

**RANDALL ABRAMSON**

# Wholesale at retail, or vice-versa...

**M**any healthy specialty retailers are selling at bargain-basement prices now, some at multi-year valuation lows.

I recommend the purchase of shares of Abercrombie & Fitch Co. (ANF-NYSE, \$9, 614-577-6500, [www.abercrombie.com](http://www.abercrombie.com)) and TJX Companies Inc. (TJX-NYSE, \$22, 508-390-1000, [www.tjmaxx.com](http://www.tjmaxx.com)), as well as the 5.25-per-cent convertible debentures of Sunglass Hut International Inc. (RAYS-NASDAQ, \$6.75, 305-461-6100, [www.sunglasshut.com](http://www.sunglasshut.com)).

The bargains are the result of several factors. In the recent technology craze, investors virtually ignored other market segments such as retailers.

Also, the perception that brick- and-mortar retailers might be vulnerable to an onslaught of e-tailers had a negative impact, along with rising interest rates.

But the depressed prices of some quality specialty retailers have more than discounted a potential slowdown and probably World War III.

Abercrombie & Fitch is the cheapest of the lot based on its solid fundamentals. The company generated \$150 million of after-tax earnings in the last 12 months, yet its entire market value is only \$900 million. A&F has announced its earning growth rate should slow this year to 10

to 20 per cent from more than 40 per cent in 1999. But it is trading for a mere six times earnings. Abercrombie & Fitch is 'GAP-like' and caters mainly to 16- to 25-year-old males. A&F reached 50 times trailing earnings, as it traded at more than \$50 at its peak last year. The stock price has now fallen more than 80 per cent from its high.

A&F is not only cheap but debt free, with more than \$100-million cash on its balance sheet. It enjoys industry-leading operating margins at 23 per cent, nearly double the average for the key specialty retailers. Its sales per square foot and returns on invested capital are at the top of the industry, only matched by Gap Inc.

With just more than 200 A&F stores the company has plenty of room to grow its core franchise. After successfully testing 14 'abercrombie' stores, which serve 7- to 14-year-olds, the company expects to add more than 40 of these stores this year.

A little market skepticism is healthy, but in this case the market has gone overboard, creating a very cheap stock and a great opportunity for patient investors. With little downside risk, I believe A&F will trade for \$25 within 12 months.

Another outstanding retailer bargain is TJX Companies. TJX owns TJMaxx, Marshalls and

Winners. As such, the company is America's leading off-price retailer. At about 10 times earnings, the company is a bargain. The stock currently trades around \$21, down nearly 50 per cent from the 52-week high that, I believe, better reflected the true value of this company and where I target the stock to return in the next year or so.

Sunglass Hut is the world's largest specialty retailer of sunglasses, with more than 1,500 locations throughout the U.S., Canada, the Caribbean, Europe, Australia, New Zealand and Singapore.

The company is very profitable, with an overall 28-per-cent return on equity. Its second concept, Watch Station, has been growing strongly, with more than 100 stores. There are 200 combination stores selling both sunglasses and watches. Growth prospects look excellent, and the company trades at only 12 times projected earnings.

While the prospects for the stock itself look good, I prefer an investment in the company's 5.25-per-cent convertible debentures, which mature June 15, 2003. It's a short-term instrument; so, if interest rates move, risk is minimized.

At its current discounted price (\$730 per \$1,000 bond), the debentures show a yield to maturity (including the gain to re-

payment) of 17 per cent per year, more than 10 per cent per year more than government bonds of the same term.

The bargain was created because the share price is trading down so far from its conversion exercise price (\$30).

This is what's known as a 'busted convert'. Convertibles are usually purchased by equity investors, but when the security's price falls so far below its exercise price, the issue trades like an ordinary bond.

But typical bond investors ignore convertibles, which are normally not rated, and equity investors would rather buy the shares. Sunglass Hut carries about \$160 million of debt, of which only about \$40 million ranks ahead of these debentures.

More importantly, the company has almost \$85 million in annual earnings available to pay \$9 million in interest, or nine times 'interest coverage'. Typically, coverage for high-yield paper is a fraction of that. At a time when it's prudent to be cautious, the yield from these low-risk debentures is very attractive.

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*Randall Abramson, CFA, is a portfolio manager with Strategic Capital Partners Inc. and Strategic Advisors Corp. He and these firms might have an interest in securities mentioned.*