Loblaw Companies Ltd.: Buy the Dip?

Description

Loblaw Companies Ltd. (TSX:L) is now down ~15% from its all-time high thanks to a number of headwinds, including rising minimum wage, disruptions caused by meal-kit delivery services, rising competition from brick-and-mortar grocers, and the entrance of **Amazon.com, Inc.** (NASDAQ:AMZN) into the Canadian grocery scene starting with Vancouver and Toronto.

On June 27, 2017, I warned investors that Canadian grocers could suffer a nasty sell-off in the months following Amazon's acquisition of Whole Foods Market. Shares of Loblaw are now down over 9% since my warning, and it appears that all Canadian grocers are going to be dealing with several major long-term headwinds that will eat into the top and bottom lines.

This is unfortunate for Loblaw, because it has been operating really smoothly, despite the negative phenomenon of food deflation. Margins in the grocery business are razor thin, but Loblaw was able to perform really well in spite of this.

The management team has even been investing in "Click & Collect" initiatives to offset the rise of e-commerce grocery retailers; however, I do not believe such initiatives will be effective in stopping Amazon and its plans to take over the grocery world.

Amazon is a huge disruptor, and I'm confident that it'll be successful in its plans to steal market share from Canadian grocers over the next few years. Sadly, Loblaw, as well as other Canadian grocers, will fall victim to Amazon and the technological changes that the grocery sector is experiencing.

Going forward, Loblaw is probably going to experience sub-par earnings growth thanks to competition from Amazon in addition to minimum wage hikes and higher interest rates. I expect Loblaw to continue with cost-cutting initiatives; however, I do not believe the results from such initiatives will offset the mounting headwinds that will likely cause Loblaw to underperform in the year ahead.

Shares of Loblaw currently trade at a 22.34 price-to-earnings multiple, a two price-to-book multiple, and a 8.3 price-to-cash flow multiple, all of which are lower or in line with the company's five-year historical average multiples of 94.3, two, and nine, respectively.

The stock appears to be fairly valued at these levels, but I believe shares should be substantially cheaper considering the numerous headwinds that will eat away at the company's profitability over the medium to long term.

I'm not a big fan of Loblaw right now and would recommend waiting for a further pullback to the low $60 levels before thinking about buying the dip.

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