

# Street Insight

## The Long/Short Investor |



### Long VLCM: Skate Your Way to Returns with the New Edge in Lifestyle Trends

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For all posts on VLCM in the past year, click [here](#).

Remember the crowd in high school (Gen X-ers and beyond) that was too cool to bother trying to be mainstream cool, the "skate crowd"? Well, this crowd's swagger is now emerging as the new lifestyle and fashion edge. As the hip-hop aesthetic no longer conjures up as many offensive feelings as a result of being fully embraced by suburban youths, a new crop of rappers are professing the mantras of the skate crowd. This trend is not only transcending cultural demographics, but also, age and geographical ones as well.

#### Welcome to Planet Volcom

Uniquely positioned to capitalize on this cultural trend is **Volcom** (VLCM), one of the most authentic and distinctive brands of "board" culture (skateboard/surfboard/snowboard). Shares of the \$494-million-market-cap company are just off of a fresh 30% selloff. This selloff was a result of an announcement by one of the company's largest accounts, **Pacific Sunwear** (PSUN, 29% of VLCM's sales) that 3Q06 orders would be lower. However, some, including myself, believe that this could actually be perceived as a positive for VLCM. PSUN is not perceived as being on the cutting edge, in my opinion, because its presence in malls has been around for too long and under a different connotation and era. On the other hand, **Zumiez** (ZUMZ) (another fast-growing name in this space that I like, but with a much higher P/E of approximately 55) has only recently begun to really expand its store and brand footprint across the states via special events with professional skaters and well-known bands. ZUMZ is seen as a fresh presenter of this space's culture. As such, PSUN has been losing marketshare to ZUMZ, which is also another major and important account for VLCM.

#### Cultural Convergence: The Skater-Rapper

Examples of the skater-rapper cultural convergence include superstar music producer Pharrell Williams (who has produced hit records for rappers such as Ludacris and pop stars like Britney Spears), now known as Skateboard P, and Lupe Fiasco whose first single "Kick Push" from his new album refers to the action taken while skating. Just last week, the *Wall Street Journal* featured a story on Jay-Z's clothing line Rocawear that will now feature a "Custom Fit" line. This is all on the heels of the X-Games (skateboarding, motocross, snowboarding, etc.) moving from only being occasionally seen on ESPN 2 to primetime on NBC. Further, now you can see professional skateboarders such as Tony Hawk (who has his own video game and clothing line), on Home & Garden television shows showcasing their beautiful homes that were paid for by all the proceeds from their skating conquests.

### **Age Convergence: 40-Year-Olds Dress Like They're 20-Year-Olds**

This trend's legs reach even further as a recent article in *New York* magazine, (April 3, 2006, "Up With Grups") about Grups, grownups that don't want to grow up, or as our dear editor calls them, "just slobs," proclaimed to be "...an obituary for the generation gap... a story about 40-year-old men and women who look, talk, act, and dress like people who are 22 years old." At our firm, we refer to it as the Demographic Convergence Thesis. The article goes on to include anecdotes about 40-year-olds buying skateboards and rock t-shirts, not only for their kids, but also for themselves. Or as *New York* magazine put it, "for a Grup, professional success is measured not by how many employees you have but by how much freedom you have to walk, or boogie-board, away."

VLCM highlights:

- According to Board-Trac, the boardsport segment (\$12 billion) is growing faster than the overall apparel market.
- VLCM has only reached about half of its penetration here in its domestic accounts.
- Strong European growth prospects remain, as the company takes back control from its licensee at the end of 2006, a move that **Quicksilver** (ZQK) found successful. This augurs for international revenue growth.
- VLCM has one of the lowest P/E's in the space at approximately 17 (ZUMZ has a PE of 55, and ZQK has a PE of 20).
- After a recent 30% selloff, VLCM offers a great opportunity, especially going into the back-to-school market.
- The stock's recent retreat has returned it to almost IPO levels.
- The brand has not suffered at all in the same way that the issues have and should benefit from the continued growth in popularity of this space.
- VLCM is trading at a forward P/E of 14 based on consensus estimates for earnings in 2007 (\$1.44, 29% higher than consensus EPS estimates for 2006 of \$1.12), which I view as quite cheap given the growth prospects for VLCM.
- This trend is transcending cultural, age and geographic lines, and is reinforced through other lifestyle mediums.
- Based on an average price target of \$32.25, appreciation prospects suggest 60%+. My investment horizon is 12 months.

### **Comfort for the 'Slowing Consumer' Theorists**

If you are concerned about the slowing consumer, there are several factors which can provide some comfort. First, this segment of the consumer space is a little more insulated from broader market dynamics as teen spending continues to grow. Teens also have less concern for the overall market dynamics as this demographic is not as concerned with the reduction in value of their homes. Second, teen spending continues to grow. Teen Research Unlimited (TRU) 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. Third, this space is set to grow further as the Grup lifestyle shift continues (see above) and includes both a larger age demographic and geographic footprint as this trend makes it way from the larger cities to Middle America.

### **Risks and Stop Loss**

Risks include broader market selloffs as some investors are extremely jittery over economic data and expect the consumer to slow just because he/she has in the past. This is a different era where credit is used to update wardrobes, and not as an emergency resort. Next, the transition of the European business could have some trip-ups, but the management team in place seems to have a good understanding of their international prospects (as well as their U.S. prospects, with systems in place to

guarantee that they can be "consistently inconsistent," or cool) and have ZQK's experience to draw from. A stop loss of 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.

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*Long VLCM*