Aeropostale (ARO)

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- I am not a registered investment advisor and I do not offer any investment advise
- No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments

Aeropostale – business

- Mall-based specialty retailer of casual apparel and accessories
- + e-commerce Website aeropostale.com
- Targeting 14 to 17 year-old young women and men
- Apparel, including graphic t-shirts, tops, bottoms, sweaters, jeans, and outerwear, as well as accessories, including sunglasses, belts, socks, and hats
- Casual clothing and accessories focusing on elementary school children between the ages of 7 and 12
- 895 Aeropostale stores in 49 states and Puerto Rico; 44 Aeropostale stores in Canada; and 15 P.S. from Aeropostale stores in 6 states

Aeropostale - business (cont'd)

Aeropostale – Misc thoughts

- What can go wrong?
  - Teenage retailer – very fickle audience
  - Buyers may shift to more upscale brands if low-normal ends and Aeropostale is considered too cheap
  - New CEO after the tenured (1996-2010!) CEO left
  - “P.S. from Aéropostale” kid stores may fail
  - Store saturation? (I don’t know how to measure this, but it’s important)
- Opportunities:
  - Aeropostale went through 2008-2010 recession in black with great results
  - International licensing (5 stores in UAE).

Strategic considerations

- Moat (*switching costs, habit, low cost*):
  - What are the moats? Brand, price point, but not much
  - What does it take to sustain the moats? Retain brand loyalty
  - Bargaining power of suppliers/customers? Not really
- Is it a low risk business? No.
- Is there high uncertainty? Yes
- How capital intensive is the business? Not really
- Future growth – unknown
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? Possibly understated due to recession.

Management

- I don’t usually do management analysis. Included for template completeness
- No dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV

Is it a good business?

- >10 year history of profits
- ROE:
  - 2008:65.5 2009: 42 2010:52.9 2011h1:36
- Margins
  - 2009: 8 2010:9 2011:10
- Growing earnings: 3 year sales growth 6%, earnings growth 11%
- No dilution
- Very strong balance sheet
  - Cash+current assets cover all liabilities
- ROIC = Earnings / (Equity + Debt – Cash) = Earnings / (Assets – non-debt liabilities - Cash)
  - > ROE

Is it a good business? Cash flow

- Strong cash flow
  - 2010 229M earnings, 334M operating cash flow, 280M FCF (FCF = OCF – capital expenditures)
  - Operating cash flow higher than earnings
  - Free Cash Flow/Share higher than dividends paid

Is business cheap? - Buffettology calculations

- ROE 25%
- Earnings in 10 years = ROE*Equity*$(1+ROE)^9$ = $926M
- Equity in 10 years = Equity*$(1+ROE)^9$ = 3.7B
- Market cap = 926M x P/E (15) = $13.9B
- Rate of return = ~17% after tax (calculations omitted)

- 9 year earnings growth: 28%. Assuming same earnings growth for 10 years into the future and 15 PE at the end, shareprice would grow 31% annually. Assuming 15% earnings growth: 18% share price growth.
- Not clear if the recent performance can be repeated for 10 years either in equity or earnings

Is business cheap? DCF

- Discounted cash flow
  - Current earnings of ~178M
  - 10% growth for 5 years, leveling after that
    - 15% discount -> $1.7B current valuation (if you buy company at <$1.7B, you will get 15% return or higher)
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $1.6B current valuation
  - 15% growth for 10 years, leveling after that
    - 15% discount -> $3B current valuation
- Owner's yield = earnings / (market cap + debt - cash) = earnings/EV
  - 178M / (2470M+100M-300M) = 8%

- What makes up the margin of safety? Low valuation
- Is there a sufficient margin of safety? Not clear

Is business cheap? - Graham investment considerations

- N/A for ARO – included for completeness
- 4.9 P/Book – not a net net
- Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)