Applied Investment Management (AIM) Program

AIM Class of 2015 Equity Fund Reports
Spring 2015

Date**:* January 23, 2015 | ***Time: 3:00 - 4:30 p.m. | ***Location: AIM Research Room (488)***

Join us in person, or considering joining us live at:
Connect to the LIVE meeting via Blackboard web-based conferencing tool

Student Presenter	Company Name	Ticker	Price	Page No.
Richard Bernard	Cherokee Inc.	CHKE	$18.90	2
Dustin Hwang	Abengoa S.A.	ABGB	$16.76	5
Charlie Houser	Nelnet, Inc.	NNI	$44.10	8
Thomas Desmond	PriceSmart, Inc.	PSMT	$83.90	11

These student presentations are an important element of the applied learning experience in the AIM program. The students conduct fundamental equity research and present their recommendations in written and oral format – with the goal of adding their stock to the AIM Equity Fund. Your comments and advice add considerably to their educational experience and is greatly appreciated. Each student will spend about 5-7 minutes presenting their formal recommendation, which is then followed by about 8-10 minutes of Q & A.

David S. Krause, PhD
Director, Applied Investment Management Program
Marquette University
College of Business Administration, Department of Finance
436 Straz Hall, PO Box 1881
Milwaukee, WI 53201-1881
mailto: AIM@marquette.edu

Website: MarquetteBuz/AIM AIM Blog: AIM Program Blog
Twitter: Marquette AIM Facebook: Marquette AIM

Cherokee Inc. (CHKE)

January 23, 2015

Richard Bernard | Consumer Discretionary

Cherokee Inc. (NASDAQ:CHKE) markets, manages, and licenses fashion and lifestyle apparel, footwear, and accessories for brands that it owns or represents worldwide. The company owns well-known brands such as Cherokee, Sideout, Liz Lange, and Tony Hawk, among others. CHKE generates 70% of its revenues in North America, 10% in Asia, 9% in Latin America, 7% in other countries, and 4% in Europe. The Cherokee brand began as a footwear company in 1973 and has since grown to include an impressive portfolio of brands that cover a variety of consumer tastes. The company competes primarily with other brand licensers and mangers, such as Quicksilver Inc. (ZHK), Iconix Brand Group (ICON), and G-III Apparel (GIII). Cherokee Inc. is headquartered in Sherman Oaks, CA and has approximately 39 employees.

Price ($): (1/13//2015)	18.90	Beta:	1.00	FY: Janurary	2014A	2015E	2016E
Price Target ($):	23.96	WACC	8.80%	Revenue (Mil)	28,614	35,633	38,899
52WK H-L ($):	21.00-12.95	M-Term Rev. Gr Rate Est:	9.00%	% Growth	7.74%	9.17%	10.25%
Market Cap (mil):	159.40	M-Term EPS Gr Rate Est:	10.00%	Operating Margin	41.90%	47.43%	47.70%
Float (mil):	7	Debt/Equity:	121.78%	EBITDA Margin	42.40%	47.83%	53.88%
Short Interest (%):	0.21%	ROA:	18.37%	EPS (Cal)	0.72	1.11	1.37
Avg.Volume(3month):	26,600	ROE:	41.35%	FCF/Share	$ 0.82	$ 1.17	$ 1.44
Dividend ($):	-	P/S:	4.70	P/E (Cal)	26.24	17.03	13.81
Yield (%):	-	PEG:	1.13	EV/EBITDA	12.66	10.38	9.32

Recommendation

Over the past four years, Cherokee Inc. has transformed its business model and transitioned itself into a growth driven company. CHKE has developed a differentiated licensing and marketing strategy that sets it apart from its competitors. In 2012, the company launched its proprietary, "360° turnkey" solution that it believes will deliver long-term growth to customers and partners by providing strategic sales initiatives, support services, marketing services, and product design and development. As of 2014, the company has $85 million in forward facing, minimum guaranteed royalty contract revenue. The company licenses its brands to retailers in over 40 countries including Target, Kohls (U.S.), RT Mart (China), and Magnit (Russia), among others. The appeal of the company's brands come from the casual styles they offer at affordable prices. Revenues for FY2014 were $28 million (up 7% from FY2013), and with the acquisition of Hawk brands in January, top line results are strong. From 2011-2013 the company grew revenues at a CAGR of 6%, and in Q3 of 2014, the company reported revenues up 30% YoY from 2013 to $8 million. The growth in revenues has been attributed to both organic growth of the Cherokee brand and the accretive results of the Hawk Brand acquisition. Cherokee boasts some of the highest profitability metrics among its peers with ROIC of 21% and a net profit margin of 27%. The company has made changes to its business that will position itself for long-term growth and allow for rapid product category expansion. For those reasons and a favorable valuation it is recommended that Cherokee Inc. be added to the AIM Equity portfolio with a price target of $23.96, which represents a 27% upside.

Investment Thesis

- **International Expansion Opportunities.** The company has focused on shifting its business from being concentrated primarily in North America to a global distribution of its products. As Cherokee's revenues have grown, international revenue has continued to increase, changing North American total revenue from 76% to 70% from 2013 to 2014. In the third quarter, the company saw 25% YoY growth in Asia, where the Cherokee Brand performed well specifically in the RT-Marts in China. The company also performed well in Mexico, Peru and Chile, with revenues up 11%, 24% and 39% respectively. In early 2014, a partnership with Reliance Retail in India was announced, which should boost global sales moving forward.

- **Growth Through Acquisitions.** In 2014, Cherokee purchased the Hawk brand from Quicksliver, a direct competitor, for $19 million. The acquisition was the company's third major acquisition in as many years. Management has made its intentions clear to search for brands that fit into its global platform and infrastructure in 2015. In addition, the company announced plans to cut its dividend in order to retain capital and invest in new brands and partners as the year progresses, further emphasizing their intentions for growth.
- **Improving Macroeconomic Conditions.** The U.S is experiencing strong economic growth and consumer spending is likely to pick up due to job growth and increased consumer confidence. With falling energy prices, retailers like Target and Kohl's, Cherokee's key customers, are positioned well to see positive benefits. Brands like Cherokee, Hawk, and Liz Lange target a variety of consumers, most of whom are likely to see increased disposable incomes due to current economic trends.

Valuation

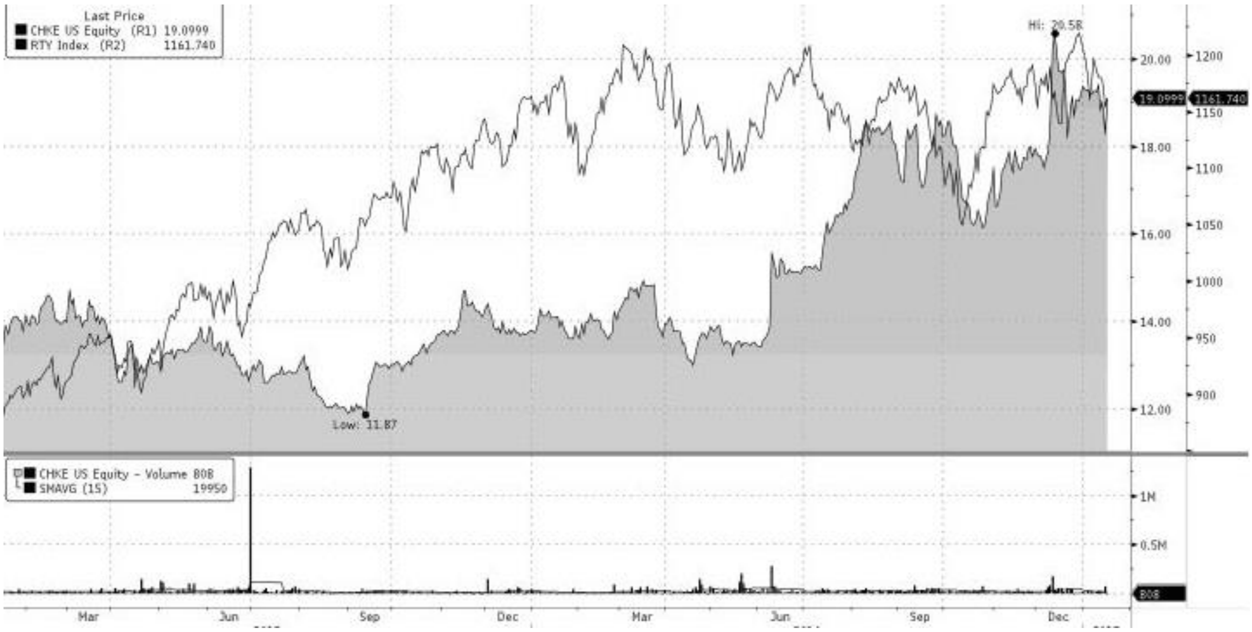
In order to reach an intrinsic value for CHKE, a five year discounted cash flow model was utilized. Using a terminal growth rate of 3% and a WACC of 8.80% resulted in a valuation of $25.68. A sensitivity analysis on both the terminal growth rate and WACC provided for a range between $16.50 and $26.79. EV/EBITDA and P/E relative valuation methods were also employed. Using a comparable peer average P/E multiple of 19.9x and a 2014 estimated EPS of $1.11, a value of $22.12 was obtained. An EV/EBITDA peer average of 11.06 yielded a valuation of $22.44. By weighing the DCF model 50%, the EV/EBITDA and the P/E multiples 25% each, a price target of $23.96 was established, which results in an upside of 27%. The company does not pay a dividend.

Risks

- **Significant Revenue Dependence on Target.** Target (TGT) has invested heavily in the Cherokee brand and accounted for 57% and 53% of U.S royalty revenue in FY2013 and FY2014 respectively. The current licensing agreement with Target extends until 2017, with $10.5 million guaranteed royalties annually. If Target were to experience declining sales of the Cherokee brands, or fail to extend the current agreements revenues would be significantly impacted.
- **Macroeconomic Issues Abroad.** Fears of a global economic slowdown, and deflation are growing, especially in Europe, where countries have experienced a slowdown in consumption and spending. Recently, the company announced plans to cease business with Tesco, and large UK retailer. Although the company plans to announce a new partnership with another prominent European retailer, weaker than expected demand for its products in Europe would negatively affect European expansion.
- **High Levels of Debt.** In order to fund the acquisitions of Liz Lange in 2012, and Tony Hawk brands in 2014, the company has incurred significant debt. Cherokee Inc. entered into a credit facility with JP Morgan which currently stands at $38 million, with $32 million outstanding. With a debt to equity ratio of 121.78%, the company runs a risk of not having the cash flows to make the scheduled debt payments.

Management

Henry Stupp has been the Chief Executive Officer of Cherokee since being elected in 2010. Prior to joining the company, he co-founded the Montreal based apparel company NTD Apparel, a major brand licensing company. Jason Boling was hired as Chief Financial Officer in 2013, and was previously the Vice President of Finance and Accounting at DTS Inc. an audio solutions company. He has a strong background in mergers and acquisitions and acquisition integration. The Chairman of the Board is Jess Ravich who has held this position since 2011 and has been a member of the Board of Directors since 1995.



Ownership

% of Shares Held by All Insider and 5% Owners:	32%
% of Shares Held by Institutional & Mutual Fund Owners:	40%

Source: Yahoo! Finance

Top 5 Share Holders

Holder	Shares	% Out
Cove Street Capital, LLC	710,570	8.43%
Renaissance Technologies, LLC	615,600	7.30%
Park Circle Co	332,531	3.94%
The Vanguard Group, Inc.	316,284	3.75%
Wellington Management Company, LLP	310,615	3.68%

Source: Yahoo! Finance

Peers

Company	Market Cap	P/E	EV/EBITDA
G-III Apparel Group Inc	2.1 B	23.22	9.18
Iconix Brand Group Inc	1.5 B	19.19	11.70
Quicksilver Inc.	341.15 M	-	15.12
Weyco Group Inc	285.72 M	26.36	10.31
Rocky Brands Inc.	102.15 M	13.53	7.28

Source: Bloomberg

Abengoa S.A. (ABGB)
January 23, 2015

Dustin Hwang | International Energy

Abengoa (NASDAQ: ABGB) is a global energy technology company that provides solutions for the sustainable development of energy by generating electricity from the sun, desalinating sea water, producing biofuels, and recycling industrial waste. The company operates through three primary business segments: engineering and construction; concession-type infrastructure, and industrial production. The engineering and construction segment specializes in performing complex turnkey projects for power plants, biofuel facilities, hybrid solar-gas plants, and power transmission lines. Abengoa operates in over 80 countries classified into 5 regions with the US accounting for 27.80% of the company's total revenue, followed by Latin America (18.92%), Other Regions (15.86%), Spain (15.81%), Europe (except Spain) (11.74%) and Brazil (9.87%). The company was founded in 1941 and has 28,658 employees. The company is domiciled in Seville, Spain.

Price ($): (1/17/2015)	$16.76	Beta:	1.17	FY: Dec. 31	2013A	2014E	2015E
Price Target ($):	$21.94	WACC	14.35%	Revenue (Mil)	$7,357	$7,504	$7,729
52 WK L-H ($):	$7.71-$30.75	L-Term Rev. Gr Rate Est:	3.30%	% Growth	16.55%	2.00%	3.00%
Market Cap (mil):	$2,813.3	L-Term EPS Gr Rate Est:	2.67%	Gross Margin	39.40%	40.00%	41.00%
Float (mil):	N/A	Debt/Equity	3.61	Operating Margin	18.45%	20.00%	21.00%
Short Interest (%):	18.3%	ROA:	5.34%	EPS (Cal)	$0.18	$0.23	$0.35
Avg. Daily Vol (mil):	0.3	ROE:	8.71%	FCF/Share	$2.10	$2.29	$2.37
Dividend Yield:	--			P/E (Cal)	92.45	79.27	62.46

Recommendation

Alternative energy is a growing industry as governments and international communities start to pay more attention to the changing environmental landscape. The UN Intergovernmental Panel on Climate Change, as well as the Stern Report, stated that if changes are not made that by 2100, hundreds of millions of people across the globe who live near the coastlines will be forced to abandon their homes. Abengoa is a well-diversified company in the clean energy space that was named as the leading international contractor in power transmission and distribution space. According to the 2013 World Energy Outlook, over half of the increase in total power generation from 2011 to 2035 is to be derived from renewable energy sources. Additionally, renewables are predicted to become the second-largest source of electricity by the end of 2015 and approach coal as the primary source by 2035. Last year, ABGB grew revenues by 17 % with an increase of 44% EBITDA. Engineering and construction, which includes the development and maintenance of solar, wind and water powered plants, is the firm's largest business segment at 65% of revenues in 2014 and experienced a 27% CAGR. Solar continues to be a strength for ABGB as the company pioneered the world's largest solar-thermal plant in Solana, Arizona in 2014. The organic growth from the solar industry has grown nearly 35 times its capacity over the past 10 years and is expected to accelerate even further to over 49 gigawatts by 2016 for a growth rate of 125%. In addition, as part of its growth strategy, ABGB intends to expand its business portfolio by entering into diversified and potential markets through strategic acquisitions. ABGB invests heavily in proprietary technologies particularly in areas of high barriers to entry. With industry leading diversification, a strengthening renewables market, and strong focus on research and innovation, it is recommended that ABGB be added to the AIM International Fund with a favorable valuation and an upside potential of 31.03%.

Investment Thesis

- **Growing Renewable Energy Market.** Renewable energies compose the largest portion of the projected increased demand in the forward looking investment horizon. Significantly increased costs associated with building and operating nuclear plants has made renewable energy attractive. It is anticipated that renewable energy will contribute up to 77% of future energy demand. Additionally, decreasing financial constraints act as an industry catalyst to help move growth forward. Lower costs to produce solar energy methods, grid parity, and overall business structures, are expected to drive another wave of growth. Heightened demand for renewable energy sources will further improve top line revenues.

- **Strengthening Transmission and Distribution Market.** A total of $7 trillion is estimated to be invested into the transmission and distribution market by 2035, with approximately 25 million kilometers of transmission and distribution lines expected to be built during the outlook period. Growth is anticipated to be driven by increasing energy demand from India and China as well as upgrades of aged infrastructure North American and Europe. This growth should contribute significantly to the firm's Engineering and Construction segment's top line.
- **Refined Growth Strategy.** Acquisitions have been carefully made to ensure that the company is expanding in a balanced manner without over concentration in any particular product, geography, or technology. In May of 2014, Abengoa purchased GreenTech Water Engineering to further their United States hydropower exposure. Along with acquisitions, the company aims at growing margins through improved operational efficiencies as well as an asset rotation program aimed at periodically selling assets to optimize investment returns and free up capital for new investments. This has the net effect of improving both top and bottom line cost structures.

Valuation

The valuation process utilized a weighted average of a discounted cash flow model as well as an EV/EBITDA ratio valuation. Using a terminal growth rate of 2.5% and 8.35% for the weighted average cost of capital, a valuation of $23.65 was obtained. A sensitivity analysis of both the WACC and terminal rate was conducted resulting in a range between $22.13 and $23.50. A comparative valuation, using 5 industry peers, as well as a historical ratio weighting, was employed. The historical EV/EBITA multiple used was 7.8X and the peer mean valued a 9.87X ratio. Weighing both multiples evenly, an 8.85X multiple resulted in a target price of $20.26. Blending both the DCF and EV/EBITDA valuations evenly, a target price of $21.96 was obtained, representing a 31% upside.

Risks

- **Difficult Global Economy.** Difficulty in the global economies may prove to be detrimental to the demand of the firm's products and services. This may occur due to lower government budgets and contribute to the fact that a substantial number of Abengoa's customers are state owned companies. This may also have implications for subsidies or the lack thereof.
- **Environmental Regulation.** Abengoa is subject to significant environmental regulation. New developments related to conflict minerals as well as the need to continually complete impact studies may take up additional expenses. As of May 2014, conflict minerals will require companies to conduct due diligence and disclose whether or not certain minerals originate from the Democratic Republic of Congo and adjoining countries. Due to a complex supply chain structure this may become a difficult task to uphold.
- **Competition.** Changes in prices, technology, or the industry overall may change the competitive position of the company. Because the industry is rapidly changing, new technology may render existing products obsolete. If the company is not able to introduce new products in a cost effective manner to the market, their competitive position as an industry leader will be jeopardized.

Management

Manuel Sanches Ortega is the Chief Executive Officer of Abengoa S.A. and has been with the company since 2002 and was made CEO in 2010. He has been considered a very efficient manager of the organization with the ability to make good decisions in difficult times. He served as the CEO of Televent prior to this position with his background in software engineering. In 2009 he received the 15th Javier Benjumea Award from the ICAI Association of Engineers in recognition of his professional career and his social and human principles displaying his commitment to the renewable energy.

% of Shares Held by All Insider and 5% Owners:	N/A
% of Shares Held by Institutional & Mutual Fund Owners:	N/A

Top 5 Shareholders

Holder	Shares	% Out
Waddell & Reed Financial Inc.	6,882,248	4.10%
Jupiter Asset Management Limited	247,065	0.15%
Brown Advisory Inc.	82,416	0.05%
Natixis Asset Management	47,024	0.03%
Tiemann Investment Advisors, LLC	10,339	0.01%

Source: Bloomberg

Peer Group	Share Price	EV/EBITDA
Acciona S.A.	$61.50	5.69x
CIRCOR International	$50.90	9.30x
Biesse SPA	$12.26	11.43x
Prysmian SPA	$14.88	3.42x
Fomento De Construc Y Contra	$11.68	19.43x

Nelnet, Inc. (NNI)
January 23, 2015

Charlie Houser | Financial Services

Nelnet, Inc. (NYSE: NNI) is an education financing and planning company that assists families with the planning, preparation and payment of education. Additionally, they make administrative and financial processes more efficient for educational and financial institutions. NNI was founded in 1978 as a student loan servicing company, and has since developed into a leading originator, holder and servicer of federal student loans under the FFEL Program (FFELP). The company offers fee-based products and services in asset management and financing, loan servicing, payment processing, and education planning, while also earning interest on a portfolio of federally insured student loans. Nelnet is headquartered in Lincoln, NE, and operates internationally in the United States and Canada. NNI houses 2,800 employees.

Price ($): (01/13/15)	$44.10	Beta:	1.10		FY: Dec	2013A	2014E	2015E
Price Target ($):	$54.53	WACC:	2.40%		Revenue (M)	894.52	964.70	992.16
52WK L-H ($):	34.86-48.52	L-Term Rev. Gr Rate Est:	2.3%		% Growth	26.33%	7.85%	2.85%
Market Cap (mil):	2,040.00	L-Term EPS Gr Rate Est:	5.1%		Operating Margin (%)	52.04%	52.26%	54.45%
Float (mil):	21.4	ROA:	1.11%		Profit Margin (%)	26.46%	25.41%	26.44%
Short Interest (%):	1.25%	ROE:	23.20%		EPS (Cal)	6.50	6.96	7.59
Avg. Daily Vol (thou):	71,830	P/E	6.72x		P/E (Cal)	6.48x	6.34x	5.81x
2014 Dividend ($):	0.40	P/B	1.24x		NIM (%)	1.57%	1.50%	1.48%
Yield (%):	0.91%				Div. Per Share	$0.40	$0.40	$0.60

Recommendation

Nelnet, Inc. has been a strong performer over the past two years, while maintaining an attractive valuation. Although NNI has returned more to its shareholders than the Russell 2000 Financial Services Index (51.65% compared to 26.45%) during that period, it has maintained lower P/E (6.7x vs. industry average of 16.6x) and P/B (1.2x vs. 3.1x) multiples than its index. Between 2012 and 2013 alone, NNI's net income grew 14%, its operating margin increased from 38.77% to 52.04%, and its profit margin grew from 17.84% to 26.46%. Nelnet is a highly diversified company that divides its services into four segments including: Asset Generation and Management, Student Loan and Guaranty Servicing, Tuition Payment Processing and Campus Commerce, and Enrollment Services. Within these divisions, NNI services students and families in colleges and universities, private or faith-based K-12 schools, state agencies, and government entities – a current market of greater than 76 million students according to the U.S. Department of Education. Nelnet has industry-leading customer service due to its segregated federal and non-federal loan operations, wealth of experience, and its diverse product base. As a result, the company has grown its loan portfolio from $26B to $29B in the first three quarters of 2014. NNI has positioned itself to continue this growth in one of the fastest-growing assets classes in the nation. Due to Nelnet's recent and projected growth, it is recommended that we add NNI to the AIM Equity Fund with a target price of $54.53, which offers a potential upside of 23.66%. Nelnet recently announced a quarterly dividend of $0.15, representing an annual dividend yield of 1.36%.

Investment Thesis

- **Educational Demand.** According to MeasureOne, the student loan market had an outstanding balance of $1.22 trillion as of 3Q14, making it the second largest consumer-lending category in the United States. Based on the U.S. Department of Education's most recent educational statistics (2012), 21 million students are currently enrolled in higher education. That number is projected to rise to 24 million, a 14.3% increase, by 2021. Considering 85% of students attending 4-year institutions receive financial aid according to the U.S. Department of Education, a rise in student enrollment will increase NNI's servicing opportunities. Furthermore, as the market continues to grow, schools will need to become more efficient and consistent to recruit and retain students; a market in which NNI competes.

- **Exclusivity.** In June 2009, NNI entered a five year contract with the U.S. Department of Education to provide additional servicing capacity for loans owned by the Department. Nelnet was one of just four companies to participate in this contract, which was recently renewed through June 2019. The companies are awarded a portion of the Department's loans based on prior performance as measured by customer satisfaction and loan performance. During the past two allocation periods, Nelnet was the top ranked servicer and therefore received a 30% allocation of the available loans.
- **Growing Servicing Platform Customer Base.** In each of its four segments, NNI has developed servicing software that it uses internally and contracts to third-party organizations in a fee-based manner. As of December 31, 2013, Nelnet owned 49 trademarks and service marks (Marks). Each Mark is protected by copyright laws and confidentiality agreements with indefinite durations, as long as NNI is using the Mark. Many of NNI's customers are smaller companies that do not have the depth of knowledge, products, or experience as NNI, although many student loan lenders utilize NNI's software either directly or indirectly.

Valuation

To find the intrinsic value of NNI, a price to book and price to earnings multiple methods were used. Using a five year historic P/B multiple for NNI of 1.26x, coupled with the peer average of 2.11x, and NNI's current P/B of 1.24x, an intrinsic value of $54.13 was calculated. Each multiple was weighed equally at 33.3%. Using a five year historic P/E multiple for NNI of 6.37x, coupled with the peer average of 7.49x, an intrinsic value of $69.79 was calculated. Both multiples were weighed equally at 50%. Weighing these valuations at 50% apiece, the final estimated intrinsic value of NNI was calculated at $54.53, which provides an upside of 23.66%.

Risks

- **Legislation Eliminating New FFELP Originations.** As of 3Q14, NNI serviced a portfolio of $28.7 billion in Federal Family Education Loan Program student loans that will amortize over the next 25 years. The Health Care and Education Reconciliation Act of 2010 eliminated new loan originations under the FFELP program (existing loans were not affected). NNI maintains liquid reserves in order to have cash available when FFELP acquisition opportunities present themselves. NNI acquired $368M FFELP loans in 3Q14, and $4.8B the quarter before. Recent opportunities include Wells Fargo's $9B FFELP portfolio, Bank of America's $3B portfolio, and a $335M portion of SunTrust's $5B portfolio up for sale. Nelnet plans to at least partially participate in each of these transactions.
- **Interest Rate Risk.** NNI generates a significant portion of its earnings from its student loan spread, which will be affected by changing interest rate environments. Nelnet wholly invests in variable-rate debt instruments, while 42.5% of their loans are fixed rate. Currently, the company is earning a large premium over debt on their fixed-rate assets due to the near-zero interest rates. As rates rise, this profit will decrease. NNI attempts to mitigate the impact of a rise in short-term interest rates by participating in interest rate swaps.

Management

On January 1, 2014, Jeffrey Noordhoek became Nelnet's CEO, replacing then 13 year CEO and co-founder Michael Dunlap, who is now solely the chairman of NNI's board. Noordhoek has been with the company since 1996 and held various presidential positions prior. Nelnet's COO and CFO, Terry Heimes and Jim Kruger, have been with the company since 1998.

Source: Bloomberg

Ownership

% of Shares Held by All Insider and 5% Owners:	29%
% of Shares Held by Institutional & Mutual Fund Owners:	60%

Source: Yahoo! Finance

Top 5 Shareholders

Holder	Shares	% Out
Angela L. Muhleisen	5,416,897	15.58
Michael S. Dunlap	2,159,607	6.21
Union Bank & Trust Company	1,775,387	5.11
Dimensional Fund Advisors, L.P.	1,657,432	4.77
The Vanguard Group, Inc.	1,610,055	4.63

Source: Thompson ONE

Peer Group

Company Name (Ticker)	Market Cap ($M)	P/E Ratio	P/B Ratio
Navient Corp. (NAVI)	8,265.00	9.80x	1.99x
Sallie Mae (SLM)	4,108.90	7.21x	3.28x
Nelnet, Inc. (NNI)	**2,040.00**	**6.72x**	**2.39x**
World Acceptance Corp. (WRLD)	756.70	8.08x	2.58x
Cash America International Inc. (CSH)	617.03	4.95x	0.57x

PriceSmart, Inc. (PSMT)
January 23, 2015

Thomas Desmond — Consumer Staples

PriceSmart, Inc. (NASDAQ: PSMT) employs a business model that consists primarily of international membership shopping warehouse clubs. The company owns and operates membership shopping warehouse clubs through wholly owned subsidiaries in Latin America (68%) and the Caribbean (32%) using the trade name PriceSmart. The warehouse clubs sell basic high quality consumer goods at low prices to individuals and businesses. PSMT ships its U.S. and internationally sourced merchandise directly to its warehouse clubs or to their own distribution centers. There are currently 36 owned and operated warehouse clubs in 12 countries and one U.S. territory. The firm is headquartered in San Diego, California and employs 6,371 people.

Price (1/20/2015)	$83.90	Beta	0.87		FY	2014 (A)	2015 (E)	2016 (E)
Price Target	$99.84	WACC	8.50%		Revenue (mil)	$2,517.60	$2,765.50	$2,980.20
52 WK H-L	111.99-78.63	M-Term Rev Gr Rate Est:	7.00%		% Growth	9.50%	9.80%	7.76%
Market Cap (mil)	$2,504.00	M-Term EPS Gr Rate Est:	8.00%		Gross Margin	16.04%	16.61%	16.90%
Float (mil)	19.50	Debt/Equity	16.68%		Operating Margin	5.49%	5.61%	5.70%
Short Interest (%)	6.73%	ROA	10.52%		EPS (Cal)	$3.07	$3.33	$3.60
Avg. Daily Vol (K)	149.90	ROE	17.73%		P/E (Cal)	28.90	24.96	23.38
Dividends (Yr)	$0.70	ROIC	16.07%		FCF/Share	0.64	1.12	1.32
					EV/EBITDA	15.81	12.95	12.44

Recommendation

In 1997, PSMT spun off from Costco and penetrated the Latin American markets with U.S. style membership shopping warehouse clubs. The 36 clubs operate in a similar manner to Costco's U.S. model, boasting a wide range of high quality products at very low prices. Additionally, they offer a wide range of services to individuals and businesses. In 2014, revenue and EPS grew at 9.5% and 10.5% respectively, as PSMT added 4 new warehouse clubs. In late 2014, management announced plans to open 2 more stores in Columbia in order to take advantage of the large population and growing economy. Moving forward, management plans to continue expansion around densely populated urban areas in Latin America and the Caribbean. Since 2008, they have grown their number of warehouse clubs at a 5% CAGR and each store today averages roughly $70 million in annual revenue. PSMT grew its membership base roughly 18% in 2014 to 1.3 million members, while maintaining a membership renewal rate of 85%. Management continues to emphasize efficiency through its distribution network, reflected in the opening of 2 more distribution centers in Costa Rica and Panama. PSMT also now offers online retail sales in some countries, as access to the Internet and mobile devices is increasing in Latin America and the Caribbean. For these reasons, and an attractive price, it is recommended that PSMT be added to the AIM Equity Fund with a target price of $99.84, representing a 19% upside. The firm pays a $0.70 dividend with a 0.80% yield.

Investment Thesis

- **Diversified Product Offering and Robust Membership Growth.** PSMT has a product offering of over 2,200 products and a variety of services including food courts, bakeries and tire shops that is seen nowhere else in Latin America or the Caribbean. This unique offering has proven to attract customers, as they have grown their membership base at a 15% CAGR since 2008, reaching 1.3 million members and over 2 million cardholders. As the company plans to continue to add more warehouse clubs, their clientele is expected to continue to grow at a rate above 15% annually and PSMT will continue to profit from membership fees.
- **Expansion in the Columbian Market.** PSMT announced in late 2014 that it will be opening up two more warehouse clubs in Columbia. PSMT has been successful in the four existing stores in

Columbia as it is the third most populated country in Latin America and is developing at a rapid rate. Although Columbia holds some geopolitical risk, its economy is growing faster than most as its 2013 GDP grew at 4.5%. These additional two warehouse clubs should create great revenue growth as they are both located right along two densely populated urban areas.

- **New Distribution Network.** In 2014, PSMT opened up two new distribution centers to improve efficiency in their high volume products. They opened up centers in Costa Rica and Panama to complement their main distribution center located in Miami. They now can advantageously operate container-based shipments through ocean freight, executing over 15,000 shipments annually.

Valuation

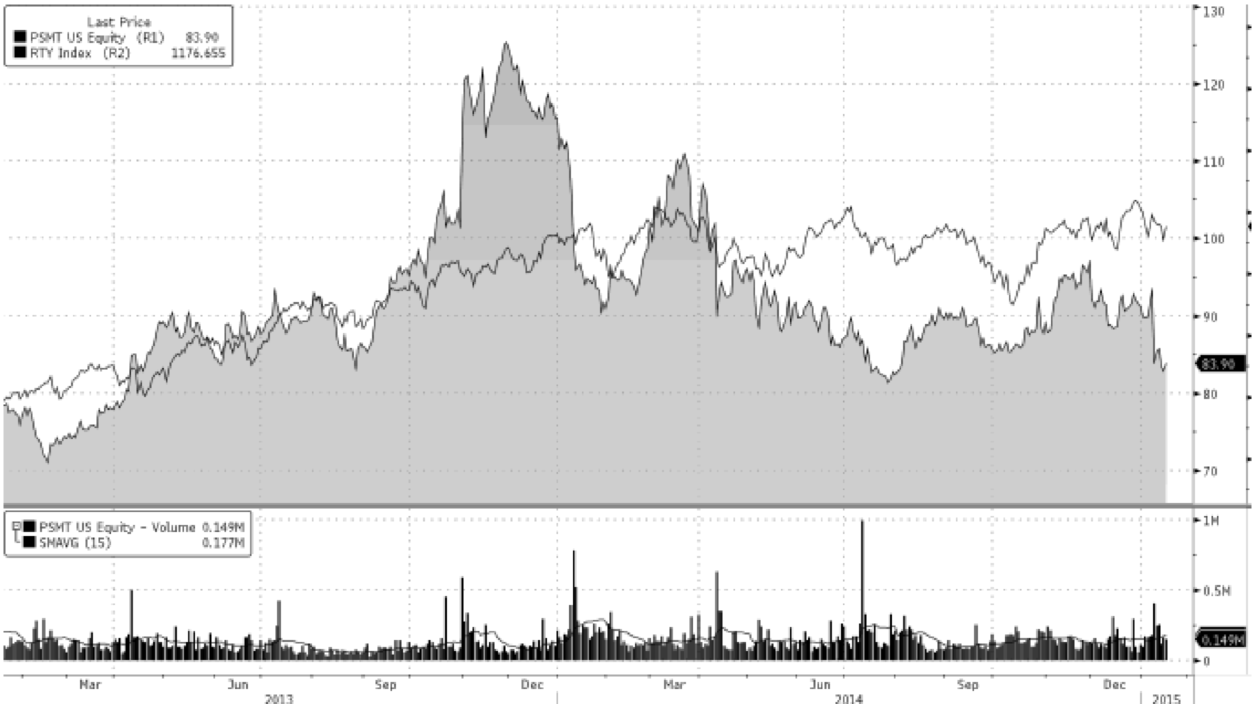
In order to reach an intrinsic value for PSMT, a five year discounted cash flow model was conducted. Using a terminal growth rate of 3.0% and a WACC of 8.50% resulted in a valuation of $105.84. A sensitivity analysis on both the terminal growth rate and WACC provided for a range between $82.74 and $121.06. Additionally, P/E and P/S multiples were analyzed. Using four industry competitors and a five year historical average, a P/E multiple of 27.42x was attached to a 2015 expected EPS of $3.33 generating a value of $91.33. A 5 year average P/S multiple of 1.05x and an estimated Sales/Share of $86.26 generated a value of $90.57. By weighing the DCF model 60% and the P/E and P/S multiples 20% each, a price target of $99.84 was established, representing a 19% upside. The firm pays a dividend yield of 0.80%.

Risks

- **Intense Competition**. PSMT's international warehouse club business competes with exporters, importers, local retailers and trading companies. Some of these competitors have greater resources, buying power and name recognition than PSMT. With that said, there is no direct competition from a direct membership warehouse club operator within Latin America or the Caribbean.
- **Widely Dispersed Operations.** With operations running in 12 different countries and one U.S. territory, management faces challenges of monitoring economic conditions, changes in consumer demand and geopolitical risks within each country. If they are unable to efficiently update their internal systems, financial controls, and inventory plans at each individual location, there may be adverse effects on their financial condition.
- **Volatility in Foreign Currency Exchange Rates.** Out of their 36 warehouse clubs, 26 of them operate under currencies other than the U.S. dollar. Those 26 warehouses represent 79% of their warehouse club sales. Therefore, PSMT is subject to both economic and political instabilities that can cause volatility in foreign exchange rates or weak economic conditions. Devaluing local currencies compared to the U.S. dollar could negatively impact the purchasing power of members within those countries.

Management

Jose Luis Laparte has served as the CEO of PSMT since 2010, previously serving as President of the company. Prior to coming to PSMT, he spent his entire career in the discount stores industry in various management roles. Robert E. Price has been Chairman of the Board of Directors since 1994. He previously served as the CEO from 1994 to 1998 and 2003 to 2010. John Heffner has been an Executive Vice President and Chief Financial Officer at PSMT since 2004. He has over 30 years of experience in various financial management roles.



Ownership	
% of Shares Held by All Insiders and 5% Owners:	20%
% of Shares Held by Institutional & Mutual Fund Owners:	75%
	Source: Bloomberg

Top 5 Share Holders

Holder	Shares	% Out
T. Rowe Price Associates, Inc.	3,280,909	10.86%
Robert E. Price	2,848,318	9.43%
Price Charities	2,759,471	9.13%
The London Company	2,230,345	7.38%
Grupo Gigante SAB de CV	1,667,333	5.52%
		Source: Bloomberg

Company Name	P/E (ttm)
PriceSmart, Inc.	27.6
Massmart Holdings	28.0
Big Lots Inc.	19.5
Costco	28.9
Walmart De Mexico	23.9