Aeropostale Inc.

"Aeropostale, Inc. (together with its wholly-owned subsidiary, Aeropostale West, Inc., the "Company" or "Aeropostale") is a mall-based specialty retailer of casual apparel and accessories for young women and young men. The Company provides customers with a focused selection of high-quality, active-oriented, fashion basic merchandise at compelling values. Aeropostale maintains complete control over its proprietary brand by designing and sourcing all of its merchandise. The Company's products can be purchased only in its stores, or organized sales events at college campuses. The average store size of approximately 3,500 square feet is generally smaller than that of its mall-based competitors and the Company believes that this enables it to achieve higher sales productivity and project a sense of activity and excitement. As of November 1, 2003, the Company operated 460 stores in 41 states."

Aeropostale has grown steadily since it became independent in 1998 from Federated Department Stores, Inc. the parent of Macy's. Number of open stores increased from 119 in Aug 1998 to 367 in the fiscal year 2002. By Nov 2003 the total number of open stores stood at 460.

Aeropostale	1998	1999	2000	2001	2002	2003 (As @ end of Q3)
# Of Open Stores	119	151	224	278	367	460
Trailing 12 Month Net Sales ($, 000s)		152,506	213,445	304,767	404,438	668,649

The increase in sales is despite the fact that the new stores opened are much smaller in size compared to the existing ones. So the sales per square feet are rising consistently. It jumped from $322 to $471 from 1998 to 2002. Increase in sales would have meant little if it weren't accompanied by sustained profitability and cash flow from operations. Income from operations has consistently exceeded 10%. The company has managed to maintain high profit margins in the sector, which is known for razor thin margins. Aeropostale also substantially increased its ability to generate cash as a percentage of sales from 1.6% in July 2000 to 15% in Nov 2003. The quality of earnings increases sharply by the fact that the company has virtually no debt. Having said that, all of its stores are rented and the operating leases of those stores are a form of debt.

Key Growth Drivers

It is clear from above that Aeropostale is a growing retail company. Given the company's recent growth momentum we believe that the firm could continue to grow at the current rate for at least the next five years. The following five years will experience decline in growth leading up to the start of the steady state growth. The primary rationale for the continued high growth for the next five years is that the company is still comparatively small. At 460 stores there is ample opportunity for the company to easily double the number of stores in operation by expanding geographically within US. Also, it seems to have hit upon a reliable formula for profitability. The key determinant of this formula seems to be the opening of small stores in strategic mall locations with high teenage population, which is its target customer. The company seems to appeal more to young women than young men. Contribution to sales from young women increased from 37% in 1999 to 56% in 2002. According to an independent research firm, spending among teenagers has grown from to $172billion in 2001 from $141billion in 1998 reflecting a compounded annual growth rate of 6.8%.

In summary, increasing number of stores, tested profitability formula based on store selection and quality merchandise and increasing spending among teenagers and a should help Aeropostale grow despite intense competition in the category.

Discounted Cash Flow Model

Based on the above fact pattern, a three-phase growth scenario has been selected for company valuation. We expect the company to be able to open about 50 stores on average per year for the next five years. It reflects the company's current growth rate of 7.9% per annum. After that the number of new stores opened gradually decreases to zero by the tenth year. Once the company reaches around 800 stores then the Aeropostale would no longer be the growth company that it is today. It will resemble more like a mature apparel retailer of the industry. So, after the ten-year period we assume a standard growth in earnings to be at 4% per annum, which reflects the industry growth estimates.

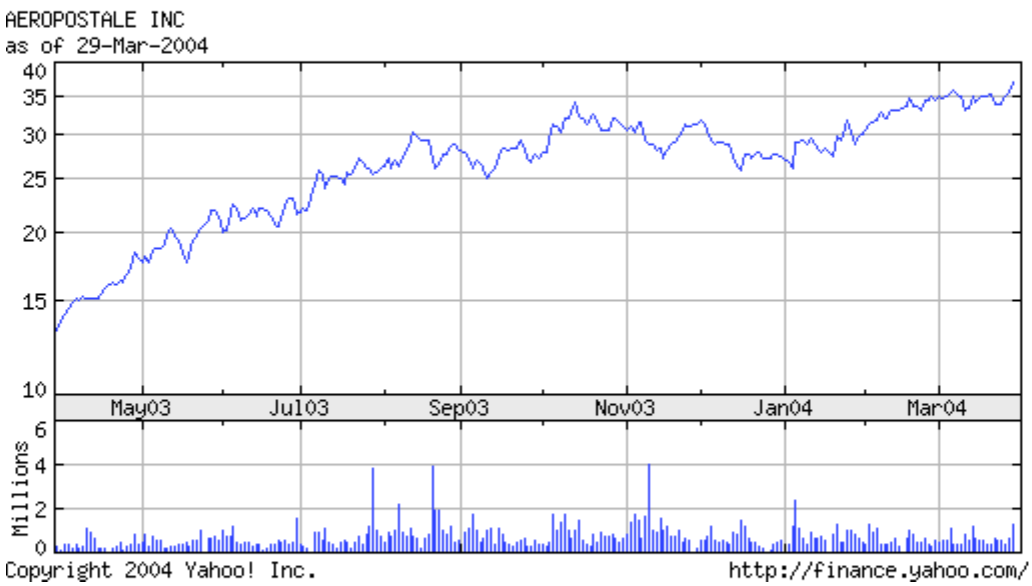
Year	***Current***	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
New stores opened		50	50	50	50	50	40	30	20	10	0
# Of Open Stores	460	510	560	610	660	710	750	780	800	810	810

Discounted Cash Flow for Aeropostale values each common stock at $38.31. Aeropostale closed at $36.90 on 29th March 2004.

DCF analysis for the company is most sensitive to the stable growth rate assumption.

Stable Growth Rate	3.0%	3.5%	4.0%	4.5%	5.0%
Share Price	$29.82	$33.36	$38.31	$45.72	$58.05

Based on this analysis it appears that Aeropostale is fairly priced. The stock chart also confirms that as the company started to provide consistent performance on a quarterly basis the market has rewarded its stock. By revising its growth prospects upward.



Value Enhancement

Aeropostale continues to show strong performance record. So the key value enhancement strategy for the company is to continue to defend its existing growth in the competitive market. It can do that by:

1. Continue executing its store expansion plan. Increase sales.
2. Keep its sales per square foot metric high while keeping costs under control. Focus on more efficient operations.
3. Consistent growth through internally generated cash flow from operations. Closing non-profitable stores and opening new stores in good locations can preserve these cash flows.
4. As a result of expanding to new geographic locations the company should find that its effective tax rate get lowered.
5. Aeropostale should continue to invest in its brand name. The duration of high growth period and the sustainable growth rate will increase with a stronger brand.
6. Sourcing from highly competitive overseas locations (Asia, which it already does) will continue to justify the length of the growth period.
7. Given that the company doesn't have any direct form of debt, cost of equity is the significant part of its cost of capital. It can continue to keep low cost of equity by making its product less discretionary (attracting teenagers throughout the year thereby smoothening seasonality in its earnings) by investing in advertising.

Each additional store added to its portfolio provides a $1.2million of sales in the first twelve months. Given that currently after tax operating earnings are at 7.35% of sales. Every new store contributes $88,000 to Free Cash Flow to the firm. Taking that analysis all the way to the share price we get the following result:

Additional stores (open today)	**0**	**10**	**20**	**30**	**40**	**50**	**60**	**70**	**80**	**90**	**100**
Share Price (DCF)	$38.31	$38.82	$39.32	$39.83	$40.34	40.85	$41.36	$41.88	$42.39	$42.91	$43.42

So if the company were to open 10 additional stores today then the share price of the company will increase by 50 cents to $38.82.

Comparable analysis

Aeropostale ranks in the specialty retail category. It also belongs in the apparel group. For Relative valuation purposes we picked up all the firms in the two categories as a first step. Then we discarded those firms that either too big (more than $1.5billion) or too small (less than $500million) in sales.

Ticker	**Name**
ARO	AEROPOSTALE INC
CHS	CHICO'S FAS INC
CLE	CLAIRE'S STORES INC
PSUN	PACIFIC SUNWEAR OF CALIF
URBN	URBAN OUTFITTERS INC
HOTT	HOT TOPIC INC
MW	THE MEN'S WEARHOUSE INC
FINL	THE FINISH LINE-CL A
PLCE	CHILDREN'S PLACE
STGS	STAGE STORES INC
TOO	TOO INC
SMRT	STEIN MART INC

DBRN	DRESS BARN INC
GCO	GENESCO INC
CTR	CATO CORP-CL A
GDYS	GOODY'S FAMILY CLOTHING INC
WTSLA	WET SEAL INC -CL A
SCVL	SHOE CARNIVAL INC

Price to Sales

Given that the retail sector values firms by Price to Sales ratio, a regression was performed on these comparables against the underlying fundamental parameters that drive Price to Sales ration. The result of the regression confirmed the DCF analysis that the firm is being fairly priced. Aeropostale is trading at a P/S multiple of 1.99. Doing the regression gets us to the exact same multiple.

EV/EBITDA

With the two analyses agreeing so much with the market a third analysis was done using EV/EBITDA. The company's enterprise value is 12.74 times EBITDA. The regression of the multiples suggests a lower multiple of 10.52. This disparity is mainly due to the firm having higher regression beta than most of its comparables.

Final Recommendation (Hold with positive outlook)

The company seems to be fairly priced based on the above analysis. All the current growth prospects of the firm have already largely taken into account in its price. There is some visibility of a little upside potential to the company's share in the short term. However, in the long-term, evidence of successful execution of its growth plans by the management could significantly improve the prospects of the share price

Target Price: $38.31

Valuing Options or Warrants

Enter the current stock price =	$36.90	close of 3/29
Enter the strike price on the option =	$10.50	
Enter the expiration of the option =	4.7	
Enter the standard deviation in stock prices =	47.22%	(volatility)
Enter the annualized dividend yield on stock =	0.00%	
Enter the treasury bond rate =	3.75%	
Enter the number of warrants (options) outstandi	1995.00	
Enter the number of shares outstanding =	37,374.00	

Do not input any numbers below this line

VALUING WARRANTS WHEN THERE IS DILUTION

Stock Price=	**36.9**	# Warrants issued=	1995
Strike Price=	**10.5**	# Shares outstanding=	37,374
Adjusted S =	**36.46368015**	T.Bond rate=	**3.75%**
Adjusted K =	**10.5**	Variance=	**0.2230**
Expiration (in years) =	**4.7**	Annualized dividend yield=	**0.00%**
		Div. Adj. interest rate=	3.75%

d1 =	1.900134538
N (d1) =	0.971292334

d2 =	0.876429332
N (d2) =	0.809601703

Value per option =	$28.29	
Value of all options outstanding =		$56,438.02

Implied Risk Premium Calculator

Enter level of the index =	1122.47	**close of business 3/29/04**
Enter current dividend yield =	2.78%	
Enter expected growth rate in earnings for next 5 y	8.10%	
Enter current long term bond rate =	3.75%	
Enter risk premium =	5.50%	
Enter expected growth rate in the long term =	3.75%	

Intrinsic Value Estimate

	1	2	3	4	5
Expected Dividends =	$33.73	$36.46	$39.42	$42.61	$46.06
Expected Terminal Value =					$868.91
Present Value =	$30.88	$30.55	$30.23	$29.91	$587.89
Intrinsic Value of Index =	$709.46				

Implied Risk Premium

Implied Risk Premium in current level of Index = 3.50% **(Go under Tools and choose Solver: See below)**

	1	2	3	4	5	
Expected Dividends =	$33.73	$36.46	$39.42	$42.61	$46.06	**$49.06**
Expected Terminal Value =					$1,365.98	
Present Value =	$31.45	$31.70	$31.95	$32.21	$995.15	
Intrinsic Value of Index =	$1,122.47					

Operating Lease Converter

Inputs

Operating lease expense in current year = $34,600.00

Operating Lease Commitments (From footnote to financials)

Year	Commitment	
1	$ 79,349.00	! Year 1 is next year, …. from 10q
2	$ 69,156.00	
3	$ 137,758.00	
4	$ -	
5	$ -	
6 and beyond	$ -	

Output

Pre-tax Cost of Debt = 4.10% ! If you do not have a cost of debt, use the ratings estimator

From the current financial statements, enter the following

Reported Operating Income (EBIT) = $72,671.00 ! This is the EBIT reported in the current income statement
Reported Debt = $0.00 ! This is the interest-bearing debt reported on the balance sheet

Number of years embedded in yr 6 estimate = 0 ! I use the average lease expense over the first five years to estimate the number of years of expenses in yr 6

Converting Operating Leases into debt

Year	Commitment	Present Value	
1	$ 79,349.00	$76,220.89	
2	$ 69,156.00	$63,810.92	
3	$ 137,758.00	$122,099.69	
4	$ -	$0.00	
5	$ -	$0.00	
6 and beyond	$ -	$0.00	! Commitment beyond year 6 converted into an annuity for ten years
Debt Value of leases =		$ 262,131.51	

Restated Financials

Depreciation on Operating Lease Asset = $52,426.30 ! I use straight line depreciation
Adjustment to Operating Earnings = $10,757.88 ! PV of operating leases * Pre-tax cost of debt
Adjustment to Total Debt outstanding = $ 262,131.51

Input Summary

Normalized EBIT (before adjustments)	$72,671.00
Adjusted EBIT =	$83,428.88
Adjusted Interest Expense =	$10,757.88
Adjusted Capital Spending	$68,173.00
Adjusted Depreciation & Amort'n =	$64,067.30
Tax Rate on Income =	41.10%
Current Revenues =	$668,649.00
Current Non-cash Working Capital =	$59,097.00
Chg. Working Capital =	$26,820.00
Adjusted Book Value of Debt =	$262,131.51
Adjusted Book Value of Equity =	$127,959.00

Length of High Growth Period =	10	Forever
Growth Rate =	7.93%	4.00%
Debt Ratio used in Cost of Capital Calculation=	15.65%	15.65%
Beta used for stock =	1.10	1.00
Riskfree rate =	3.75%	3.75%
Risk Premium =	3.50%	3.50%
Cost of Debt =	4.10%	4.10%
Tax Rate =	41.10%	41.10%
Return on Capital =	12.60%	12.60%
Reinvestment Rate =	62.93%	31.75%

Output from the program

Cost of Equity =	7.60%
Equity/(Debt+Equity) =	84.35%
After-tax Cost of debt =	2.42%
Debt/(Debt +Equity) =	15.65%
Cost of Capital =	6.79%

Intermediate Output

Expected Growth Rate	7.93%	
Working Capital as percent of revenues =	8.84%	(in percent)

Intermediate Output

Expected Growth Rate	7.93%	
Working Capital as percent of revenues =	8.84%	(in percent)

The FCFF for the high growth phase are shown below (upto 10 years)

	Current	1	2	3	4	5	6	7	8	9	10	Terminal Year
New stores opened		50	50	50	50	50	40	30	20	10	0	
# of Open Stores	460	510	560	610	660	710	750	780	800	810	810	
Total sq. ft	1,610,000	1,785,000	1,960,000	2,135,000	2,310,000	2,485,000	2,625,000	2,730,000	2,800,000	2,835,000	2,835,000	
Projected Sales	$668,649	$721,658	$778,870	$840,618	$907,260	$979,186	$1,049,122	$1,115,812	$1,177,975	$1,234,348	$1,283,722	
Sales per sq ft ($)	415	404	397	394	393	394	400	409	421	435	453	
Expected Growth Rate		7.93%	7.93%	7.93%	7.93%	7.93%	7.14%	6.36%	5.57%	4.79%	4.00%	
Cumulated Growth		107.93%	116.48%	125.72%	135.69%	146.44%	156.90%	166.88%	176.17%	184.60%	191.99%	
Reinvestment Rate		62.93%	62.93%	62.93%	62.93%	62.93%	56.70%	50.46%	44.23%	37.99%	31.75%	
EBIT * (1 - tax rate)	$49,140	$53,035	$57,240	$61,778	$66,675	$71,961	$77,101	$82,002	$86,570	$90,713	$94,342	$98,115.54
- (CapEx-Depreciation)	$4,106	$28,692	$30,967	$33,422	$36,072	$38,931	$37,534	$35,486	$32,792	$29,479	$25,593	$26,085.83
-Chg. Working Capital	$26,820	$4,685	$5,057	$5,457	$5,890	$6,357	$6,181	$5,894	$5,494	$4,982	$4,364	$5,069.44
Free Cashflow to Firm	$18,214	$19,658	$21,216	$22,898	$24,714	$26,673	$33,386	$40,622	$48,284	$56,252	$64,385	$66,960.27
Cost of Capital		6.79%	6.79%	6.79%	6.79%	6.79%	6.73%	6.67%	6.61%	6.55%	6.49%	
Cumulated Cost of Capital		1.0679	1.1404	1.2178	1.3005	1.3888	1.4822	1.5811	1.6856	1.7961	1.9127	
Present Value		**$18,408**	**$18,605**	**$18,803**	**$19,004**	**$19,206**	**$22,524**	**$25,693**	**$28,645**	**$31,319**	**$33,662**	

Growth Rate in Stable Phase =	4.00%
Reinvestment Rate in Stable Phase =	31.75%
FCFF in Stable Phase =	$66,960.27
Cost of Equity in Stable Phase =	7.25%
Equity/ (Equity + Debt) =	84.35%
AT Cost of Debt in Stable Phase =	2.42%
Debt/ (Equity + Debt) =	15.65%
Cost of Capital in Stable Phase =	6.49%
Value at the end of growth phase =	**$2,685,441.03**

	Valuation
Present Value of FCFF in high growth phase =	**$235,868.41**
Present Value of Terminal Value of Firm =	**$1,404,007.57**
Value of operating assets of the firm =	**$1,639,875.99**
Value of Cash, Marketable Securities & Non-operating assets =	**$87,475.00**
Value of Firm =	**$1,727,350.99**
Market Value of outstanding debt =	**$262,131.51**
Market Value of Equity =	**$1,465,219.47**
Value of Equity in Options =	**$33,242.00**
Value of Equity in Common Stock =	**$1,431,977.48**
Market Value of Equity/share =	**$38.31**

Valuation Sensitivity

Stable Growth Rate	3.0%	3.5%	4.0%	4.5%	5.0%
Market Value of Equity/share =	$29.82	$33.36	$38.31	$45.72	$58.05


AEROPOSTALE INC
as of 29-Mar-2004
40
35
30
25
20
15
10
May03
Jul03
Sep03
Nov03
Jan04
Mar04
6
4
2
0
Millions
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Relative Valuation – Price to Sales Ratio of Comparables

Ticker	Name	Beta	Payout Ratio	Profit Margin	Projected EPS Growth Plus Yield	Price to Sales Ratio	Regressed Price to Sale
ARO	AEROPOSTALE INC	1.87	66.74	5.68	23.09	**1.99**	**1.99**
CHS	CHICO'S FAS INC	1.10	67.40	13.04	24.31	5.10	3.94
CLE	CLAIRE'S STORES INC	1.30	82.09	10.15	17.22	1.80	2.73
PSUN	PACIFIC SUNWEAR OF CALIF	1.10	78.06	7.71	19.50	1.83	2.20
URBN	URBAN OUTFITTERS INC	1.36	81.20	8.82	24.92	3.33	2.96
HOTT	HOT TOPIC INC	0.87	75.03	8.40	21.82	2.18	2.51
MW	THE MEN'S WEARHOUSE INC	1.07	89.82	3.76	14.70	0.74	0.82
FINL	THE FINISH LINE-CL A	0.91	90.05	4.79	15.11	0.89	1.11
PLCE	CHILDREN'S PLACE	1.12	90.51	2.88	21.89	1.01	1.14
STGS	STAGE STORES INC	1.03	85.54	6.21	15.00	0.85	1.48
TOO	TOO INC	1.03	91.58	3.77	11.09	1.12	0.55
SMRT	STEIN MART INC	0.89	90.27	1.47	22.50	0.41	0.78
DBRN	DRESS BARN INC	0.62	97.13	1.14	15.00	0.70	0.11
GCO	GENESCO INC	1.29	85.41	3.44	11.62	0.59	0.52
CTR	CATO CORP-CL A	0.93	86.48	4.20	10.68	0.62	0.60
GDYS	GOODY'S FAMILY CLOTHING INC	1.81	92.57	1.44	15.44	0.36	0.39
WTSLA	WET SEAL INC -CL A	1.29	97.98	0.70	11.75	0.45	(0.15)
SCVL	SHOE CARNIVAL INC	0.91	86.96	3.05	16.37	0.35	0.72

Criteria for selection: 500million < Sales < 1,500million

Relative Valuation – Regression of P/S Ratio determinants

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Regression Analysis: Price to Sales R versus Beta, Profit Margin, ...

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The regression equation is
Price to Sales Ratio = - 1.88 + 0.156 Beta + 0.268 Profit Margin
           + 0.0046 Payout Ratio + 0.0759 Projected EPS Growth Plus Yiel

Predictor        Coef     SE Coef          T        P
Constant       -1.880       3.568      -0.53    0.607
Beta           0.1560      0.4939       0.32    0.757
Profit M      0.26761     0.07278       3.68    0.003
Payout R      0.00458     0.03209       0.14    0.889
Projecte      0.07592     0.03829       1.98    0.069

S = 0.5787      R-Sq = 83.1%     R-Sq(adj) = 77.9%

Analysis of Variance

Source            DF          SS          MS         F        P
Regression         4     21.3691      5.3423     15.95    0.000
Residual Error    13      4.3541      0.3349
Total             17     25.7232

Source       DF      Seq SS
Beta          1      0.4390
Profit M      1     19.4454
Payout R      1      0.1677
Projecte      1      1.3170

Unusual Observations
Obs       Beta   Price to         Fit      SE Fit    Residual    St Resid
  2       1.10      5.100       3.935       0.362       1.165       2.58R
  3       1.30      1.800       2.722       0.360      -0.922      -2.03R

R denotes an observation with a large standardized residual
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Relative Valuation –Value/EBITDA comparables

Ticker	Name	Beta	Effective Tax Rate	EBITDA(Earn Bef Int Dep & Amo)	Capital Expenditures/Prop Add	Changes in Working Capital	Depreciation & Amortization	Sales Growth	EV To Trailg 12M EBITDA	Regressed Value/EBITDA
ARO	AEROPOSTALE INC	1.87	40.00	61.09	-29.72	48.61	8.99	36.21	12.74	10.5183
CHS	CHICO'S FAS INC	1.10	38.00	181.90		20.42	21.13	44.70	16.90	19.2303
CLE	CLAIRE'S STORES INC	1.30	34.05	214.23		39.16	41.45	13.11	8.92	5.3659
PSUN	PACIFIC SUNWEAR OF CALIF	1.10	37.81	164.50	-40.21	133.69	36.25	22.91	9.93	6.5532
URBN	URBAN OUTFITTERS INC	1.36	40.50	103.12	-33.08	7.66	22.41	29.71	14.90	18.4379
HOTT	HOT TOPIC INC	0.87	38.30	95.34	-35.65	51.46	18.79	29.06	13.97	13.0467
MW	THE MEN'S WEARHOUSE INC	1.07	37.26	113.68	-45.42	33.85	44.28	7.54	8.51	7.8192
FINL	THE FINISH LINE-CL A	0.91	37.00	49.33	-26.05	11.71	17.54	30.21	8.73	11.1741
PLCE	CHILDREN'S PLACE	1.12	37.54	76.97		35.00	40.03	18.85	8.37	16.4075
STGS	STAGE STORES INC	1.03	37.00	105.59	-43.97	35.27	17.47	122.26	4.13	3.4507
TOO	TOO INC	1.03	37.34	65.11	-22.51	36.91	19.70	-7.53	6.45	12.4538
SMRT	STEIN MART INC	0.89	38.00	40.79	-19.07	-33.43	18.77	6.70	47.78	18.5168
DBRN	DRESS BARN INC	0.62	36.00	59.94	-63.33	-123.10	19.32	-1.40	5.28	9.4696
GCO	GENESCO INC	1.29	34.68	88.56	-36.28	10.23	19.31	1.10	5.45	(0.2258)
CTR	CATO CORP-CL A	0.93	36.30	83.07	-28.95	-49.70	14.91	-0.14	5.60	11.9965
GDYS	GOODY'S FAMILY CLOTHING INC	1.81	37.00	49.00	-20.45	22.89	21.66	2.82	3.15	5.0288
WTSLA	WET SEAL INC -CL A	1.29	35.00	26.11	-38.96	-12.68	22.70	1.10		0.4016
SCVL	SHOE CARNIVAL INC	0.91	37.50	38.61	-19.14	2.92	12.48	9.05	6.92	15.1029

Relative Valuation – Regression of EV/EBITDA determinants

Regression Analysis: EV To Trailg 12M versus Beta, Effective Tax Ra, ...

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The regression equation is
EV To Trailg 12M EBITDA = - 97.3 - 8.60 Beta + 3.30 Effective Tax Rate
           + 0.0144 EBITDA(Earn Bef Int Dep & Amo)
           + 0.201 Capital Expenditures/Prop Add
           - 0.0401 Changes in Working Capital
           + 0.009 Depreciation & Amortization - 0.032 Sales Growth

Predictor        Coef     SE Coef         T        P
Constant       -97.27       72.49     -1.34    0.209
Beta           -8.604       9.497     -0.91    0.386
Effectiv        3.305       1.850      1.79    0.104
EBITDA(E      0.01443     0.07155      0.20    0.844
Capital        0.2009      0.1711      1.17    0.268
Changes      -0.04013     0.07137     -0.56    0.586
Deprecia       0.0088      0.3569      0.02    0.981
Sales Gr      -0.0324      0.1077     -0.30    0.769

S = 10.83       R-Sq = 34.6%     R-Sq(adj) = 0.0%

Analysis of Variance
Source            DF          SS          MS         F        P
Regression         7       619.9        88.6      0.76    0.635
Residual Error    10      1172.5       117.2
Total             17      1792.4

Source       DF      Seq SS
Beta          1        49.0
Effectiv      1       330.8
EBITDA(E      1         4.4
Capital       1       173.2
Changes       1        49.5
Deprecia      1         2.4
Sales Gr      1        10.6
Unusual Observations
Obs       Beta   EV To Tr         Fit      SE Fit    Residual    St Resid
 12       0.89      47.78       18.70        5.42       29.08       3.10R

R denotes an observation with a large standardized residual
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