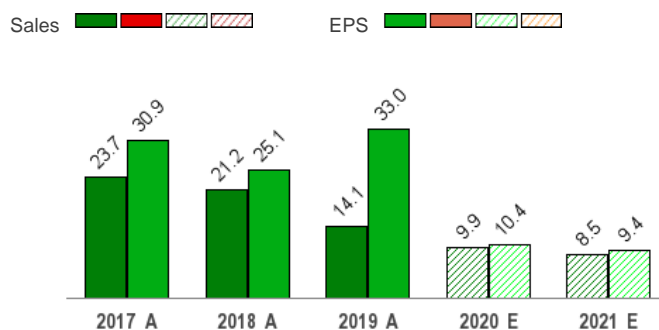
Price, Consensus & Surprise



Data Overview

52 Week High-Low	\$368.83 - \$222.00
20 Day Average Volume (sh)	940,046
Market Cap	\$15.1 B
YTD Price Change	4.1%
Beta	1.13
Dividend / Div Yld	\$0.00 / 0.0%
Industry	Retail - Miscellaneous
Zacks Industry Rank	Top 13% (33 out of 254)

Sales and EPS Growth Rates (Y/Y %)



Last EPS Surprise	5.6%
Last Sales Surprise	-0.2%
EPS F1 Est- 4 week change	0.0%
Expected Report Date	03/12/2020
Earnings ESP	0.0%
P/E TTM	22.5
P/E F1	22.0
PEG F1	1.2
P/S TTM	2.1

Sales Estimates (millions of \$)

	Q1	Q2	Q3	Q4	Annual*
2021	1,887 E	1,809 E	1,842 E	2,477 E	8,007 E
2020	1,743 A	1,667 A	1,683 A	2,288 E	7,383 E
2019	1,544 A	1,488 A	1,560 A	2,125 A	6,717 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	\$3.37 E	\$3.02 E	\$2.51 E	\$4.20 E	\$13.11 E
2020	\$3.08 A	\$2.76 A	\$2.25 A	\$3.73 E	\$11.98 E
2019	\$2.63 A	\$2.46 A	\$2.18 A	\$3.61 A	\$10.85 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 01/09/2020. The reports text is as of 01/10/2020.

Overview

Bolingbrook, IL-based, Ulta Beauty Inc., previously known as Ulta Salon, Cosmetics & Fragrance, Inc., is a leading beauty retailer in the United States. Founded in 1990, the company changed its name to Ulta Beauty in January 2017.

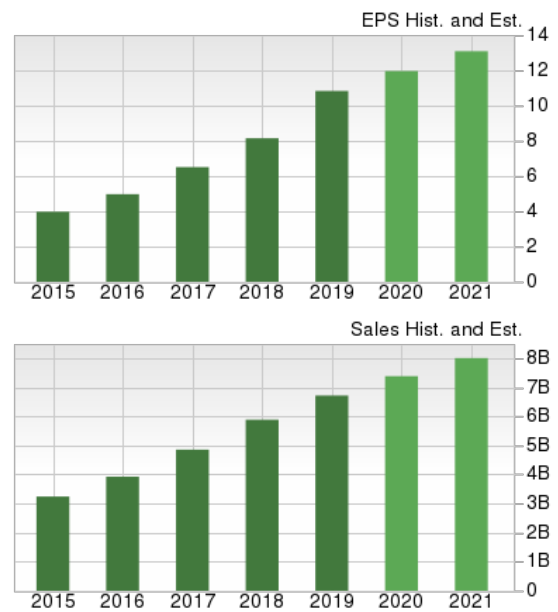
The company offers a wide range of products including cosmetics, fragrance, skincare, hair care, bath and body products, and salon styling tools in stores. It sells more than 25,000 products from about 500 well-established and emerging beauty brands across all categories and price points.

The retailer also provides private label products comprising Ulta Beauty Collection branded cosmetics, skincare, and bath products. Additionally, the company operates a full-service salon in every store offering hair, skin and brow services. Additionally, it offers products through its Website, [ulta.com](https://www.ulta.com), as well as mobile applications. The products offered by the company include the prestige and mass beauty brands.

As part of its value proposition, Ulta Beauty provides a range of loyalty programs through its Customer Relationship Management platform. It also offers frequent promotions, coupons, in-store events and gifts. The company also makes use of a range of media platforms to advertise products as well as generate awareness. The company strives to boost distribution center capabilities to better support store footfall and online demand.

The company has a strong vendor base and holds partnerships with companies such as Estee Lauder, L'Oréal and Shiseido. Ulta Beauty works closely with vendors to provide improved growth platforms for new and existing brands.

As of Nov 2, 2019, the company operated 1,241 retail stores. For fiscal 2019, the company plans to open nearly 80 stores and remodel or relocate 20.



Reasons To Buy:

- ▲ **Strength in Loyalty Program:** Ulta Beauty's loyalty program has been a key business driver. Notably, the company increased its Ultimate Rewards Loyalty program to 31.8 million active members at the end of fiscal 2018, up 14.4% year over year. In the third quarter of fiscal 2019, the metric grew to 33.9 million active members. Moreover, sales from loyalty program members continued to represent more than 95% of the company's total revenues, along with rise in average spend per member. This growth was fueled by the company's excellent marketing and merchandising endeavors.

Also, the credit card program has also been yielding well. The program surpassed expectations in fiscal 2018, backed by robust store associate engagement, acquisition campaigns, effective integration into the loyalty calendar and solid support from partners. The company is focused on personalization efforts through relevant product recommendations and replenishment to boost the loyalty program. Notably, growth in the company's credit card program contributed to the top line in fiscal third quarter.

Moreover, strength in loyalty program will continue on the back of the addition of brands, maturation of loyalty members and higher penetration of the credit card program. Such upsides are likely to aid performance in the forthcoming periods. Expectations of consistent growth have boosted investors' optimism in the stock. Ulta Beauty's shares have gained 6.1% in the past three months, compared with the industry's rise of 2.3%.

- ▲ **Omni-channel Growth:** Ulta Beauty is known for its strategy of striking the right balance between online and physical stores. This is probably one of the reasons behind garnering goodwill in a short span. Amid the rising online competition, Ulta Beauty has managed to grow both e-commerce and in-store sales. The company continued to witness growth in online traffic in the third quarter of fiscal 2019.

For fiscal 2019, management anticipates e-commerce sales growth of 20-30%. The company is undertaking measures to strengthen its omni-channel presence. In this respect, its store-to-door strategy has been yielding. It is also seeing growth in the usage of buy online and pick up in store facilities. Moreover, the company is enhancing mobile application capabilities. During fiscal third quarter, Ulta Beauty expanded its mobile pilot point-of-sale to stores with increased volumes. This is likely to help the company enhance customer experience during the holiday season.

Earlier, the company converted its the distribution center in Romeoville, IL, into its first Fast Fulfillment Center (FFC).. Further, its second FFC is in progress and is expected to open in 2021 in Jacksonville, FL. The company is on track to reach its goal of 2-day e-commerce shipping by 2021. Such moves are likely to help in creating a seamless digital shopping experience for Ulta Beauty's customers.

- ▲ **Efforts to Boost offerings:** Ulta Beauty has created a niche market on the back of solid mix of beauty products it offers. The company's stores are a one-stop shop for beauty enthusiasts, featuring prestige and discount beauty brands, as well as offering salon products and services, all under one roof. This business model, focused on "All Things Beauty, All in One Place", makes Ulta Beauty a go-to destination for cosmetics and beauty product lovers.

Further, the company remains keen on enhancing beauty products offerings, while also improving store traffic with superior services. In sync with this, the company frequently innovates products to cater to consumers' evolving beauty needs. Exclusivity, relevance and speed are some of the key elements that the company pays attention to while undertaking efforts to boost merchandise. The company's initiative to be the partner for digitally-native brands like Morphe and Kylie cosmetics are delivering impressive results and driving store traffic. Recently, Ulta Beauty launched an assortment of Hero products by Laura Mercier, online. Another exciting launch for the company was an exclusive vegan cruelty free capsule collection with Thrive Causemetics. During the third quarter, Ulta Beauty also expanded its distribution network for iconic brands like benefit, Clinique, Lancome, MAC and Estee Lauder to additional stores as well as launched exciting products under these banners. These brands are expected to aid resu

Its in fiscal 2019. Brand launches and rollouts will continue to drive the company's top line, thus, generating higher profitability. Additionally, the company is planning to expand business internationally.

Ulta Beauty is gaining from robust omni-channel experience as well as salon services and unique loyalty programs. These are likely to remain robust in fiscal 2019.

Reasons To Sell:

▼ **Softness in the U.S. Beauty Industry:** The U.S. beauty market is struggling with soft makeup sales trend, which remains a concern for Ulta Beauty. Makeup has witnessed a number of up and down cycles in the United States. The most recent downside started in 2017 and accelerated in the late 2018 as a result of absence of innovations and newer products in the makeup category. This trend continued through 2019 and saw further slowdown during the third quarter of fiscal 2019. Further, management believes that this cyclical trend will persist, which we believe might hurt the company's topline and overall profitability.

Ulta Beauty expects operating margin deleverage of 60-70 bps for fiscal 2019. Softness in the U.S. beauty industry remains a headwind.

▼ **Higher SG&A Costs Remain Concerns:** Ulta Beauty has been struggling against rising selling, general and administrative expenses (SG&A) expenses for a while. This is a limiting factor for the company's operating margin. Notably, operating margin contracted 80 bps to 10% during the third quarter. A rise of 140 bps in SG&A expenses, as a percentage of sales, negatively impacted operating margin during the quarter.

Further, the company expects operating margin deleverage of 60-70 bps for fiscal 2019 compared with the prior guidance of a leverage of 10-20 bps. The company's expenses are usually allocated toward increasing store labor and greater spending on growth initiatives and innovation. Further, higher costs of investments toward digital channels, salon services, infrastructure, personalization efforts, brands and initiatives to enhance customer experience may result in higher corporate overheads. This might weigh on the operating margin and affect the company's overall profitability.

▼ **Change in Customer Preferences:** One major concern with consumer-driven industries like the cosmetics and apparel is that the trend changes rapidly. Hence, failure to stay up to date on product mix by continually searching for new products and anchoring new supplier agreements may result in becoming obsolete. Further, new trends like "all-natural" among women (who are the primary customers for the cosmetics industry) may reduce the demand for makeup products, resulting in lower sales for these companies.

Last Earnings Report

Ulta Beauty's Q3 Earnings Top Estimates, Sales Rise Y/Y

Ulta Beauty posted third-quarter fiscal 2019 results, wherein both top and bottom lines improved year over year and the latter beat the Zacks Consensus Estimate. Results were backed by an improved gross margin as well as a rise in ticket and transactions. Management is impressed with its solid performance despite the challenges in the U.S. beauty category, due to the soft makeup business. In fact, Ulta Beauty continued to see market share gains in all beauty categories.

However, the top line marked its third consecutive quarterly miss. Management squeezed its fiscal 2019 guidance range for sales, comparable sales (comps) and earnings per share.

Quarter Ending **10/2019**

Report Date	Dec 05, 2019
Sales Surprise	-0.24%
EPS Surprise	5.63%
Quarterly EPS	2.25
Annual EPS (TTM)	11.70

Q3 Numbers

Ulta Beauty's earnings grew 3.2% to \$2.25 per share and surpassed the Zacks Consensus Estimate of \$2.13. This included gains from federal income tax credits. The year-over-year rise in the bottom line can be attributable to improved sales and margins.

Net sales of this cosmetics retailer grew 7.9% year over year to \$1,682.5 million but missed the Zacks Consensus Estimate of \$1,692 million. Comps (including stores and e-commerce) climbed 3.2%, compared with 7.8% growth recorded in the prior-year quarter and 6.2% in the preceding quarter. Increase in transactions and average ticket led to the increase. During the third quarter, the company registered a transaction increase of 2.3%, while average ticket was up 0.9%.

Gross margin expanded 40 basis points (bps) to 37.1%, backed by higher merchandise margins stemming from impressive marketing and merchandising strategies. Also, fixed-store expense leverage aided the gross margin. This was somewhat offset by impacts from investments in salon services.

However, operating margin contracted 80 bps to 10% as higher gross margin was offset by a 140 bps rise in SG&A expenses (as a percentage of sales). Pre-opening expenses grew 14.5% to \$6.5 million.

Other Financials

Ulta Beauty ended the quarter with cash and cash equivalents of \$208.8 million, and total stockholders' equity of \$1,847.2 million. Net merchandise inventories summed \$1,616.9 million as of Nov 2, increasing 8.9% from the year-ago period. Also, average inventory per store rose 2.1% year over year.

Net cash provided by operating activities was roughly \$557.5 million at the end of the first nine months of fiscal 2019.

Ulta Beauty bought back 529,404 shares for \$128.6 million in the reported quarter. In the first three quarters of fiscal 2019, the company repurchased 1,639,438 shares for \$506.9 million. With this, the company had \$388.8 million outstanding, as of Nov 2, under its \$875-million share repurchase plan announced in March.

Store Updates

During the third quarter, Ulta Beauty opened 31 stores and shuttered three. As of the end of the quarter, it operated 1,241 stores, increasing its total square footage by 6.9% year over year.

In fiscal 2019, the company plans to open nearly 80 stores and remodel or relocate 20. Also, it intends to complete roughly 270 store refreshes.

Guidance

Management is impressed with the company's efforts to strengthen brand portfolio through collaborations and innovation. It is particularly impressed with the skincare category. Further, during the quarter, Ulta Beauty expanded its mobile pilot point-of-sale to stores with increased volumes. This is likely to help the company enhance customer experience during the holiday season.

For fiscal 2019, management now projects total sales to increase 10% compared with the previous view of 9-12% growth. Comps are expected to increase 4.7-5% now, which includes e-commerce improvement of 20-30%. Earlier, management projected comps to rise 4-6%.

The company continues to expect operating margin deleverage of 60-70 bps for fiscal 2019. Earnings per share are now envisioned to be \$11.93-\$12.03 compared with the prior projection of \$11.86-\$12.06.

Markedly, Ulta Beauty's earnings guidance includes the impact of share repurchases worth roughly \$700 million and an effective tax rate of 23%.

The company plans capital expenditures of \$305-\$315 million for fiscal 2019 compared with \$340-\$350 million projected earlier.

Valuation

Ulta Beauty shares are down 7.2% over the trailing 12-month period. Over the past year, the Zacks sub-industry is down 8% but the Zacks Retail-Wholesale sector is up 20.5%.

The S&P 500 index is up 25.3% in the past year.

The stock is currently trading at 20.22X forward 12-month earnings, which compares to 12.79X for the Zacks sub-industry, 25.51X for the Zacks sector and 18.94X for the S&P 500 index.

Over the past five years, the stock has traded as high as 42.32X and as low as 16.61X, with a 5-year median of 27.76X. Our Neutral recommendation indicates that the stock will perform in line with the market. Our \$279 price target reflects 21.41X forward 12-month earnings.

The table below shows summary valuation data for ULTA

Valuation Multiples - ULTA					
		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	20.22	12.79	25.51	18.94
	5-Year High	42.32	20.29	26.13	19.34
	5-Year Low	16.61	12.7	18.99	15.17
	5-Year Median	27.76	15	22.91	17.44
P/S F12M	Current	1.89	0.99	1.08	3.51
	5-Year High	3.5	1.21	1.1	3.51
	5-Year Low	1.69	0.86	0.8	2.54
	5-Year Median	2.49	1.05	0.9	3
EV/EBITDA TTM	Current	13.99	13.89	15.28	11.99
	5-Year High	22.22	16.89	15.3	12.86
	5-Year Low	11.56	10.69	10.27	8.48
	5-Year Median	16.76	14.05	12.33	10.67

As of 01/09/2019

Industry Analysis Zacks Industry Rank: Top 13% (33 out of 254)



Top Peers

Avon Products, Inc. (AVP)	Outperform
Helen of Troy Limited (HELE)	Outperform
Sally Beauty Holdings, Inc. (SBH)	Outperform
Coty Inc. (COTY)	Neutral
The Estee Lauder Companies Inc. (EL)	Neutral
The Michaels Companies, Inc. (MIK)	Neutral
Regis Corporation (RGS)	Neutral
Inter Parfums, Inc. (IPAR)	Underperform

Industry Comparison Industry: Retail - Miscellaneous				Industry Peers		
	ULTA Neutral	X Industry	S&P 500	MIK Neutral	RGS Neutral	SBH Outperform
VGM Score	B	-	-	A	F	A
Market Cap	15.06 B	1.33 B	23.94 B	1.14 B	597.92 M	1.92 B
# of Analysts	12	4	13	5	1	8
Dividend Yield	0.00%	0.00%	1.78%	0.00%	0.00%	0.00%
Value Score	C	-	-	A	D	A
Cash/Price	0.01	0.11	0.04	0.10	0.10	0.04
EV/EBITDA	14.54	7.33	13.97	7.33	89.57	6.04
PEG Ratio	1.20	1.45	2.03	0.58	2.55	1.89
Price/Book (P/B)	8.39	1.26	3.33	NA	2.11	NA
Price/Cash Flow (P/CF)	16.76	6.12	13.73	2.32	7.12	5.17
P/E (F1)	22.07	10.56	18.79	3.70	19.11	7.07
Price/Sales (P/S)	2.09	0.37	2.64	0.22	0.58	0.50
Earnings Yield	4.55%	8.52%	5.32%	27.06%	5.23%	14.17%
Debt/Equity	0.92	0.86	0.72	-2.47	3.17	-26.43
Cash Flow (\$/share)	15.72	3.34	6.94	3.35	2.36	3.18
Growth Score	B	-	-	C	F	B
Hist. EPS Growth (3-5 yrs)	27.52%	11.48%	10.56%	11.36%	170.18%	9.31%
Proj. EPS Growth (F1/F0)	10.41%	10.15%	7.49%	-10.72%	-36.23%	2.93%
Curr. Cash Flow Growth	22.98%	10.02%	14.83%	0.85%	23.56%	0.84%
Hist. Cash Flow Growth (3-5 yrs)	24.61%	8.72%	9.00%	8.72%	-2.98%	2.83%
Current Ratio	1.67	1.41	1.23	1.19	0.70	2.55
Debt/Capital	48.03%	51.52%	42.99%	NA	76.03%	NA
Net Margin	9.67%	3.82%	11.08%	5.30%	-2.66%	7.01%
Return on Equity	36.91%	10.84%	17.16%	-22.75%	17.49%	-221.38%
Sales/Assets	1.64	1.54	0.55	1.54	1.09	1.84
Proj. Sales Growth (F1/F0)	9.92%	0.68%	4.20%	-3.94%	-21.94%	0.68%
Momentum Score	C	-	-	B	C	C
Daily Price Chg	2.13%	-0.76%	0.53%	-3.48%	1.63%	-0.72%
1 Week Price Chg	-1.18%	-0.65%	-0.30%	1.25%	-10.42%	-4.26%
4 Week Price Chg	1.79%	-0.65%	1.92%	11.33%	-3.28%	-11.80%
12 Week Price Chg	6.21%	-1.25%	6.54%	-20.41%	-18.55%	4.31%
52 Week Price Chg	-4.88%	-8.43%	22.58%	-50.10%	-11.43%	-8.00%
20 Day Average Volume	940,046	341,180	1,580,816	6,536,543	319,432	1,230,133
(F1) EPS Est 1 week change	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
(F1) EPS Est 4 week change	0.00%	0.00%	0.00%	-1.04%	0.00%	0.00%
(F1) EPS Est 12 week change	0.19%	0.10%	-0.50%	-11.85%	23.94%	6.65%
(Q1) EPS Est Mthly Chg	0.00%	0.00%	0.00%	-1.79%	0.00%	0.00%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

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	C
Growth Score	B
Momentum Score	C
VGM Score	B

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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