Canadian Groceries: An Action-Packed Investment Opportunity?

Description

Grocers aren't typically classified under the heading "exciting investment opportunity". But, why not? After all, the industry is prone to what economists call *inelastic demand.* Meaning, changes in price don't significantly impact how much product is demanded.

Consider, if your groceries suddenly cost 10% more, would you still buy them? Of course you would! Food is a product that we need everyday, so the grocery industry is always going to be around. That's at least moderately exciting, right?

And for a relatively staid industry, there has been a lot of activity in this space in recent times. For instance, **Tesco**, the second-largest retailer in the world by profits and third-largest by revenues behind Walmart and Carrefour(a French Multinational Retailer), is up 16% in the last year. When the euro crisis crushed the value of European stocks in general last year, Tesco began to get a lot of attention from value investors. Most significantly, Warren Buffett's Berkshire Hathaway is a major shareholder – a consideration that tends to get investors whipped up.

Tesco isn't the only grocery store that has received a lot of investor attention though. **Supervalu** (NYSE:SVU) is a U.S. grocer that's buried under a mountain of debt. However, investors have recently looked past this mountain and focused on the company's potential for a turnaround.

Even though the stock has declined by 71% over the past 5 years, this potential has driven the shares up by 235% over the past 12 months.

Lately, there has been quite a bit of hedge fund activity regarding the company. JANA Partners picked up 14 million shares last quarter and Omega Partners invested in more than 6.8 million shares, no doubt contributing to the stock's strong run.

On the home front

Recently, however, the action in worldwide groceries has come to Canada. **Loblaw** (TSX: L) has agreed to buy **Shoppers Drug Mart** (TSX:SC). This deal takes two of Canada's best known retail brands and merges them into a single gigantic business. According to the Wall Street Journal, Loblaw

intends to get more small market exposure through the acquisition while also providing it with a strong entry into the pharmacy business.

In addition, there is great potential for costs to be removed from the combined entity. Given the valuation that Shoppers is being taken out for, at least Loblaw's management expects the cost savings to be significant.

Not only is Loblaw paying up for the opportunities that the Shoppers platform brings, and the cost savings potential, but also the consistency of the underlying business. Shoppers has earned between $550M and $650M in net income in each of the last four years. In a volatile marketplace, consistency earns a premium.

There are sure to be bumps in the road as these 2 Canadian giants become 1. At the very least however, it's nice to see the historically sleepy Canadian grocery space providing investors with a shot of adrenaline of late.

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CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:L (Loblaw Companies Limited)

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