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What's exciting about boring products? Profit

BY FRANÇOIS ROCHON, THE GAZETTE MAY 24, 2011

In the movie Other People's Money, Larry Garfield (Danny DeVito) talks about the company New England Wire and Cable and of its many small subsidiaries. Referring to these companies, he uses the expression: "Dull, but making a decent profit!" I saw this movie about 20 years ago and, to this day, this is what I'm looking for: a highly profitable company that produces non-exciting products.

I've owned many boring companies over the years. One of my best stocks ever was BMTC Group, the leading furniture store chain in Quebec. I remember during the tech bubble (in 2000), one of my clients wanted me to buy Nortel - a company with exciting fibre-optic related products - instead of owning shares in that boring furniture store company. He compared BMTC to dead wood. Well, the exciting company vanished and the "dead wood" one thrived: it's up 1,400 per cent since then.

Most investors want to put their money in the next Google or the next gold mine wonder. They want to invest in exciting and promising companies. But they forget (or will learn at their own expense) that for one huge winner in that field, there are hundreds of losers. Good prospects attract lots of competition and growth without a solid competitive advantage, which is not a guarantee of profitability.

On the other hand, you can find dull and profitable companies in all sort of un-sexy industries. In 1998, I invested in two retail chains: Bed Bath & Beyond and Fastenal. BB&B was a retail chain that sold items for the bathroom and the bedroom (linens, sheets, etc.). The company was growing 30 per cent annually by cloning its retail concept all over the U.S. (it went from 250 to 800 stores within seven years). It was nothing exciting like a new fashion retailer or some Internet start up, but it was well managed and highly profitable. I sold it in 2005 at a 300-per-cent profit.

Fastenal turned out even better. The Minnesota company sells thousands of different products ranging from bolts and screws (fasteners) to janitorial equipment. Since my first purchase in 1998, earnings have increased 15 per cent annually (up 515 per cent in 13 years) and the stock has increased tenfold. This outstanding company is not well known even after years and years of stellar performance. Bolts and screws aren't as sexy as social networking (like LinkedIn, for example) but shareholders in Fastenal have been handsomely rewarded over the years.

Lately, I discovered Lumber Liquidators. Based in Toano, Va., the company sells hardwood and laminate floors for about 20 per cent less than such competitors as Lowe's and Home Depot. They focus solely on that niche and in just a few years have grabbed around 10 per cent of the market by opening 225 stores (in 2010, they entered the Canadian market). Its stores are in out-of-town warehouses, so its operating costs are very low. Moreover, LL is vertically integrated. It has been able to pass the savings to its customers, much to their delight. The stock is not cheap - at around 22 times 2011 estimated earnings per share - but its growth prospects look quite promising.

Another example of a dull company is Copart. Have you ever wondered where totally wrecked cars end up? Many of them are sold on Copart's auction website. Insurance companies use Copart to get the most money from the car they get stuck with. And clients from all over the world buy the wrecked cars to reuse these parts.

Copart has built an outstanding network and an efficient Internet platform and dominates that market. Copart is highly profitable and has grown its earnings at a 16 per cent annual rate over the last 10 years (and it did quite well during the recession). Lately, the company rewarded its stockholders by buying back 15 per cent of its shares in a Dutch tender offer. Like Fastenal and Lumber Liquidators, very few investors have heard of Copart. But the stock is up 1,000 per cent in the last 15 years.

Dull, yes, but making a decent profit!

François Rochon is the head of wealth-management firm Giverny Capital, which he founded in 1998.