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True Religion Brand Jeans (Nasdaq:TRLG) - Long

TRUE RELIGION
BRAND JEANS®



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COMPANY OVERVIEW

- Premium denim jeans/clothing provider with 139 stores worldwide
- Founded in 2002 by Jefferey Lubell, who is still the CEO today
- Produce their jeans in the U.S.A
- Recently announced that they are for sale

STOCK SUMMARY



- Share Price: \$25.78 (update)
- P/E (ttm): 13.92
- EPS: 1.85
- MKT Cap: 664.86M
- Total Cash: 160.39M
- Total Cash Per Share: 6.33
- 52-Week Range: 20.22-37.82
- Beta: 1.47
- Long-term debt: 0
- EBITDA (ttm): 92.43M
- Free (Levered) Cash Flow: 37.29M
- Operating Cash Flow (ttm): 58.77M



THESIS POINTS - LONG

- Solidification as an established, high-quality, and successful brand name
- Creates a high quality product that is segmenting within itself
- Proven financial resilience, growth, and expansion outlook
- High potential for merger after announcement

1. Solidification as an established, high-quality, and successful brand name

- True Religion has solidified itself as an established and successful brand name in the high-end denim and clothing category.
- I have owned both regular jeans [Levis, Lucky] and True Religion jeans, and my preference always tended to go towards the latter because of the quality feel of its fabric, correct seam dimensions, and social notoriety.
- Worn by celebrities such as David Beckham, Beyoncé, Jessica Alba, Megan Fox, Colin Farrell, and more.

2. Creates a high quality product that is segmenting within itself

- True Religion Brand Jeans focuses on creating the highest quality clothing and selling them at elevated prices.
- Normally their product is seen as flashy from the white in-seams and the contrasted reverse horseshoe rear pocket stitching.
- They are bringing this distinctive flair to a more modest and less-flashy version; for the type of consumer that wants the comfort of TRLG brand jeans without them shouting out loud about it.
- Creating variations of their quality product to differentiating consumers within their market.

3. Proven financial resilience, growth, and expansion outlook

- Founded post-dotcom collapse in 2002 and survived the financial crisis of 2008.
- TRLG has positive cash reserves at the moment in the case of another market downturn.
- Not heavily reliant on profits for continuing operations.
- Positive view on brand will most likely increase sales in the future as the economy recovers when more people choose to buy premium quality jeans and clothes.
- Experimentation of growth strategies including increased segmentation within its own market, creating variations of its quality product that includes a less-flashy version (no white-seam, straight rear pocket stitch) of its already popular jeans.

4. High potential for merger after announcement

- With long-term debt is zero
- Ample cash reserves
- Continual average revenue growth rate of 35.3% over the last 10 years
- Expanding without leveraging debt to fuel expansion
- Stock price is less expensive relative to competitors (RL, VFC)

1. Barriers to entry

Relatively easy to enter market

- No patent requirements for markets TRLG deals with (USA, Europe, Asia)
- No heavy governmental regulation on denim industry
- No specific capital requirements to enter such market
- Brand controls directly most of its stores, very few concessions

2. Buyer power

In spite of availability of substitutes to TRLG jeans,

- High switching costs for buyers (quality issues, not the same customer care with other brands)
- Concentrated and efficient market channels (TV, fashion magazines, ear-to-ear promotion, etc.)
- As a compensation for lower US womens' buyer volume, good buyer volume in stores abroad

3. Supplier power

Flexible environment, advantageous for TRLG since:

- Low switching costs
- Quite high labor solidarity
- Fiduciary relationship with suppliers
- Selling price almost 2x supplier costs, but legitimated by brands' marketing strategy (made in the USA + premium brand), high margin for profitability

*Potential problems:

- Moderate availability of alternative suppliers (suppliers available in America but higher labor cost)

4. Threat of substitutes

Fairly high, since

- Vast product differentiation in the market => high likelihood of consumer turning to a substitute product by other competitors
- Relatively good, low-end price performance of substitutes (Ralph Lauren Denim, 7 for all mankind, etc.)

5. Rivalry among competitors

Main problem: competition with other firms in the industry which have slightly less pricey jeans and similar designs, ex. Ralph Lauren, MET, 7 for all mankind, etc.

=> Moreover, price rivalry rather than quality rivalry

MISPERCEPTION #1

- A. Jeans cannot be high-end products
- B. High quality but too pricey
- C. No great diversification in TRLG products, because not adapted to different kinds of taste (ex. too flashy sewings)

MISPERCEPTION #2

- A. The management is being too heavily compensated (faster mgmt. Compensation growth than revenue growth)
- B. Mgmt. is too hierarchical (assets growing faster than revenue) so less efficient
- B. The market for jeans is saturated, limiting potential growth

VAR #1

- ⇒ Proven financial resilience, growth, and expansion outlook
 - ⇒ Conducted in-person interview with store manager in Tysons Corner in Northern Virginia
- Jeans and varsity jackets are most successful products, varsity jackets are mostly seasonal though sales usually pick up around the holidays versus during the summertime
- Their new modest style jeans have been doing well in a suburban and NOVA setting versus those stores in NY that tend to attract Europeans who want the more flashy jeans
- Good current store activity, sales have been picking up
- Top management is easy to reach, responsive to feedback, can quickly send email (fast response), kept small business feel
- Good saturation in northern Virginia market, 2 stores one in DC and Georgetown and two outlets

VAR #1 CONT'D

- Not going too trendy with products, experimentation in NY market, Europe stores more responsive to fashion trends there including skinny jeans etc.
- Respond to market trends quickly
- Unique and handmade jeans that are hard to counterfeit
- 1700 sq ft average store size, small boutique feel
- Manager was happy with her company, 4.5 years there
- Loyal customers and management
- Advertising spread through word of mouth instead of money, not just celebrities
- Hard to go back once they try and buy, superior product
- Expansion into Saudi Arabia (manager was Iranian) based on opening stores within established stores (not standalone)



VAR #2

⇒ High quality product that is segmenting within itself

⇒ Conducted email interview with a high-end jeans (not TRLG) store manager in Printemps, Lyon

A. Jeans can be a high-end product:

- Quality of handcraft and design very much appreciated
- Customers attracted by positive feedback or positive experience

B. More expensive because crafted in the USA. Less pricey alternatives available in outlet stores and UK/Canada.

C. Product adapted to different markets (USA: flashy designs still successful, but less flashy products in East Coast markets and Europe, since customers prefer more sober designs but with TRLG quality) and the brand is continuously working on product diversification (denim, sportswear, accessories, ...)

RISKS/PITFALLS

- True Religion could turn out to be a fad, and high-end denim products will be restricted to small specialty clothing makers
- True Religion could start to turn away from its successful core business model by trying to appeal to lower-end markets
- If another financial downturn occurs, then the market for premium goods will fall (i.e. fiscal cliff)
- Higher input prices and wages could lead to lower profit margins and slow down growth
- Potential merger could not materialize

Q3 REPORT

35/121 stores in North East USA closed for some time because of superstorm Sandy, but no precise evaluation of impact on Q3.

Strong sales performance US (all sales segments), thanks to US and int'l expansion, BUT low same-store sales.

Transition to better merchandising = consolidation of positive trends and higher productivity for 2013.

3 new stores in the US, 5 abroad (Cd, De, At).

Strategy:

1. Extension of differentiated brand to more customers, more exports and more offerings to women
2. Growing profitability in US stores and int'l businesses through merchandising offering and specialist penetration
3. Separate design M/W to enhance W growth. More brand investment targeting marketing, all the while leveraging sales gains through selling classics and launching sportswear

Q3 REPORT CONT'D

Net sales +9.4% (+++US), exceeded forecast. Third consecutive year of all segments quarterly sales. Plan: more volume and variety of designs to be sold in outlet stores, since better profit margins.

Negative retail store performance, but expect a higher one in Q4.

Earning/cost margin dropped to 63.3% , overall income \$89.9 million.

Separation cost \$1.2 million, but excluding that operating income \$22.1 million. \$49 cents per diluted share. 3 retail stores opened, 191 stores.

Same-store sales -9%. -3% net sales at the international level, because less wholesale sales.

Balance sheet: \$224 bn. -\$700 mn expenses. Less cash: \$2,4 mn v. \$2.82 mn in Q2 2012.

+18,4% inventory, increase in unfinished sportswear and inventory in transit.

Q3 REPORT CONT'D

Expectations for Q4: expansion of net sales to \$463 mn; effective income tax rate 37.5%; 25,6 mn shares; EPDS \$0.52-\$0.58; sales to EPS 1,80 – 186 per d.s.. More costs associated to strategic review.

Strategic details: Women = shift back to denim + accessories.

Change in mgmt in Korea and Japan, sized-down teams but new merchandising and marketing research. Prices lowered in UK and Canada to broaden customer range. Research for market in Europe, Asia and Latin America (Panama, Brazil).

Buyout proposal received in October, goal: maximize shareholder value. However, no conclusive decision made.

RECOMMENDATION

Initiate a Long position at 2.5%