Dropping Coverage of a Few Clothing Retailers

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Valuentum is dropping coverage of a few clothing retailers to focus resources elsewhere.

Structure of the Retail--Apparel Industry

The specialty apparel industry is highly competitive. Firms compete with various individual and chain specialty stores, as well as casual apparel sections of department stores and discount retailers. Identifying and responding to fashion trends remains key, and business fluctuates with changes in the economy and customer preferences. Fashion missteps can result in lower sales, excess inventories, and higher markdowns, which can severely impact profits. Improving productivity, managing new store growth and developing new brand concepts are critical for long-term success. We're neutral on the group.

Citi Trends (CTRN)

Citi Trends' healthy balance sheet should help it navigate the difficult to predict fashion trends.

Citi Trends is a retailer offering value-priced, urban fashion apparel. The company has a large customer base and serves a favorable demographic. It has over 500 stores, with most of them located in the Southeast. Citi Trends was founded in 1946 and is headquartered in Georgia

The firm's concept, merchandise and locations are tailored to its core customer: 70% African-American with $20,000-$40,000 median household income. This group continues to grow and has significant buying power.

Citi Trends' key customer has a greater propensity to purchase apparel and a greater focus on brands and fashion. As of 2012, African-Americans spend 4.4% of annual net income on apparel expenditures, compared to 3.4% by the average US consumer. 52% of apparel purchases are of trend setting fashions (compared to the 30% US average), and 67% are on unique merchandise (US average of 42%).

When it comes to difficult-to-predict fashion trends, a healthy balance sheet is a must. Citi Trends certainly has one, boasting just over $87 million in cash and cash equivalents and no debt on the books as of the end of fiscal 2016. This will come in handy should the firm make any missteps in a trend focused business.

Citi Trends has a well-diversified merchandise offering. Ladies', children's, and men's account for ~25%, 25%, and 20% of net sales, respectively. The balance comes from accessories and home décor.

Our published fair value estimate range for Citi Trends is $16-$26 per share, with a Valuentum Buying Index rating of 3 and an Economic Castle rating of Attractive.

Express (EXPR)

Though Express is quick to point to solid e-commerce sales performance, overall top-line performance and margins continue to contract.

Express is a specialty apparel and accessories retailer of women's and men's merchandise, targeting the 20 to 30 year old customer. The firm offers a combination of fashion and quality for multiple lifestyle occasions across work, casual, jeanswear, and going-out occasions. It was founded in 1980 and is based in Columbus, Ohio.

Express has made significant changes to its business model since 2007. The company has successfully reinvigorated the brand, applied data-based decisionmaking to lessen fashion risk, and executed against its outlet strategy. Its more recent operating environment has brought new challenges, however.

Express has not been spared the pain in the broader retail space. Challenging mall traffic trends and aggressive promotional activity across retail continue to weigh on results. Though management is quick to point to solid e-commerce sales performance, overall top-line performance and margins continue to contract.

The company has four growth pillars it is focusing on moving forward: 1) optimize retail and expand outlet real estate; 2) improve existing store performance; 3) drive e-commerce growth; 4) improve international performance. Profitability improvement and sharpening brand positioning will be a focus as well.

The company is not immune to competitive pressures, and gross margins, while advancing nicely since 2007, have experienced some volatility. Margin pressure has become common of late as the firm continues to battle traffic weakness and an overly promotional retail environment.

Our published fair value estimate range for Express is $5-$15 per share, with a Valuentum Buying Index rating of 3 and an Economic Castle rating of Unattractive.

Genesco (GCO)

Genesco continues to grow its store count, but omparable sales, including direct-to-consumer, continue to face pressure.

Genesco sells footwear, headwear, sports apparel and accessories in more than 2,400 retail stores throughout the US, Canada, the UK and Ireland. It operates under the names Journeys, Journeys Kidz, Shi by Journeys, Underground by Journeys, Schuh, Lids, Locker Room by Lids, Johnston & Murphy. The company was founded in 1920 and is based in Nashville, Tennessee

Comparable store sales have faced pressure and are expected to continue to do so as online retailers continue to disrupt traditional retail. Gross margin pressure and poor new store performance have also hurt overall results.

Genesco's businesses serve a fashion-conscious customer base and depend upon the ability of its merchandisers to react to fashion trends, to purchase inventory that reflects such trends, and to manage inventories appropriately in view of the potential for sudden changes in fashion, consumer taste, or other drivers of demand, including the performance and popularity of individual sports teams and athletes.

Genesco continues to grow its store count, with plans to open ~80 stores in fiscal 2018. The majority of these will be in Jouneys Kids, Canada, and the UK, but it still expects total sales to be flat to up 1%. Comparable store sales are expected to be between down 1% and up 1% from the previous year.

Competition is intense in the footwear and headwear industry. The company's retail footwear and headwear competitors range from small, locally owned stores to regional and national department stores, discount stores, and specialty chains.

Our published fair value estimate range for Genesco is $21-$31 per share, with a Valuentum Buying Index rating of 3 and an Economic Castle rating of Unattractive.

Iconix Brand (ICON)

Iconix continues to prioritize debt repayment and has done a nice job lowering its long-term debt load of late, but *we've lowered our fair value estimate as profitability expectations continue to face meaningful pressure.*

Iconix Brand is a brand management company and owns a diversified portfolio of fashion and home brands that touch every segment of retail distribution from the luxury market to the mass market. A few of its brands include Candie's, Mudd, and Joe Boxer. The company was founded in 1978 and is based in New York, New York.

Iconix is in charge of marketing/advertising, licensing and trend direction. The company has no operational or inventory risk and has aggregate guaranteed royalties of over $720 million as of the end of 2016. Its business model has very high margins.

Though Iconix may not have the traditional risks of an operating retailer, its business is not without flaw. In 2016, licensing revenue fell 3% from 2015 levels. The company recently sold its Sharper Image business for $100 million in cash, which it plans to use to help delever its balance sheet, a prudent move, in our opinion.

Iconix recently sold its interest in the Peanuts (80%) and Strawberry Shortcake (fully owned) brands to DHX Media for $345 million in cash. The company continues to prioritize debt repayment and lowered its long-term debt load to ~$663 million as of June 2017 from nearly $1.1 billion at the beginning of the year.

Iconix's men's segment has been under material pressure as of late. In 2016, revenue fell 12%, and due to the decline in the segment in recent years and based on the company's budgeting process, certain intangible assets may be impaired.

Our published fair value estimate range for Iconix is $5-$15 per share, with a Valuentum Buying Index rating of 3 and an Economic Castle rating of Attractive.

Zumiez (ZUMZ)

Zumiez targets a large population of young people, and its breadth of merchandise exceeds that offered by many other action sports specialty stores.

Zumiez is a leading multi-channel specialty retailer of action sports related apparel, footwear, accessories and hard goods, focusing on skateboarding, snowboarding, surfing, motocross and bicycle motocross (“BMX”) for young men and women. The company has over 700 stores in the US, Puerto Rico, Canada, and Europe.

The company targets a large population of young men and women, and the breadth of merchandise offered at its stores exceeds that offered by many other action sports specialty stores. We also like the firm's deep-rooted culture. Competition is fierce, however.

Weak mall traffic has been an issue for Zumiez of late. It cites a lack of a clear and compelling fashion trend within its target customer base, as well as the impact of foreign exchange rates on its international and tourism-oriented locations. The challenging US retail environment continues to impede progress in its multi-year growth initiatives.

Zumiez plans to continue its international expansion. After beginning its international exposure through Canada in 2010, it now generates roughly 10% of its revenue from international markets. Acquisitions significantly advanced its European opportunities. Traffic woes in the US are expected to persist.

Zumiez's resilience comes in part from its intense focus on employee and management training. The firm prioritizes sales and leadership and empowers workers that are passionate for the 'lifestyle.'

Our published fair value estimate range for Zumiez is $13-$23 per share, with a Valuentum Buying Index rating of 7 and an Economic Castle rating of Attractive.