

Group Valuation Report- Francesca's Holdings Corporation

Group 2: Dan Cadeau, Eric Koehn, Phil Ratman

Executive Summary

Search Process	Francesca's	Value Investing Criteria
Price/Earnings:	7.54x	<= 13
Price/Book:	1.79	<=1.2
Market Cap:	\$199,708,080	<= \$1,200,000,000
Dividend:	No	Yes
Debt/Capitalization:	66.6%	Low
52 Week High/Low	\$19.01/\$5.31	Trading near 52 Week low

The initial search process for Francesca's as a value stock was inconclusive. The P/E ratio is below the value investing threshold, market cap is lower than the threshold for a US traded company (NASDAQ), and they are currently trading at 28.9% of their 52-week high. However, the P/B of 1.79 exceeds the 1.2 threshold, not a dividend paying stock and because of operating leases have a very high D/V ratio.

Business Risk- High: Francesca's is a boutique retail chain offering women's apparel, jewelry, and accessories through its 714 physical boutiques and online storefront. We consider the business risk to be high for the following reasons, industry cyclicality and seasonality, fragmented market share, limited barriers to entry, customer downward pressure on prices, company's dependence on brick and mortar sales, and the continued rise of online retail.

Financial Risk- High: The optimal capital structure for a company with high business risk is 10-29% debt to capitalization. We calculated Francesca's capital structure to be 66.6% D/V, Francesca's carries no long-term debt, but the PV of their operating leases is \$223mm and their shareholders equity is only \$112mm. The D/V is above the threshold for a high business risk company, giving them a high financial risk. **Bond rating-BBB**, this aligns with their business and financial risk, BBB was selected over C because of our further analysis of additional liquidity ratios. **WACC- 6.09%:** D/V-66.6%; Kd-4.6%; Ke-12.6% and Marginal Tax Rate of 37.9% (35% Federal + 2.7% State). Exhibit 1. **First Pass ROIC-20.2%:** ROIC calculated using book values, shows an ROIC significantly higher than WACC. With a delta of 14.1% we expect calculated EPV to be substantially larger than NAV. We also hypothesis that the first pass ROIC is so large because of their substantial use of off balance sheet financing in the form of operating leases. Exhibit 2

NAV- \$7.67/share Exhibit 4. **EPV- \$15.93/share** Exhibit 5. **Second Pass ROIC -8.7%:** The second pass ROIC using NOPLATPA in the numerator and NAV operating assets resulted in an ROIC 2.6% higher than WACC. ROIC second pass dropped from the first pass ROIC because of the addition of their substantial operating leases to the NAV operating assets. ROIC>WACC confirming that EPV>NAV. Exhibit 3

Strategy Analysis and Decision- Buy: The calculated Intrinsic Value is \$12.63/share, applying a 1/3 margin of safety the entry price is \$8.42 which is 52.5% greater than the current stock price of \$5.52, making this a strong buy! We believe that Francesca's has a sustainable franchise despite the pressures that all retailers currently face with the rise of ecommerce competition, particularly Amazon. Most of the items sold by Francesca's are unique to them and can not be bought elsewhere, additionally 50% of sales come from apparel which shoppers still enjoy buying through brick and mortar. Given our belief in Francesca's moat we assigned a 60% probability to their franchise which equates to a franchise value of \$4.96. (Exhibit 6 and 7)