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Still not 'cheep'

Fabiano Santin writes:

There were few surprises in third-quarter results for Ollie's Bargain Outlet Holdings, Inc. (OLLI on the Nasdaq) after the bell on Tuesday, but there was plenty of news preceding that report. On Dec. 1 came the unexpected death of Mark Butler, 61, CEO, chairman and co-founder. John Swygert, former COO, succeeds him as president and CEO.

Ollie's stock has plunged 30% since our bearish analysis in the March 8 issue of *Grant's*. After 20 consecutive quarters of positive same-store sales growth, comps turned negative in the quarter ended Aug. 3. Ollie's explained away the miss as a snafu in its supply chain. We remain bearish on the brick-and-mortar-only discount retailer trading at nearly 33 times trailing earnings.

On Aug. 28, Ollie's reported a negative 1.7% comp for second-quarter same-store sales vs. expectations for positive 1.9%. Gross margins fell by 194 basis points to 37.2% vs. guidance of a decline of 25 basis points. The share price dropped by 27.5%.

On Sept. 17, investors filed a class-action lawsuit in the U.S. Southern District of New York alleging that Ollie's had failed to disclose "a supply-chain issue that impacted the initial inventory available at new stores," resulting in "[in]sufficient inventory to meet demand at certain store locations."

Katherine Spurlock, owner and editor of short-selling-focused publication Norne, LLC, tells me that former Ollie's employees have complained to her about the "ancient" information technology, which employs IBM's 1988-vintage AS/400 operating system. It's the one with the notorious non-user-friendly pitch-black background screen with green letters and a flashing cursor. The alumni mentioned shortfalls in inventory-control procedures, too.

"I haven't seen an AS/400 in probably 10 to 15 years," Rob Oglesby, associate partner at retail consulting firm The Parker Avery Group, whose client roster includes leading giants such as Walmart, Inc. and Dollar Tree Stores, Inc., tells me. "It's pretty rare to see store labor being used to actually tag products. . . . I don't think there's a single point-of-sale system out there today that doesn't support a UPC as a lookup mechanism and its database."

Why not speed up and modernize the infrastructure? Calls and emails to Ollie's headquarters went unreturned by presstime. Oglesby, who hasn't worked for Ollie's, commented: "When you get into a company that's got that level of complexity to it, there's a lot of moving parts and it's really hard to big bang anything. The broader the change, the harder it is to get all that stuff in there. . . . It's a massive investment to upgrade all the hardware in stores."

Since we wrote, six insiders have dumped OLLI shares worth $26.4 million. Among 35 insider transactions, there was one buy (by an external director for $129,320). The Street numbers 11 buys, four holds and no sells. Short interest amounts to 18% of the float from 7% nine months ago.

Butler's estate owns 8.5 million shares, or 13.4% of the total (slightly behind T. Rowe Price Group, Inc., which is the company's largest shareholder), worth more than $500 million. If his estate were forced to sell stock to satisfy, say, a 40% tax bill, 3.4 million shares ($200 million's worth) would go on the block. If the estate limited itself to 15% of the average trading volume, it would take almost a month to divest the shares.

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