

The Long/Short Investor |



Why Denim Doesn't Fade

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Jeans Are the New Trouser

How many pairs of jeans do you own? Do you own more jeans than other styles of pants? How much are you willing to pay for denim? Did you spend more on your last pair of jeans than your last pair of trousers? That's because jeans are the new trouser.

Uniquely positioned to capitalize on this cultural trend is **Blue Holdings** (BLUE), a \$115-million-market-cap company that closed last Friday at \$4.40 and I believe could reach \$7. BLUE, a designer, manufacturer and distributor of high-end fashion jeans and denim apparel, also recently announced that it has signed a definitive merger agreement to acquire **Long Rap**, which currently owns 24 high-end denim retail stores under the name "Up Against the Wall." The merger is expected to close by September 2006, according to the company.

Denim Isn't Denim Anymore

Some of the specific trends may fade, but denim is here to stay, and here are several reasons why:

- The dotcom era ushered in a new permanence and acceptance of casual.
- Designers' offerings of new denim treatments have introduced dressier cuts and finishes.
- The varieties in treatments, tailoring and lifestyle brands offer unique and fun ways for all to express themselves and tell you something about who they are without having to speak.
- Television shows such as "Sex and the City" and "Desperate Housewives" helped shepherd in a new permanence, acceptance and perspective on denim for the older Boomer demographic that already vowed to stay young as they found visual inspiration from these image-driven manifestations of culture.
- BLUE also is an illustration of what my firm calls the [Demographic Convergence Thesis](#) that I frequently [discuss](#). The end of the generation gap has old and young acting a lot alike. Denim is no longer what you put kids in but a sophisticated option for either a first date or dinner with your spouse.

Diversified Denim

BLUE makes for an interesting play as the to-be-acquired stores will continue to sell competitor labels, including high-end brands such as **True Religion** (TRLG), Seven for all Mankind, Citizens, LRG and Red Monkey as well as BLUE's marquee brands Antik Denim, Yanuk and Taverniti. A pure play is always fun, but requires impeccable timing and taste. This play allows one to make a denim trade. For instance, here you don't have to worry about the life expectancy of the demand for a brand like True Religion, which I have owned as well. Also, as the hottest brands cool off, BLUE now has a platform to continuously offer the latest "it" labels, even if that doesn't include its own at the time.

Some Numbers

The stock is off 50% over the last 52 weeks and is trading below its 50- and 200-day moving averages; together with the Up Against the Wall deal in the pipeline, BLUE offers a great opportunity. For those who like to see large insider holdings, BLUE posts 70%. The company's year-over-year EPS increased by 75% in the second quarter, and revenue increased by 167%, with a continued strong growth outlook.

BLUE has a P/E of approximately 14, which is at the low end of the range for this space and is trading near IPO levels. The company's operating margin has cooled off, but this is a function of investments.

The Consumer

If you are concerned about the slowing consumer, here are several reasons that I outlined in my [last piece](#) that should provide some comfort:

- One part of the consumer story that I think many are missing is that higher gas prices have been subsidized by the ailing auto companies with both lower prices and higher incentives.
- The teen and young adult segment of the consumer space, which is more Up Against the Wall's tilt, is insulated from broader market dynamics as teen spending continues to grow and they have less cause for concern for overall market dynamics such as a reduction in housing prices. Teen Research Unlimited observed teen spending at \$169 billion in 2004 (growing at 5% a year for the past seven years). Again, being cool is not about to cool off any time soon, so I wouldn't expect this number to retreat.

Risks and Stop Loss

Risks include broader market selloffs as some investors are extremely jittery over tick-by-tick economic data and expect for the consumer to slow just because he/she has in the past. As I have said before, this is a different era in which credit is used to update wardrobes. The Up Against the Wall deal could fall through, however, I think the deal offers many synergies for both experienced parties. And even if the deal flops, BLUE still possess the compelling characteristics of a good investment at current levels. The company also does not have a huge float and does not offer much liquidity with its low trading volume. A stop loss of 10% to 15% from current levels will probably indicate that the markets have made a directional turn against the consumer, but prospects look more bullish as we enter the back-to-school and holiday seasons. My investment horizon is 12 months to 18 months.

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