

Mossberg's Investor Digest

Best Idea Profile

Aeropostale (NYSE: ARO)

DESCRIPTION:

Headquartered in New York City, Aeropostale (which means "air mail" in French) is a mall-based teen retailer that offers moderately priced clothing and accessories. The chain, which was originally created by R.H. Macy and Co., was sold to investors, including the current management team, approximately 12 years ago. Since that time, the chain went public and has grown from 119 stores to over 900 throughout the U.S., Canada, and Puerto Rico. The company differentiates itself by offering proprietary brands that are only available at company stores (or on the company's website www.aeropostale.com) at prices that are generally lower than its competitors.

KEY INVESTMENT CONSIDERATIONS:

Slower growth rates are already priced into the stock – After significant growth in its store base during the past several years, the company's traditional store concept is reaching saturation. The company has 900 stores and could add 20%, approximately 200, more stores to reach the equivalent level of its peers American Eagle (NYSE: AEO) (1,100 stores) and Abercrombie (NYSE: ANF) (1,130 stores). While it is inevitable that the pace of store growth will slow, the concept's value appeal has played well in the current economy and driven same store sales growth of approximately 8% to 12% during most of 2009, which is on top of double digit same store growth the prior year. This value appeal should continue to drive positive comps in the "new normal" economy.

Tween market offers growth opportunity – Since June, 2008, the company has opened 10 stores called P.S. from Aeropostale, which offer apparel and accessories targeted at children 7 to 12 years old. If successful this concept could provide the next leg of growth for the company. This is an underserved market with \$14 billion in annual sales, growing at a pace that is faster than the overall market. Plans call for 25 to 30 more of this type of store in 2010.

Attractive store level economics – Stores opened in 2008 only required a net investment of \$500,000, including the cost of inventory and net of payable. This investment is far lower than the investment required by AEO and ANF to open stores, which have larger footprints. The smaller footprint generates comparable sales, but higher sales per square foot and ultimately better returns for shareholders. During 2008, sales per square foot were \$572, which compares favorably to \$446 at AEO and \$425 at ANF.

Share repurchase - While I'd prefer that the company pay a dividend, it has regularly returned value to shareholders by aggressively repurchasing shares. The company has repurchased over \$550 million in stock in recent years. Early this month, the company added another \$250 million to its current repurchase authorization.

RISK:

Leadership change – Long-time CEO Julian Gerger plans to retire at the end of this year. Execution is key in the success of retail stories like this, and the change in leadership introduces a potential execution risk. Whether it is real or just perceived, execution risk could limit multiple expansion.

VALUATION:

The market appears to have already priced in slower growth rates. Shares are trading at just 10x the trailing twelve month's earnings and 9x next year's consensus. This is an attractive multiple for a company with continued growth potential, and more importantly, a consistent track record of producing high returns. The lowest ROE number since the company came public in 2002 was 32%. Shares are trading at the low end of the historical multiple range, and could easily justify a multiple in the mid teens, which could yield a \$50 stock price in the next year.

(NYSE: ARO)

Investment Data (as of 12/18/09)

Recent Price	\$32.40
52-Week Range	15.34 - 44.85
Fiscal Year End	January
Shares Outstanding	66 MM
Average Trading Volume (3 mos)	3.5 MM
Market Capitalization	2.1 B
Cash	286 MM
Long Term Debt	N/A
Enterprise Value (EV)	1.9 B
LT Debt/ Equity	N/A
BV/ Share	6.79
TTM Revenue	2.1 B
P/ Revenue	1.0x
TTM EPS	2.96
P/ EPS	11x
TTM EBITDA	393 MM
EV/ EBITDA	4.8x

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