Attention, Contrarian Investors: Forget Loblaw Companies Limited and Buy This Retailer Trading Below Book Value

Description

Indigo Books & Music Inc.'s (TSX: IDG) mission is “to provide our customers with the most inspiring retail and digital environments in the world for books and life-enriching products and experiences.”

In its latest quarter, Indigo has seen a turnaround. While one quarter does not make a trend, it is worthy of our attention. Revenue increased 5.4% even though the company had seven fewer stores and online sales increased 14% to $20.3 million, with double-digit increases in books, lifestyle, paper, and toys. This increase was partly attributed to the timing of the Easter holiday as well as the launch of the American Girl specialty boutiques.

Loblaw Companies Limited (TSX: L), on the other hand, has been struggling to grow as it faces new and heated competition from other food retailers and big-box stores such as **Wal-Mart Stores Inc.** (NYSE: WMT) and **Target Corporation** (NYSE: TGT). While Target’s entry into Canada has been a disaster, with the latest quarter recording a loss of $200 million in its Canadian operations and a same-store sales decline of 11%, Wal-Mart has been successfully ramping up its presence in the food business. It has added food in 260 stores in the last five years and plans to continue to expand in this area.

And Loblaw has been feeling the pinch. The acquisition of Shoppers Drug Mart was an attempt to gain a stronger foothold over consumers, but the pharmacy business is also one that is increasingly competitive.

Same-store sales growth

Same-store sales over at Indigo increased a very strong 8.3% in superstores (representing 72% of total sales) and 1.9% in small-format stores (representing 14% of total sales). Loblaw’s recent quarter saw same-store sales growth of 1.8% at its Loblaw stores and 2.4% in its Shoppers Drug Mart stores.

Opportunities

Indigo intends to continue to leverage its retail space by introducing new and exciting products to drive sales and margins. As evidence of its progress on this front, we can see that in the latest quarter, revenues from print (books, calendars, magazines, newspapers) represented 68.1% of revenue versus 71.5% of revenue last year, and the general merchandise category (lifestyle, paper, toys, music, dvds, electronics) increased as a percentage of revenue, to 27.4% from 21.9%.

The American Girl boutiques have been a profitable addition to the mix, as well as other new products that complement the store. During the quarter, the company launched two American Girl specialty boutiques, one in Yorkdale Shopping Centre in Toronto and another in the Robson Vancouver store. The company plans to open another American Girl boutique in its Ottawa store before Christmas.

While Indigo certainly faces competition from online book retailers such as **Amazon.com**, the fact remains that there is nothing like the physical experience of going into a bookstore, and with improving online sales, Indigo is increasingly well positioned.

Costs declining

While the company continues to struggle with profitability, we are seeing an improvement on this front as well. Cost of sales at Indigo decreased to 55.8% of revenue from 57.9% of revenue in the same period last year. And cost of operations decreased to 37.2% of revenue from 38.7% of revenue in the same period last year. Loblaw is currently facing strong competitive headwinds from large U.S. retailers such as Wal-Mart, Target, and **Costco**, and there is no end in sight to this struggle.

Valuation

Indigo has certainly been in the doghouse in the last few years. The stock has a five-year return of -6.12%, as it fell from $18 to just over $11 currently. At this point, the stock is trading below book value, at a price-to-book ratio of 0.95 times. With cash of $154 million on the balance sheet, no long-term debt, and signs that things are turning around, I think this stock represents a very compelling opportunity.

Loblaw trades at a P/B of almost two times and has a five-year return of over 78%.

The bottom line

With its stock trading at below book value, revenues starting to show some life, and an offering that is unmatched in Canada, I believe that Indigo and its stock will see better days ahead. Loblaw, on the other hand, is faced with weak sales growth and is trying to survive in an increasingly competitive and crowded marketplace.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TGT (Target Corporation)
2. NYSE:WMT (Wal-Mart Stores Inc.)
3. TSX:IDG (Indigo Books & Music)
4. TSX:L (Loblaw Companies Limited)

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