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Betting on Under Armour to fall

Despite doubters, sports apparel maker's stock stays hot

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Sports apparel company Under Armour Inc. is popular among more than just gym rats and teenage athletes.

Short sellers, who try to make money by betting that the price of a company stock will fall, have made Under Armour one of the hottest stocks for short sales on Wall Street in recent months.

About 37 percent, or 10.5 million shares, of Under Armour's stock is owned by short sellers -- excluding shares owned by company insiders. In a July ranking by Bloomberg News of companies with more than 10 percent of shares available for short trading, Under Armour ranked 25th among companies with the largest amount of short sales on the New York Stock Exchange.

"There are a lot of people making bets against it," said Geoffrey Garbacz, a principal at Quantitative Partners, an institutional research firm in Wisconsin. "They just feel the growth isn't going to continue forever."

But so far, the gamble that short sellers are taking has been stonewalled -- by a large block of investors who believe Under Armour stock will move even higher. Rather than falling, Under Armour stock has been increasing to record highs during the past several months as investors push up demand for shares. The stock reached a record high of $67.10 on Thursday -- it has jumped about 8 percent since the company released second-quarter earnings July 31 and raised its financial outlook for the year. The stock is up about 32 percent so far this year. Shares closed Friday at $66.44.

These diverging views have created a Wall Street money battle on which direction the stock will turn. It's another chapter in the story of Baltimore-based Under Armour, a rapidly rising company that went public two years ago and has seen its stock price move widely as it grapples with the praise and criticism that come from its new life in trading publicly.

Institutional investors, who are satisfied with the business fundamentals of the company and aware of its popularity among athletes and non-athletes alike, have been buying the stock and pushing up its price.

"That is causing a problem with short sellers out there because they're betting the stock will fall," said David Lutz, a trader with Stifel Nicolaus & Co.

A short sale involves a block of stock that an investor borrows, typically from a brokerage. The borrower sells the stock at what he or she hopes is a top price. If the shares fall, the borrower buys back the stock at the lower price and returns those securities to the brokerage. Anything left is profit for the borrower. But if the stock goes up, the borrower has to cover the higher price with his or her own cash.

"With some wiggles and waggles, the short interest has progressively grown higher even as the stock has stayed in the upper echelons," said Phil Erlanger, who owns Phil Erlanger Research, an investor research company. "For whatever reason, the market is telling the short sellers they're wrong."

Under Armour executives declined to comment for this article, noting a policy of not discussing the company's stock activity. But Kevin A. Plank, Under Armour's chief executive officer and president, has said in the past that the company's performance has to be considered over the long run.

Price questioned

Several top institutional investors and companies who specialize in shorting stocks also declined to discuss their Under Armour investments, saying company policy does not allow them to talk about stock prices and holdings.

It is not surprising that Under Armour's stock is hot among short sellers, several analysts said.

Since the company became publicly traded in November 2005, its stock price has prompted frequent Wall Street criticism. Many analysts have wondered if the company can maintain a large enough growth in sales to justify its stock price.

"When you have a lot of shorts you have a lot of nonbelievers," said Daniel Scalzi, an analyst with Matrix USA who believes Under Armour's stock is overvalued and has a "sell" rating on it.

The company's price-to-earnings ratio -- the most common Wall Street gauge in determining how expensive a stock is relative to its market value and earnings during the past year -- is 78.16, according to Bloomberg statistics. In comparison, Nike, which dwarfs Under Armour, has a P-E ratio of 19.57. Under Armour has revenue of $467.32 million, Nike $16.3 billion.

"That's a pretty high number, even for a growth company like Under Armour," Morningstar stock analyst Brady Lemos said of its P-E ratio. "If they keep growing like they've been growing, that's how I think they could get to the current stock value, but that's pretty optimistic."

"I think there's plenty of room to grow," Lemos added. "But I just think over time it's going to be difficult to sustain the type of growth they have now."

It's not unusual for a new company that is expanding to be valued higher than companies with established roots. But some analysts believe Under Armour has passed that threshold. A number of risk factors leave the company vulnerable to a slowdown in growth, they said.

"If they hit any blip, that stock is going to hurt," Scalzi said. "The stock sort of acts on its own. We would stay away because of the valuation, not because of the fundamentals."

Under Armour's sweat-resistant clothing isn't patented and, therefore, not as resistant to competition. Under Armour owns about 75 percent of the form-fitting compression wear market, but Nike, Champion and Adidas are among companies that have developed similar lines.

The company is also entering categories with lower gross margins, including footwear. Profit margins dropped slightly the second quarter of last year, from 51 percent to 47.8 percent, after the company introduced football cleats. Wall Street responded by sending the stock down 80 cents the day it reported earnings. This was despite it taking 20 percent of the football cleat market.

But Wall Street rewarded Under Armour's stock last week -- which is rare for the company around earnings time -- after it reported stronger-than-expected second-quarter earnings and raised its financial guidance.

More competitors

Under Armour will soon enter the noncleated footwear category, where there are more competitors. Analysts predict Nike and other companies will defend this turf more aggressively than they did football cleats.

The company is expanding internationally and hopes its women's line, which makes up 24 percent of sales, will one day become as large as men's products. It recently launched a marketing and advertising campaign aimed at female consumers.

Still, some analysts have questioned whether the company is using the right tactics to go after women. Others said the overseas market is a tough one to break into. Goldman Sachs analyst Margaret Mager recently wrote in a report that the Under Armour brand isn't as well-known outside the United States. She predicted that it would take the company longer to become established overseas than it did in the U.S.

Even as some analysts criticize the company's market value and stock price, many applaud its business model. It's one of the more popular sports apparel brands on the market right now.

"They keep putting out great growth numbers, great margin numbers," Lemos said. "It's clearly a very popular brand right now."

Joseph Parnes, president of Technomart Investment Advisors and editor of the market letter Shortex, which writes about short and long trading, said the fundamentals of the company make it unattractive as a short-sell investment.

"On the long-term basis I don't think it's overvalued," Parnes said of Under Armour. "It will probably be very fruitful in the long run."

As for the practice of short selling, the issue has garnered more scrutiny during recent years.

Overstock.com, which sells electronics, kitchen goods and other discounted brand-name products over the Internet, is suing several brokerages for allegedly causing its shares to drop by manipulating the market through short selling.

Overstock claims the brokerages took short-sell orders with no intention of covering them with borrowed stock.

In Under Armour's case, some analysts say short sellers may already be feeling the squeeze. They could be causing the stock price to rise by buying the stock back to cover their loans.

"If those shorts are wrong," Scalzi said, "it's terrific for the stock."

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