



Wal-Mart Stores, Inc. and Costco Wholesale Corporation: 3 Reasons to Spin off Canada

Description

The IPO market hasn't exactly been on fire so far in 2016 with just 42 companies going public in the U.S. through the first six months of the year compared to 105 during the same time last year—a decline of 60%. It's the worst start for IPOs since 2009.

While I don't have a remedy for re-energizing the IPO market, I do have three reasons why both **Wal-Mart Stores, Inc.** ([NYSE:WMT](#)) and **Costco Wholesale Corporation** ([NASDAQ:COST](#)) should consider setting their Canadian businesses free.

They're both doing well

Wal-Mart announced its first-quarter 2017 earnings results in mid-May. Canada's performance was better than most of the company's other international businesses as well as its biggest revenue generator at home in the U.S.

Net revenues in Canada increased 8.6% with same-store sales growth up 6.7% year over year thanks to a 460 basis point increase in traffic and a 210 basis point jump in average ticket. Only its Mexican business did better with net sales up 9.5% on the strength of an 8.6% same-store sales increase.

The first quarter was Wal-Mart Canada's eighth consecutive quarter of same-store sales growth, it gained a full percentage point of market share, its online business continues to grow in Canada, and its operating profits grew at a greater clip than its sales.

Over at Costco Canada, the parent company announced third-quarter results at the end of May and, excluding gasoline and foreign currency, Canada's numbers were the best in the company with same-store sales up 8% for the 12 weeks ended May 8, 2016, and 9% for the first nine months of its fiscal year. That compares to 3% same-store sales growth (excluding gas and foreign exchange) for the entire company.

Very few successful Canadian retail stocks

The list of Canadian retailers that are both public companies and successful elsewhere is short. **Lululemon Athletica Inc.** and **Alimentation Couche-Tard Inc.** are the only two that come to mind. Sure, there are TSX-listed companies such as **Dollarama Inc.** that have done extremely well, but they are less known to investors outside this country.

The demand for a Wal-Mart Canada or Costco Canada IPO from institutional investors both here in Canada and south of the border would be strong in my opinion; it'd be exactly the elixir the IPO market is looking for. I'm not saying it's got a snowball's chance in Hell of happening, but that it would elicit a great deal of media attention.

The big paydays won't always be around

Equity markets in Canada and around the world are arguably higher than they've been from a valuation perspective in some time. The Shiller P/E ratio for the entire U.S. market is 26.3 as of July 1, 58% higher than the historic mean of 16.7. While the extended period of near-zero interest rates has a lot to do with investors' willingness to pay up for quality stocks, eventually this willingness is going to dissipate.

Why not strike while the iron's hot and let investors decide the value of their Canadian businesses?

Outperforming Wal-Mart's domestic business in terms of growth, there is some justification for a rich valuation, thus providing shareholders with an unexpected but welcome return on their investment. That's especially true for long-time Wal-Mart investors who've seen annualized total returns over the past three years of less than 2% compared to 11.5% for the S&P 500.

Over at Costco, it recently announced that it had repatriated \$904 million in cash in fiscal 2015 from its Canadian operations and another \$685 million in fiscal 2016 without paying taxes on that cash due to a tax loophole that allows U.S. companies to benefit from a stronger U.S. dollar. Without getting into tax-treaty specifics, it's unlikely, in my opinion, that the same opportunity will come around a second time; at least not in the foreseeable future. Thus, the cash aspects on an IPO would be less of an issue.

Bottom line

While I don't see this happening, it sure would make for interesting conversation in Canada's retail circles.

CATEGORY

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1. Editor's Choice

TICKERS GLOBAL

1. NASDAQ:AMZN (Amazon.com Inc.)
2. NASDAQ:COST (Costco Wholesale Corporation)
3. NYSE:WMT (Wal-Mart Stores Inc.)

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