



Date: 11/9/2020
 Company Ticker: E.L.F.
 Sector: Consumer Staples
 Industry: Cosmetics

Forward P/E: 30.8
 Sector Forward P/E: 20.8
 Market Price: 21.93
 Target Price: 19.97

Recommendation: Sell

Company Summary

E.l.f. Beauty, Inc., formerly J.A. Cosmetics Holdings, Inc., conducts its business under the name e.l.f. Cosmetics. It offers beauty products for eyes, lips, face, and skin care. The company sells its products through direct-to-customer channels, which include e-commerce, e.l.f. Stores, and other retail stores in the U.S.; and internationally through distributors. Some e.l.f.'s major retail stores customers include Target, Walmart, & Ulta Beauty. It is based out of Oakland, CA and has approximately 270 employees.

Industry Outlook

The cosmetics industry has faced serious headwinds related to COVID-19 as consumers have been forced to quarantine due to government mandated lockdowns. This has resulted in a decrease in the sector's revenue as store traffic has been disrupted and consumers have less disposable income and fewer occasions to wear makeup. E.l.f.'s growing e-commerce platform and ability to continue to attract a younger customer segment has provided stability in the face of the downturn.

Earnings Forecast

Year	FY 2019A	FY 2020A	LTM Ending 6/30/20	FY 2021E	FY 2022E	FY 2023E	FY 2024E	FY 2025E
Revenue	267,656	282,851	287,614	290,488	315,470	331,243	344,493	356,550
COGS	104,632	101,728	100,341	110,385	123,033	129,185	134,352	139,055
Gross Profit	163,024	181,123	187,273	180,103	192,437	202,058	210,141	217,496
SG&A	137,669	157,155	165,432	152,409	163,939	170,480	175,576	179,939
Restructuring (income) expense	22,200	(5,982)	(4,190)	-	-	-	-	-
Operating Income	3,155	29,950	26,031	27,694	28,498	31,579	34,565	37,557
Other income (expense)	200	426	26	-	-	-	-	-
Interest expense, net	7,700	6,307	6,100	5,560	5,560	5,560	5,560	5,560
Income before taxes	(4,345)	24,069	19,957	22,134	22,938	26,019	29,005	31,997
Income taxes	1,300	(6,185)	(4,328)	(4,648)	(4,817)	(5,464)	(6,091)	(6,719)
Net Income	(3,045)	17,884	15,629	17,485	18,121	20,555	22,914	25,278
EPS	(\$0.06)	\$0.37	\$0.31	\$0.34	\$0.36	\$0.40	\$0.45	\$0.50
Basic Shares Outstanding	48,022,926	48,498,813	50,721,893	51,033,310	51,033,310	51,033,310	51,033,310	51,033,310

Drivers								
Revenue Growth		5.7%	1.7%	2.7%	8.6%	5.0%	4.00%	3.50%
Gross Margin	60.9%	64.0%	65.1%	62.0%	61.0%	61.0%	61.0%	61.0%
SG&A Margin	51.4%	55.6%	57.5%	52.5%	52.0%	51.5%	51.0%	50.5%
Effective Tax Rate	29.92%	25.70%	21.69%	21.0%	21.0%	21.0%	21.0%	21.0%
D&A as % of Sales	15%	8.1%		13.1%	12.6%	12.1%	11.6%	11.1%
Interest exp as % of avg debt	5.2%	4.4%		4.8%	4.8%	4.8%	4.8%	4.8%

E.l.f. is expected to experience top line growth of mid single digits through the projection period, translating to consistent growth in EPS as margins remain relatively consistent to pre-pandemic levels. We are projecting FY 2021 EPS of \$0.34 which is slightly bearish compared to analyst estimates of \$0.45. The major boost in top line growth is expected to come in FY2022 as the company launches a new skin care product line which will be in partnership with the singer Alica Keys. This partnership is another effort to connect with millennial and Gen-Z customers and growth their market share in the cosmetics industry.

Valuation

Valuation					
Year	2021E	2022E	2023E	2024E	2025E
Net Income	17,485	18,121	20,555	22,914	25,278
Plus D&A	38,186	39,893	40,231	40,118	39,739
Less Change in NWC	(3,957)	(5,321)	(2,846)	(2,390)	(2,175)
Less Capital Expenditures	(8,000)	(7,000)	(6,000)	(6,000)	(6,000)
Plus change in debt balance	0	0	0	0	0
FCFE	43,715	45,693	51,940	54,641	56,842
Terminal Value					1,223,689
Sum of Discounted FCFE	198,043				
Discounted Terminal Value					821,059
Equity Value	1,019,102				
Shares Outstanding	51,033,310				
Share Price	\$19.97				

We expect long term growth of 3.5% for e.l.f. following the projection period ending in FY 2025. The discount rate of 8.3% was calculated using a forward industry P/E multiple of 20.8x next twelve months earnings and a 3.5% growth rate. Changes in NWC were calculated using historical ratios including accounts receivable days, inventory days, and accounts payable days while other current assets and other current liabilities were calculated as a percentage of sales. Capital expenditure projections and debt repayments were modeled using company guidance pulled from either earnings transcripts, SEC filings, or other equity research reports. Depreciation and amortization was modeled in line with historical data as a percentage of sales.

Sensitivity Analysis

Discount Rate: The table below shows the effect on the stock price of changes in the discount rate in 0.50% increments. We recommend considering the area highlighted in gray as we believe a half percent turn on both ends of the calculated discount rate captures the most accurate valuation.

Long Term Growth Rate: As there was not an obvious driver for the model within the projection period, we decided to also sensitise the stock price based on the long term growth rate. With e.l.f.'s focus on e-commerce sales and digital customer engagement, the growth rate outside of the projection window could end up being higher than 3.5%. The growth rates in the sensitivity table were given a quarter percentage turn on both sides of 3.5%

Sensitivity Analysis		Long Term Growth Rate		
		3.25%	3.50%	3.75%
Discount Rate	6.8%	27.30	29.12	31.24
	7.3%	23.91	25.27	26.82
	7.8%	21.26	22.31	23.49
	8.3%	19.14	19.97	20.89
	8.8%	17.40	18.07	18.81
	9.3%	15.94	16.50	17.10
	9.8%	14.71	15.17	15.67
	10.3%	13.65	14.04	14.47

Conclusion

We recommend selling our position of 900 shares in e.l.f. Our model shows the company is currently overvalued, and trading more like a growth stock than a value stock on a multiples basis. The sensitivity analysis shows that when growth slows or cash flows are discounted with more risk, it provides a more compelling argument for exiting. This investment has provided strong returns for our portfolio, and we believe it is time to realize them.