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Time to Hit the Mall

Your family's shopping habits can lead you to some surprising investments.

Jack Hough

The mall is a great place to shop for growth stocks. Collegiate outfitters Abercrombie & Fitch and American Eagle have rung up enough cargo shorts and prefaded T-shirts to send their share prices 10 and 50 times higher, respectively, over the past decade. Virtual shoot-'em-up specialist GameStop has tripled in price since Barnes & Noble spun it off five years ago. Claire's Stores, where $20 can get a girl earrings, a bead necklace and a cubic zirconium ring, is in the process of being acquired by a private investment group after a 17-fold stock gain since 1990.

Not only are the rewards considerable for investors who find the next great chains early, the choices are plentiful, and the field research could hardly be called work. Stock screeners like the one at SmartMoney.com include hundreds of retailers ranging from Wal-Mart, whose sales last year were more than the GDPs of some 20 nations, to chains too small to mention specializing in everything from saddles to strollers. And whereas the inner workings of a steelmaker or drug developer are a mystery to most consumers, the right way to hold a caramel latte while sampling every massage chair in the luxury gifts store isn't.

> **Research retailers the way you would other companies—but then add one key metric: same-store sales.**

Research the investment prospects of a retailer the same way you would those of other companies: by assessing things like growth rates, financial resources and recent share-price momentum. But add one key metric—same-store sales. It's used to isolate the sales growth that comes from improvements at longstanding stores from the growth that comes from adding new stores to the chain. Think of growing a retail chain as akin to growing grapes rather than wildflowers. Anyone can produce a big field of the latter simply by planting more. But a wise vintner prunes underperformers to make the best use of his acreage as he expands. Similarly, a wise retailer tries to ring each register more, even while he's adding more registers.

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Most industries that continuously add or remove capacity have unique productivity measures. Airlines track "revenue passenger miles" while hotels look at "revPAR," or revenue per available room. Same-store sales, the metric of choice for retailers, is commonly defined as sales for stores open at least one year. Companies aren't required to report the measure. If they do, they're free to tinker with the methodology. Some use stores open 13 months as their same-store base. Shoe seller DSW uses stores open at least 14 months, but resets the list only once a year, meaning a store may be open 26 months before entering the same-store base.

In general, double-digit same-store sales growth is a hallmark of a young chain that can afford to add plenty of stores. Healthy single-digit growth suggests a chain is maturing but still has room to expand. Declining same-store sales means a chain should stop expanding and perhaps close underperformers.

While Wall Street watches same-store sales closely, until recently there has been little research available on the link between the measure and stock returns. A just-finished study by a Harvard Ph.D. candidate named Halla Yang provides some insight. Yang looked at monthly same-store sales results for 71 retailers for the eight years ending last year. For each month he simulated buying the best-performing quartile of companies while selling short the worst quartile. As is common, Yang adjusted his returns to account for factors that are known to predict better-than-average stock returns. For example, small companies tend to outperform large ones, as do companies with low price/book-value ratios, volatile trading histories and recent share-price momentum. Adjusting for these factors allows us to see whether the results are indeed coming from same-store sales rather

Photograph by Gary Spector

SEVEN REASONS TO GO SHOPPING The mall holds a wealth of investment ideas that a simple screen can uncover.

Company (Ticker)	Price 4/12/07 ($)	Market Value ($mil)	Sales, Trailing 12 Months ($mil)*	March Same-Store Sales Growth (%)	March Consensus Same-Store Sales Growth (%)	Year-Ago Rate (%)	P/E**	Long-Term EPS Growth (%)†	PEG Ratio
American Eagle Outfitters (AEO)	31.18	6,864	2,794	20.0	11.1	4.0	16	15	1.1
Ann Taylor (ANN)	39.07	2,709	2,342	6.1	1.7	0.8	18	15	1.2
Gottschalks (GOT)	13.92	187	687	6.4	NA	−3.6	30	15	2.0
Gymboree (GYMB)	40.66	1,276	792	9.0	5.8	6.0	17	15	1.1
Kohl's (KSS)	77.98	25,041	15,544	16.8	9.2	3.7	20	18	1.1
Pacific Sunwear (PSUN)	22.40	1,566	1,447	14.1	3.4	−10.9	22	15	1.5
Saks (SKS)	20.33	2,875	2,940	9.0	6.0	−0.6	44	8	5.5

*As of Jan. 2007. **Current fiscal year. †Annualized, five-year projection. NA = Not available.

SOURCES: REUTERS RESEARCH; PR NEWSWIRE

than from other, "lurking" variables. Even after the adjustments, Yang's long/short portfolio outperformed the broad market by 2.1 percent a month over the study period, or more than 28 percent a year.

Yang's data set is smaller and his study period shorter than those this column has cited in past assessments of the predictive power of things like positive earnings surprises. But whereas sales and earnings data has been readily available for decades, same-store sales data hasn't been distributed as long. Yang based his retailer study on monthly lists of same-store results put out by PR Newswire, a press release distributor, starting in 1998.

For now the best way to "screen" for impressive same-store sales growth doesn't involve using screening software. Simply pay attention to the monthly report put out by PR Newswire on the second Thursday of each month, when many retailers report same-store sales for the prior month. The report focuses mostly on clothing sellers and department stores. To find it, go to *prnewswire.com* and click "Industry & Markets," then "Retail," and then look for a link labeled "Retail Review and Comparison." I compiled the list above by looking for impressive March same-store sales growth. But since some stores got a March boost from Easter falling early in April this year, I also looked for companies whose same-store sales had topped analysts' estimates, which presumably accounted for the holiday shift. To judge how expensive each company is relative to its current profit and growth expectations, compare its PEG ratio with the broad market's average of about 1.5. The PEG ratio divides a stock's price/earnings ratio by the annual rate at which analysts expect its earnings to grow over the next several years. It's not a foolproof gauge of valuation, but low-PEG stocks tend to outperform. According to a Merrill Lynch study, the 50 lowest-PEG stocks within the S&P 500 have returned more than twice as much as the entire index since 1989.

American Eagle sells to what analysts call the "mating phase," or students ages 15 to 25. It posted the strongest results on our list. Spring-break garb did well online; demand was particularly high for the company's Aerie brand of girls' "dormwear." **Ann Taylor** specializes in women's clothes suitable for the office and drinks afterward (martinis, not beer). It's turning things around in its lower-price Loft division after some merchandising missteps last year. **Gymboree** sells kids' clothes through its namesake chain and posh Janie and Jack boutiques; it recently began offering chubbier sizes. The stock has jumped more than 15-fold in price after bottoming out in the summer of 2000.

Pacific Sunwear sells board-sport clothes (skate, surf) worn by 18- to 24-year-olds who participate in those activities or wish to look like those who do. It benefited from warm weather and generally strong demand for California-lifestyle clothes. Staid department store **Saks** is growing like a youngster, with a 40 percent share-price gain since the beginning of September. One analyst says the company is refocusing on its core "classic and slightly older" customer after flopping with a "Hollywood bling-bling" look in recent years.

Gottschalks reported its strongest same-store sales gain in three years. Industry watchers call the department store a half step below Macy's and a half step above JC Penney in terms of ritz. It has long been a subject of takeover speculation due to its underperformance and small size. The company has recently shrunk its less-profitable home department while remodeling its shoes, cosmetics and accessories areas. Finally, **Kohl's** is halfway between a department store and a mass merchant, with top brands but also centralized checkout counters. Its March results were helped by mild weather in the Midwest, where a third of stores are located, and by merchandise improvements made over the past two years. Ten-year holders of Kohl's shares are up sixfold.

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