Jean Coutu Group PJC Inc.: There Are Better Buys in the Pharmacy Space

Description

Loblaw Companies Limited bought Shoppers Drug Mart in March 2014. The move made **Jean Coutu Group PJC Inc.** (TSX:PJC.A) the only pure-play pharmacy stock trading on the TSX. Almost overnight, its stock began a nine-month journey higher that ended with it hitting an all-time high of $28.95—up 33% in less than a year.

That was then.

Today, its stock trades in the low $20s, well off its five-year low of $12.15, but nowhere near its all-time high.

At first glance, this might seem odd given that Jean Coutu has zero debt, $149 million cash, and a respectable 2.38% dividend yield, better than 31 stocks in the TSX 60.

However, before you buy Jean Coutu stock, you definitely should consider several U.S. alternatives. Long term, you'll probably do better despite ongoing speculation that the Coutu family, which owns 93% of the voting shares and 58% of the equity, would likely consider a takeover bid from **Metro, Inc.** or some other strategic buyer, driving its stock much higher than its current price.

Play the "what if" game all you want, but I tend to work in the here and now.

If not Jean Coutu, then what?

Two stocks come to mind

CVS Health Corp. (NYSE:CVS) and **Walgreens Boots Alliance Inc.** (NASDAQ:WBA) are more compelling investments, in my opinion, despite having some baggage.

More than a year later, Walgreens's US$17.2 billion deal to acquire **Rite Aid Corporation**, the third-largest drugstore in the U.S., appears to be getting closer to happening. Walgreens originally wanted it done by the end of January; the Federal Trade Commission needs it to sell 650 stores of the merged company's U.S. store network, which works out to 5% of the total.

With the Trump victory, Walgreens likely wouldn't oppose a delayed ruling by the FTC beyond January because the Republicans are far more likely to approve the deal than the Democrats.

In October, Walgreens announced mixed fourth-quarter earnings that saw sales barely budge up less than 1% year over year to US$28.6 billion on a 22% increase in earnings per share. In fiscal 2016 it generated adjusted EPS of US$4.59; it expects fiscal 2017 adjusted EPS of at least US$4.85 per share.

From a valuation perspective, its stock trades at 11.4 times cash flow and 0.8 times sales compared to 14.2 times cash flow and 1.3 times sales for Jean Coutu. Although its dividend is 1.8% or 60 basis points lower than Jean Coutu, Walgreens's stock has been held back by the uncertainty of the FTC decision.

That's ironic given Jean Coutu used to own Rite Aid. Ultimately, however, the FTC should approve the deal, sending Walgreens's stock much higher.

The other player in the U.S. drug store war, CVS Health, announced its third-quarter results November 8 and although it beat analysts' expectations for earnings—adjusted EPS of $1.64 versus the consensus of $1.57—its downbeat guidance for fiscal 2017 sending CVS stock down more than 10% on the day; it now trades down 21.5% year-to-date, much of that coming in the past couple of weeks.

Beaten down, CVS is still the biggest drugstore chain in the U.S. by revenue. It will recover from this downturn—its first losing year since 2008. In the meantime, this presents a big buying opportunity with CVS stock valued at lower multiples of both cash flow and sales—7.2 and 0.5 times, respectively—than either Walgreens or Jean Coutu.

There's nothing wrong with Jean Coutu. I just see better buys south of the border.

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