How Much Longer Can Investors Ride Out The Shoppers Drug Mart Bump At Loblaw Companies Ltd?

Description

It's been two quarters now since Shoppers Drug Mart became part of **Loblaw Companies Ltd.** (TSX: L) and gave investors something to get excited about in the Canadian grocery market. There was some upward momentum on Loblaw's stock following the completion of the deal, but the real question faced by investors is when to cash out.

How many PC Points do I need to see the quarterly report?

Back when the second quarter came out, I spoke about how the inclusion of Shoppers Drug Mart would inflate revenues and give the stock a nice bump. We can see this trend in effect as the stock has gone from $47.00 when the Q2 report came out to a Thursday closing price of $60.60.

Thanks to Shoppers Drug Mart, revenues have increased by 36% relative to Q3 2013. In terms of dollars and cents, $13.5is sales were booked in the quarter up, from $10.2 billion in Q3 2013.

When we exclude Shoppers Drug Mart from the books, Loblaw only had a 2% increase in revenues, earning $10.2 billion in the quarter compared to $10 billion during the same period last year.

Both Shoppers and Loblaw had similar same store sales increases with Shoppers showing a 2.5% increase and Loblaw showing a 2.2% increase. In terms of the bottom line, net earnings came in at $142 million down from $150 million in Q3 2013. This is not a real surprise as Loblaw is still facing several onetime charges following the acquisition.

Loblaw also paid out $46 million in restructuring and reorganization charges in the quarter. The hope is that the unified company will reach $44 million in net synergies in the near future. The fruit of this is already starting to creep into the books as adjusted operating margins increased to 4.9% from the 3.8% before the Shoppers deal.

Three's a crowd

The greatest struggle that is happening behind the scenes at Canada's grocery stores is the secretive dealings between the retailers and their suppliers. Now the Federal Competition Bureau is getting ready to shine its light on these secretive dealings to see if Loblaw is “hindering its competitors”.

The FCB investigation is really not surprising as it has already laid out certain restrictions on how Loblaw can deal with Shoppers’ vendors. In the FCB’s eyes this is the next step: issues such as “restrictive trade practices” and vendor allowances are believed by the FCB to lead to higher price’s at Loblaw’s competitors which could be passed down to consumers.

Once the information begins to come to light about how grocers deal with vendors, it could set off a domino effect across the industry. Already several grocers, most notably **Sobeys**, have begun to refuse price increases retroactively. These types of ultimatums have soured relations and this investigation could swing some of the negotiating power back in favour of the vendors.

The clock is ticking

No matter how this investigation ends, it will have little effect on how investors can best navigate Loblaw’s stock over the short term. The best time to consider an exit remains around the release of the Q4 report because the stock has seen a drastic price increase between Q2 and Q3. The rise in share price has left a smaller profit window for investors, as the stock now trading just below a 52 week high at $60.60.

The average price target is currently sitting at $65.50 with only a couple of analysts setting $68.00 and up target prices. The issue is that when the Q2 2015 report comes out the Shoppers bump will be over and we’ll no longer see 36% revenue increases and we’ll be lucky by then to see a 3% increase.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:L (Loblaw Companies Limited)

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