Sniper Research

The Sure Shot Letter

Picking Off Profits One Stock at a Time!

May 2, 2013

Over the years, one strategy that has worked well for me has been to buy well-known brands and retailers when they are on sale. Not just any brands or retailers…but the ones with solid balance sheets and enough financial strength to make it past the rough spots. Marc Gerstein and Forbes both wrote articles about my strategy back in 2008. Back then, retail had hit a rough spot (along with the rest of the market) and numerous retailers were left for dead. My Deep Value retail strategy helped me to sift through the carnage and find some diamonds in the rough.

Given the market recovery we have seen since 2009, it's been harder to find retailers or consumer stocks that fit into the strict criteria for addition into the portfolio. Many of the stocks that do qualify for the portfolio are micro cap stocks that are too small or illiquid to trade in any size. Most of them are so small that their name brands are not recognizable on a national level let alone internationally. Even so, my weekly screens will still, on occasion, throw off one of those diamonds in the rough. This month's pick, I believe, is one of those diamonds in the rough.

Before telling you about this month's pick, I want to briefly go over the criteria I use for adding stocks to the Deep Value segment of our portfolio. To start the process I run a proprietary screen to rank stocks based on seven criteria; 2 based on valuation, 2 on financial strength, 2 in relation to balance sheet strength. The final measure is a technical trigger. All U.S. stocks and ADRs are given a rank based off these seven criteria.

Stocks with a rank above 50 are then screened again so that only the stocks trading at the lowest values with the strongest balance sheets and financial strength can make the cut. The five factors that all potential candidates must pass are:

- The stock must be trading for less than 1x book value.
- The stock must also trade for less than 1x sales per share.
- The current ratio must be above 2.00.
- Debt as a percent of capital must be below 50%.
- There must be a potential catalyst on the horizon.

This month's pick, **Perry Ellis International**, meets all of these criteria.

Sniper Quick Shot

Perry Ellis International (PERY, $17.27)

Sniper Estimate: 2013: $1.65   2014: $1.95 **Consensus:** 2013: $1.56   2014: $1.82

$15 - $18	$18 - $21	$21 - $24	$24 - $27	$27 - $30	$30 - $33
X					

Description

Perry Ellis International is a designer, manufacturer, marketer and retailer of apparel. In 2012, men's sportswear and swimwear accounted for 73% of revenues, while women's were 15% of sales. Direct to consumer sales amounted to 9% of sales while licensing accounted for the remaining three percent of revenues. The company's top five customers accounted for 46% of sales last year. PERY's top five customers are: Kohl's, Macy's, Marmaxx, Dillard's and Sam's Club.

The Opportunity

For the past year **PERY's** stock price has been weak due to missed earnings caused by a fashion miss as well as by the struggles of one of its largest customers. Management took aggressive steps to rectify the situation by replacing key personnel at their top brands, selling off underperforming brands and aggressively pairing inventories.

Their actions started to bear fruit last quarter when the company reported their first positive comp of the year after three quarters of revenue declines. The period also marked the largest fourth quarter in the company's history. Indeed, sales increased 13% year over year, while the gross margin recovered 138 basis points. The product revamps brought in by the new management teams at the Perry Ellis and Rafaella brands were seeing higher bookings from retailers as well as great editorial coverage from the media.

Although the stock surged after the better-than-expected results, the colder-than-anticipated Spring has taken the bloom off the rose as investors began to think that the cold weather would lead to poor sales of the company's golf related product. The fourth and first quarters are typically the strongest quarters of the year for **PERY,** thus it is a valid concern. Looking ahead, I expect the quarter to be solid, regardless of the weather. The company was experiencing strong sales at the beginning of the quarter and their inventories were lean, down 8% on a year-over-year basis. While sales may have tapered off near the end of the period, the lower inventory levels should at least help to support margins.

A second reason I am bullish on the shares here is the new casual line of men's clothing that the company will be rolling out during the second half of the year. The collection, known as *Perry Ellis America*, will be launched in 200 doors during the fall and should help to spur demand in the seasonally weaker third quarter. Moreover, *PGA Tour*, one of the company's licensed brands is expanding into Canada this year and continues to expand into Mexico. The *Ben Hogan* brand is also growing strongly. The brand has launched a Golf lifestyle collection this Spring that is being shipped to over 2000 Wal-Mart stores. Finally, the women's *PGA Tour* golf collection is already in 400 department store and sporting goods doors and management is optimistic that they can increase the door count for this brand by 100% over the next two years.

I have three additional reasons to be bullish here. First is the stock's valuation versus its prospects. See the valuation section below for more details than I will put in this paragraph, but I will note that sometimes valuation is the key catalyst. My second reason to remain optimistic here is that I believe management's guidance for the full year is conservative. The company is guiding to full-year earnings of $1.50 - $1.60. The earnings are based on the Perry Ellis brand seeing flat sales year over year…even though their latest product was well received in the market and sales were "encouraging". When pressed on the conference call management stated that the "flat" sales guidance was being based off of last year's experience and not off of what they saw in the fourth quarter. This leads me to believe that the company is set up to under promise and over deliver.

My final potential catalyst for the company is a potential turnaround at JC Penney. Sales to JCP were down strongly last year as the retailer struggled with its own problems including same-store sales that were down at a high double-digit rate. It wasn't long ago that JC Penney was a top 5 customer for PERY. If JCP sales were to begin to recover this year, **PERY** could see some stronger-than-expected incremental sales. I have focused on JC Penney stores during my last two channel checks and I have noticed a marked improvement in sales people attitudes and in the look and feel of the stores. In fact, last week, there were lines at the registers in both the shoe department and at the registers closest to the new Joe Fresh section. For those looking to speculate on a recovery in JCP**, PERY** might not be a bad way to play it.

Valuation

Currently, **PERY** shares are trading at 8.8x their forward earnings estimate and 5.9x its projected forward cash flow. This is near the low end of its traditional range for both metrics. My projected 12-month high price target is predicated on the stock trading at about 17.4x my forward earnings estimate. Moreover, the stock is trading at 0.7x book and at less than 0.3x projected sales, thus it easily meets the valuation criteria set for the Deep Value part of our portfolio. My high price target implies a price/book ratio of 1.27x, a level that the stock has hit or surpassed in eleven out of the past fifteen years.

With that said, I find the stock a good value near the current quote, and would be a buyer to $19.00 a share. Note that **PERY** shares can be volatile. Indeed, over the past fifteen years the average difference between its 52-week high and its 52-week low is 56.4%. Note that in only two years out of the past sixteen has the share price failed to top 1x book value. Given that the stock hasn't traded above book value yet this year, and that I believe management's earnings guidance is conservative I believe PERY shares could be in for a good run during the second half of the year. With this in mind, I recommend investing 4% of your capital into the stock and set a 30% trailing stop.

Risks

1. The apparel industry is highly competitive and fragmented. **PERY**'s competitors include numerous apparel designers, manufacturers, importers, licensors, and their own customers' private label programs, many of which are larger and have greater financial and marketing resources than the company has available to them. While the company has been able to compete effectively, there can be no assurance that new competition will not develop in the future that may impact results.
2. Loss of a key customer could hurt revenues and earnings. Last year, 46% of sales came from the company's top five customers. Kohl's and Macy's accounted for over 10% of sales alone. A significant decrease in business from or loss of any of major customer could harm the company's financial condition. This risk faces most competitors within the industry.
3. Weakening consumer spending or an economic downturn would tend to lower both revenues and earnings.

4. **PERY** does not have long-term contracts with any of their customers and purchases generally occur on an order-by-order basis. There is a risk that if customers curtailed or ceased business with the company, revenues and earnings would be immediately impacted. Thus order volatility is a concern.
5. Misreading consumer preferences and fashion trends is a real risk that could have an immediate impact on results.
6. Swings in raw material prices could have a significant impact on margins.
7. Sales and earnings can be impacted by weather patterns and natural disasters. These setbacks are usually short term in nature.

Action to Take

Buy a 4% position in **PERY** below $19 a share and look to hold the position indefinitely, absent a change in the balance sheet or business fundamentals or if the stock was to hit our 30% trailing stop. We will track this position in the portfolio from today's close at $17.27 a share.

Portfolio Pulse

Name	Ticker	Date Initiated	Purchase Price	Current Price	Return	Dividends Received	Rating
Deep Value							
2% Willbros Group	**WG**	**1/3/13**	**$5.55**	**$9.71**	**+74.9%**	**N/A**	**HOLD**
4% Perry Ellis Int'l	**PERY**	**5/2/13**	**$17.27**				**Buy up to $19**
Catalyst/Momentum							
3% Nucor Corp.	**NUE**	**3/7/13**	**$46.78**	**$43.38**	**-7.2%**		**Buy up to $47**
Income							
3% Occidental Petroleum	**OXY**	**2/7/13**	**$88.17**	**$88.09**	**-0.1%**		**Buy up to $94**
1% Putted to us at $83.80	**OXY**	**2/7/13**	**$83.80**	**$88.09**	**+5.1%**		
4% Potash Corp.	**POT**	**4/4/13**	**$39.60**	**$41.77**	**+5.4%**		**Buy up to $42**

Next Report Due Out on June 6th!