

# QV UPDATE

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## Filtering the Noise

The steady stream of economic indicators, headlines, and central bank actions can not only be dizzying, but also distracting for investors. Getting too caught up in recent headlines and 'new' news can negatively impact an investor's discipline, judgement and results.

No doubt the news of the latest central banker pow-wow at Jackson Hole will have media and speculators eagerly waiting to react. Undisputedly, new information from fiscal policy makers can have important implications for the markets and the direction of the economy as a whole. But with the natural tendency to focus on the most readily available information and act on instinct, taking the time to cut through the rhetoric generated by the polling machine that is the market can be a challenge.

Amidst this noise, second quarter earnings results from companies, including QV holdings, are a reminder that in the long-term fundamentals drive stock prices. As bottom-up investors and shareowners, we are often excited when management teams report on their progress. When a company's operating results are strong, such as revenue growth and earnings per share growth, it can be easy to get complacent. But thinking about the context of reported results, can add substantial value to the judgement making process. A strong indicator of a company's underlying business health is the ability to improve when the rest of the industry is suffering and competitors are challenged.

For investors, rising tides can cover a multitude of deficiencies. Applying this thought process to business managers, as shareowners we find it encouraging and compelling when managers find ways to improve their businesses in difficult environments. Leon's Furniture (Leon's) and Lassonde Industries (Lassonde) are two examples of QV holdings that have continued to execute well, despite tougher end markets.

Founded in 1909, Leon's is one of Canada's largest retailers of home furnishings and appliances. The past few years have seen challenged markets, as debt levels and a slow economy have seen consumers reluctant to spend. The end markets have contracted close to 3% per

annum over the past three years. The company's same store sales have declined at a similar level. However, Leon's management has used market pressure to its advantage and purchased its largest competitor, The Brick, in early 2013. We estimated the deal would result in substantial earnings growth with no synergies factored in. In this past quarter, Leon's has begun to demonstrate further benefits. Organic growth was down 1% year over year, but Leon's reduced their total operating expenses at a faster rate of 2%, which was attributed to the efficiencies from the deal. As a result, earnings per share grew 15% from \$0.20 to \$0.23. With over \$2 billion in sales, even a small percentage reduction in costs has a big benefit on the bottom line. Consumers might be wary of spending, but as the integration progresses we anticipate continued earnings growth and excess cash generation to repay debt.

In the second quarter, juice seller, Lassonde has also made improvements as North American juice demand has remained sluggish. The company estimates the Canadian fruit juice and drink market has shrunk at -1% per annum over the past five years. Comparatively Lassonde's sales and operating profit have grown at close to 15% per annum. In the second quarter, volumes on Lassonde's branded juices continued to suffer, but their private label offering has continued to grow consolidated volumes and sales. Retailers offer their own branded products, which Lassonde often supplies the juices for. This enables the team to partner with their customers and maintain steadier volumes. Although the demand outlook continues to be unfavorable, Lassonde expects to grow sales and leverage its latest US based acquisition, Apple and Eve. Lassonde's management continues to generate excess capital to repay debt and generate earnings growth through cost savings initiatives.

Leon's and Lassonde have improved their businesses and profitability in tough times. Improved end markets would simply add to our expected returns. While we will follow the news from Jackson Hole, our focus and decision making is based on company specific fundamentals.