Applied Investment Management (AIM) Program

AIM Class of 2019 Equity Fund Reports
Spring 2018

Date**: Friday, May 4th* | ***Time:** 3:00 PM – 4:00 PM* | ***Location: AIM Research Room 488

3:00 PM Presenter	Company Name	Ticker	Sector	Page
Andrew Plank	California Water Service Group	CWT	Utilities	2
Christopher Barry	Ring Energy	REI	Energy	5
Jacob Bishop	Sumitomo Mitsui Financial Group, Inc.	SMFG	International Financials	8
Ronnie Terry	Stitch Fix, Inc.	SFIX	Consumer Discretionary	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.

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California Water Service Group (CWT)

May 4, 2018

Andrew Plank | Domestic Utilities

California Water Service Group (NYSE: CWT) operates in the utility industry as a pure play water distribution company. Currently serving 518,000 customers within the United States, California Water Service Group conducts business in California (93.9% of 2017 revenue), Hawaii (3.6%), Washington (3.3%), and New Mexico (.7%). Founded in 1926, the company is headquartered in San Jose, CA.

Price:	$39.55
Price Target:	$47.56
52WK H-L:	$46.15-$32.75
Market Cap (mil):	$1,911
Insider Holdings:	1.2%
Avg. Daily Vol (000):	457.7
Yield:	1.9%
ESG Rating:	BB
Short Interest:	2.0%

Beta:	0.87
M-Term Rev. Gr Rate Est:	3.55%
M-Term EPS Gr Rate Est:	8.68%
Debt/Equity:	1.20%
Debt/EBITDA (ttm):	4.03x
WACC:	7.40%
ROA:	2.52%
ROE:	9.93%
ROIC:	4.95%

FY: Dec	2017A	2018E	2019E	2020E
Revenue (Mil)	666.9	726.3	778.6	812.1
% Growth	9.44%	8.91%	7.20%	4.30%
Oper Inc	94.6	114.2	123.9	129.9
% Growth	14.19%	15.72%	15.91%	16.00%
CapEx (Mil)	259.2	201.2	162.3	149.0
EPS	$1.40	$1.51	$1.65	$1.83
P/E (Cal)	32.4	28.1	26.5	24.5
EV/EBITDA	14.4	12.6	12.0	11.4

Recommendation

California Water Service Group is the second largest water utility in the United States. Since completing its IPO in 1972, the company has grown to manage subsidiaries covering four states and servicing more than half a million consumers. Over the past five years, it experienced a 5-year sales CAGR of 2.7%, an operating income CAGR of 5.0%, and a net income CAGR of 7.3%. California Water Service Group demonstrated strong bottom line growth, largely attributed to decreasing maintenance costs and purchased electricity. Operating as a pure-play water utility, the firm obtains 46.5% of its water supply from underground wells, with the remainder of the supply being acquired by wholesalers. Underground wells are categorized into three levels of management: adjudicated, managed, and unmanaged. The California Water Commission sets limits on adjudicated wells, known as safe yields, to manage the conservation of underground water sources. These adjudicated wells make up 14.7% of California Water Service Group's water supply. Managed wells make up 58.9% of California Water Service Group's water supply and have increased regulation compared to unmanaged wells, but no extraction limits. Unmanaged wells have no set limit or regulation for groundwater extraction and the remainder of California Water Service Group's supply comes from these water sources. The state of California has pushed for more control over water extraction from wells, which could soon drastically decrease the amount of unmanaged groundwater sources as well as increase the amount of adjudicated and managed wells. As wells become managed, users will be required to monitor their water extraction and report to the State Water Board. California Water Service Group operates solely in regulated operations with its rates negotiated by public utility commissions and independent municipalities. The firm relies on roughly half of its water being supplied by wholesalers whose contracts at the minimum are on an annual basis to ensure adequate supply to consumers. The company stated at the end of 2017 that it plans on expansions largely through municipal leasing arrangement which it used with the cities of Hawthorne and Commerce in Southern California. This system allows the firm to avoid large infrastructural spending associated with installing piping, while also decreasing its maintenance and depreciation costs. Since 2011, California has faced the worst drought in the state's history. As water distribution and acquisition continue to become a growing problem for the state, utility companies will be tasked with a massive undertaking. Because of California Water Service Group's access to groundwater, the population growth of California, and its plans for expansion, this firm should be added to the AIM portfolio with a price target of $47.56, a potential upside of 20.3%, and a dividend yield of 1.9%.

Investment Thesis

- **Groundwater Access:** California Water Service Group obtains 46.5% of its annual water supply from underground wells. Historically, the firm has never exceeded 100% of its safe yield in adjudicated wells and has the right to carry up to 20% of its unused water supply forward to the next period. With California snowpack levels 33% lower than its annual average, management is confident they will be able to meet water demands for this upcoming year and have sufficient room for growth in its distribution network.
- **Population Growth:** California is currently the most populated state within the United States, with an estimated 3.5 million people projected to be added in the next 5 years. Southern California, where a large amount of California Water Service Group's operations takes place, is expected to receive the bulk of that population increase.
- **Expansion Projects:** California Water Service Group plans to expand through muncipal leasing in southern and central California. Through these leases, the company will not be required to invest heavily in infrastructure because it will be using the distribution methods already employed by the municipality. It will only be responsible for supplying the water that is already carried in surplus by the firm. This will effictively lower maintenance and depreciation expenses while decreasing CAPEX as well.

Valuation

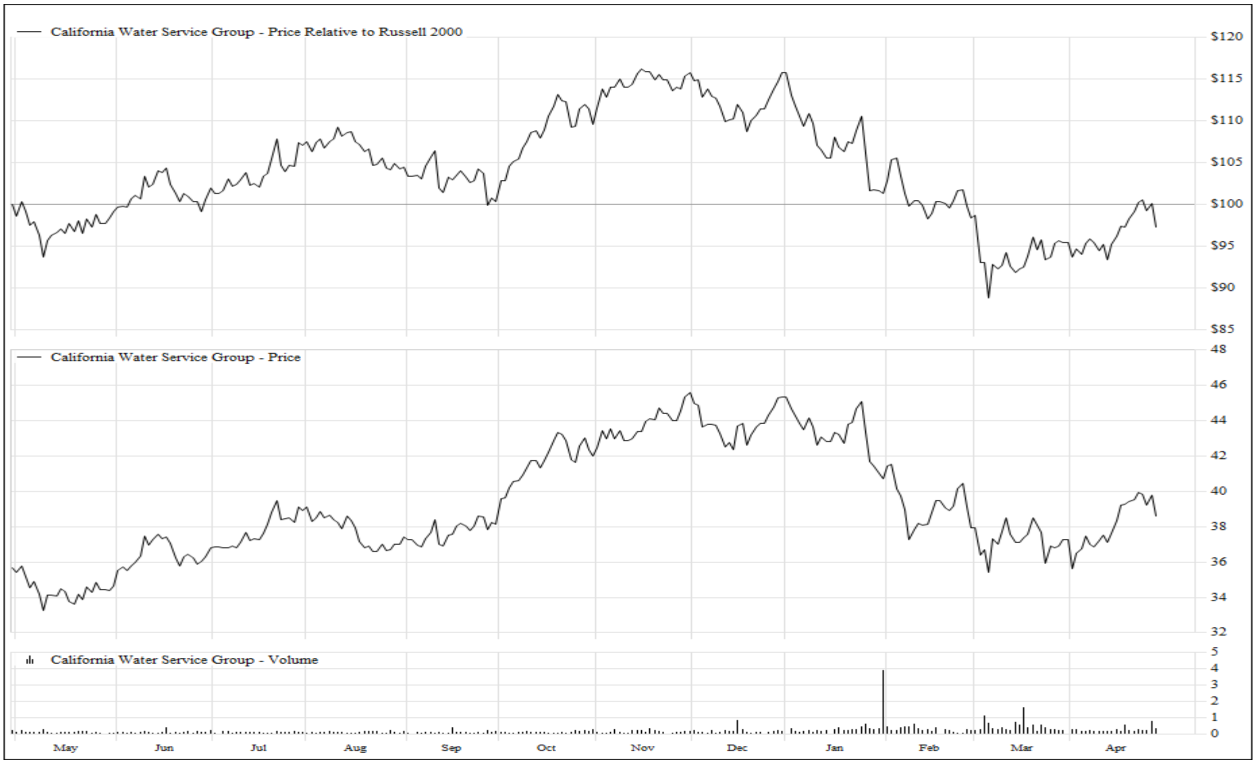
In order to reach the intrinsic value for California Water Service Group, a forward looking price/book and EV/EBITDA model were created. An EV/EBITDA multiple of 13.4x was utilized to reach an intrinsic value of $43.74. A price/book multiple of 3.2x was applied to reach an intrinsic value of $53.28. By weighing the two models 60/40, a price target of $47.56 was reached, resulting in a 20.3% potential upside. California Water Service Group maintains a 1.9% dividend yield.

Risks

- **Government Water Restrictions:** During drought, government restrictions on water use may negatively affect the demand for water. Customers may begin using recycled water and cutting down on water use altogether, even if California Water Service Group continues to maintain an abundant water supply. Commissions may not allow surcharges to collect lost revenue.
- **Regulatory Uncertainty:** The state of California in 2014 implemented the Sustainable Groundwater Act, requiring firms to adopt a sustainability plan by 2022 and show significant steps towards that plan in 2027. This legislation also required most groundwater basins to select a sustainability agency. While California Water Service Group has closely followed water legislation, it is unknown what other regulatory laws may soon be put in place.
- **Competition:** As California struggles to fight water shortages, utility companies will continue to enter the marketplace to serve growing demand. The San Jose based SJW Group and Connecticut Water Service, Inc. announced plans for a merger making them the third largest water utility in the country. The potential for this conglomerate to focus its resources on southern California is high, which could increase competition for California Water Service Group.

Management

Martin A. Kropelnicki has been the president and CEO of California Water Service Group since 2013. Prior to his position as CEO, Mr. Kropelnicki served as the Chief Financial Officer and Chief Operating Officer from 2006 to 2012. Along with serving as CEO, Mr. Kropelnicki is currently the Vice President of the Board of Directors at the National Association of Water Companies since October of 2015.



Peer Valuation Analysis

Name	Ticker	Market Cap	EV/EBITDA (FY 1)	Price/Book (FY 1)	P/E (TTM)	Est 5 yr NI growth
California Water Service Group	CWT	1,911	12.1x	2.4x	28.3	8.8%
American States Water Company	AWR	2,031	15.4x	3.5x	29.4	3.1%
Aqua America, Inc.	WTR	6,080	16.8x	3.1x	25.3	5.6%
AmeriGas Partners, L.P.	APU	3,909	14.1x	6.1x	35.9	1.1%
WGL Holdings, Inc.	WGL	4,382	12.1x	2.6x	16.1	3.3%
NiSource Inc	NI	8,017	10.6x	1.8x	60.9	2.7%
Atmos Energy Corporation	ATO	9,309	11.3x	2.3x	15.5	11.4%
Peer Averages		5,621	13.4x	3.2x	30.5	4.5%

Source: FactSet

Name	Ticker	Revenues	ROE	ROA	Debt/Equity	Dividend Yield
California Water Service Group	CWT	666.9	9.9%	2.5%	1.2%	1.9%
American States Water Company	AWR	440.6	13.5%	4.8%	0.7%	1.7%
Aqua America, Inc.	WTR	809.5	12.6%	3.8%	1.1%	2.0%
AmeriGas Partners, L.P.	APU	2,453.6	13.7%	4.0%	3.7%	8.4%
WGL Holdings, Inc.	WGL	2,337.7	13.2%	3.1%	1.5%	2.4%
NiSource Inc	NI	4,874.6	3.1%	0.6%	2.1%	2.7%
Atmos Energy Corporation	ATO	2,868.8	10.4%	3.4%	0.9%	2.2%
Peer Averages		2,297.5	11.1%	3.3%	1.7%	3.2%

Source: FactSet

Ring Energy, Inc. (REI)
May 4, 2018

Christopher Barry — Domestic Energy

Ring Energy, Inc. (NASDAQ: REI) is an exploration and production company. They engage in oil and natural gas acquisition, exploration, development and production activities in the Permian Basin. Within the Permian Basin, Ring operates within the Central Basin Platform and in the Delaware Basin. Between these two Permian Basin plays, Ring has a combined 22,307 gross developed acres and 100,688 gross undeveloped acres. Ring sells their oil and natural gas production to end users, marketers, and other producers. Ring was incorporated in 2004 as "Blanca Corp" and the name was later changed to Ring Energy, Inc. in 2008. The firm is headquartered in Midland, TX.

Price ($): 4/26/2018	$16.10	Beta:	0.63	FY: Dec	2016	2017	2018E	2019E
Price Target ($):	$19.26	WACC	7.47%	Revenue (Thou.)	30,846	66,698	142,978	217,216
52WK H-L ($):	17.10-10.88	M-Term Rev. Gr Rate Est:	34.95%	% Growth	-0.5%	116.2%	114.4%	51.9%
Market Cap (mil):	972,247	M-Term EBIT Gr Rate Est:	41.54%	Annual Production (BOE)	878	1,439	2,399	4,007
Float (%):	94%	Debt/Equity (ttm):	0.00	% Growth	18%	64%	67%	67%
Short Interest (%):	8%	Debt/EBITDA (ttm):	0.00	Operating Cost per BOE	11.24	11.11	11.75	11.75
Avg. Daily Vol (Thou):	851.95	ROA (%):	0.46%	EPS (GAAP)	-$0.97	$0.03	$0.81	$1.19
Dividend ($):	0.00	ROE (%):	0.54%	FCF/Share	-$0.76	-$2.26	-$0.95	-$0.19
ESG	B	ROIC (%):	0.54%	EBITDAX Margin	35.5%	54.7%	68.0%	66.0%

Recommendation

Ring Energy was established in 2004 and since then the firm has been busy acquiring land in various parts of the Permian Basin. This Texas oil field has long been one of the most favored crude oil and natural gas basin within the United States. As crude oil prices continue to rise, Ring likely will continue to develop more of their land in the Permian Basin. The firm had a total of 201 well sites between Central and Delaware Basins in 2016. As of 2017, the total rose to 253 well sites, a 25% increase YoY. Additionally, they have identified over 1,000 potential well sites. Ring has a part time staff of engineers, geologists, and other personnel that have helped them drill with a 99.5% success rate. Over the past year, these increases in well sites have helped Ring capitalize on rising oil prices and have increased BOE output by 64%. The main contributor to this increase is their oil output increase – which is expected to increase as oil prices remain strong. Ring has employed a "costless collar" hedging strategy to stabilize cash flow predictability by reducing commodity pricing risk. The options are structured so that the premium paid for the put option is offset by the premium received from selling the call option. They have in place a hedging arrangement that covers 2,000 barrels of oil per day for the entire year of 2018. Ring's revenues are also dependent on the pricing of natural gas, which according to the Henry Hub gas futures quotes, are expected to remain relatively stable for the next five years. Ring is attempting to reach a lower breakeven price point by employing new technologies in their drilling and extraction processes. They have begun investing more in horizontal drilling techniques to extract more from each well site. Management's proactive approach of acquiring more land, finding ways to reduce risk through hedging, and increasing profit margins by finding ways to reduce production costs have already proven to be a successful strategy. With oil prices continuing to increase and natural gas prices remaining stable it is recommended that Ring Energy, Inc. be added to the AIM Equity Fund, with a price target of $19.26, representing a potential upside of 16.39%.

Investment Thesis

- **Experienced Management.** The average level of experience on Ring's management team is 25 years. Most of this experience has come from working within the Permian Basin. This experience has been the main driver behind the management team's confidence in implementing new drilling techniques and expanding production by increasing well sites. Management's experience is one of the main reasons that Ring has been able to ramp up production quickly. Their team intends to grow reserves and production through a multi-year inventory project, which includes developing, drilling, and exploring activities on their land, as well as through oil weighted acquisitions.

- **Prime Location.** The Permian Basin is the leading site for oil and natural gas production in the U.S. This area is home to a plethora of natural gas and oil – and has been identified as possessing over 1,000 potential well sites. These potential wells are in addition to the over 250 wells that Ring currently operates. The vast plots of land are home to an estimated 31.9 million BOE of proven reserves, which consist of 91% oil and 9% natural gas.
- **Increasing Demand.** OPEC has recently stated that they will continue to reduce the level of output from their members. This reduction has helped increase oil prices and has also left a need for greater supply. The US oil and natural gas share of global production has been increasing as domestic firms continue to increase their output. This estimated output increase is the result of new technologies, recovering oil prices, and improved drilling efficiencies, all of which Ring's management team has implemented. Many experts expect the US to provide over half of the world's supply of oil by 2023, and with all the potential well sites that Ring owns, they do their part to ramp up production levels significantly in order to meet this demand.

Valuation

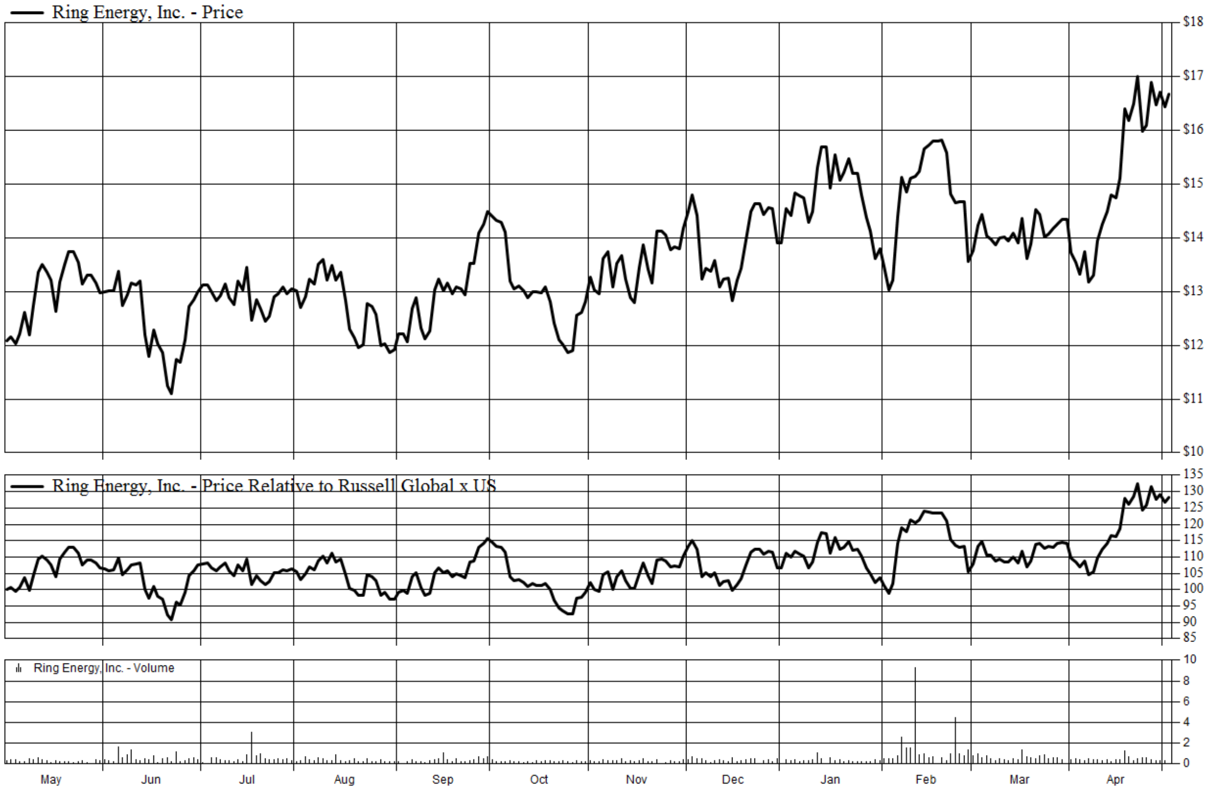
In order to reach an intrinsic value for REI, a five year DCF model was constructed. Using a terminal growth rate of 2.00% and a WACC of 7.47%, an intrinsic value of $17.66 was reached. A sensitivity analysis on the price of oil and WACC ranged from $16.98-33.85. A NAV was calculated using reported natural gas and oil reserves. The NAV yielded a price target of $20.29. An EV/EBITDAX multiple valuation was conducted, using a weighted average, which resulted in an intrinsic value of $10.45. A EV/1P multiple was also constructed, which yielded a ratio of 42.54 that lead to an intrinsic value of $22.76. EV/1P is enterprise value divided by thousand barrel of oil equivalents of proven reserves. By weighting the four models 30/30/10/30, a price target of $19.26 was reached, resulting in a 16.39% potential upside. REI does not pay a dividend.

Risks

- **Project Complications.** There are many risks involved in drilling for oil and natural gas. A particularly risky element of their drilling efforts is the new technologies that management has been implementing. If drilling complications arise, it could result in a material impact on revenues.
- **Incorrect Estimation.** A substantial proportion of Ring's assets still need to be extracted. If estimates are incorrect or Ring is unable to extract the estimated amount from these sites, that could significantly affect production, depending on the severity of the missed estimate.
- **Commodity Pricing.** Since their revenue stream is entirely reliant on the price they can sell oil and natural gas for, they are exposed to significant risk if oil or natural gas prices suddenly decrease. Even with the hedging strategy implemented, Ring faces significant commodity pricing risk.

Management

The acting CEO, who is Kelly Hoffman, began his career in the Permian Basin in 1975. He is tasked with oilfield construction, crew management, and drilling and completion operations. David A. Fowler is the acting president and board director, and has been working in the Permian Basin for over 17 years. Ring's management team has over 100 years combined experience in the oil and gas industry.



Peer Analysis

Name	Ticker	Market Cap (mil)	Revenue (mil)	EBITDAX (mil)	EV/ EBITDAX	EV/1P	Reserve Life Index
Ring Energy	REI	972	66.70	32.70	29.27	29.96	22.00
Callon Petroleum Compant	CPE	2,767	366.47	241.90	13.98	24.69	16.00
Diambondback Energy, Inc.	FANG	12,575	1,205.11	933.20	15.29	2.78	12.00
Viper Energy Partners	VNOM	3,308	172.03	155.20	21.17	85.92	10.00
SM Energy	SM	2,629	1,129.40	326.10	15.79	11.00	11.00
RSP Permian Inc	RSPP	7,911	803.71	468.90	19.76	24.64	19.00
Peer Averages		5,838	735.34	425.06	18.83	42.54	13.60

Source: FactSet

Ownership

% of Shares Held by All Insider Owners:	6.07%
% of Shares Held by Institutional & Mutual Fund Owners:	75.48%

Source: FactSet

Top 5 Shareholders

Holder	Shares		% Out
RBC Global Asset Management, Inc.	3,920	▼	6.49%
Daruma Capital Management LLC	3,213	▲	5.32%
BlackRock Fund Advisors	3,159	▲	5.23%
Encompass Capital Advisors LLC	2,692	▲	4.46%
The Vanguard Group, Inc.	2,222	▲	3.68%

Source: FactSet

Sumitomo Mitsui Financial Group, Inc. (SMFG)
May 4, 2018

Jacob Bishop International Financials

Sumitomo Mitsui Financial Group, Inc. (NYSE: SMFG) was established in December 2002 as a holding company for the SMFG group. The firm operates through the following segments: Commercial Banking, Leasing, Securities, and Consumer Finance. The Commercial Banking segment consists of consumer banking, middle market banking, wholesale banking, retail banking, international banking, and treasury units. The Leasing segment provides leasing services that include equipment leases, operating leases, leveraged leases, and aircraft operating leases. The Securities segment offers financial products, investment consultation, and administration services. The Consumer Finance segment handles domestic credit card business, consumer loans and loan guarantee businesses. The company is headquartered in Tokyo, Japan.

Price ($):	8.44
Price Target ($):	11.43
52WK H-L ($):	$7.10 - 9.67
Market Cap (mil):	58,997
Float (mil)	-
Avg. Daily Vol (mil):	1.31
Div Yield (%):	2.80%
Short Interest	0.07%

Beta:	1.44
M-Term Rev. Gr Rate Est:	12.0%
M-Term EPS Gr Rate Est:	10.0%
Financial Leverage	3.22
WACC	5.53%
ROA (%):	0.38
ROE (%):	7.83
Tier 1 Capital Ratio (%)	80.38
Loan/Deposits (%)	66.7

FY: Dec	2017	2018E	2019E	2020E
Revenues	50,374.99	54,834.89	58,439.94	62,074.54
% Growth	27%	9%	7%	6%
Net Interest Income	12397.56	12438.0183	13100.37	14279.40
%Growth	5%	0.326%	5.33%	9.00%
Net Interest Margin	34.46%	39.43%	42%	42%
Efficiency Ratio	74%	81%	81%	82%
P/E	9.1	8.2	8.50	9.04
P/B	0.61	0.625	0.65	0.67

Recommendation

Sumitomo Mitsui Financial Group has consistently been a premier financial services company in the Japanese market. Since 2015, the company has experienced an interest income CAGR of 2.91%, a non-interest income CAGR of 5.5%, and a net income CAGR of 1.39%. The firm is currently undergoing a new medium-term management plan that focuses on expanding across the globe into emerging markets in order to gain more market share. In 2017, Sumitomo expanded their global network into India and the United States, increasing their total countries of operation to 41. SMFG currently offers almost every financial service possible by way of its five business units with 72 different branches across the globe. In addition to expansion, the firm is capitalizing on the economic growth of their home country Japan. Their home country has experienced improved economic growth since 2012, resulting in an average real GDP growth rate of 1.98% per year. As a result, consumers have invested more money into banks and securities, as well as taken out more loans. This increase is reflected on the firm's balance sheet; since 2015 SMFG's total assets have grown on average by 5.34%, while their total deposits have grown on average by 7.17%. The company currently invests heavily into disruptive technology, such as contactless smart cards, helping them increase their customer base by over 1.5 million customers last year. Due to the consistent financial strength, global expansion plan, and economic development in target markets, it is recommended that Sumitomo Mitsui Financial Group, Inc. be added to the AIM International Equity Fund with a price target of $11.43, representing a 35.38% upside. The firm's stock yields 2.8%.

Investment Thesis

- **Medium Term Management Plan.** SMFG is implementing a new Medium-Term management plan that emphasizes profitability. The firm is practicing group-based administration of operations, switching to digitalization, and reorganizing retail branches in order to minimize costs. They are centralizing shared functions through this reorganization with a target to save $460 million in expenses in the medium term while maintain a 7%-8% ROE. In addition, the program seeks to adopt a progressive dividend policy with a payout ratio of 40%.

- **Economic Growth.** Japan has experienced seven straight quarters of economic expansion, its second longest economic expansion in the post-WW2 era. Since 2012, Japan's GDP has grown nearly 2% per year. As the economy expands, consumers will have seen increased levels of disposable income. With the Bank of Japan (BoJ) increasing the money supply, consumers will likely put more funds into banks, invest more, and take out more loans. This should increase deposits and therefore the funds SMFG can lend.
- **One Stop Shop.** Sumitomo currently is configured with the following segments: Business Unit, Retail Unit, Wholesale Unit, International Unit, and Global Markets Unit. They provide almost every financial service possible, leading consumers to consolidate all their information here. SMFG currently has 27 million retail customers, 42 million cardholders, 2.1 million consumer finance customers, 3 million investment customers, 84,000 corporate loan clients, and they facilitate $28.4 billion in leasing loans. Sumitomo's ability to provide customers every financial instrument available creates a competitive advantage that allows them to gather and retain clients.
- **Digital Integration.** SMFG has placed a large emphasis on technology and digitalization for future growth. They are developing the first Contactless IC Debit card in Japan, a product that will allow customers to carry around a contactless smart card that will grant access to 710,000 bank locations in 72 countries in the world. In addition, the bank is incorporating a biometric authentication platform so that consumers will be able to use unique biological characteristics (such as fingerprint) in order to access their account without the need to carry anything. This technology has created buzz in Japan, incentivizing consumers to switch from other companies to SMFG.

Valuation

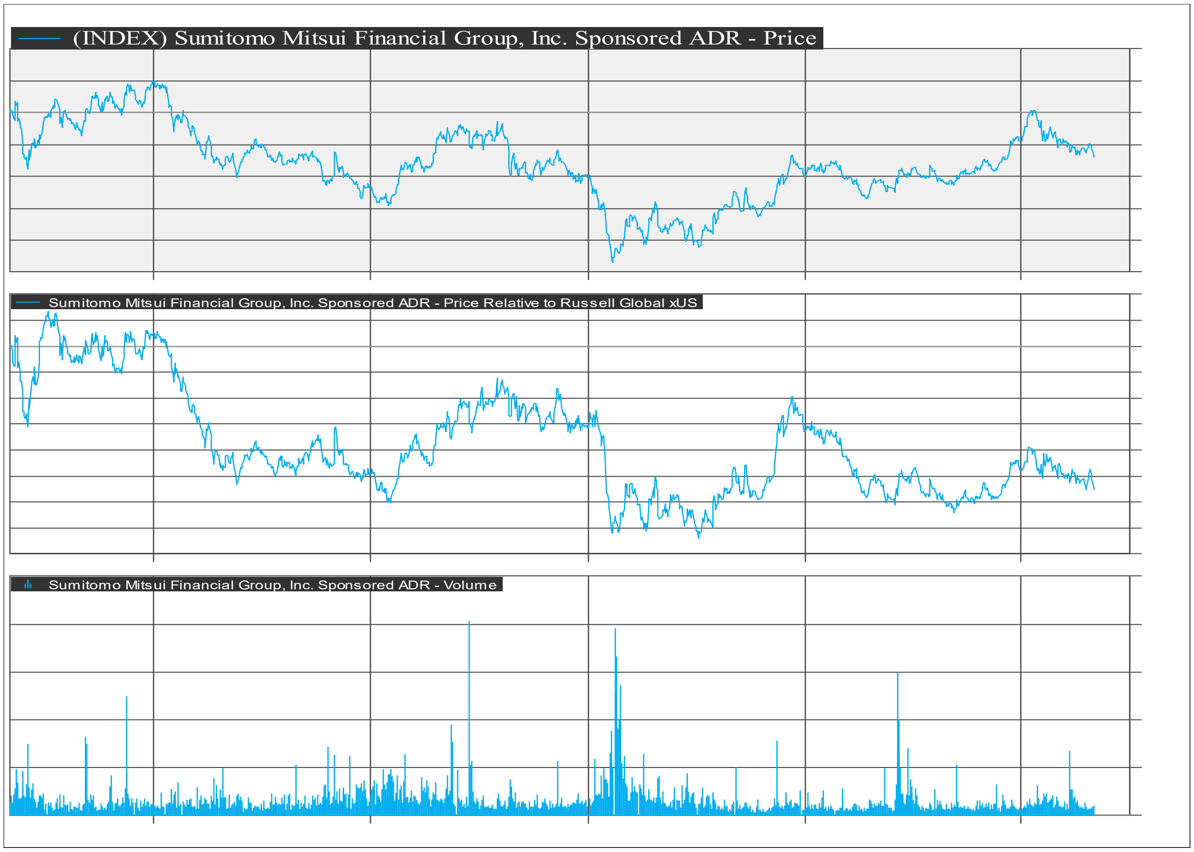
In order to reach an intrinsic value for SMFG, a three year Excess Return model was constructed. Using a terminal growth rate of 1.20%, an intrinsic value of $12.14 was reached. Additionally, a P/E multiple valuation approach was employed. Using a 2018E EPS of $1.156 and utilizing a blended average P/E multiple of 9.43x, resulted in an intrinsic value of $10.89. Finally, an Price to Book multiple valuation was conducted using a blended average multiple of 0.649x, resulting in an intrinsic value of $9.80. By weighing the three models 60/20/20, a price target of $11.43 was reached, resulting in a 35.48% potential upside. SMFG currently pays a dividend of $0.23.

Risks

- **Negative Interest Rates.** The Bank of Japan has consistently set the short-term policy rate at negative 0.1% and the 10-year yield target around 0%. The BoJ aims to increase inflation to 2% by fiscal 2019, a target that they are currently well below. Pushing inflation up will enhance lending to the real economy while squeezing banks' profits. Banks will either have to increase rates to remain as profitable as before, thus losing market share, or keep rates the same and lose profitability. SMFG has kept loan rates moderately stable in order to capitalize on the increased demand.
- **Japanese Yen Value.** The value of the Yen has decreased in the trailing twelve months by 3.23%. If the value of the Yen continues to decrease, the value of debt outstanding will decrease. This will help banks in the short term because the value of the amount they must pay back will decrease. However, the money they loaned out long term will decrease in value as well, causing their profits to diminish.

Management

Takeshi Kunibe is the President, Group CEO & Director of Sumitomo Mitsui Financial Group. He is on the Board of Directors at NEC Corp and Sumitomo Mitsui. He has been with the company for 11 years. Jun Ohta is the Head of Finance and Public Relations and has served the company for 9 years.



Source: FactSet

Peer Analysis

Name	Ticker	Market Cap (mil)	P/E	P/B	P/TBV	Div Yield
Sumitomo Mitsui Financial Group, Inc. Sponsored ADR	SMFG	58997	9.12	0.61	0.65	3.14%
Shinsei Bank Ltd Sponsored ADR	SKLKY	4306	10.15	0.61	0.69	0.37%
Woori Bank Sponsored ADR	WF	10045	8.23	0.62	0.64	0%
Mizuho Financial Group, Inc. Sponsored ADR	MFG	46178	8.88	0.55	0.70	3.18%
Mitsubushi UFJ Financial Group, Inc. Sponsored ADR	MUFG	93427	11.06	0.66	0.68	2.21%
Nomura Holdings, Inc. Sponsored ADR	NMR	21113	9.54	0.80	0.91	2.89%
Peer Averages		35013.8	9.57	0.65	0.72	1.73%

Peer Analysis

Name	Ticker	Net Margin	ROE	ROA	Tier Capital Ratio
Sumitomo Mitsui Financial Group, Inc. Sponsored ADR	SMFG	15%	7.83%	0.38%	17.02%
Shinsei Bank Ltd Sponsored ADR	SKLKY	2.40%	6.55%	0.58%	14.20%
Woori Bank Sponsored ADR	WF	1.71%	7.88%	0.43%	15.29%
Mizuho Financial Group, Inc. Sponsored ADR	MFG	0.54%	7.47%	0.32%	15.41%
Mitsubushi UFJ Financial Group, Inc. Sponsored ADR	MUFG	0.85%	6.23%	0.32%	16.01%
Nomura Holdings, Inc. Sponsored ADR	NMR	13.96%	8.73%	0.57%	N/A
Peer Averages:		3.89%	7.37%	0.44%	15.23%

Stitch Fix, Inc. (SFIX)
May 4, 2018

Ronnie Terry Jr. — Domestic Consumer Discretionary

Stitch Fix, Inc. (NASDAQ: SFIX) is a provider of subscription-based personal shopping and delivery services for clothing. The firm sells a range of apparel, shoes, and accessories online and through its mobile app. Stitch Fix has reinvented the shopping experience by providing a one-to-one approach to personalize the customer's shopping experience by way of data science and human judgment. Stitch Fix operates within the retail clothing segment, which generated all of its revenue. Stitch Fix has over 75 data scientists, over 3,400 employee stylists that work directly with customers, and more than 5,800 total employees. The company has over 2.2 million active clients. Fix Stitch, Inc. was founded in February 2011 and is headquartered in San Francisco, California.

Price ($): 05/01/2018	$ 22.12
Price Target ($):	$ 32.44
52WK H-L ($):	$14.48-$30.07
Market Cap (mil):	2,149
Insider Holdings	0%
Avg. Daily Vol (mil):	0.5254
Yield (%):	0%
ESG Rating	N/A
Short Interest	N/A

Beta:	1.00
M-Term Rev. Gr Rate Est:	16.1%
M-Term EPS Gr Rate Est:	43.8%
Debt/Equity:	0.0
Debt/EBITDA (ttm):	0.00
WACC	10.03%
ROA (%):	1.56%
ROE (%):	2.7%
ROIC (%):	2.7%

FY: July	7/30/2017	7/30/2018	7/30/2019	7/30/2020
Revenue (Mil)	977.14	1,213.02	1,479.88	1,775.85
% Growth	34%	24%	22%	20%
Oper Inc	31.64	63.84	103.59	135.42
% Growth	-51%	102%	62%	31%
Op Margin	3.24%	5.26%	7.00%	7.63%
EPS*	$ 0.49	$ 0.84	$ 1.09	$ 1.52
P/E (Cal)	45.14	28.97	24.56	19.37
EV/EBITDA	1.88	1.52	1.27	1.05

Recommendation

Stitch Fix, Inc. completed their IPO in November 2017 at $15 per share and they are developing into a true leader in the retail clothing industry by way of online shopping. The firm's tag line is: Transforming the Way People Find What They Love. Founded in 2011, the firm currently has 2.5 million active clients. Stitch Fix has managed to impressively grow the number of active customers through its various improvements in algorithms, allowing for a more customer-focus and personalized experience for their clients. The company forecasts continued growth in the online U.S. apparel, foot ware and accessories market (from an estimated $70 billion in 2017 to over $133 billion in 2022). As a result of improvements in their algorithms, Stitch Fix experienced a 22% growth in 2017 in the average number of items purchased per "fix" - since 2014. As of Q2 2017, Stitch Fix has seen a 31% increase in active clients (YoY), and a 24% increase in revenues generated per client (YoY). Considering the company's use of predicative algorithms, exclusive brand development opportunities, deep client relations and strong cash flow generation, it is recommended that Stitch Fix, Inc. be added to the AIM Equity Fund with a price target of $32.44. Representing a potential upside of over 46%.

Investment Thesis

- **Massive Opportunity in the US.** In 2017, the US apparel, footwear, and apparel accessories market brought in $342 billion, with $70 billion coming from online sales. This indicates an omline penetration of 20.4%. In 2022, the the market is projected to bring in $406 billion, with $133 billion coming from online sales (online penetration of 32.7%). Within this 5-year span, the market is expected to experience a CAGR of 3.5% while online sales will experience a CAGR of 13.8%.
- **Growth of Active Clients.** Stitch Fix, Inc. has been able to grow their active clients, as reported at the end of the last fiscal quarter (01/27/2018), by 30.6% year-over-year. Such growth puts the company in a great position to contine to penetrate the market for online sales, and ultimately grow their revenues.
- **Millenial Interest in Shopping Online.** Millenials have matured at a time of technological change; a time in which computers and mobile devices seem to satisfy their needs. A June 2017 Forbes article about Millenial shopping trends indicates that about 1/3 of millenials make the

majority of their purchases on a desktop computer, and about 16% of millenials use mobile devices. Companies like Stitch Fix, have placed an emphasis on personalizing the customer experience and appealing to their wants and needs. As more millenials enter the workforce and experience an increase in disposable income, it can be inferred that more purchases will be made by way of online shopping.

Valuation

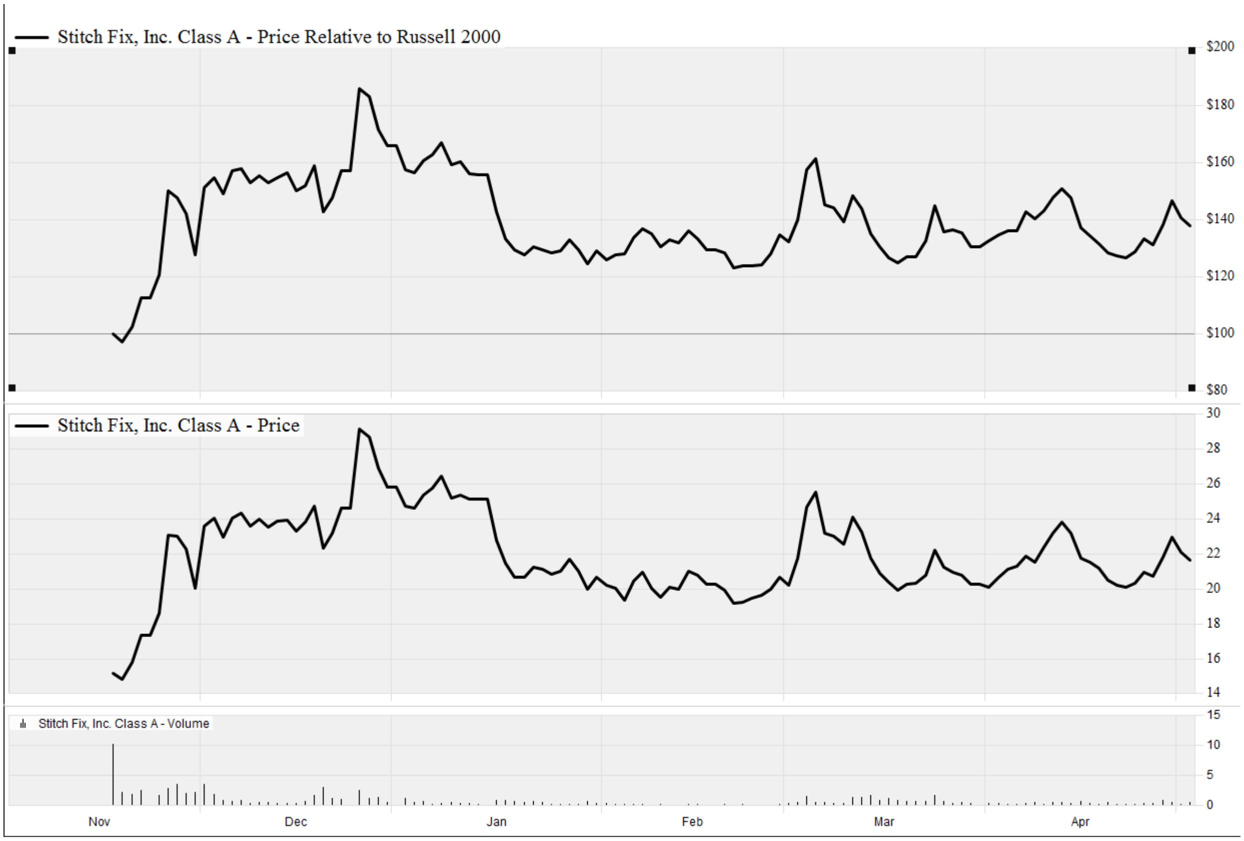
In order to reach an intrinsic value for SFIX, a five year DCF model was constructed. Using a terminal growth rate of 4.00% and a WACC of 10.3%, an intrinsic value of $26.46 was reached. A sensitivity analysis was also created, providing a range of $21.19 to $35.23. An EV/SALES multiple valuation based on peer comps was used, yielding an intrinsic value of $38.42. By weighing the models 50/50, a price target of $32.44 was reached, resulting in a 46% potential upside. SFIX currently does not pay a dividend.

Risks

- **Short Operating History.** Due to such short operating history in a rapidly evolving industry, it may be difficult to adjust to future changes. The lack of management experience could be tested if Amazon or other online retailers seek to enter their space.
- **Attracting Customers Through Paid Marketing.** Much of the company's clientele growth within the first 5 years came as a result paid marketing, so Stitch Fix has decided to increase their marketing initiatives. Such paid marketing may become increasingly expensive and generating a meaningful return may be difficult. Even if Stitch Fix is able to increase revenue through paid marketing, it may not offset the additional marketing expenses that they will incur.
- **Retaining Vendors and Attracting New Vendors.** The merchandise coming from Stitch Fix comes from hundreds of both established, and emerging brands. In order to maintain vendors and attract new vendors, Stitch Fix must help these vendors increase their sales and provide a cost-effective fulfillment process.

Management

Katrina Lake has served as the CEO and Director at Stitch Fix, Inc. since inception. She also serves as an independent director at GrubHub, Inc. Her prior experience consists of being an associate at Leader Ventures LLC and an associate at The Parthenon Group LLC. Paul Yee has served as the CFO at Stitch Fix, Inc. since June 2017. His prior experience consists of serving as Vice-President of Finance & Investor Relations at Peet's Coffee & Tea, Inc.



Name	Ticker	Market Cap (mil)	EV/Sales	P/E	EV/EBITDA	EV/EBIT
Stitch Fix	SFIX	2,149	1.27	240.90	49.00	77.00
Amazon	AMZN	787,279	2.71	84.20	20.50	62.40
Alibaba Group Holding	BABA	458,427	6.53	21.40	16.20	22.70
Wayfair	W	5,627	0.77		-135.20	-32.10
JD.com	JD	51,259	0.55	56.20	20.90	50.30
Overstock	OSTK	959	0.47	-	-19.60	12.00
Peer Averages		260,710	2.21	53.93	-19.44	23.06

Source: FactSet

Name	Ticker	Revenues	ROE	ROA	Debt/Equity	Est 5 yr NI growth
Stitch Fix, Inc.	SFIX	1450	1.8%	2.1%	0.0%	25.0%
Amazon	AMZN	290,188	18.4%	5.0%	63.0%	62.0%
Alibaba Group Holding	BABA	54,481	22.2%	10.2%	17.0%	29.0%
Wayfair	W	8,335	6.0%	4.4%	-33.0%	25.0%
JD.com	JD	92,899	10.5%	4.6%	38.0%	25.0%
Overstock	OSTK	2,064	-26.8%	70.0%	0.0%	NM
Peer Averages			6.1%	18.8%	17.0%	35.3%

Source: FactSet