

Mossberg's Investor Digest

Best Idea Profile

CPI Corp. (NYSE: CPY)

DESCRIPTION:

Headquartered in St. Louis, Missouri, CPI Corp. has 3,000 locations in the U.S., Canada and Mexico. With 45% market share in the mass retailer category (about 7% of the \$6.8 billion professional portrait industry), CPI Corp. operates the largest number of portrait studios in North America. The company is the sole operator of portrait studios inside Sears...1,000 stores with the Sears Portrait Studio brand. During 2007, the company acquired the PictureMe business out of bankruptcy and became the sole operator of portrait studios inside Wal-Mart stores. (2,000 studios under the PictureMe Portrait Studio brand).

KEY INVESTMENT CONSIDERATIONS:

Cash flow generation and returns should improve significantly despite tough economic conditions –

The portrait studio business normally requires limited working and fixed capital. Because of the cash or credit nature of the sale, the company typically receives cash on a sale before it is required to pay its vendors. In addition, there is limited inventory requirements...gross margin (excluding D&A) was 91% during 2009. In the past two years, the company has spent \$83 million acquiring PictureMe and approximately \$40 million upgrading its studios to digital technology. Going forward capex requirements should be at the \$5 million mark for several years. The company also has a \$17 million NOL, which should give it no cash tax outlays until the end of 2010. Based on first quarter's improved profitability levels and assuming there is not another leg down in the economy, the company should be able to produce \$25 million in free cash flow this year.

RISK:

Obviously the biggest risk is the exposure the company has to Wal-Mart and Sears. In the case of Sears, the company has enjoyed a relationship for 50 years and in December 2008 renewed its license agreement through 2014. In the case of Wal-Mart, the company has lease agreements that are on two-year renewals in the U.S. and have various terms in Canada and Mexico.

The company is currently in a proxy contest with a 23% shareholder, the results of which will be known at the annual meeting scheduled for July 8. It appears that the shareholder is on the losing side of the contest. If they lose, the shareholder may decide to liquidate their position creating excess supply of stock, limiting near-term upside potential, and potentially putting downward pressure on shares.

POTENTIAL CATALYSTS:

The company has several growth initiatives designed to improve top line performance and increase utilization of its existing assets and productivity of its employees. The company is testing a mobile portrait initiative near its headquarters location in which studio personnel shoot photos at a customer's home and/or an event. In addition, the company has indicated it may use excess manufacturing capacity to provide fulfillment services for smaller portrait studios, thus improving the utilization of its five central processing plants.

VALUATION:

Shares trade at an attractive 4.5x EV/ EBITDA. While top line will likely continue to struggle this year, EBITDA levels should increase significantly, which should help drive valuation. In addition, improving cash flows should garner increased investor attention including the possibility of more sell side sponsorship (there is currently one analyst following the company). The company also pays an attractive 3.4% dividend yield, which appears very sustainable due to expected improvements in cash flows.

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Investment Data (as of 6/29/09)

Recent Price	\$16.62
52-Week Range	1.00 - 22.20
Fiscal Year End	January
Dividend	0.64
Yield	3.8%
Shares Outstanding	7.0 MM
Average Trading Volume (3 mos)	104,000
Market Capitalization	116 MM
Cash	27 MM
Long Term Debt	102 MM
Enterprise Value (EV)	191 MM
LT Debt/ Equity	N/A
BV/ Share	0.48
TTM Revenue	453 MM
P/ Revenue	0.3x
TTM EPS (non-GAAP)	-0.77
P/ EPS	N/A
TTM EBITDA	42 MM
EV/ TTM EBITDA	4.5x