Why Loblaw Companies Limited Is a Strong Buy Right Now

Description

Loblaw Companies Limited (TSX:L) has taken a huge beating in recent months; the stock has pulled back nearly 14% since August. The company is Canada's largest grocery retailer, and it owns one of the fastest-growing pharmacy chains in Canada: Shoppers Drug Mart. I believe the business is as strong as ever, and the sell-off is nothing more than an entry point for investors who are looking to own a stock they can hold for many years down the road.

The Q2 results saw Shoppers Drug Mart increase same-store sales by 4% thanks to the addition of great Loblaw-exclusive products after the acquisition. Same-store sales at Loblaw's grocery retail division saw a very small 0.7% increase in same-store sales, which is anything but impressive.

While the grocery segment struggles to increase same-store sales, the Shoppers Drug Mart acquisition is showing to be a huge success. The company has been able to grow profits thanks to management's ability to grow food sales as well as pharmacy store sales.

What about valuation?

The stock trades at a 39.8 price-to-earnings multiple and has a 1.64% dividend yield. While the stock may seem quite expensive at current levels, it is actually tremendously undervalued considering the growth potential of its Shoppers Drug Mart chain and the fact that its grocery segment has a strong hold of the Canadian market, particularly in the west.

It has a price-to-book ratio of two, a 0.6 price-to-sales, and a 8.2 price-to-cash flow, all of which are in line with their five-year historical average values. The stock is around fair value, but what isn't considered is the growth potential of Shoppers Drug Mart and the fact that the grocery business looks to be at a low thanks to competition brought on from firms like **Wal-Mart Stores Inc.**

Is competition a serious threat to Loblaw stores?

I don't believe Wal-Mart is a huge threat to Loblaw because in western Canada there are way more Loblaw branded stores and they are much better dispersed. As we've seen with **Target Corporation** and its failed attempt to get into the Canadian market, competition will have a hard time getting grocery shoppers to move away from Loblaw stores, which have the most competitive prices and the best exclusive brands, which will continue to drive margins for Loblaw.

Loblaw store count in Canada is a moat that will keep competition on their heels. If you're looking to do grocery shopping, you will go to the store with the biggest selection, the best prices, and the closer location.

Loblaw has low prices and a huge selection, and, in most cases, there's a Loblaw store closer to the average Canadian than a Wal-Mart. The average Canadian won't go out of their way to go to a store that is farther and may have less selection.

If Wal-Mart were to take over the Canadian market, it would have to invest a lot more over the long term in order to avoid the fate of Target, which failed in Canada. I don't see the company doing this in the medium term, and it will make a very small impact to Loblaw's bottom line right now. This is why I don't see competition taking a huge chunk out of Loblaw's market share.

If you're a long-term investor, Loblaw is quite cheap right now, and there is a lot of upside from current levels after the sell-off. Buy the stock and collect the yield, as this stock will rebound in 2017.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:L (Loblaw Companies Limited)

PARTNER-FEEDS

1. Yahoo CA

Category

1. Investing

Date
2025/08/27
Date Created
2016/11/15
Author
joefrenette