3 Reasons Investors Should Buy Loblaw Companies Limited

Description

In my view, **Loblaw Companies Limited** (TSX: L) is a great buy today. Here are three reasons why it belongs in your portfolio.

1. World Bank revises global growth downward

Earlier this week, the World Bank lowered its estimate for global growth, revising its forecast to 3% this year (down from the 3.4% forecast they made in the spring), 3.3% in 2016 and 3.2% in 2017. Not surprisingly, it notes that consumer spending is expected to get a boost from low oil prices, and overall growth in China, Japan, and Europe is especially weak.

Loblaw is a defensive company as it has significant exposure to consumer staples (i.e., food) sales and health care expenditures (in-store pharmacies and Shoppers Drug Mart). Spending on these two categories is not dependent on the economy, so will hold strong regardless of economic weakness.

The company has its sights on international expansion and recently announced plans to expand its Joe Fresh fashion line to Africa, Asia, the Middle East, and Europe, and it has six Joe Fresh stores in New York. Loblaw is still pretty much a Canadian story, but this expansion of the successful Joe Fresh line offers good upside potential.

I like the fact that Loblaw also has exposure to discretionary consumer spending. Yesterday, I filled up the tank of my Kia Sorrento, and was very pleased to see my total cost was roughly $52 versus $85 just a few months ago. I fill up my tank three times a month so that equates to approximately $90 per month of extra cash. I want exposure to consumer spending because the longer oil prices remain below $50 per barrel, the more we will see a positive effect on consumer spending.

2. Target exiting Canada

The risk of **Target** (NYSE:TGT) getting its act together and shaking up the industry is no more. I personally am a fan of Target and believe that it is unmatched in Canada with regard to its quality/price proposition, but the fact is that the departure of Target eliminates a competitor, which can only be a good thing for Loblaw. And if Loblaw snatches up some of the Target locations, this increased presence and penetration would obviously be good for the company.

3. Improving financials

Same-store sales growth in the latest quarter, the third quarter of 2014, was 2.6% versus 0.4% in the same period last year. Over at Shoppers Drug Mart, pharmacy same-store sales growth was 3.5%, prescriptions dispensed increased 4.4%, and generic penetration increased to 63.1% versus 61.6% in the same period last year. Front store same-store sales increased a more modest 1.6%.

With all of this, the company achieved an EBITDA margin of 7.4% versus 6.4% in the same period last year. And strong free cash flow of roughly $600 million year-to-date versus $45 million in the same period last year has helped the company reduce its indebtedness and improve its balance sheet.

Synergies related to the Shoppers acquisition totaled $44 million in the quarter and $52 million year-to-date. Loblaw expects annualized synergies of $300 million in the third full year following the close of the Shoppers acquisition.

The environment is still competitive, but management commented that there is greater predictability in regulatory drug reform and it expects both of these trends to continue into 2015. Last year, as payors (government and insurance plans) were increasingly mandating that the generic drug must be the drug of choice, pharmacies saw growth of generics, and hence, erosion in pharmacy revenues.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:TGT (Target Corporation)
2. TSX:L (Loblaw Companies Limited)

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