3 Reasons Why Every Investor Should Own Loblaw Companies Limited

Description

The grocery industry certainly isn't a sexy one. But it's very necessary.

No matter how poor the overall economy looks to be, folks are still going to go shopping for staples like milk, bread, or toilet paper. There's even the argument to be made that grocers benefit from a poor economy, since people who feel poorer often cut back restaurant spending.

A stock like **Loblaw Companies Limited** (TSX:L) is never going to get the attention that a tech company garners. But that doesn't make it a bad investment. In fact, over the last year shares of Canada's largest grocer are up more than 26%, while the overall market has sunk nearly 5%. That's the kind of outperformance everyone can get behind.

Even after that kind of run up, there are still plenty of reasons why investors should own Loblaw.

A reasonable valuation

Upon first glance, Loblaw shares look expensive. They trade at more than 40 times trailing earnings.

But those trailing earnings don't tell the whole story. Loblaw might not reflect it in earnings, but the company is actually quite profitable when you look at it from a free cash flow perspective. Through the first six months of 2015, Loblaw generated $1 billion in free cash flow.

And remember, the fourth quarter is the most profitable one for the grocery sector, since everyone is loading up for Christmas. If the company ends up having a great fourth quarter, it's possible for it to generate something like $2.3-2.5 billion in free cash flow for the year. At a market cap of $28.6 billion, that puts shares in the neighborhood of 12 times free cash flow.

Analysts are also bullish on the stock. Collectively, they expect the company to earn $3.54 per share in 2015, and follow that up with an even more impressive 2016, with projections saying Loblaw can earn $4.09 per share. That puts shares at 19.6 times 2015 earnings and 17.0 times 2016 earnings.

Huge potential growth

Before the Shoppers Drug Mart acquisition, Loblaw didn’t really have much growth potential. Management has done a great job expanding across the country, so there really weren’t many growth avenues that could really make a difference.

The Shoppers acquisition changed that. Now the combined company is on the cusp of a couple of huge growth trends.

The first is in pharmacy. There are more than nine million baby boomers in Canada alone who are entering their golden years. It’s estimated we’ll collectively spend well north of $1 trillion keeping them healthy. Prescription drugs are a huge part of that.

The relationship with a pharmacist is sort of like one with a doctor. After the pharmacist gets to know all a patient’s medical history, there is a huge cost to moving to a competing pharmacy. And since prescriptions are usually refilled once a month, the model offers nice recurring revenue.

And baby boomers are likely to pick up other items at Shoppers Drug Mart while they’re grabbing prescriptions. They can afford to pay a little more for convenience, and when you get a little older, walking a gigantic store for a few items becomes a pain.

Other interesting assets

The other thing that makes Loblaw an intriguing investment is its financial services division.

During the first half of 2015, the financial services segment added $99 million to earnings before income taxes. That’s higher than last year, even after second-quarter earnings from the unit were slightly disappointing.

Most of the earnings come from credit card receivables, which is a good business to be in. The average rate charged to customers was 13.7%, while write offs were 4.7%. A 9% pre-tax earnings yield is nothing to sneeze at.

There’s also the company’s real estate holding company, **Choice Properties**. Loblaw owns an 82.9% stake in the publicly listed REIT, which has a market cap of just over $1 billion. But the publicly listed part of Choice is only a small part of the overall company. Thus, Loblaw’s real estate alone is worth approximately $4 billion.

There’s a reason why Loblaw Companies has grown to become Canada’s largest retailer. Perhaps now is the time to put this stock in your portfolio.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:L (Loblaw Companies Limited)

Category

1. Investing

Date
2025/07/08
Date Created
2015/11/05
Author
nelsonpsmith