

RealMoney Investment & Trading Ideas



Not Down With ODP
By **Scott Rothbort**
RealMoney Contributor
2/26/2008 2:48 PM EST

Updated from 12:45 p.m. EST on Feb 25.

Office Depot (ODP) is a real mess. The company is too concentrated in Florida and California; it might as well be called Office Home Depot. Even outside of the U.S., where most multinationals are making up for domestic shortfalls, Office Depot is having difficulties. The company's commitment to eliminating stores is half-hearted and, frankly, is misleading.

There is no reason to own this office supply company. If you are betting on a small business/consumer rebound in this sector, then go with best-in-breed **Staples** (SPLS) .

Office Depot reported fourth-quarter EPS of 7 cents on a GAAP basis and 10 cents on an adjusted basis on net sales of \$3.87 billion. For the full year, GAAP EPS was \$1.43 and \$1.54 on an adjusted basis. Sales rose 3%, to \$15.5 billion for the full year.

For the North American retail arm, same-store comps in U.S.-based stores declined 7% in the quarter. The slowdown began in Florida and California, where the company has concentrated nearly 26% of its total store sales and 40% of total comp sales. The key to the same-store sales decline was 70 basis points from new store cannibalizations, 60 basis points from competitive intrusion and 20 basis points from private brand penetration.

According to a third-party research report, there is a direct correlation between the company's sales decline and the high inventory of unsold homes. The real correlation, if you ask me, is because Office Depot is so concentrated in Florida and California. That third-party research was wasted money. I could have told them that relationship for free.

Office Depot's market share rose in the fourth quarter. Furniture sales had positive dollar and unit growth.

Operating expenses were 26.3% of adjusted sales and rose 40 basis points year over year. Operating margins declined by 140 basis points as a result of promotions, inventory clearance and deleveraging of fixed property costs (100 basis points) and higher shrink (75 basis points) offset by 50 basis points for lower operational expenses.

Office Depot is committed to lowering operational hours and closing stores, yet 12 new stores were opened and two stores were closed in the quarter, bringing the total store count to 1,222. Seventy-five new stores are expected to be added in 2008.

For 2008, Office Depot expects comp sales to trail those of 2007. Management cited the Easter shift (a convenient excuse). The company also expects operating margins to improve 225 to 275 basis points sequentially in first quarter 2008, which will be below first quarter 2007 margins.

North American business solutions sales declined 4% in total and 13% to midsized customers. On the other hand, sales rose 5% to large national accounts and 10% to the public sector.

Margins declined 380 basis points in fourth quarter 2007 after dropping 310

basis points in full year 2007. A similar drop is not expected in first quarter 2008.

Internet sales rose to \$4.9 billion vs. \$4.3 billion in 2006. Eighty percent of business solution sales were online vs. 72% in 2006.

International sales declines 12% year over year for the quarter. Organic sales in local currency increased 2%.

The operating profit margin declined by 230 basis points year over year, mostly due to weak conditions in the U.K. Outside the U.K., margins dropped by 40 basis points.

ODP Preview: More Consolidation Needed

Office Depot (ODP) is scheduled to report fourth-quarter and full-year 2007 results and conduct its quarterly conference call before the market opens on Tuesday.

Analysts are expecting the company to earn 17 cents per share on net sales of \$3.83 billion for the quarter. In the year-ago quarter, the company earned 54 cents per share on net sales of \$3.84 billion.

Hitting directly at the expected drop in earnings are tightening margins from an increasingly competitive environment for office supplies, furniture and technology.

Office Depot is the cheapest priced stock on a valuation to earnings basis vs. its peers.

Just last week, **Staples** (SPLS), the biggest entrant in this space, made an unsolicited \$3.7 billion for the Dutch **Corporate Express** (CXP). While the offer was turned down, it does indicate that more consolidation is needed and could take place in this retail segment.

OfficeMax (OMX), which reported a better-than-anticipated December quarter last week (65 cents actual vs. 52 cents estimates), has long been seen as a quality partner for Office Depot.

No matter which way you cut it, Staples remains the best of the bunch. Unless Office Depot can pull out a real surprise when it reports this week, the stock will likely languish unless a suitor appears.

RELATED STORIES

A LOW Blow

TGT Preview: Many Concerns

HD Preview: Still a Shaky Foundation?

At the time of publication, Rothbort had no positions in the stocks mentioned, although positions can change at any time.

Scott Rothbort has over 20 years of experience in the financial services industry. In 2002, Rothbort founded LakeView Asset Management, LLC, a registered investment advisor based in Millburn, N.J., which offers customized individually managed separate accounts, including proprietary long/short strategies to its high net worth clientele.

Immediately prior to that, Rothbort worked at Merrill Lynch for 10 years, where he was instrumental in building the global equity derivative business and managed the global equity swap business from its inception. Rothbort previously held international assignments in Tokyo, Hong Kong and London while working for Morgan Stanley and County NatWest Securities.

Rothbort holds an MBA in finance and international business from the Stern School of Business of New York University and a BS in economics and accounting from the Wharton School of Business of the University of Pennsylvania. He is a Professor of Finance and the Chief Market Strategist for the Stillman School of Business of Seton Hall University.

For more information about Scott Rothbort and LakeView Asset Management, LLC, visit the company's Web site at www.lakeviewasset.com. Scott appreciates your feedback; [click here](#) to send him an email.

Read our [conflicts and disclosure policy](#).

Terms of Use | Privacy Policy

© 1996-2008 TheStreet.com, Inc. All rights reserved.