Lumber Liquidators: A Proxy Fight In The Making

Summary

- Lumber Liquidators has accumulated losses of over $200 million since 2014.
- Shares are trading at the same price as their $11 IPO in 2007.
- Management has received high compensation, but shareholders have seen zero appreciation on their investment.
- A change is needed at the company.

Over the last few years, Lumber Liquidators (NYSE:LL) has faced many adversities. There have been lawsuits, fines, tariffs, and management changes. The company has lost money. Lots of it. It has announced a loss every year since 2014, accumulating to over $200 million.

I have been bullish on the company. Expecting a recovery. I have written several positive articles about Lumber Liquidators. It seemed like a rebound was always just around the corner. And, possibly, it still is.

But one cannot help but feel a tinge of resentment towards how shareholders have been treated over the years by Lumber Liquidators management. After all, we have not all suffered equally. Lumber Liquidators stock currently trades at about $11, which incidentally is the same as the company's IPO price, 12 years ago. In 12 years, investors in the company have seen exactly zero return. Think about how far the stock market has come since 2007. The great recovery. The longest bull market in history. The Trump stock market rally. The S&P has returned about 100% since 2007. Actually, 150% if you included dividends. And Lumber Liquidators? Zero.

Some Are More Equal Than Others

Meanwhile, throughout all this, management has been making millions. In 2018, Lumber Liquidators' CEO, Dennis Knowles received total compensation of $2.3 million, and a similar amount in 2017. Considering that the company actually lost over $50 million in 2018, and close to $40 million in 2017, this hardly seem very fair.

I fully understand the need to compensate executives and to reward performance. Nobody should be working for free. But as a shareholder in Lumber Liquidators, I must question the performance of management.

- What has the CEO done to justify his $2.3 million pay package? The stock fell 70% in 2018. Is that performance?

- In 2018, Mr. Knowles received a 7.4% base salary increase for "merit." What exactly did he do to merit that?

The management team also received healthy performance bonuses in 2018. Despite missing the target bonus level for each bonus benchmark, management still received a prorated bonus award since the company was able to achieve (just barely in some cases) the threshold bonus levels. As an analogy, that would be like a baseball player failing to hit the ball with his bat, but instead of calling a strike, the umpire lets the player walk to first base, because "he did come close to hitting the ball."

To add further insult, for 2019, the company has doubled the target bonus payout rate for the lowest level of performance (threshold level). In this way, management will be able to get double the bonus payout, for reaching a same, mediocre level of performance (threshold level).

But Wait, There's more...

As the stock price has been falling over the last 18 months (from over $40 per share in September 2017, to $11 in April 2019), management and the board of directors have actually been accumulating more stock-based compensation that ever. Management's stock-based compensation is calculated in dollars, but issued in shares. By simple math, this means that if the dollar amount of compensation stays the same (or rises) but the shares fall in price, management is rewarded with more shares. In fact, the lower the stock price goes, the more shares management receives.

Management has stated many times in their DEF-14A Proxy filing that these stock awards are created to "align their interests with our long-term growth and the creation of stockholder value." I fail to see the logic or fairness in awarding management more equity compensation as the stock price falls? How exactly does this benefit shareholders? And most importantly, perhaps Mr Knowles can explain his definition of "stockholder value."

Bonus, From The Board

In an display of boldness, after everything that shareholders have been put through over the last few years, in the 2019 proxy vote filing, the Lumber

Liquidators Board of Directors also wants to increase the number of shares of common stock authorized for issuance by 1,750,000 in order to grant still higher equity-based compensation awards. Due to management issuing increasingly higher levels of stock-based compensation the so-called "burn rate" (number of shares subject to equity awards) under the standing equity compensation plan has increased, and if the company wants to continue to issue shares to management as a reward for their "performance," then they need to authorize more shares. This means that after watching their stock value drop precipitously since 2014, shareholders are now being asked to dilute their holdings by authorizing the issuance of more shares, so that those shares can be given to management as added compensation.

Of course, the Board has made it clear that this form of equity compensation is absolutely "necessary to position the Company for long term success and critical to the development and strength of our senior management team to attract the experience and talent to further implement our strategy."

I am sure that the many levels of humor buried within that last statement are not lost on any long-term shareholder of the company. But I would like to bring particular attention to the last word in that quote... "strategy."

It's Not Bad Management, It's A "Strategy"

So, apparently, Lumber Liquidators has a strategy. In the 2018 Annual report, the company mentions the word "strategy" 11 times. And, the word is used in several different contexts, leading me to believe that the company has more than one strategy. Furthermore, in the executive biographies listed on the Lumber Liquidators website, it is mentioned that CEO Dennis Knowles "has deep experience and knowledge in, among other things... strategies." While it brings me some comfort to know that strategies are quite abundant at the company, I can't help but wonder what these actual strategies are and when they might actually lead to even a slight appreciation in the stock price. I will reluctantly admit that I am not the most patient of individuals, but shareholders have been waiting 12 years for the various growth strategies, profit strategies, marketing strategies and sales strategies to amalgamate into some form of a master plan. But so far, the only strategy which seems to be paying off for anybody is the compensation strategy. For the regular shareholders, all those other much heralded strategies were actually tragedies.

What Now?

After all these years of misery, what are the long-term, honest, committed Lumber Liquidators shareholders to do? Well, at a certain point, one must say, enough is enough. The way I see it, shareholders have 3 options.

1. You can either sell your shares and move on to a new investment.
2. You can continue holding LL and hope for the best.
3. Or, you can finally fight back and demand a change.

Vote For A Change At Lumber Liquidators

Which brings us finally to an initiative which I have been working on. An initiative to instigate a positive change at Lumber Liquidators. It won't be easy, and it might take a while. But it can be done. Shareholders have many rights, and their most important right is their vote.

As an opening move, I will urge all shareholders of Lumber Liquidators to vote against all management proposals to be tabled at the Annual Meeting of Stockholders to be held on May 22, 2019. The proxies are being mailed to all shareholders, and in some cases, they are available online with your broker. It takes only a few minutes to vote your shares.

The Lumber Liquidators Value Committee

I have formed an ad-hoc group (Lumber Liquidators Value Committee (LLVC)) composed of several large holders of Lumber Liquidators shares (myself included), and we are actively soliciting large and small shareholders to vote against management's proxy proposals. We have so far received strong support, as many shareholders share our concerns and feel less than satisfied with how management has guided the company.

The other goal of the group is to present a plan to shareholders for how the company can successfully and rapidly implement a turnaround. Our goal is to rapidly increase profit and growth at Lumber Liquidators. Our plan would be accretive to earnings from the start. By our estimates, we could drive earnings per share to $0.30 per quarter with minor operational changes. These would involve increasing store hours to drive traffic and revenue (competitors have store hours which are 3 to 6 hours longer per day), focus on design services to increase the average sale, improve rewards for Pro customers to increase repeat business, and a minor price increase which would go almost unnoticed to consumers, but which would be immediately and substantially accretive to the bottom line.

Further to this, we want the company to announce a strategic review, to gauge interest for a possible sale, if it should be substantially beneficial to shareholders. This does not mean that we simply want to sell the company to the highest bidder. But all options should be on the table so that shareholders can finally see some return on their investment.

We intend to release complete details of our plan shortly.

For all interested shareholders, I have attached below our simple reasoning as to why shareholders should vote against the management proposals. This is also an excerpt of the communications we have sent to all large fund holders of Lumber Liquidators, including BlackRock, Vanguard, Neil Gagnon, and others.

Letter To Lumber Liquidators Shareholders

The Lumber Liquidators Value Committee is a coalition of value-oriented shareholders with a sizable stake in Lumber Liquidators Holdings Inc. We have deep concerns about the direction of the company, as it has been unprofitable since 2014 and accumulated losses of over $200 million

As a shareholder in Lumber Liquidators, we urge you to vote against several Lumber Liquidators proxy proposals to be tabled at the 2019 Lumber Liquidators Annual General Shareholder Meeting, which we feel do not align with the best interests of shareholders.

Proposal 3 - To approve a non-binding advisory resolution approving the compensation of our named executive officers

In 2018, Lumber Liquidators CEO, Dennis Knowles received a 7.41% increase to his base salary for "merit." Mr. Knowles also received equity grants valued at $1,250,000. His total compensation for the year was over $2.3 million. This hardly seems appropriate considering that Lumber Liquidators' stock collapsed almost 70% in 2018, and the company lost over $54 million. In addition to already high Senior Management compensation packages, for 2019, the company has doubled the target bonus payout rate for the lowest level of performance (threshold level), thereby further rewarding and incentivizing mediocre performance. Effectively, this means that if management is able to achieve an even lower target than 2018, they will earn twice the bonus.

We feel that considering the financial performance of the company, management compensation is too high and is not properly aligned with shareholder interests

We urge you to vote against the executive compensation plan (Proposal 3).

Proposal 4 - To approve an amendment and restatement of the Amended and Restated Lumber Liquidators Holdings, Inc. 2011 Equity Compensation Plan

The Lumber Liquidators Board of Directors proposes to increase the number of shares of common stock authorized for issuance by 1,750,000 in order to grant still higher equity-based compensation awards. The number of shares subject to equity awards (burn rate) has increased substantially due to the low stock price and management has been issuing increasingly higher levels of stock-based compensation. This is, and continues to be, highly dilutive to shareholders. Furthermore, while the Board states that high equity compensation is critical to "attract the experience and talent to further implement our strategy", shareholders have not actually seen a clear strategy presented by management, and experience and talent are not only lacking at the company but leaving (note the recent departure of the CFO).

We feel that considering the financial performance of the company, allowing the Board to issue a highly dilutive amount of new shares as part of an equity compensation plan is contrary to shareholder interests.

We urge you to vote against the amended equity compensation plan (Proposal 4)

Proposal 1 - To elect two directors, Terri Funk Graham and Famous P. Rhodes, to hold office until the 2022 Annual Meeting of Stockholders, until their successors are elected and qualified

Both Terri Funk Graham and Famous P. Rhodes are recent additions to the Lumber Liquidators board of directors. While they bring much needed "fresh blood" to the board, we feel that their experience is lacking. Lumber Liquidators is a company in need of a dramatic and urgent turnaround. New board members should have experience with business and financial strategy in order to guide the company toward a recovery.

Terri Funk Graham is a branding strategy consultant, with most of her experience being in marketing. Famous P. Rhodes, similarly has mostly marketing and customer relations experience.

In addition, both candidates currently serve on the Lumber Liquidators Compensation Committee where we feel they have been ineffective at aligning executive compensation with shareholder interests. Executive compensation appears excessive relative to performance and peers, and we believe the compensation committee has failed to address this issue

We urge you to vote against the election of the two directors, Terri Funk Graham and Famous P. Rhodes (Proposal 1)

At the moment, Lumber Liquidators shares trade at a similar price as the company's IPO ($11), and shareholders have not seen any gain on their investment in 12 years. The Lumber Liquidators Value Committee believes that with a clear plan and effective leadership, Lumber Liquidators can become a great and prosperous corporation. We want to ensure that the interests of management and shareholders are well aligned so that shareholders can eventually see a return on their investment.

Yours truly,

Mario Rizzi

Representing the Lumber Liquidators Value Committee

[ReBuild LL - A Shareholder Proxy Fight to Boost Growth and Profits at Lumber Liquidators]