



MADISON'S TIMBER PREVIEW

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As 2010 draws to a close, investors and industry leaders have no better grasp of what is going to happen with US home building than they did at the beginning of this year. While the US economy appears to be blundering toward recovery, some economic indicators continue to suggest sluggishness. The North American forest industry did not wait until autumn of 2008 to crash along with everything else. Rather it was immediately struck by the sudden and marked decline in US home building over a period of months preceding the crash, noticeably beginning a decline in late 2006.

As it began to slump earlier than the rest of the economy, is it possible that forestry will begin to see better results ahead of many other industries? Recent surges in lumber prices, apart from continued depressed US home building, and at a time of year when traditionally lumber prices sag through year end, seem to indicate recovery could be around the corner.

Lumber producers and wholesalers remain skittish however, having been burned badly post-2006, and having watched many of their friends and competitors disappear. They are reluctant to commit to increasing capacity or inventory building until they see indisputable indications of resurgence in demand. The performance of the following company could be an indication of recovery or is it an example of continued confusion?

Lumber Liquidators Holdings Inc, out of Toano, VA, posted 3Q net income November 3 of US\$4.3 million, down 44.8 per cent from US\$7.8 million for the same quarter in 2009. Sales for 2Q were US\$147.2 million, up 4.7 per cent from US\$140.5 million reported for the same period of 2009. The largest hardwood-flooring retailer in the US, with approximately 225 stores and US\$650 million in estimated 2010 revenue, Lumber Liquidators's reduced productivity resulted in approximately US\$12 to US\$14 million in unrealized net sales during 3Q.

The company implemented an integrated business solution from SAP, out of Germany, on August 22. Due to poor staff training, the new systems apparently impacted 3Q by reducing productivity, primarily across store and warehouse operations. Now that the learning curve has been surmounted, the newly streamlined program should offer more lucrative results in coming quarters. Indeed, Lumber Liquidators expects a 10 to 15 per cent increase in 4Q over the same period in 2009, for a range of US\$151 million to US\$157 million, with total net sales for 2010 of up to US\$624 million. Lumber Liquidators is planning to open 11 new US stores in 4Q, as well as 25 or more stores in Canada during 4Q, the company announced in 1Q results released April 29.

The company has a P/E ratio of 23.9 and P/S ratio of 1.2.

Analysts could not wait to jump all over Lumber Liquidators for the apparently poor financial showing. Not having considered the company's new inventory tracking system seriously, investors and analysts sent the stock's share price crashing down when 3Q results were released. While analysts had been predicting US\$0.32 EPS, the company posted just US\$0.15, representing a miss of more than 50 per cent.

On November 6, Rick Munarriz of The Money Times declared Lumber Liquidators "broken".

The day after 3Q results were released, November 4, share prices sank to US\$22.09 when markets opened, a 13.58 per cent drop from close the previous day when share prices stood at US\$24.89. Shares have recovered nicely since, to close December 2 at 24.77.

Given that founder and 10 per cent owner Thomas Sullivan sold 200,000 of his shares between November 19 and November 23, company share prices rising during that time seems to say something important. Sullivan currently owns at least 3.6 million shares. Share prices rose between 3.4 and 5 per cent since each Sullivan sale. Again on November 29, Sullivan sold 4,850 shares, this time at an average price of US\$23.1 a share. At this rate he's sure to make a tidy sum.

In total Sullivan has sold roughly five million shares since March 2009 lows of US\$7.02 with the great majority of sales at prices north of US\$20. At last week's closing price of \$23.42, the stock changed hands at 24x and 18x 2010 and 2011 consensus earnings expectations, respectively.

Does Munarriz feel foolish now?

Brian Stoffel wrote on Motley Fool November 19, "I love buying positions in a company when the market punishes it for taking steps to improve long-term profitability at the cost of short-term losses. Essentially, while it will take employees some extra time to master the new SAP system, the supply lines will be far more efficient for it years from now.

"If the company manages to make good, Lumber Liquidators could end up being a steal, trading at 17 times next year's projected earnings, and with a whole pile of growth left in front of it."

Or, as a November 30 piece by Roger Friedman also at Motley Fool states, "There's something to be said for a company that can open a new store and recoup 100 per cent of its investment in the first year. "Something important to watch for, which might throw these insights for a loop, is a US Department of Commerce anti-dumping charge against China's imports of multilayered wood flooring, launched November 10.

November 12 the Commerce Department sent a letter to US laminated floor sellers requesting information on the quantity and US dollar sales value on the product from April 1, 2010 through September 30, 2010, with a deadline no later than December 3, 2010. Speculation is rampant that a duty of 50 per cent might be placed by the US on imports of Chinese multilayered wood flooring.

Lumber Liquidators' financial statements indicate that laminate wood flooring accounts for 11 per cent of total company sales.

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