Is Empire Company Limited a Buy After Shares Plunged 13%?

Description

Thursday is not shaping up to be a good day for **Empire Company Limited** (TSX:EMP.A).

Canada's second-largest grocer released earnings that were, to put it lightly, a bit disappointing. The company reported a loss of $1.35 billion for its fiscal third quarter, which works out to a $5.03-per-share loss.

The loss came entirely from a write-down of the company's prized acquisition, Safeway. Empire beat out major competitors **Loblaw Companies Limited** (TSX:L) and **Metro, Inc.** (TSX:MRU) when it agreed to pay $5.8 billion for Safeway's 213 stores located mostly in western Canada. The acquisition price was said to be a little rich, but Empire decided it was willing to pay up for what it viewed as premium assets.

The total write-off in the quarter was $1.59 billion. But even without that impairment, earnings were still down compared with the same quarter last year, falling to $82.5 million compared to $118.6 million a year ago. This translates into a profit reduction of more than 36%. On a per-share basis, earnings were down from $0.43 to $0.30.

Empire is struggling with a few different things. The Safeway acquisition hasn't been nearly as attractive as management thought it would be. But not all of that is their fault. The decline in the energy patch hit Safeway hard in Alberta as cash-strapped consumers moved away from upmarket Safeway stores to cheaper options. It happens every recession.

Because of the move on the stock, Empire shares are now trading at a level not seen since the middle of 2014. Is today a buying opportunity, or should investors wait for more bad news?

The bull case

There are a few reasons to take a very hard look at Empire shares.

The first is the company's moat. The company owns more than 1,500 stores in every province, operating in more than 900 communities. It's been around long enough that it boasts some of the country's finest grocery stores in some terrific locations. That's exactly the rationale behind acquiring Safeway. Sure, it looks like the price was a little expensive, but it's hard to knock the quality of the assets.

The company is expanding in some interesting ways. It picked up more than 250 fuel locations with convenience stores from **Shell** in a 2011 deal and upped that to 350 with the Safeway acquisition. With energy companies looking to weather the storm by selling off convenience store assets, Empire can and should expand this area of its business.

Empire also trades at a more attractive valuation than its peers. The current book value of the company is $4.67 billion, while shares have a current market cap of $4.09 billion. Both Loblaw and Metro trade at significant premiums to book value with Loblaw at more than two times book value and Metro at approximately four times book value.

And remember, in the grocery business, book value is usually quite understated, since so much of it is in real estate that has been heavily depreciated over the years.

Even from an earnings perspective, Empire is cheaper than its peers. Even after including its most recent disappointing quarter and stripping out any one-time write-offs, Empire has earned $1.64 per share in the last 12 months. That puts shares at just 14.3 times trailing earnings.

That's much cheaper than its two main competitors. Loblaw trades at more than 20 times trailing earnings, while Metro trades at a virtually identical valuation as its larger peer. Both of these companies are approximately 30% more expensive on a P/E basis than Empire.

Empire has issues–there's no doubt about it. But the company has been in the food business for more than a century. If anyone can figure out how to fix these issues, it's this company. Investors are rewarded for taking on any uncertainty with a cheap valuation and a dividend with a consistent history of growth behind it.

CATEGORY

1. Dividend Stocks
2. Investing

TICKERS GLOBAL

1. TSX:EMP.A (Empire Company Limited)
2. TSX:L (Loblaw Companies Limited)
3. TSX:MRU (Metro Inc.)

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