The Rematch: Onex Corporation vs. Indigo Books and Music Inc.

Description

It's been nine months since I first pit **Onex Corporation** (TSX:ONEX) against **Indigo Books and Music Inc.** (TSX:IDG), a contest that Onex won, so I thought it made sense to have a look to see if anything has changed at the two companies that would merit overturning my May 2016 recommendation.

Something has changed at Onex since then that bears mentioning, but you could hardly call it earth shattering — although it does make a lot of sense. At the end of October, Gerry Schwartz and company changed its stock symbol from OCX to the four-letter ONEX — a much easier symbol to remember.

I'm not sure what Indigo could do to match that.

I suppose it could always get rid of IDG for IBM (Indigo Books and Music, not the technology company) but clearly, Heather Reisman has transformed Indigo into a purveyor of gifts making the IBM moniker not nearly as useful as it once could have been. Oh well.

As Onex is the incumbent, I'll start with Indigo and what's happened, good and bad, over the past nine months.

- The all-important holiday quarter, ended December 31, 2016, was a hit. Same-store sales increased 3.8% in Q3 2016 to $400.3 million.
- Pre-tax earnings increased 7.3% year over year to $54.4 million.
- Non-book categories, such as toys and lifestyle gifts (think: scotch rocks for men, soft blankets for women), did very well, accounting for 43.2% of the company's revenue — 370 basis points higher than a year earlier.
- As Fool.ca contributor Karen Thomas reminded readers February 9, online sales increased 11.8% in the quarter to $60.5 million, or 15.1% of its overall revenue — 100 basis points higher than a year earlier.
- The company's 50% equity investment in the Calendar Club delivered $2.9 million in net earnings in the third quarter — 20.8% higher than a year earlier.

- It finished the quarter with $316.3 million in cash and cash equivalents.
- The only downside: its print category, which includes books, magazines, and newspapers, experienced a 2,8% decrease in revenue to $215.3 million.

Overall, I’m relatively impressed with its performance through the first nine months of the year. My only real concern is that it’s still not generating enough profits. In the nine months ended December 31, 2016, its adjusted EBITDA margin was 6.8% — 20 basis points less than a year earlier.

Considering its revenue mix is moving more toward general merchandise, which has higher margins, and it’s less reliant on books, I would really like that number to be higher. However, it could finish the year with free cash flow as high as $35-40 million.

If it does that, its free cash flow yield would be around 8%, making its stock a good buy.

Now, on to Onex. Here’s what’s happened, good and bad, over the past nine months.

- In November, it closed its fourth mid-market private equity fund, raising $1.1 billion for its ONCAP private-equity platform. ONCAP generated a gross internal rate of return of 43% over the past 16 years.
- It acquired U.S. grocery store chain Sav-A-Lot for US$1.4 billion. Onex gains a business with 1,370 stores across the U.S.
- Onex announced in December that it was acquiring Parkdean Resorts, a U.K. camping-resort operator, for US$1.7 billion.
- In January, rumours began circulating that it was close to acquiring the Ferrara Candy Co. for US$1.3 billion including debt. At over 100 years old, Ferrara brands include Rain-Blo and Fruit Stripe gum. Annual revenues are around US$880 million.
- It finished the third quarter (September 30, 2016) with a lot of dry powder to make investments, including $1.7 billion in cash and near-cash, along with $2.2 billion of uncalled committed capital from its partners. It’s ready to make a deal or three.
- The downside in the past year has been the inability to meet its long-term goals of growing its capital per share by 15% annually (6% over the last 12 months through September 30, 2016) and fee-generating assets by 10% annually (2% over the same 12-month period).

Over the past 12 months, Indigo’s total return was 25.8% compared to 26.2% for Onex — a statistical dead heat. However, what continues to pull me in the direction of Onex is the fact its stock continues to do reasonably well, despite the fact it’s not meeting the long-term goals it has set for itself. It will, and when it does, watch out.

Actually, I’d be comfortable owning both stocks at this point.

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2. TSX:ONEX (Onex Corporation)

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