An Equity Note

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- *Five Below (FIVE)*
- *Target (TGT)*
- *Walmart (WMT)*
- *TJ Maxx (TJX)*
- *Amazon (AMZN)*
- *Costco (COST)*

Equity Note: Five Below (FIVE) is An Emerson Milkshake

Five Below (FIVE) is a teens-and-tweens discount retailer offering unique (read: trendy/fad) products in various categories like Sports, Style, Tech, Crafts, Party, and Candy.

We wrote about FIVE in March 2021 during our "Market Crash Shopping List" *Note,* which you can read here.

This week has been a nightmare for *any* retail stock. Target (TGT) is down 30%+, and Walmart (WMT) saw its market cap decline by 20%. Even Charlie Munger's darling Costco (COST) fell nearly 18%.

FIVE also sustained some damage, ending the week down 20%+.

Here's the good news. The stock now trades below our March 2021 Market Crash Shopping List price while the long-term fundamental drivers of the business remain strong.

During this note, we'll examine the bull case for FIVE over the next few years and why it's structurally insulated from both online and offline competition.

We'll also run FIVE through our Emerson Milkshake Framework, a concept we introduced last week (read here if you missed it). I learned *a ton* from doing this exercise, and I know you will too.

Here's why you should care about FIVE. The company is well insulated from nearly every competitor and generates 150% per-store ROICs at 24% EBITDA margins. Today, the stock trades at ~10x 2025E EPS.

In other words, the current price allows investors to benefit from both earnings *and* multiple expansions and a chance to nearly double our money in 4-5 years.

Excited yet? Let's get after it!

Five Below (FIVE): Riches in Niches

FIVE is a discount retailer that sells trendy/fad items for $5 or less (they released a new $5 Beyond section this year).

FIVE is the only retailer obsessed with the teens-and-tweens demographic. Stores cater to that demographic with spunky store designs, open concepts, and eight distinct product categories (see below).

Each store is ~9,000 square feet and houses ~4,000 SKUs. Shoppers usually spend $150 per year buying ~60 items over 10 trips.

FIVE is a testament to "riches in niches." Since its IPO in 2012, the company has 10x'd revenues while expanding its store count from 244 to 1,200 (as of 2021).

There are five (no pun intended) main factors to FIVE's success and competitive insulation:

1. Target Customers

FIVE's main customers (teens and tweens) provide a distinct advantage against other retailers like Target and Dollar General.

Tweens don't voluntarily suggest Target for themselves. They're usually with mom or dad getting what mom or dad wants. Maybe the parent remembers to check the toy aisle. But to the kid, it feels like an afterthought.

Kids also don't want to shop at Dollar General or Dollar Tree stores. The stores look depressing and rarely have items kids actually want (unless your kid wants laundry detergent or soap).

The very nature of FIVE's target customer insulates it from competitors.

2. Products

The company focuses on three main "trends" in its eight product categories: **Craze**, **Licensed & Brand,** and **Relevancy**.

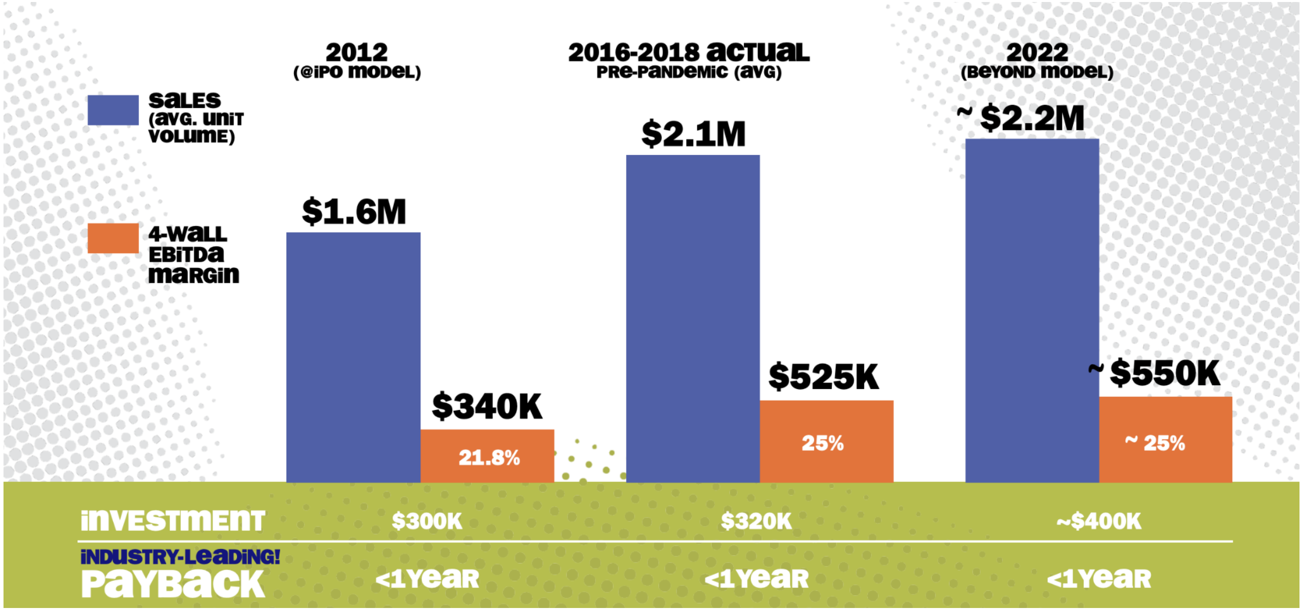
FIVE doesn't *set* or *bet* on trends. Instead, they identify hot trends and distribute such products across its 1,200 stores.

Customers love FIVE's products because it offers a treasure-hunt experience on "must-have" cultural/societal items (think Fidget Spinners, Rubber Band animals, etc.) that other retailers can't / won't stock at scale.

Additionally, FIVE can command lower prices on fast-trending items because vendors *know* FIVE's customers will buy instead of *hoping that* competing retailers will purchase them.

3. Unit Economics

FIVE boasts industry leading unit economics. Each store costs ~$350K to build. New stores generate ~$550K in EBITDA at 25% margins within their first year.



That means FIVE generates 150%+ new store ROICs and a payback period of <1 year.

Because each new store generates so much profit quickly, FIVE can open more stores with greater frequency than its competition without tapping financial markets for assistance.

4. Store Locations/Experiences

Various Tegus calls indicate that FIVE has the industry's leading real estate team. This makes sense as most of the company's core team remains there today. The secret to FIVE's location strategy is proximity to where *mom* shops.

FIVE purposely builds stores next to high-traffic shopping areas like Target, TJ Maxx, and grocery stores. Such locations make it *easy* for parents to treat their kids to a unique shopping experience.

And FIVE's shopping experience is unique. You can see the store layout below.

Bright colors, loud fonts, and hip music bleed throughout the store. There's even a "Dribble Area" where kids (are encouraged to) play with basketballs, footballs, and other items before they buy.

Everything in the store is about tweens and teens.

The in-store experience is vital because kids feel like it's *their* store. They can't get that from Target or Dollar Tree. It *feels* different asking your child, "Are you ready to go to Five Below?!" versus "Are you ready to go to Dollar Tree?"

5. Low Prices

The last – but arguably most important – differentiator is FIVE's commitment to low prices. Low prices are beneficial for a few reasons. Most of FIVE's items are discretionary purchases of trendy things for kids. These aren't the most durable items. But if you pay $5-10 for it, who cares if it breaks?

Two, low prices allow tweens to buy what they want, and parents can treat their kids without breaking the bank. Parental reviews show that though parents enter the store expecting 1-2 purchases, they leave with 5-7 items.

Finally, FIVE's low prices insulate it from online competitors like AMZN. Most of FIVE's products are (to steal Cliff Sosin's phrase) "Un-Amazonable," as the price of FIVE's average product makes shipping the item uneconomical for online retailers.

Scaled Economies + Social Media = Call Option on Trends

FIVE currently operates 1,200 stores as of 2021. Management thinks they can reach 3,500 by 2025. Growing store count provides all the scaled economy benefits you'd expect like lower per-unit SG&A spend, greater leverage on vendor pricing, and reduced logistics costs with more distribution centers, among other things.

However, one thing investors aren't talking about is FIVE's ability to use social media to spot and distribute on-trend items at scale. Gen Z and Millennials are increasingly shopping on platforms like TikTok.

These platforms create trends and fads at a lightning pace. More stores allow FIVE to better distribute these "faster" trends at scale, increasing revenue and profits over time.

Valuation

I never thought FIVE would trade where it is today at ~8x 2026E EBIT. The company outlined a clear path towards 17% store-count growth and 20% sales growth through 2025.

Also, FIVE should increase its competitive advantage if the US heads into a recession. Consumers will trade down but won't stop showing their kids they love them.

FIVE should generate nearly $1B in EBIT by 2026 if they're remotely right on store count growth and revenue growth. Since its IPO, FIVE has traded at an average of 27.5x EV/EBIT. **Assume a 25x multiple of 2026 EBIT, and you get ~$22B in shareholder value or nearly $400/share.**

Next, we'll run FIVE through our Emerson Milkshake Framework and see how customers "hire" FIVE to get jobs done.

Running FIVE Through Our Emerson Milkshake Framework

FIVE has two target customer groups: **teens and tweens** and **parents**. Let's see how each customer group answers our core *Jobs To Be Done* questions.

Question 1: What is the job to be done?

Teens-and-Tweens: I want the cool, trendy stuff all my friends have/that I see on Instagram/TikTok, and I want to buy it myself.

Parents: I want to show my kids that I care about them and help them fit in without breaking the bank.

Question 2: What are the experiences in purchasing, using, and living with the product we need to provide to get the job done?

Teens-and-Tweens: A store dedicated to my interests that offers everything trending in my age range. A vibrant "treasure hunt" shopping experience where you find things you didn't know you wanted. Wide assortment of evergreen and fad-products. Low prices for buying what you wish to with allowance/summer job earnings.

Parents: It is a store dedicated to my kids' interests, so it feels like their unique shopping experience. The stores should be located near where I usually shop for groceries or other household items, so I don't have to go out of my way. Low prices because I know my kids won't care about these products in 3-6 months.

Question 3: What and how must we integrate to create the best mousetrap?

FIVE integrates both customer group experiences into an Emerson Milkshake. The company puts stores next to high-traffic places like Target and grocery stores, so parents can quickly drop in on their weekly shopping runs.

FIVE sells nearly all its products for $5 or less. This accomplishes two things. It allows parents to show kids they care without breaking the bank. And two, parents don't have to worry if their children stop using the product (it was only $5!).

Teens-and-tweens love FIVE because it feels like *their* shopping trip, not an afterthought on mom's grocery run.

Kids can roam free in FIVE stores because everything there is *for them* and *only them* increases the treasure-hunt shopping experience. Parents don't have to worry about their kids wandering into more adult shopping sections.

Finally, prices are low enough that kids can buy what they want with their money.

FIVE's Actual Competitive Landscape

Teens-and-Tweens: Niche products that friends use to fit in like shoes or clothing brands. FIVE also competes with music, movies, and TV shows for cultural relevance (Marvel films, etc.). They also compete with virtual worlds like Fortnite and Roblox as tweens fit in by purchasing "skins" for characters and items for their Roblox creations.

Parents: FIVE doesn't *actually* compete against other retailers like Target or discount retailers like Dollar Store. Instead, it competes against experiences like taking kids to sporting events, concerts, parks, or sleepovers.

The company also competes against other low-cost treats like ice cream and pizza.

The Three-Legged Stool Score

Now we can rank FIVE based on our Three-Legged Stool Score (1-5):

- **Stool 1: The quality of the mousetrap (product/service)**
- **Stool 2: The quantity of the economic value extracted (business model)**
- **Stool 3: The discount embedded in the current market price (ROI)**

FIVE's product/service for tweens-and-teens is unmatched in the retail space *and* against online competitors. Stool 1 gets a **5**.

The company generates 150% ROICs with every new store build and ~25% incremental EBITDA margins. FIVE knows how to profitably extract some of the value they create. Stool 2 gets a **5**.

Finally, today's ~10x 2025E EBIT price makes FIVE a great business at a **cheap** price. Stool 3 gets a **4.5**.

Final score = **14.5/15**

Portfolio Updates

Buys

- **BOUGHT** Starter Long in Micron (MU)
- **BOUGHT** Bonds (ZBM2022)
- **BOUGHT** Second-Leg Tactical in Square (SQ)
- **BOUGHT** Starter Long in Tidewater (TDW)
- **BOUGHT** Tesla (TSLA) Dec 2022 $350 Puts
- **BOUGHT** Second-Leg Tactical in Pantheon Resources (PANR.LSE)

Sells

- **SOLD SHORT** Second Leg in Ethereum (ETHUSD)
- **SOLD** Remaining Yellow Cake (YCA.LSE) Long
- **SOLD** Half of US Dollar (DXM2022) Long for Profits