Is This a Good Time to Start a Short-Term Strategy on Empire Company Limited?

Description

Grocery stocks in Canada are often seen as an expensive way to invest in companies with little margins and little growth. The sector is ultra-competitive, margins can dissolve in an instant, and people can be picky about their food. So what can investors do with this segment of the market?

One possible strategy involves **Empire Company Limited** (TSX: EMP.A) and its blockbuster acquisition of Safeway.

Cooking the books

Since hitting a 52-week high of $82.25 last November, the stock has slipped to a 52-week low of $64.63 on June 2. What comes next is quite interesting. On June 26, the Q4/year-end report came out with the combined financials of Sobeys and Safeway. The stock immediately jumped from $67.87 to $72.56 in three days, and has continued its upward momentum.

All these gains came because the addition of Safeway makes it look like the combined company has enjoyed massive sales growth. This is a trend that will continue for the rest of the year. Each quarter from now to June 2015 will show results with massive increases in sales year over year, which should continue to push up the stock.

But there is a limit to this, and once fiscal 2016 comes into play these massive gains will dissolve into single-digit growth. So while we don't normally advocate short-term investing, in this case, one could ride out the post-merger quarterly reports until Q4 2015, pocket some gains, then sell.

The latest report

Let's look at the most recent quarterly report to see this in action. Revenues came in during the quarter at $6.22 billion, up drastically from $4.6 billion. But when we look at Q4 2014, we see mostly combined revenues of $5.94 billion, a modest increase, but not a major one.

Net income in the quarter was $123 million, up from $82.6 million. We see here that cash is starting to return to the company post-merger, another factor that can push up the stock. As we saw in Q4 2014, net income was only $2 million thanks to the cost of acquiring Safeway.

One number that is encouraging and is not influenced by the merger is same-store sales, which climbed by 1.3% during the quarter. Thanks in part to a growing shift in the company to provide healthier options for customers, through its Better Food for All marketing strategy.

Debt dilemma

Thanks to the Safeway acquisition, long-term debt levels have increased to $3.1 billion in the quarter, up from $945 million compared to last year's quarter, as was expected. But the company is working fast to pay off its debt, as its consolidated ratio of funded debt to total capital was 35.5%, up from 19.9% before the merger. This strategy appears to be paying off as in the previous quarter the long-term debt was at $3.4 billion.

A safe way to look at this company's stock

A big factor in this strategy is the price target on Empire; with a recent closing price of $76.32, there is still some growth room. The average price target is only $80.60, but analysts are becoming a tad more bullish in their outlooks, with Credit Suisse raising its price target on Empire to $85.00 and CIBC World Markets increasing its target to $84.00.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:EMP.A (Empire Company Limited)

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