A Defensive Way to Build TFSA Wealth in 2018

Description

Ontario's minimum wage increase to $14 per hour will affect restaurants and other low margin businesses. The wage is expected to rise again in 2019 to $15. Minimum wage has risen faster than usual in the last three years; this represents a 7% per year increase compared to a ~4% per year increase back in the mid-200s. Remember when minimum wage was $7.45, circa 2005?

For some context, the minimum wage in Denmark converts to above $22 CDN per hour; therefore, Ontario *can* still pay people more for work.

Loblaw Companies Limited (TSX:L) has been in the spotlight recently. With roughly 2,400 corporate, franchised and associate-owned locations, and being one of Canada's largest private sector employers, the attention is warranted. Loblaw has 190,000 full and part-time employees, a figure that is virtually unchanged compared to four quarters ago.

Deriving a conclusion, it is true that the ***cost of business*** will increase in 2018 for Loblaw. The company generated $47 billion in revenue in the trailing 12 months (TTM) with $33 billion in costs for a gross profit of $14 billion. Quick calculations: the company made ~$73000 per employee, or $6 million per location in a year. The wage hike will cut into those profit margins. The market has known about this for months, however, which explains why the share price has already dropped substantially, as much as 17% below the 52-week high (summer 2017).

Things I like about Loblaw

1. The enterprise value to EBITDA — a measure of efficiency and profitability — is currently well below 12 (a semi-arbitrary but *helpful* cut-off). When share price increases, then the enterprise value goes up. The EV/EBITDA ratio gives investors a more honest indication on whether earnings have kept up with the hype/momentum. In the U.S. markets, where valuations have been stretched, you would be hard-pressed to find EV/EBITDA's this low without resorting to trolling for value traps or fishing for companies embroiled with bad press.
2. Return on equity (ROE) is around 13%, which is not as impressive as the EV/EBITDA and is slightly below industry average. In my opinion, it is still business as usual as long as the ROE stays above 10%.
3. The current ratio is a solid 1.45. A corresponding measure of financial leverage, debt-to-equity, is now 0.74 and below the company's historic debt levels.
4. The share price is awfully close to $66, which would be an absolute bargain share price.
5. Looking forward, the company estimates earnings-per-share to increase in 2018 to $4.69 (keep in mind that Loblaw estimates have historically been pretty accurate). The industry average price-to-earnings (P/E) is around 22. If the Loblaw share price hits $66, then the forward price-to-earnings will be 14. My interpretation: strong value!

Opinion on Loblaw is decidedly mixed (here and here); I'm leaning toward the positive, but it is good to consider all sides. I will point out that **MTY Food Group Inc.** (TSX:MTY), which is more of a growth stock in the food sector, estimates EPS to drop in 2018, whereas Loblaw has EPS guiding upward.

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bmacintosh