Should You Buy Empire Company Limited After the 9% Drop?

Description

Empire Company Limited (TSX:EMP.A) fell close to 9% on Thursday after reporting its first quarter fiscal results. The highlights included the following:

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- Sales increase of 0.4% to $6.2 billion
- Net earnings decrease of 11.6% to $108.8 million
- Free cash flow generation of $216.8 million, a decrease of 28.5% compared with the same period last year

Why the poor first-quarter results?

Management attributes the poor first-quarter results to the Safeway integration, which is taking more time and resources than initially thought. Empire Company acquired Safeway stores in Canada in June 2013.

Lowered earnings and free cash flow is a sign of fundamental deterioration, especially for Empire Company, which is in the defensive industry of grocery stores. However, results from one quarter is too short a time period to tell whether this will become a trend or not.

If the problem is really in the Safeway integration, then it should be a temporary issue. So, long-term investors might opt to hold on to their shares. However, should new investors buy Empire Company Limited shares today? First, let's look at how Empire Company makes money.

The business

Empire Company is divided into two business segments: food retailing and investments and other operations. Its retail segment includes 1,500 retail stores in 10 provinces under the banners Sobeys, Safeway, IGA, Foodland, FreshCo, Thrifty Foods, and Lawton's Drug Stores. You've probably shopped in at least one of them. On top of that, Empire Company also has 350 retail fuel locations.

Its investments and operations include 41.5% interest in **Crombie Real Estate Investment Trust**, a retail real estate investment trust that pays a juicy yield of 7%. Empire Company also has equity interests in Genstar, a residential property developer with operations in select markets in Ontario, western Canada, and the United States.

So, if you're holding Empire Company shares, you're not only taking ownership in retail stores, but also gaining exposure to real estate for your portfolio.

Should you buy today?

Under $84 per share, Empire Company yields 1.4%. Based on its historical price-to-earnings ratio, it'd be a fairer price to buy its shares between $74-79, which is 5.5-11.5% below today's levels.

Further, the company is about to perform a stock split on a three-for-one basis. So, non-voting class A shareholders of record at the close of September 21, 2015 will receive two additional shares for each share held. The split shares are payable on September 28, 2015. Usually, after a stock split shares of a company go down a bit more.

So, due to the shares still being 5.5-11.5% expensive, investors thinking of buying Empire Company should hold off until the stock split occurs. After the stock split, the estimated fair price range of $74-79 becomes $24.7-26.3.

CATEGORY

1. Dividend Stocks
2. Investing

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

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