Applied Investment Management (AIM) Program

AIM Class of 2017 Equity Fund Reports
Spring 2017

Date: Friday, February 17th | ***Time:*** *2:30 – 3:30* p.m. | ***Location: AIM Research Room 488***

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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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Landec Corporation (LNDC)
February 17, 2017

Patrick Wade — Consumer Staples

Landec Corporation (NASDAQ: LNDC) and its subsidiaries design, manufacture, and market health and wellness products for the biomaterials and food markets. Landec has two primary businesses: Apio and Lifecore. Apio is responsible for their food related business segments, which includes their Packaged Fresh Vegetables (78% of revenue) and their Food Export business (12%). Lifecore is responsible for the biomaterials segment (10%) and focuses primarily on the production of pharmaceutical-grade sodium hyaluronate products, which is used in ophthalmic surgeries and orthopedic injections. Approximately 84% of their business is conducted in the United States and Canada, while the remaining 16% is exported to various countries located in Asia. Landec Corporation was founded in 1986, and is headquartered in Menlo Park, CA.

Price ($):	13.10
Price Target ($):	16.88
52WK L-H ($):	$9.48 - 15.50
Market Cap (M):	346.3
Float (M):	26,561.00
Short Interest (%):	4.61%
Avg. Daily Vol:	79,378.00
Dividend ($):	-
Yield (%):	0.00%

Beta:	0.90
WACC	7.20%
M-Term Rev. Gr Rate Est:	5.60%
M-Term EPS Gr Rate Est:	59.04%
Debt/Equity:	25.2%
Debt/EBITDA (ttm):	2.09
ROA:	-3.40%
ROE:	-5.30%
ROIC:	-4.50%

FY: May	2016	2017E	2018E	2019E
Revenue (Mil)	541.10	558.68	589.27	624.78
% Growth	0.34%	3.25%	5.48%	6.03%
Gross Margin	13.11%	13.43%	13.53%	13.81%
Operating Margin	2.63%	1.60%	1.98%	2.76%
EPS (Cal)	($0.43)	$0.22	$0.34	$0.45
FCF/Share	($0.73)	$0.44	$0.68	$0.75
P/E (Cal)	-	60.4	38.5	29.4
EV/EBITDA	17.0	14.3	12.6	10.7

Recommendation

Landec Corporation has a unique business model for a consumer staples company - 90% of their revenues are generated from selling fresh vegetables with the remaining 10% is generated from the sale of biomaterials. In addition to their everyday operations, they also have an investment in Wintset Farms, a privately held company. Windset is a leader in hydroponic, greenhouse grown produce and owns approximately 10 million square feet of greenhouse space in North America. In FY'16 Landec recognized an increase in the fair market value of Windset of approximately $1.2M including a 7.5% annual dividend on a $22M investment for a total of $2.9M. Landec's biomaterials company, Lifecore, primarily produces and sells pharmaceutical grade hyaluroante; however, they have recently engaged in providing specialty contract development and manufacturing services. The past three years they generated approximately $1.4, $1.8, and $4.5 M through the CDMO operations. Although this is only a small percentage of Lifecore's total revenue, they are focused on growing their CDMO services in the periods to come. Due to the projections that Landec Corporation and its subsidiaries will continue to provide fresh foods both domestically and internationally while growing their biomaterial segment, it is recommended that Landec Corporation be added to the AIM Equity Fund with a price target of $16.88, representing a 28.86% upside. LNDC does not pay a dividend.

Investment Thesis

- **Salad Explosion.** In FY'13 Apio launched its first Salad Kit which only generated $26.1M or about 7.5% of their overall revenue in their Package Fresh Vegetables segment. However, since the introduction of the product line there are now 9 different Salad Kits and the revenues generated from this product line have reached $154.3M in FY'16 – equivalent to a CAGR of 81%. With this product line accounting for 36% of the total revenue generated in the Package Fresh Vegetables segment and Apio's focus on product innovation, this segment will continue to grow rapidly in the near term.
- **Aging Population.** As the Baby Boomer generation enters retirement and develops more complex health issues, there will be an increased amount of spending on these problems.

According the Mayo Clinic, individuals aged 65 and over are at an increased risk of developing cataracts, and when they reach the age of seventy the likelihood of developing cataracts increases to over 50%. Cataracts are the result of naturally occurring protein clumping in the lens of the eye that can cause blurriness, glaucoma, and blindness if left untreated. The World Health Organization estimates that approximately 32 million cataract surgeries will take place in 2020, which is an increase of 46% from 2015. Lifecore's pharmaceutical-grade hyaluronate is used in these cataract surgeries as it's a natural occurring in the eyes. With this increased demand, Landec should be poised for healthy revenue growth in the coming periods.

- **Facility Expansion.** Both Apio and Lifecore's facilities were expanded in 2016 to meet the projected growth for both subsidiaries. Apio's renovation of their Hanover, CA facility increased the overall area 300%, and Lifecore expanded their manufacturing facility in Chaska, MN by 22%. The renovation in the Hanover facility will increase the number of production lines 5x by increasing from 2 to 10. The additional lines will allow Apio to grow its brands in the Northeast, Mid-Atlantic, and Midwest.

Valuation

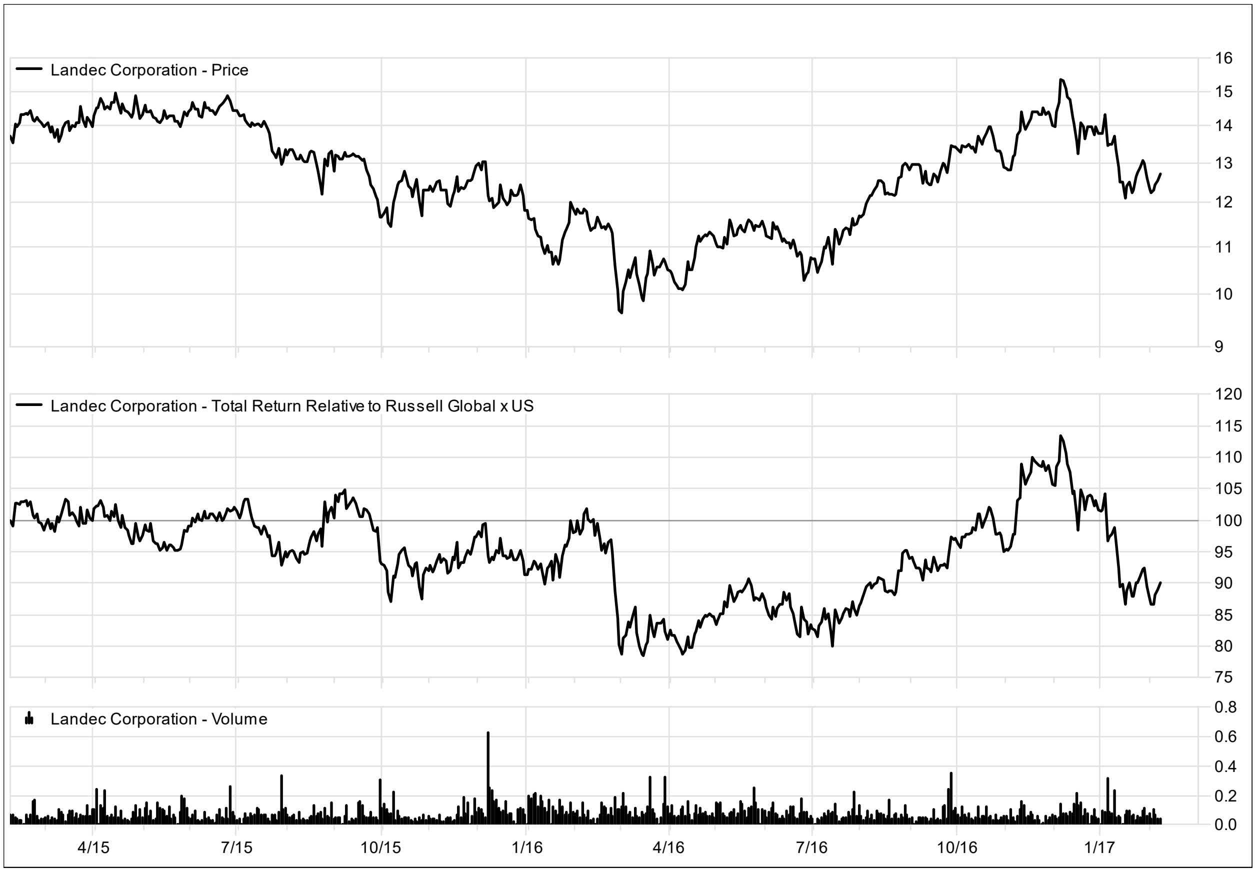
In order to reach an intrinsic value for LNDC, a five year DCF model was constructed. Using a terminal growth rate of 2%, WACC of 8.10%, an intrinsic value of $17.56 was reached. A sensitivity analysis on the terminal growth rate and the WACC ranged from $14.49 - $22.56. Additionally, an EV/EBITDA multiple valuation was conducted using 2017 expected EBITDA of $27.99 and a comparables average EV/EBITDA of 17.28 which resulted in a valuation of $15.87. By weighting the two valuation models 60/40, a price target of $16.88 was reached, which yields a 28.86% upside. LNDC does not pay a dividend.

Risks

- **Adverse Weather Conditions.** In FY'16 the Packaged Fresh Vegetables and the Exports section experienced a decrease in revenue compared to previous periods due to a decrease in total unit sales. This decrease in was due to a shortage of produce caused by adverse weather conditions in the second and third quarters. If this trend continues into FY'17 there could be adverse effects on the company's share price.
- **Strong Dollar.** Although exports only make up 30% of their revenue, with Canada consisting of 15%, a strong dollar will make it more expensive for countries in Asia to purchase Landec's goods. According to The Street, the dollar will remain strong, and possibly even strengthen, in the coming periods which could have an adverse effect on their export revenue.
- **Difficulties with Facility Expansion.** With Landec's expansion of both their Apio and Lifecore facilities to meet the projected growth of both subsidiaries, there runs the risk of overcompensating for the increase in demand. If demand doesn't grow as expected, there could be an increased overhead cost and margins could shrink.

Management

Molly A. Hemmeter is the President, CEO, and Director at Landec. Previous to serving at Landec, she was the VP of Global Marketing and New Business Development at Ashland Inc. She received her undergraduate and graduate degrees at University of Louisville, and her MBA from Harvard University. The Chief Operating Officer position is headed by Ronald Lane Midyett, who's also the CEO of Apio inc. Previous to joining Landec, Midyett was the VP of operations at Dole Fresh Vegatables, inc. Additionally, he sits on the boards of both United Fresh Fruit & Vegetable Assoication and Windset Holdings.



Source: Factset

Ownership

% of Shares Held by All Insider Owners:	2.59%
% of Shares Held by Institutional & Mutual Fund Owners:	92.68%

Source: FactSet

Top 5 Shareholders

Holder	Shares	% Out
NWQ Investment Management Co. LLC	3,081,000	11.3
Franklin Advisory Services LLC	2,847,000	10.44
Wynnefield Capital, Inc	2,682,000	9.84
Dimensional Fund Advisors LP	2,254,000	8.26
BlackRock Fund Advisors	1,564,000	5.74

Source: FactSet

Peer Comparables

Name	Ticker	Market Cap	Debt/Equity	Sales (mil)	P/S	EV/EBITDA
Landec Corp.	LNDC	342.3	25.2%	541.10	0.65	15.03
John B Sanfilippo & Son	JBSS	699.6	19.5%	952.10	0.77	10.5
Limoneira Co.	LMNR	248.4	65.4%	111.78	2.21	24.18
Snyder's-Lance	LNCE	3711.3	72.3%	2,295.00	1.81	20.35
Catur Sentosa Adiprana	CSAP	150.8	66.9%	238.10	0.26	14.1
Peer Averages		1202.525	56.0%	899.25	1.26	17.28

Source: Factset

CANCOM SE ADR (COK)
February 17, 2017

Yiqiu (Ethan) Zhu — International Technology

CANCOM SE (OTC: COK) is an integrated IT system and cloud provider located in Germany. The company provides service to seven business areas: finance, purchasing, warehousing, logistic, marketing, product management, and human resource. The IT solutions operating segment (85.9% of FY 2015's total revenue) and cloud solutions operating segment (14.1%) comprise all of CANCOM's revenue. In FY 2015, the company's revenue mix was as follow: Germany (90.6% of total revenue) and rest of the Europe (9.4%). CANCOM has more than 30 office locations in Central Europe and the US. The company's stock is traded in the German DAX index within the technology sector. The company was founded in 1992 and is headquartered in Munich, Germany.

Price (€): (02/16/17)	44.56
Price Target (€):	58.52
52WK H-L (€):	59.79-43.32
Market Cap (mil):	738.7
Float (mil):	94.90%
Short Interest (%):	na
Avg. Daily Vol:	69809.00
Dividend ($):	0.50
Yield (%):	1.12%

Beta:	0.74
WACC	8.2%
M-Term Rev. Gr Rate Est:	8.7%
M-Term EPS Gr Rate Est:	9.0%
Debt/Equity:	18.9%
Debt/EBITDA (ttm):	0.83
ROA:	8.5%
ROE:	15.9%
ROIC:	13.8%

FY: December 31	2015	2016E	2017E	2018E
Revenue (Mil)	932.80	1,016.75	1,108.26	1,196.92
% Growth	11.13%	9.00%	9.00%	8.00%
Gross Margin	30.10%	30.20%	30.30%	30.40%
Operating Margin	4.55%	5.10%	5.20%	5.30%
EPS (Cal)	€ 1.67	€ 1.85	€ 2.06	€ 2.27
FCF/Share	€ 2.51	€ 2.97	€ 3.28	€ 3.59
P/E (Cal)	22.0	20.1	19.3	18.6
EV/EBITDA	9.8	9.1	8.1	7.6

Source: Bloomberg

Recommendation

CANCOM is one of the leading independent integrated systems providers in Europe – and especially in Germany. In terms of market share, the company is among the top three IT solutions provider in Germany (1% market share). According to research report done by GlobalData, CANCOM has partnerships with more than 300 suppliers in the world. In Germany, CANCOM is one of the largest partners with Microsoft and Hewitt Packard – and the company is also the largest partner with Apple and Adobe. The majority of the CANCOM's revenue comes from the IT solution's segment. According to industry estimates, expenditure on IT services will increase 2.7% for both 2016 and 2017, and 2.6% for 2018 and 2019. CANCOM could capitalize on this positive outlook, which will increase its future revenue. In FY 2015, CANCOM posted a revenue of EUR 801 million for its IT solution segment compared to EUR 721.4 million in FY 2014, representing a YoY growth of 11%. In addition, the company's operating margin was 4.3% in FY 2015, compare to an operating margin of 3.5% in FY 2014. Due to the company's competitive advantages and strong historical performance, it is recommended that CANCOM be added to the AIM International Equity Fund with a target price of €58.52, representing a 31.33% upside.

Investment Thesis

- **Strong growth potential in cloud services protected by location and legal advantages.** According IDC's Western Europe Cloud Services forecast for 2016-2020, the demand for cloud services will grow continuously by a CAGR of 26%. Among all the countries in the survey, Germany is the second-largest territory for cloud service demand and it has the highest growth rate (CAGR 24%). In addition, Germany has very strict regulations regarding using a foreign cloud providers, which creates a less competitive environment for domestic cloud providers. Moreover, due to legal and compliance concerns, about 57% of German companies prefer a domestic cloud provider to a foreign one. Because of the strong growth potential in the cloud services industry and less competitive environment created by strict regulations, CANCOM will be able to benefit from these two factors and continuously expanding its cloud solutions revenue in next three to five years.

- **An increasing need for Integrated IT solutions services due to the growing need of a hybrid cloud.** In recent years, companies in Germany have had a strong demand for cloud services; however, due to the nature of some enterprises, a full transformation into the cloud has not been suitable. As a result, most companies prefer to use a hybrid cloud provider. According to Gartner, in Germany 68.8% of the companies will implement hybrid and multi-cloud architecture. Implementing such an architecture requires an IT system integrator to combine the existing system and the cloud system together. Therefore, a growing demand of hybrid and multi-cloud solutions will also increase the demand for an integrated IT solution provider. As one of the largest Integrated IT solution provider in Germany and with 86% of its total revenue comes from integrated IT solution, CANCOM could have a strong upside due to this trend.
- **Increasing needs of IT security in Germany.** The German cyber-security market is expected to grow from $3.71 billion in 2013 to $5.80 billion in 2019 - a CAGR of 7.70% for the period from 2013 to 2019. Most of the demand will be driven by the government regulations and companies' needs for a safer IT system to protect them from cyberattack. CANCOM offers a wide variety of IT security products. With COK's leading position in the industry, it will be easy for CANCOM to expand its customer base for its IT security products.

Valuation

In order to reach an intrinsic value for CANCOM, a five-year DCF was constructed. Using a terminal growth rate of 2% and a WACC of 8.2%, a price target of €60.99 was established. In addition, a ±0.5% sensitivity analysis on terminal growth rate and the WACC was conducted. The price ranged from €49.59-€75.62. In addition, a P/E multiple valuation was conducted using FY 2016 estimated EPS of €1.85 and peer comparable P/E multiple of 28.46x, resulting in a valuation of €52.75. By weighting the two valuation models 70/30, a price target of €58.52 was reached, resulting in a 31.33% upside. CANCOM pays an annual dividend of $0.50, yielding 1.12%.

Risk

- **Risk of losing major customers.** Although CANCOM system has a broad range of customers in different industry, it still has a dependency on large clients in some industries. Therefore, the loss of a major client or reduction in orders from a key client could have significant negative impact on the company.
- **The competition in integrated IT solution from the cloud provider itself.** Currently, CANCOM is the major provider for the integration of companies' existing IT system and cloud service. If the cloud providers starts to provide their own integration service, it will decrease CANCOM's IT solution revenue.

Management

Mr. Klaus Weinmann is the CEO and founder of CANCOM. He successfully transformed CANCOM from a software and hardware supplier to a fully integrated IT Services Provider and Cloud Business Transformation partner. According to the MSCI ESG report, the company's corporate governance and information transparency scores fall into the highest scoring range, which indicate that the company's business practices are generally well aligned with shareholder interests.

Ownership

% of Shares Held by All Insider and 5% Owners:	5.06%	
% of Shares Held by Institutional & Mutual Fund Owners:	54.90%	

Source: FactSet

Top 5 Shareholders

Holder	Shares	% Out
Hauck & Aufhauser Privatbankiers KGaA	1,488,000	9.09
Allianz Global Investor GmbH	1,477,000	9.02
AL KO Neteiligungs GmbH	819,000	5.00
Invesco Asset Management Ltd.	545,000	3.33
Threadneedle Asset Management Ltd.	486,000	2.97

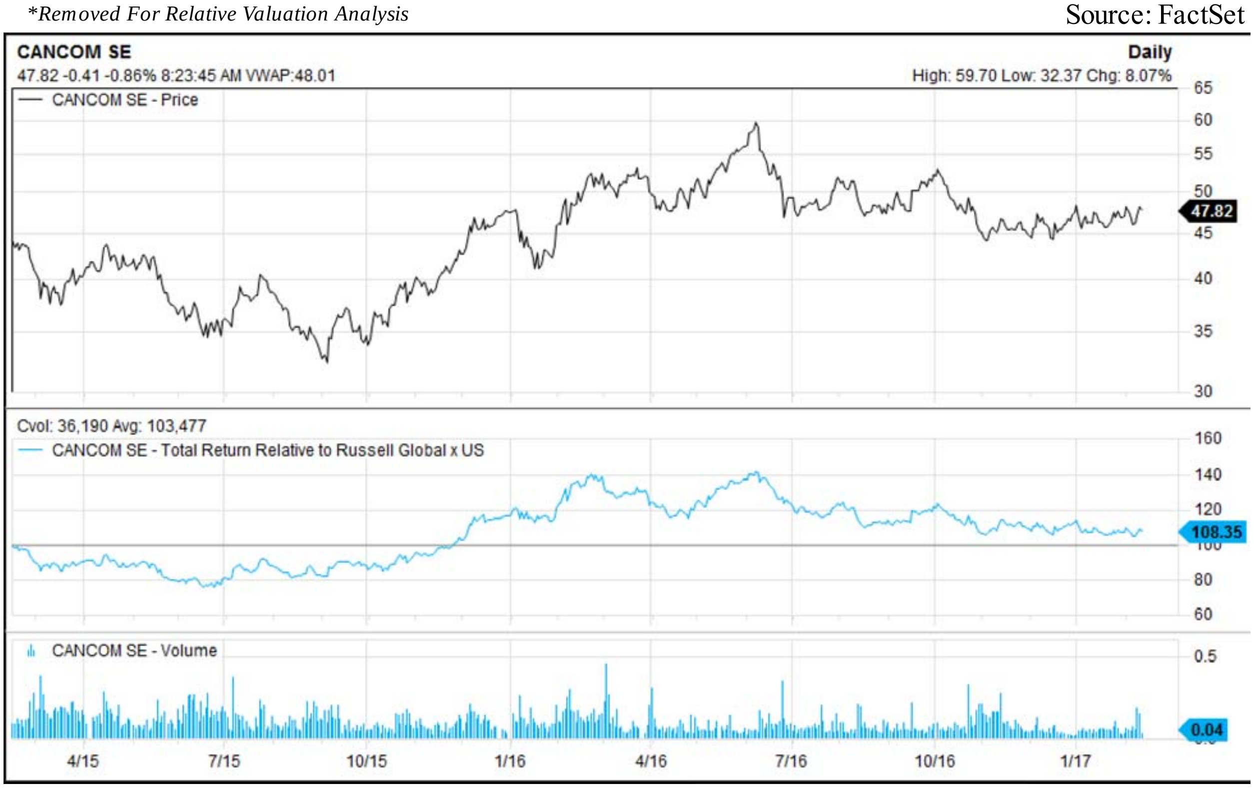
Source: FactSet

Peer Analysis

Name	Ticker	Market Cap (mil)	D/E	Sales Growth 5yr	P/E	EV/ EBITDA
CANCOM SE	COK-DE	789	18.90%	47.0%	16.81	9.94
Bechtle	BC8-DE	2,162	9.40%	14.4%	19.17	12.62
NTT Com Security	AAGN-DE	na	na	na	na	na
SQS Software Quality Systems	SQS-GB	244	57.10%	34.5%	28.89	8.67
Insight Enterprises, Inc.	NSIT	1,603	53.90%	6.1%	20.26	9.92
Cap Gemini SA	CAP-FR	14,103	60.90%	6.3%	10.49	9.11
Peer Averages		4,528	45.3%	15.33%	19.70	10.08

**Removed For Relative Valuation Analysis*

Source: FactSet



Banc of California, Inc. (BANC)
February 17, 2017
Brendan Hopkins Financial Services

Banc of California, Inc. (NYSE: BANC) operates as a multi-bank holding company, which engages in the provision of retail deposits from the general public and invests in consumer, commercial, and real estate secured loans. The bank operates through the segments of Commercial Banking, Financial Advisory, Mortgage Banking, and Others. The Commercial Banking segment consists of retail banking, commercial banking, private banking, financial institutions banking, residential portfolio lending, commercial real estate, multifamily lending, construction and rehab lending, commercial specialty finance, and warehouse lending. The company operates over 100 banking offices in California and the West and was recently recognized by Forbes for the second straight year as one of the top 100 Best Banks in America. Founded in March of 2002, the company has over 1,700 employees and is headquartered in Irvine, CA.

				FY: Dec	2016A	2017E	2018E	2019E
Price ($): (2/9/17)	18.82	Beta:	0.811					
Price Target ($):	23.04	WACC	5.9%	Net Interest Income	325.47	362.92	405.15	433.79
52Wk H-L ($):	23.23 - 10.93	M-Term Rev. Gr Rate Est:	5.4%	% Growth	45.48%	11.51%	11.64%	7.07%
Market Cap (mil):	1,005	M-Term EPS Gr Rate Est:	7.9%	Div. Per Share ($)	0.49	0.49	0.53	0.53
Float (mil):	0.92	LT Debt/Total Assets	6.65	EPS (Cal)	$1.94	$2.78	$2.89	$3.44
Short Interest (%):	28.26	ROA:	1.2%	P/E (Cal)	8.9	8.3	8.0	6.7
Avg. 3 Month Vol:	1,663	ROE:	14.1%	BVPS	35.82	28.11	26.96	28.57
Dividend ($):	0.49	Dividend Payout Ratio:	25.3%	P/B	1.55	1.22	1.17	1.24
Yield (%):	2.60%	Tier 1 Capital Ratio:	13.2%					

Recommendation

The Banc of California must continue to utilize their guiding principles in order to stay true to their mission and vision of being California's bank. In order to accomplish this task, BANC has established four pillars as the foundation of their business and these include responsible and disciplined growth, strong and stable asset quality, focus and optimization, and strong corporate governance. The bank had a successful 2016 as they reached a milestone in $10B in assets, showed steady progress in EPS and net income, exceeded their stated financial targets in both ROE and ROA, optimized their balance sheet, reduced risk in their portfolio, and efficiently redeployed capital to support their business. In order to clean their balance sheet, the firm divested their Commercial Equipment Finance division worth $243M in loans, sold $604M of season mortgage loans at a premium of BV, and because of decisions like this, they were able to reduce nonperforming assets by 51%, delinquent loans by 42%, and their TDR portfolio by 59% just in 4Q16. Based upon BANC's management capabilities and focus, their strict enforcement of changing corporate governance, and their mission to become the bank of improving economic state of California, it is recommended that BANC be added to the AIM equity fund with a price target of $23.04. The stock offers a 2.60% dividend yield.

Investment Thesis

- **Company Vision & Current Market Opportunities.** The regional-Pacific banking landscape has experienced significant shifts in recent years as large scale M&A's have occurred by out-of-state institutions and large players in the market have relocated their headquarters from San Francisco to New York. This change in competition has provided BANC the opportunity to expand their operations through the newly available clients, employees, communities, and businesses. With these opportunities, the company is determined to realize its mission and vision of becoming California's bank through empowering the diverse businesses, entrepreneurs, and communities within the region. The bank has stated their aspirations to collaborate with groups within this underserved market by sharing their clients' values and containing the same passion about their businesses and lives.

- **Efficiency, Scalability, and Focus on De-Risking Business.** Coupling the company's mission with being the only full-service mid-sized bank focused exclusively on California, BANC finds itself in a unique position in which it can truly utilize its size, people, products, and balance sheet to reach clients and provide them with enough resources and expertise to develop long-term partnerships. With this in mind, the bank has gone through the process of de-risking their loan portfolio, which includes retreating from the mortgage sector and winding down certain lending activity. Utilizing the capital received from the sale of business activities or loans, BANC has redeployed their capital effectively back into their spread-based revenue businesses of loans and deposits. In the past quarter, the company was able to improve their spread income, fee income, credit quality, and manage a lower tax rate because of management tactics, but higher expenses offset most of these moves. Moving forward, management is optimistic and intends to continue to grow and expand their operations, but with greater discipline and a sharper focus on scalability and efficiency.
- **Improving Corporate Governance.** Despite the change in leadership and SEC investigation, BANC remains steadfast on their "mission and vision of being California's bank". Following the resignation of the CEO/Chairman of the Board, Steven Sugarman, the company is taking steps to enhance their corporate governance. Some key guidelines they plan to implement include the separation of power and compensation between the CEO and chairperson positions, and restrictions of future related-party transactions. Recently, they added Richard Lashley to the board of directors and this is a statement as Lashley has strongly criticized the bank's corporate governance failings and will more than likely enforce stricter guidelines.

Valuation

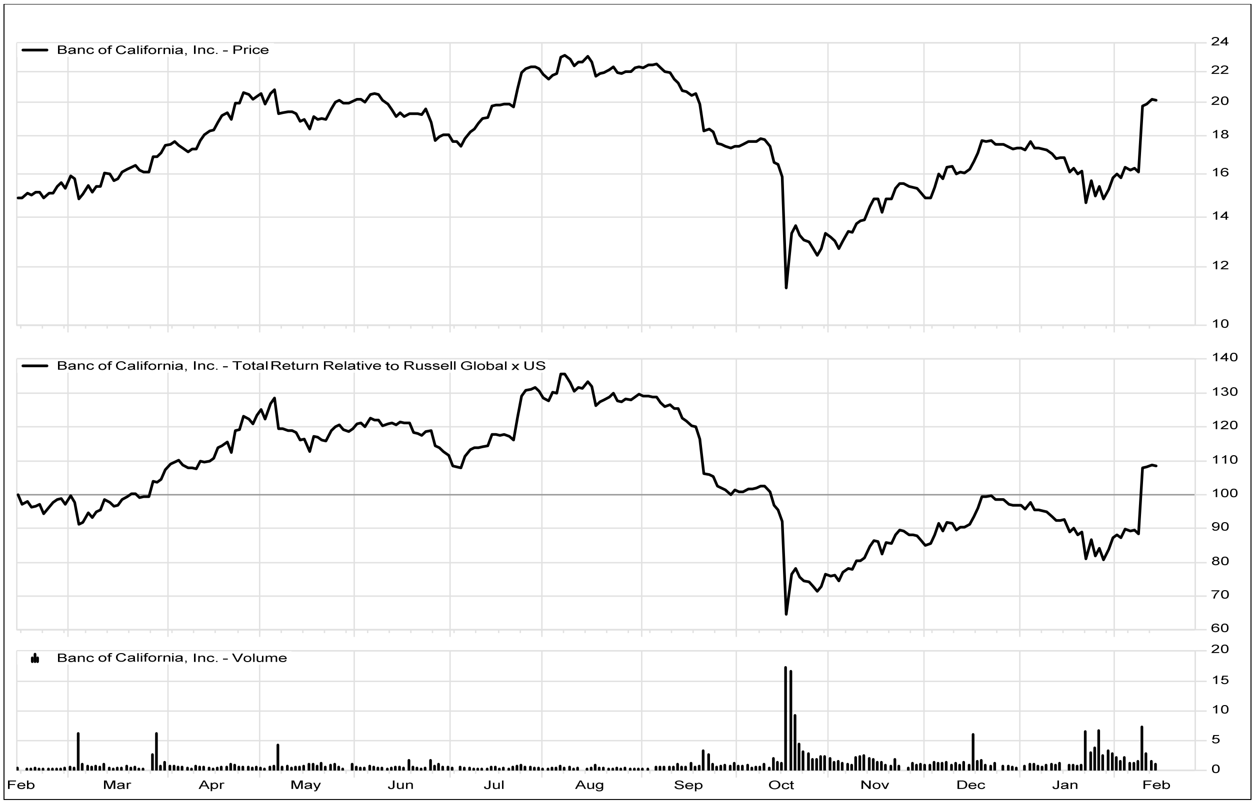
Utilizing a blended historical and peer price-to-earnings (P/E) average, a historical peer price-to-book value (P/BV) and a dividend discount model (DDM) resulted in an intrinsic value of $23.04. For the DDM, a cost of equity of 8.4% and a terminal growth rate of 4.2% yielded a value of $23.79. A sensitivity analysis of the cost of equity and terminal growth rate produced a range of $20.39 – 29.40. Following this method, a current and historic blend of the company's four peers was used and P/BV multiple of 1.41X was achieved leading to a valuation of $20.02. Finally, a current and historic blend of the company's four peers was again used and a P/E multiple of 9.79X was achieved leading to a valuation of $25.30. Weighing the P/E multiple, DDM, and P/BV all equally, a price target of $23.04 was established representing a 22.41% upside. GBDC also paid a $0.49 dividend in 2016, yielding 2.6%

Risks

- **Litigation Risk.** During October 2016, the financial news website *Seeking Alpha* released an article raising questions about related-party transactions and indicating a connection between BANC executives and Jason Galanis, a fraudster who is currently incarcerated in New York. This news caused the stock to drop ~30% and attracted attention of regulators to investigate the issue. Although an independent investigation performed by law firm WilmerHale concluded that there was no violation of law, the ruling of the SEC has still not occurred so legal expenses are anticipated in 1Q16.
- **Management Make-Up.** Other than the result of SEC investigation, the most important upcoming event is the filling of the CEO role. Sugarman, the ex-CEO, grew the company by 10X and brought BANC to the level it is at today. The decision on who runs the bank next will have a profound impact on the stock's performance and how the bank will be perceived by their market.

Management

Following the resignation of former-CEO, Steven Sugarman, the board of directors have established a committee to find a replacement for this position. The board does not find the need to frantically make a decision regarding this and has stated their current management team will continue to represent the bank and work toward their mission of growing and becoming California's bank. Hugh Boyle, current Chief Risk Officer, has been placed as Interim CEO for the time being.



Ownership

% of Shares Held by All Insiders:	8.23% ▼
% of Shares Held by Institutional & Mutual Fund Owners:	105.69% ▲

Source: FactSet

Top 5 Shareholders

Holder	Shares		% Out
BlackRock Fund Advisors	5,294	▲	10.68
The Vanguard Group, Inc.	5,222	▲	10.54
PL Capital Advisors LLC	3,402	▲	6.86
Patriot Financial Manager Lp	2,851	▲	5.75
SSgA Funds Management, Inc.	2,845	▲	5.74

Source: FactSet

Peer Analysis

Name	Ticker	Market Cap (mil)	Div. Yld.	P/E	ROE
Banc of California, Inc.	BANC	1,005	2.6%	8.94	14.14
BofI Holding Company	BOFI	1,922	0%	9.57	19.60
Pacific Premier Bancorp, Inc.	PPBI	1,106	0%	24.21	10.58
Riverview Bancorp, Inc.	RVSB	174.9	1%	15	6.00
Provident Financial Holdings, Inc.	PROV	149.7	2.8%	20.8	5.44
Peer Averages		838.2	1.0%	17.4	10.4

**Removed For Relative Valuation Analysis*

Source: Factset

DAVIDsTEA, Inc. (DTEA)
February 17, 2016

Austin Righeimer International Consumer Discretionary

DAVIDsTEA, Inc. (NASDAQ: DTEA) operates as a beverage company, selling tea and tea related products. Tea selections include everything from black, green, and herbal to rooibos and oolong tea. As for accessories, customers can choose from a wide variety of tea mugs, travel mugs, teapots, teacup sets, infusers and filters, kettles and frothers, tins and spoons. Founded by cousins David and Herschel Segal, the first store was opened in 2008 on Queen Street in Toronto, Canada and still operates today. In 2011, the company opened its first store in the United States and now there are over 200 stores spread between the two countries. 86.4% of revenue is derived from Canada – with the United States is responsible for the remaining 13.6%. In regards to product segments, FY2015 revenue was divided 66.4%, 23.9%, and 9.7% between loose leaf tea, tea accessories, and ready-to-drink tea, respectively. The company is headquartered in Montreal, Canada.

Price ($): (2/15/17)	7.15	Beta:	0.72	FY: Jan	2015	2016E	2017E	2018E
Price Target ($):	9.51	WACC	10.2%	Revenue (Mil)	139.39	164.50	185.50	217.80
52WK H-L ($):	6.30-14.30	M-Term Rev. Gr Rate Est:	13.7%	% Growth	9.44%	18.01%	12.77%	17.41%
Market Cap (mil):	173	M-Term EPS Gr Rate Est:	30.5%	Gross Margin	49.19%	51.30%	51.50%	51.90%
Float (%):	31.8	Debt/Equity:	X	Operating Margin	8.58%	9.30%	10.50%	11.90%
Short Interest (%):	8.40%	Debt/EBITDA (ttm):	X	EPS (Cal)	$ (5.13)	$ 0.36	$ 0.43	$ 0.68
Avg. Daily Vol (mil):	0.13	ROA:	-113.5%	FCF/Share	$ (0.05)	$ (0.04)	$ 0.09	$ 0.38
Dividend ($):	0.00	ROE:	-213.0%	P/E (Cal)	N/A	20.1	16.7	10.5
Yield (%):	0.00%	ROIC:	-146.9%	EV/EBITDA	8.2	6.8	6.0	5.1

Recommendation

With tea currently representing a $12 billion market in the United States alone and $37 billion globally, DAVIDsTEA is the new industry player from Montreal. The large and growing beverage market is not just due to baby boomers – according to the Tea Association of the U.S.A. Inc., 87% of millennials drink tea. Global industry sales have been growing at a rate of 7-8% annually since 2014. Teavana, owned by Starbucks, is DAVIDs largest loose-leaf tea competitor but that has not seemed to slow down their top-line growth. Before the USD conversion, revenues for DTEA have grown at a CAGR of 24% since 2012 due to strong same store sales comps as well as store expansion. Through Q3 2016, DTEA has seen 29 consecutive quarters of positive comp sales growth. In terms of expansion, DTEA has gone from 70 stores in FY2011 to 193 stores as of FY2015. Visions for the future include the potential to open up an additional 325 stores in the U.S. (37 currently) and 74 more in Canada (156 currently). While competition is fierce in the U.S., DTEA believes that their engaging in-store customer experience, including hundreds of teas along the wall with "tea guides" to help you choose, will keep both new and seasoned tea drinkers coming back. Because of their impressive top-line growth and future profitability, it is recommended that DAVIDsTEA be added to the AIM International Fund with a target price of $9.51, representing a 33.1% upside.

Investment Thesis

- **Tea consumption isn't slowing down.** Like any other retailer, top line growth is a necessity for DAVIDs. Not only is DTEA generating high growth, but tea consumption in the U.S. remains on the rise. As an alternative to coffee and soda, offering healthy benefits that can reduce risks in certain diseases (e.g. colon cancer in men by 70%), Americans are making the switch to tea. Consumption is forecasted to increase by a CAGR of 5-6% over the next 4 years in the United States. This lines up with DAVID's philosophy of expanding further into the U.S., eventually growing to over 350 stores, outnumbering stores in Canada.
- **Organic growth.** As mentioned previously, DAVIDsTEA has had positive sales comps for 29 straight quarters, including comps of 6.6% in fiscal 2015, 11.1% in fiscal 2014 and 17.8% in fiscal 2013. That metric is vital in this industry and management predicts having middle digit

sales comps for the foreseeable future. Each new store takes an investment of around $400,000 to provide annual sales (FY2015) of nearly $750,000. While this is a solid number, same store sales growth makes that investment even more worthwhile. DTEA believes thoughtful placement in HRIs (hotels, restaurants, and institutions) will be a safe bet that will support sales comps growth with traffic to these locations. The Tea Association of Canada estimates that 550 million cups of tea are consumed at HRI locations annually.

- **Thriving off e-commerce movement.** One thing that Interim CEO Christine Bullen does exceptionally well is consumer research and e-commerce, a task she took on during her time at Lindt. Currently comprising 10% of DTEA's revenues, e-commerce is predicted to make up 15% of sales in the long term, according to recent guidance from management. The sales comps mentioned above take e-commerce into account and management looks for the same growth from their online platform. In a world where shoppers are doing more and more purchasing online, especially for items with long shelf-lives like loose-leaf tea, it's a good sign that DAVIDsTEA is staying on top of trends.

Valuation

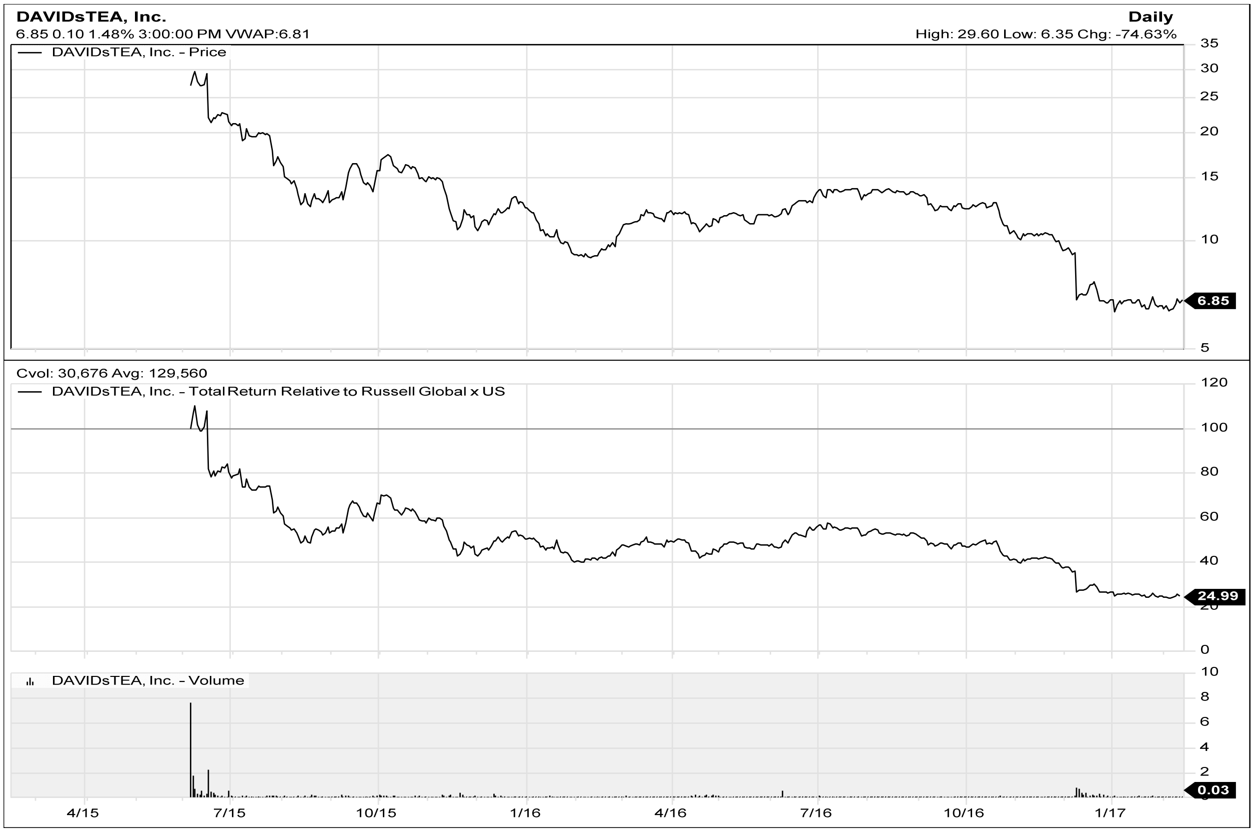
In order to find an intrinsic value for DTEA, a five year DCF model was built. Using a WACC of 10.23% and a terminal growth rate of 2.85%, an intrinsic value of $8.41 was reached. A sensitivity analysis expressed a range from $7.88-9.29. As well as the DCF, an EV/EBITDA multiple valuation was calculated using a 2016 EBITDA estimate of $21.94 million and a peer comparable multiple of 12.16x. This resulted in a valuation of $12.81. Weighing the DCF and EV/EBITDA 75/25% respectively, the price target was found to be $9.51, resulting in a 33.1 % upside.

Risks

- **Shaky Management changes.** As he announced in October, Sylvain Toutant left DTEA at the end of FY2016 for personal and familial reasons. As the President and CEO of the company since May 2014 and with previous experience at Keurig Green Mountain Inc., Toutant had expert knowledge of the beverage industry and will be missed. Christine Bullen has been named Interim President and CEO of DTEA and no announcement has been made regarding her eventual replacement.
- **Growth in the United States market.** During the Q32016 earnings call, former CEO Toutant discussed the closing of 10 locations in the United States due to underperformance. While he attributed this to poor store placement with weak foot traffic, he also mentioned that DTEA is still testing the best methods to increase U.S. sales. The company is currently testing a new strategy in the Boston market and will implement it throughout the U.S. if it is successful. Without U.S. sales growth, DTEA will have a hard time making sense of their large investment here.
- **Renegotiation of NAFTA.** As a company domiciled in Canada with entities in the United States as well, NAFTA provides DTEA with certain luxuries pertaining to imports or transfer pricing on goods. With President Trump announcing his plans to renegotiate the trade deal in North America, DTEA could see itself facing stiffer tariffs and less breaks while recording intercompany transactions to their U.S. locations as a multinational entity.

Management

Christine Bullen is the Interim President and CEO of DAVIDsTEA. She assumed this position on February 1, 2017 and will hold it indefinitely. Previously, she was with Swiss-based chocolate manufacturer Lindt & Sprungli for ten years, leading the Direct-to-Consumer and Specialty channels for the U.S. after she spent time developing sales and profitability for retail and ecommerce. CFO Luis Borgen has been with DTEA for five years while CAO Howard Tafler owns the longest tenure in the executive suite, working with the company since 2010.



Ownership

% of Shares Held by All Insider Owners:	67.80%
% of Shares Held by Institutional & Mutual Fund Owners:	30.95%

Source: FactSet

Top 5 Shareholders

Holder	Shares	% Out
TDM Asset Management Pty Ltd.	2,377,058 ▲	9.50
Fidelity Management & Research Co.	1,696,700 ▼	6.78
FIAM (Canada) ULC	1,315,328 ▼	5.26
William Harris Investors, Inc.	726,074 ▲	2.90
Wasatch Advisors, Inc.	362,013 ▼	1.45

Source: FactSet

Peer Analysis

Name	Ticker	Market Cap (mil)	Sales (mil)	EBITDA	Dividend Yield	EV/EBITDA
DAVIDsTEA	DTEA	173	139.39	17.79	0.00	8.20
Coffee Holding Co, Inc.	JVA	26	78.90	3.39	0.00	9.07
Bridgford Foods Corp.	BRID	106	140.10	13.88	0.00	7.20
Inventure Foods, Inc.	SNAK	123	282.60	6.90	0.00	34.71
Natural Grocers	NGVC	276	705.50	45.91	0.00	7.36
SkyPeople Fruit Juice	SPU	26	86.40	20.24	0.00	5.02
Peer Averages		111	259	18.1	0.00	12.67