Jean Coutu: Third Quarter Results Hit by Increasing Competition

Description

Jean Coutu (TSX: PJC.a) reported a 0.8% decrease in revenue for the quarter, and an 11% increase in net income. However, the increase in net income was due to lower taxes and lower expenses. Though not great, these results appear reasonable, however the most troubling point is that same store sales growth was weak – never a good sign.

Same Store Sales Fall

Same store sales growth refers to sales that come from existing stores and allows us to differentiate from sales growth that comes from opening new stores. As we can see in the chart below, same store sales growth has been hit hard this quarter, with overall same store sales growth declining 1.3%. This compares to pretty robust same store sales growth in the same quarter of 2013.

Third Quarter	2014	2013
Same Store Sales		
Total	-1.3%	2.6%
Pharmacy	-1.6%	2.7%
Front-end	-1.3%	2.0%

Competitive Landscape Intensifies

Retailers have become increasingly aggressive in an attempt to capture their share of the consumers' dollars. We have recently seen **Target** (NYSE: TGT) enter the Canadian market, and although they have been struggling, they represent another competitor that Jean Coutu has to deal with. Last year, the current Target locations were under the Zellers banner and Zellers was pretty inactive in the marketplace. This compares to Target, who is actively pursuing a strategy in order to step up its business. Back in August, Target announced that they had partnered with **Metro** (TSX:MRU) for the operation of the Target pharmacies.

But this is just another competitive pressure in an already intense competitive environment. The likes of **Costco** and **Walmart**, for example have been gaining market share here in Canada for many years.

Generic Sales on the Rise

Jean Coutu's pharmacy sales were hit this quarter by an increase in the proportion of generic drugs sold. As we know, generics sell at lower prices than branded drugs, hence the lower revenue. The generic penetration rate increased to 66.7% this quarter, compared to 61.8% in the same period last year. As payors (government and insurance plans) are increasingly mandating that the generic drug be the drug of choice, expect continued growth of generics, and erosion in pharmacy revenues.

Strong Balance Sheet

On the bright side, Jean Coutu has a very healthy balance sheet with no debt. Back in the fall of last year, the company paid out a special dividend to shareholders and instituted a share buyback plan as a way to return cash to shareholders.

Growth Strategy

While management has stated that they are interested in participating in the consolidation of the industry and making acquisitions of independent pharmacies, they have also stated that it is slim pickings out there. In fact, they are not very optimistic that they will find an opportunity. So they are looking to grow by opening new stores in smaller markets, where they have found that they have been successful in the last couple of years. They have seen that smaller markets provide good growth as the population is older and fill more prescriptions as compared to the big cities.

Bottom Line

While Jean Coutu is clearly feeling the effects of a difficult environment, the company at least has its pristine balance sheet going for it. But this quarter and the difficulties that have been brewing over at Jean Coutu do not bode well for the stock price.

CATEGORY

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