Management CV

Research Note: L Brands, Inc. (LB)

October 20, 2014

LB: Vision Married to Execution

L Brands' founder, Chairman & CEO Les Wexner (77) states in his annual shareholder letter that management's goal is "to be the best specialty retailer in the world…period!" And we think he and his team have LB well positioned to achieve this lofty goal. CEO Wexner is a retail visionary who transformed the way Americans shop by creating national specialty stores in an environment once dominated by department stores. Today, it is a very different company than when Wexner started it in 1963. Management that created the iconic Forenza brand at The Limited, as well as Abercrombie & Fitch, Limited Too and Express to name a few, is now out of the commoditized apparel business and focused on the higher margin, more stable, and growing categories of intimate apparel and personal care/beauty led by Victoria's Secret, PINK and Bath & Body Works. Same store sales have increased for 19 consecutive quarters and the Company has generated a strong total return of 128% over the past 3 years. Since Q3'09 management has reduced SG&A expenses by $630 million and EBIT margins have increased to 16% from 10%. Management thinks there's the potential for margins to increase to the high teens and its goal is to grow operating income 10% annually, though it fell short in FY13 due to the challenging retail environment. Wexner sees further growth opportunities in North America, though his main focus is on growing internationally, primarily through a franchise model which limits the Company's risk. Management is shareholder friendly, has a significant ownership stake (16.6% of LB), and consistently generates superior results relative to peers. We note that there has been significant selling by the management team, including CEO Wexner. In addition, even though there is a strong and seasoned management team in place, when Wexner decides to retire, we think that it will be difficult to replace his leadership and vision, similar to the situation with Steve Jobs at Apple.

EXECUTIVE TEAM SKILLS FIT We think LB has an experienced management team with a proven track record of success. CEO Wexner is the visionary behind the Company's success. He grew up in a retail environment with a father who owned a family store, Leslie, named after him. After dropping out of law school and arguing with his father over how the business should be run, he opened his own store with a "limited" selection of apparel. CEO Wexner has a net worth estimated at $6.2 billion ranking him #80 on Forbes top 400. He is not one to give many interviews or meet with investors, and is said to be introspective and focused on the big picture. President & CEO, Victoria's Secret, Sharen Turney (57) joined as President & CEO of Victoria's Secret Direct, the brand's catalogue and e-commerce arm, in May 2000. Turney was promoted to President & CEO of Victoria's Secret in 2006 and we think she has done an exceptional job of growing sales and EBIT at the division. From 1999 to 2006 Turney held a variety of roles at Neiman Marcus. The brand with the most turnover over the past several years has been Bath & Body Works. Nicolas Coe (51) is the current CEO of the brand after joining in August 2011. He replaced former Gap executive Diane Neal, who was CEO from 2007 to 2011 and credited with reenergizing the brand. We think Coe has also done a good job at the Brand with recent Comps up 10% on the strength of the fall themed product line and soap sales. COO Charles McGuigan (57) joined in 2004 as SVP of Technology Services. From 2010 to 2012, COO McGuigan served as CEO of Mast Global and in May 2012 was named COO of the overall firm. We think he has been the key executive behind the implementation of a "fast response" supply chain system, similar to fast fashion peers, allowing the team to react more quickly to demand. CFO Stuart Burgdoerfer (50) joined in 1998 and has held a variety of leadership roles in finance. He left LB from 2004 to 2006 to be SVP of Finance at Home Depot, returning in November 2006 and was named CFO in April 2007. In conjunction with the implementation of the "fast response" supply chain system, we think that CFO Burgdoerfer has done a good job of inventory management that has driven improved margins.

COMPENSATION & ALIGNMENT ANALYSIS We think cash compensation is high on an a absolute dollar basis relative to similar-sized peers, though we like that it is awarded based on sound operating metrics. We note, positively, that total cash pay is well balanced among the team, with CEO Wexner *(continued on next page)*

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receiving 36% of the total. Though the team's FY13 cash pay was much higher than peers at $15.8 million compared to $7.2 million, it was reasonable as a percentage of EBIT (0.9% vs. 4.6%). CEO Wexner's total compensation was $15.9 million (down 17% from FY12) including: $1.9 million in salary, a $2.8 million cash bonus, $9.8 million in equity and $1.3 million in other pay. Brand CEO Turney's total compensation was $7.8 million (down 70% from FY12) including: $1.4 million in salary, a $1.4 million cash bonus, $4.2 million in equity and $815k in other pay. COO McGuigan was paid $5.8 million (down 28% from FY12), while Brand CEO Coe and CFO Burgdoerfer were paid $8 million and $3.3 million, respectively, with a shareholder friendly 61% in the form of equity. Total compensation was down relative to FY12 due to management not fully achieving FY13 performance goals. The annual cash bonus is based on EBIT targets at the Corporate and Divisional levels, with payouts ranging from 125% (CFO Burgdoerfer) of salary to 190% (CEO Wexner), measured on spring and fall performance separately. Long term incentive pay (LTIP) is comprised of 25% options and 75% performance based restricted stock (PRSUs). PRSUs are awarded based on annual targets for adjusted EBIT as a percentage of sales and performance relative to the S&P Retailing Index (LB must rank in the top third). PRSUs vest over 5 years (20% in each of year 2 and 3 and 30% in year 4 and 5). We note that there is a cumulative performance metric to the PRSUs, such that if any don't vest on the annual metric, they may vest basis on performance over the entire 5 year vesting period. In FY13, Coe and McGuigan were granted special PRSUs based on their performance. The amount and timing of the CEO's performance based award is determined differently than for other executives. Wexner's award is based on a benchmark of stock award values of CEOs in LB's 19 company peer group so that if all the performance targets are met, his stock award would be at the top of his peers.

EQUITY OWNERSHIP ANALYSIS There is significant Officer and Director beneficial ownership of 48.9 million shares, or 16.6% of LB, though it is primarily held by CEO Wexner, who has beneficial ownership of 47 million shares, or 16% of LB. We note that in September, Wexner sold 2 million shares, or 4% of his beneficial holdings. The only other member of management with meaningful ownership is Brand CEO Turney at 1 million shares (0.4% of LB). In the last 18 months, Turney also sold 734k shares (42% of her beneficial ownership). In the same timeframe, CFO Burgdoerfer sold 117k shares (49% of his beneficial stake), COO McGuigan sold 79k shares (52% of his beneficial stake) and Brand President Coe sold 22k shares (55% of his beneficial ownership). Outstanding options (the majority of which belong to CEO Wexner) are well in-the-money with a weighted average strike price of $16.36. We note that upon the CEO's death, all options and PRSUs/RSUs granted prior to 2011 will vest immediately. In addition, if there is a Change-in-Control (C-in-C), 75% of his options are subject to double trigger vesting, increasing to 100% on April 1, 2016.

CAPITAL ALLOCATION PRACTICES Management has been clear and consistent with its capital allocation strategy and has been a good steward of shareholder capital. Since 2000, management and the Board have returned $15 billion to shareholders through regular dividends ($3.3 billion), special dividends ($4.1 billion), and share repurchases ($8 billion). In March 2014, the Board raised its quarterly dividend by 13% to $0.34 (annual yield of 2%), and has grown it 15% annually over the past 5 years. Management recently completed a $250 million share repurchase program, and the Board authorized an additional $500 million buyback. The Company has $1.5 billion in cash, $4.8 billion in long-term debt, and management expects to generate $600-$700 million in free cash flow this fiscal year. The team's performance in terms of the financial metrics we track has been strong vs. similar-sized peers, particularly on ROA, ROE and expense per employee. Management allocates about 70% of its CapEx to new stores (80 expected to open in FY15) and remodeling, with the remainder for technology and infrastructure to support growth. It is estimated to be $750 million in FY14, up from $691 million in FY13.

OTHER FIDUCIARY ISSUES We think that the Change-in-Control trigger is too low at 33% of voting control. We note that 5 of the 10 Directors have been on the Board ranging from 16 to 50 years, which is a concern that has been raised by shareholders.

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