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Stupid Investment of the Week

Commentary: Shopping-mall operator is a case of good company, bad stock

By Chuck Jaffe, MarketWatch
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BOSTON -- If you want proof that one man's treasure is another man's trash, you need only look to the stock market these days, where certain sectors have been pummeled to the point where some investors have gone bottom fishing, hoping to find bargains from the fallout of the real estate bubble, subprime mortgage situation and credit crunch.

Frequently, the bargain hunters are using price declines as their major decision point, believing that a market beat-down is nothing but a brief pause for a stock that has decent long-term prospects.

One such "gem" would appear to be the Simon Property Group, owner of one of the world's leading shopping mall portfolios, which is off more than 35% from its 52-week high, prompting some analysts to say it's worth buying now.

Dig a bit deeper and you may come to the conclusion that Simon Property (SPG) is a Stupid Investment of the Week.

Stupid Investment of the Week highlights the characteristics and conditions that make a security less than ideal for the average investor, and is written in the hope that showcasing trouble in one case will make it easier to find elsewhere. While obviously not a purchase recommendation, neither is the column meant to be an automatic sell signal, as there are times when bailing out on a troublesome investment serves to compound the problem.

Simon Property represents the quintessential stock that has been hurt more by industry problems than by its own doing, which is precisely why some investors expect it to make a quick round-trip back to its previous highs.

There's no denying Simon Property has great assets, nearly 380 malls encompassing more than 250 million square feet, spread throughout North America, Europe and Asia. The firm's occupancy rates top 90%, and with average sales per square foot of nearly $500, you'd be hard-pressed to find a retail real estate investment trust that looks like a better partner for your business.

Management owns about 15% of the corporate stock, which is a good sign that the brass has aligned its interests with shareholders. That said, if the interests ever get out of whack, the Simon family will likely get its way, because it controls three seats on the board of directors; combine that with the DeBartolo family - which owns another 6% of the outstanding shares and controls another three board seats - and nearly half of the board is essentially guaranteed to be in management's pocket.

More declines ahead?

While Simon Property shares finished 2007 down about 11% and have lost nearly 8% more thus far this year, the blow is softened significantly by a dividend yield that now stands above 4%. And memories of a stretch from 2003 through 2006 -- where the worst calendar year produced a 23% gain and the best delivered a gain twice that size --will convince many investors to hang in.

Despite those plusses, the problem with Simon Property is that the beating to this point hasn't been nearly severe enough, leaving a stock that appears to have significantly more downside risk than upside potential.

David Trainer, president of New Constructs, a Nashville, Tenn.-based research firm that relies on footnotes and off-balance sheet accounting to try to come up with a clear picture of a company's prospects, says that Simon Property shows a "misleading trend," namely that reported earnings have been increasing while operating profits have been declining.

New Constructs just put SPG on its monthly list of the 20 "most dangerous" stocks, and Trainer noted that analyzing "accounting distortions" brought him to the conclusion that the stock is trading at 75 times its true book value (what New Constructs calls "economic book value"), "which means the company is going to have to increase its operating profits by 7500% to justify the price."

"There's an enormous amount of growth embedded in the stock price," Trainer added. "People may say it's beaten down now, but I believe it has a lot further to go. It's a train wreck waiting to happen."

Not everyone agrees, as several firms have the stock rated as a buy. While Morningstar Inc. just dropped SPG to a four-star rating, the stock remains in the buy range, with analysts putting a fair-value estimate of $92 per share on it, which would represent a gain of roughly 12.5% from current levels. That's the kind of bargain scenario that is starting to draw investor attention.

Murky outlook

In the end, however, Simon Property is no better than a mixed bag in a troubled industry. The yield on the stock is a bit low compared to the competition, the industry itself is likely to dampen returns for the foreseeable future, and few sectors have as much potential as the shopping mall business to head south in a recession. While the economy may be able to avoid an actual recession, consumer confidence and investor optimism measures suggest that sentiment could drive down spending, which won't help Simon Property get out of the doldrums.

At the very least, Simon Property appears to be in a situation where it qualifies as a "good company, bad stock," overvalued for the foreseeable future, and destined to take the full brunt of whatever hit comes to its industry. At most, there's that dangerous issue that Trainer notes, a balance sheet that shows growth while the business is actually in decline and headed for a big fall.

Either way, there's enough uncertainty and danger to make SPG the wrong candidate for a REIT turnaround play, and not enough positives to see its short-term potential to become a treasure. For the time being, at least, it is likely to prove the point that while the market may kick an entire industry in the pants, some stocks in the sector will take the blow particularly hard and will require much more time before they can rebound from the blow.

Chuck Jaffe is a senior MarketWatch columnist. His work appears in dozens of U.S. newspapers.

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