

Mossberg's Investor Digest

Best Idea Profile:

Zale Corporation (NYSE: ZLC)

DESCRIPTION:

Zale Corporation is a leading specialty retailer of fine jewelry in North America, operating 1,163 fine jewelry stores located primarily in shopping malls throughout the United States, Canada and Puerto Rico. Zale Corporation's portfolio of fine jewelry brands includes Zales Jewelers (primarily diamond jewelry in the bridal and fashion segments), Zales Outlet, Gordon's Jewelers, Peoples Jewellers and Mappins Jewellers of Canada. Zales also operates in 666 jewelry kiosks through its Piercing Pagoda and other brands. Zale also operates online.

KEY INVESTMENT CONSIDERATIONS:

Fundamentals on Upward Curve – Zale just reported its seventh straight quarter of same-store sales gains: fiscal year 2012 same-store sales were up 6.9% compared with the prior year, and 2011 same-store sales were up 8.1% over the prior year. Fiscal 2012 was the first full year of operating earnings since 2008. Management expects positive net earnings for fiscal year 2013.

Debt Refinancing Boosts Balance Sheet – The new \$665 million credit facility announced in July 2012 is expected to result in annual pre-tax savings of \$17 million. At current interest rates, the average borrowing cost is cut in half from about 8% to 4%. Besides the savings, the refinancing creates more operating flexibility for the company to pursue its goals of improved merchandise assortment in 2013, increasing promotion and marketing effectiveness, and enhancing organizational effectiveness. All of these goals will help the company navigate through economic conditions that remain uncertain.

Short Seller Covering – Short sellers have been heavy players in ZLC with 2.5 million shares shorted. Shares shorted are approximately 9% of the float. As the company continues to deliver on its fundamentals, and analysts start looking more favorably on the stock and raising their estimates, short selling coverage should provide good support for the stock.

Streamlined and Focused – With its increased operational flexibility, the Company intends to fine tune its core assortment of merchandise and expand its proprietary branded collections in bridal and fashion. It is increasing its reach into social media channels and taking steps to grow its brand momentum. eCommerce sales were up 16% in fiscal 2012 and up 40% over the

past two years. Zale appears to be doing a good job of rethinking its businesses as is indicated by the growth in comparable store sales. Management indicated that the number of store closures for fiscal 2013 should be comparable to 2012.

Key Player in Fragmented Industry – The economy has been tough on jewelry retailers and many have been weeded out or, like Zale Corporation, have restructured. Industry growth is not predicted to be stellar, but focus on high-value pieces, like diamond engagement rings, will drive industry growth. The U.S. jewelry retail industry is highly fragmented with about 20,000 companies with combined annual revenue of \$30 billion. Zale will continue to benefit from all-important name recognition for purchases requiring such high-involvement and emotional purchases.

VALUATION:

With the successful negotiation of a new credit facility and lower interest costs, shares have already responded to the reduction in financing risk and are trading near 52-week highs. As the Company continues to execute on its plan, net margins should be able to return to historic levels of 3% to 5%, implying well over \$1.50 per share in earnings power.

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Investment Data (as of 9/17/12)

Recent Price	\$5.87
52-Week Range	\$2.06 - \$6.18
Fiscal Year End	Jul 30
Dividend	NA
Yield	NA
Shares Outstanding	32.2 M
Average Trading Volume (3 mos)	570 K
Market Capitalization	\$189 M
Cash	\$25 M
Long Term Debt	\$453 M
Enterprise Value (EV)	\$616 M
Book Value	\$5.55
TTM Revenue	\$1.87 B
P/ Revenue	0.1x
TTM EPS	\$(0.85)
P/ EPS	NA
TTM EBITDA	\$57 M
EV/ EBITDA	10.8

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