Gerry Schwartz or Heather Reisman: Whose Stock Should You Buy Now?

Description

For those who don't follow the personal lives of high-powered business executives, you might not realize that Gerry Schwartz and Heather Reisman, CEOs of **Onex Corporation** (TSX:OCX) and **Indigo Books and Music Inc.** (TSX:IDG), respectively, are married to each other.

And up until recently, Schwartz's private equity firm was the stock to own of the two—hands down.

But almost out of nowhere, Reisman and her team have managed to gain some traction with their transformation of Indigo into something other than music and books. Gifts, technology, and kid's toys have become a much bigger piece of the total revenue pie—and a much tastier one at that.

Investors have taken notice, pushing Indigo's stock to a 52-week high of $18.26 midway through Wednesday's trading. The last time it hit $18? Over 16 years ago in January 2000. Back then there actually was music in the stores. It's been a long haul for the 67-year-old native of Montreal.

That's not to say the comeback is complete. There are still some problems in its business that need sorting out.

The first issue is Indigo's small-format stores. While the performance has been more than satisfactory—they had Q3 2015 same-store sales growth of 13.4%—there just isn't a need to keep them around, and this is evidenced by the four store closures in 2015.

Add to this the fact that online revenues in the third quarter were just $2.3 million less than the $56.4 million generated by 126 small-format stores; in essence, you are paying rent on 126 doors with average revenue of approximately $1 million per year, or about 15% of what each superstore generates on an annual basis.

The small stores have to go.

Secondly, online sales, while growing at a double-digit clip—17.9% in the third quarter—they still only represent 14% of overall revenue. In 2011 online sales accounted for 9% of Indigo's overall revenue. Is growing your online business as a percentage of sales by 500 basis points a good showing? I don't think so.

The third problem for Indigo is profitability. Through the first nine months of fiscal 2015, its adjusted EBITDA was 7% of revenue; in fiscal 2010 it was 7.5%. It's done little to reduce the cost of running its business. That needs to improve. By comparison, **Barnes & Noble's** EBITDA for its retail group in 2015 was 7.8% of its US$4.1 billion in revenue.

As for Onex, it's got a lot more moving parts, making it a little tougher to assess how its business is doing. Private equity is become very popular in recent years, so it's no surprise that Onex's stock is up 15.5% on an annualized basis over the past five years through May 17 compared to 1.0% for the S&P/TSX 60. Down 10.3% year-to-date, its seven-year winning streak could come to an end if it doesn't pick up the pace in the second half of the year.

Onex tries to meet two long-term goals for its business. First, it seeks to grow its capital per share by 15% per year. Over the past five years, it's achieved just 9% per year due to higher than usual cash balance and a mark-to-market decrease in the value of its collateralized debt obligations. So, this number is always changing. The second goal is to grow its fee-generating assets by 10% annually. It delivered 11% annual growth over the past five years, so it's batting 50%.

If **Amazon** didn't exist, the choice for me would be Indigo because it's a miracle it's making money given how big a hole it dug for itself over the last few years. However, as soon as Onex puts its cash to work, its goals will likely be met and then some.

Long term, I'd go with Gerry Schwartz and Onex. But it's not an easy choice by any means.

CATEGORY

1. Investing

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1. TSX:IDG (Indigo Books & Music)
2. TSX:ONEX (Onex Corporation)

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