Gordmans Stores (GMAN)

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Disclaimers

• I am not a registered investment advisor and I do not offer any investment advice
• No parts of this talk are suggestions to invest, not invest, buy or sell any kind of securities or other financial instruments
Gordmans Stores - business

- Discount department stores - Kohl’s and TJ Maxx hybrid?
Gordmans Stores - business (cont’d)

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Gordmans Stores - Misc thoughts

• What can go wrong?
  • No moat
  • Competition from below (TGT, WMT), same level (Kohl’s, TJ Maxx, Ross) and above (Macy’s, etc.)
Gordmans Stores- Misc thoughts

• Opportunities:
  • Small size, room to grow
  • Budget segment continues to flourish?
Strategic considerations

- **Moat (switching costs, habit, low cost):**
  - What are the moats? None
  - What does it take to sustain the moats? None
  - Bargaining power of suppliers/customers? None
- Is it a low risk business? Somewhat.
- Is there high uncertainty? Yes.
- How capital intensive is the business? Somewhat.
- Future growth - Unknown
- Are the revenues and cash flows of the business sustainable or overstated / understated due to boom or bust conditions? No
Management

- I don’t usually do management analysis. Included for template completeness
- Some dilution
- Can I trust management?
- Management shareholding (> 10%)
- Management incentives?
- Are the salaries too high?
- Is there heavy insider buying?
- Is there heavy insider selling?
- Do I like the management? (Operators, capital allocators, integrity)
- Profitable reinvestment
- What has management done with the cash?
- Where is Free Cash Flow invested? Share buybacks, dividends, reinvested, ROE & ROCE, incremental BV
Piotroski Score

Only applicable to Graham Cos - N/A to GMAN

1. Net Income: Bottom line. Score 1 if last year net income is positive.
2. Operating Cash Flow: Better earnings gauge. Score 1 if last year cash flow is positive.
3. Return On Assets: Measures Profitability. Score 1 if last year ROA exceeds prior-year ROA.
4. Quality of Earnings: Warns of Accounting Tricks. Score 1 if last year operating cash flow exceeds net income.
5. Long-Term Debt vs. Assets: Is Debt decreasing? Score 1 if the ratio of long-term debt to assets is down from the year-ago value. (If LTD is zero but assets are increasing, score 1 anyway.)
6. Current Ratio: Measures increasing working capital. Score 1 if CR has increased from the prior year.
7. Shares Outstanding: A Measure of potential dilution. Score 1 if the number of shares outstanding is no greater than the year-ago figure.
8. Gross Margin: A measure of improving competitive position. Score 1 if full-year GM exceeds the prior-year GM.
9. Asset Turnover: Measures productivity. Score 1 if the percentage increase in sales exceeds the percentage increase in total assets.

- Total: / 9
Is it a good business?

- 3 year history of profits (newish IPO)
- ROE:
  - 2010: 60 2011:30 2012: 32 2013 9mo:22
- Margins
  - 2010:3 2011:3 2012:4 2013 9mo:4
- 3 year sales growth 5%, earnings growth 9%
- Some dilution
- Strong balance sheet
  - Cash >> debt
- ROIC = Earnings / (Equity + Debt - Cash) = Earnings / (Assets - non-debt liabilities - Cash)
  - >= ROE
Is it a good business? Cash flow

• Weak cash flow:
  • 2013 9mo 15.6M earnings, 15M operating cash flow, 0 FCF (FCF = OCF - capital expenditures)
    • But they are growing # of stores
  • Free Cash Flow/Share higher than dividends paid
Is business cheap? - Buffettology calculations

• ROE 15%
• Earnings in 10 years = ROE*Equity*(1+ROE)^9 = $50M
• Equity in 10 years = Equity*(1+ROE)^9 = $331M
• Market cap = 50B x P/E (15) = $750M
• Rate of return = 9% after tax (calculations omitted)

• 3 year earnings growth: 9%. Assuming 9% earnings growth: 13% share price growth.
Is business cheap? DCF

- Discounted cash flow
  - Current earnings of 21M (FCF 0M)
  - 10% growth for 5 years, leveling after that
    - 15% discount -> $204M current valuation
  - 5% growth for 10 years, leveling after that
    - 15% discount -> $188M current valuation
  - 10% growth for 10 years, leveling after that
    - 15% discount -> $255M current valuation

- Owner’s yield = earnings / (market cap + debt - cash) = earnings/EV
  - 21M / (291M-32M) = 8%

- What makes up the margin of safety? Valuation
- Is there a sufficient margin of safety? No.
Is business cheap? - Graham investment considerations

• N/A for GMAN - included for completeness
• 10 P/Book - not a net net
• Altman Z score (http://en.wikipedia.org/wiki/Altman_Z-score)