The Stock Picker's Guide to Reitmans in 2014

Description

Reitmans (TSX:RET.A) is Canada's largest specialty women's fashion retailer, operating stores under several different banners, including:

- Reitmans: 355 stores, catering to women of every size and shape
- Smart Set: 138 stores, catering to younger women
- RW & Co.: 77 stores, catering to women with an urban mindset
- Thyme Maternity: 71 stores, catering to pregnant women
- Penningtons: 151 stores, catering to plus-size women
- Addition Elle: 103 stores, also catering to plus-sized women, but with trendier clothes

The company was established in 1926 as the Reitman family expanded from one store in Montreal to two, and has been controlled by the family ever since. Jeremy Reitman has been the CEO and chairman since 1975 and his brother Stephen has been the COO since 1984. Together they grew the company to over 950 stores under all banners by 2010.

And then, it started to unravel.

Suddenly, same-store sales growth started to slow, and then dipped into negative territory. The company's buyers weren't making such good decisions anymore, leaving the company with inventory that needed to be discounted, hurting profit margins. It instituted a new, state-of-the-art inventory system in 2012, which was a bit of a disaster, leading to a one-time charge.

Target (NYSE:TGT) entered the Canadian market in 2013, further cutting into the company's sales. The culmination of all these missteps was in December, when the company announced, in a move to conserve cash, that it would be cutting its quarterly dividend 75%, from 20 cents per share to 5 cents.

Investors hit the stock hard, as shares slid from over $18 during the early parts of 2011 to current levels right around $6. Various dividend ETFs dumped the stock after the dividend cut. Analysts have cut their ratings on the company. And yet, I think management is taking the right steps to turn around the stock.

Store count has been reduced over the past few years, as more than 50 non-performing stores have been closed. The company has also signed a deal with Babies-R-Us to open 188 shops within existing Babies-R-Us stores to sell Thyme Maternity wear. It has also entered into a relationship with **Sears Canada** (TSX: SCC) to start selling plus-sized clothes starting in five test stores. And it has entered into agreements with large e-commerce sites in both New Zealand and Australia, getting its clothes into those new markets.

Additionally, it has revamped its websites in Canada, finally giving each brand an exclusive online shop of its own. This goes hand in hand with the new inventory system, as now the company knows, in real time, just how much inventory each store has at one time. This allows it to better manage its product, and will hopefully reduce the amount that gets discounted.

All these changes were enough to attract the attention of Prem Watsa, value investor extraordinaire from **Fairfax Financial** (TSX:FFH), who is sometimes referred to as Canada's Warren Buffett. He announced in December that he had acquired 13.8% of the outstanding class A shares, causing the stock to temporarily pop 7% on the news.

The Reitman family controls the company through a dual-class share structure. Class A shares are non-voting, meaning investors have no say on operational matters. This isn't a huge concern to me, since both classes of shares trade for close to the same price. Insiders own 57% of the voting shares, as well as 7% of the non-voting shares. Management is clearly motivated to get the share price back up, and investors always like to see management have the confidence to own a big chunk of the company.

The balance sheet looks great too. Nearly 40% of the company's value is in cash, it has a minimal amount of debt, and has been buying back shares steadily for years, including authorizing an additional 4 million shares for 2014, which represents about 5% of outstanding shares. While current earnings may indicate the dividend is at risk, there's plenty of cash in the bank to cover it.

Foolish bottom line

I think Reitmans is doing the right things to eventually right the ship. The Canadian dollar has gone down, giving it a bit of a break on the cost of inventory. It spent a bunch of money fixing up stores over the last couple of years, which should start to pay dividends shortly. Investors who get in at these depressed levels could be rewarded in the long term.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TGT (Target Corporation)
2. TSX:FFH (Fairfax Financial Holdings Limited)

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