Shoppers Takeover Is Approved: What Does This Mean for Investors?

Description

On Friday, Canada's Competition Bureau gave the green light to **Loblaw** (TSX:L) to acquire **Shoppers Drug Mart** (TSX:SC). Loblaw will be required to divest 18 stores and nine pharmacies, but that is of course a very small price to pay.

While the announcement is not unexpected, it is great news for shareholders of both Shoppers and Loblaw. The combined entity will be a true retailing giant, with 65 million square feet and $42 billion in revenue. The company expects to realize $300 million in cost savings by year three, and will be able to realize various revenue synergies too. Finally, Loblaw will gain important customer insights from the data on the Shoppers Optimum program.

But the news is potentially very bad for suppliers. Loblaw is infamous for treating its suppliers terribly – many have complained that Loblaw changes contracts retroactively, requiring increased payments. Others have been coerced into paying for improvements at some of Loblaw' stores.

Not so fast

With Loblaw increasing its market power, the risk of these kinds of stunts only increases. The Competiton Bureau shared these concerns, outlining "behavioural restrictions" on Loblaw regarding its relationships with suppliers. These restrictions will last as long as five years from the date of the deal's closing. And the bureau "will continue to investigate Loblaw programs, agreements and conduct related to pricing strategies and programs with suppliers that reference rivals' prices."

Only a few months ago, rival **Empire Company** (TSX:EMP.A) caused a stir after acquiring Safeway's Canadian stores, when it insisted that suppliers agree to retroactive price hikes. The move prompted suppliers to call for a Code of Conduct to be enforced on the retailers.

Be careful

Loblaw currently has a very strong position as Canada's largest grocer. The company has access to the best real estate, which helps the company block out rivals. Thus it is currently able to get away with treating its suppliers so poorly.

But that could slowly change, with large American rivals like **Walmart** and **Costco** pushing deeper into Canada. And if suppliers continue to be frustrated by Loblaw's actions, they could grant other stores more favourable terms in an attempt to create a more competitive grocery industry.

Foolish bottom line

Still, today should be cause for celebration for Loblaw and its shareholders. If the merger is executed successfully, the new company will be very powerful and efficient. But it will also have to be careful; otherwise, it will run afoul of regulators, infuriate suppliers, and enable competitors. And if thathappens, its shareholders won’t be celebrating anymore.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:EMP.A (Empire Company Limited)
2. TSX:L (Loblaw Companies Limited)

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