Vitamin Shoppe: Will Vitamin Shoppe Make It?

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While most companies, even at a 52-week low, are fairly valued, Vitamin Shoppe (VSI) is an exception. Let us define “fairly valued” as a common stock that trades within the range of the average 10-year earnings per share and the average earnings multiple range. For example, if the 10-year average earnings per share was $1 and the earnings multiple was between 10 to 15 times, then the fairly valued range would be $15 to $10. With that in mind, I sampled a few stocks that traded at a 52-week low. Only Vitamin Shoppe traded below the “fairly valued” range.

Before we go over why capital markets lowered Vitamin Shoppe's valuation, let me sidetrack and mention that there three assumptions that you make when you purchase a stock based on the 52-week low valuation. First, capital markets are wrong to discount the specific common stock price. Second, the current price is low in comparison with both the past and the future. And, most importantly, capital markets will eventually come back to their senses. While it is often the case that you can purchase stock based on one of these assumptions, it is rare to find all three. Now let us get back to the particular case of the Vitamin Shoppe.

Looking for reasons why capital markets have punished Vitamin Shoppe's stock price, I visited three stores in San Diego. When I asked the first store manager about the drop in stock price, he brushed me off and mechanically said: "I can’t discuss or disclose any information, either professional or my opinion, about my employer. I am obligated to forward all questions to the corporate office."

The second store’s manager replied in the same light: "Noam, I wish I could assist, but this is not something with which I can help." Perplexed by his use of the word "can," I pondered the world of political correctness and corporate mannerisms in which we live and in low spirits, I headed to the third store.

It was a female client of Vitamin Shoppe that came to the rescue. "Listen, in my opinion, it is awfully simple," said a fit, 30-something-year-old that works as an account manager for a local Genomics company. "There is a growing fear that Amazon will crush the company. Add to that a decline in sales alongside a huge write-off this year for the Nutri-Force acquisition. Honestly? The Street thinks the company is a walking zombie." Surprised by her Wall-Street savviness, I asked her why she continues to shop at Vitamin Shoppe. "To learn about new stuff," she answered.

I returned to my desk, hoping to understand how much Amazon (AMZN) was an immediate threat. I learned that the Vitamin Shoppe is a company based on salesmanship, not on technology. Website sales represented about 10% of the total revenue and I couldn’t find a reason to believe that management had any desire to relocate to Silicon Valley from New Jersey any time soon.

Quite the opposite. In the annual report, management explained that the company intended to upgrade the in-store shopping experience by remodeling stores and to add 15 new stores this year (the company leases 137 locations). To paraphrase management: “We will continue to do what we know best.”

I went ahead and purchased a few shares in Vitamin Shoppe. It was partly the objective stock price and partly my subjective desire to learn more about the business. As an admirer of business models, I found three qualities that made Vitamin Shoppe's business model appealing.

First, their products can stay on the shelves for a long time. Second, in the spirit of what the Vitamin Shoppe client told me, there is still value in purchasing the product in a physical store (just don't remind me what happened to bookstores over the past decade). Finally, Vitamin Shoppe had done reasonably well in the past and I didn't find any reason why it shouldn't do well in the future. Just look at the table below.

Before I leave you to research the company and its prospects on your own, let me comment on the adjusted net income calculation. The goal behind the adjusted earnings figure is to find how much cash is left to the common shareholder. To do that, I used actual cash spent on interest and actual cash spent on income taxes. This is materially different from the same line items as reported on the income statements. I also deducted from net earnings capital expenditures because they are both recurring in nature and essential to run the business.

What can you infer from the adjusted net income per share? If the historical record is of any indication of future value, then you get $0.42 to $0.10 of adjusted earnings on a purchase price of about $5, which is a yield of 8% to 2%. I will leave you to conclude whether it is an adequate return (yours truly thought it was).

Finally, my usual disclaimer: The goal behind these posts is to share how I view a specific company but not to entice you to act on it. Besides, purchasing a stock is easy. Holding it when capital markets view the position unfavorably is hard. In short, this is only a piece of the puzzle and you will need to solve the rest on your own.