Leon’s Furniture Ltd. Is an Outperformer You Can Count on

Description

Over the past 50 years **Leon’s Furniture Ltd.** (TSX:LNF) has grown to become Canada’s largest retailer of home furnishings, appliances, and electronics. It owns over 300 retail locations under various banners serving the public. It’s also the largest commercial retailer to builders, developers, hotels, and property management companies.

While the business seems rather boring from the outside, the company has grown dividends by 11% annually since the first decade, with an average return on equity of over 16%. What’s made this company so successful, and can investors count on a future with similar returns?

Management has significant skin in the game

The management team and directors control roughly 67% of the total outstanding shares. This level of ownership, while seemingly risky to minority shareholders, has allowed Leon’s shares to dramatically outperform the market over the long term due to management incentive to grow shareholder value. Over the past 15 years, Leon’s stock is up 270% versus only a 115% advance for the TSX.

Acquisition clears room for growth

In 2013, Leon’s bought out their largest competitor, The Brick Ltd., in a $700 million deal. The deal provided access to national buying opportunities in merchandising and marketing and a national distribution network that will improve their online shopping capabilities.

Since eliminating its largest domestic competitor, Leon’s has focused on integrating the new businesses. Because The Brick Ltd. was less efficient with their costs, Leon’s SG&A spending jumped from 32.7% of revenues to 37% after the deal. If the company can streamline its acquisition to its former level, it would result in over $100 million in savings.

Leon’s also has reduced a significant amount of the debt involved in the acquisition. In the past two years, the debt has been reduced by $125 million down to $310 million. With an improved financial position, synergy opportunities, and less direct competitors, Leon’s is in a healthy position.

Respectable growth targets with a low valuation and volatility

Management has noted that it expects EPS to grow at 5-10% over the long term. In 2016 analysts are expected earnings to grow 8.7%, reaching $1.12 a share.

At that level, shares would only be trading at 14.2 times earnings. This results in a 7% earnings yield on a company that has demonstrated less volatility than the TSX overall during periods of turbulence. In fact, shares have a beta of only 0.2 times that of the market.

Buy and hold for the long term

Year-to-date, shares are actually down 11% versus a market return of negative 2%. With a reasonable valuation, a 2.5% dividend, and a history of long-term success, Leon’s Furniture is a great buy-and-hold investment.

CATEGORY

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