Investor Caution: What Recent Pharmaceutical Changes Will Mean for These 2 Large Caps

Description

On what may otherwise have turned out to be a very strong day for two of Canada's largest grocery retailers and pharmacy companies, shares of both **Loblaw Companies Limited** (TSX:L) and **Metro, Inc.** (TSX:MRU) ended yesterday on a down note, despite indications that profitability has begun to pick up in this sector.

While shares of Metro traded higher in early morning trading due to outperformance in the company's earnings release, as covered by fellow Fool contributor Joseph Solitro, shares of Metro edged down approximately -0.3%, as investors priced in the potential effects of new pharmaceutical regulations, which are set to affect the company's **Jean Coutu Group PJC Inc.** (TSX:PJC.A) pharmacy locations.

Similarly, Loblaw traded down more than 3% on the news, as a downgrade by Desjardins Capital relating to pharmaceutical regulations and headwinds relating to Ontario's minimum wage hike spoiled the party for investors. Canada's largest retailer has given up all its gains since the beginning of the year, now trading below January 1st levels.

The proposed pharmaceutical changes were a result of a deal between the Pan-Canadian Pharmaceutical Alliance and the Canadian Generic Pharmaceutical Alliance in which prices of approximately six dozen popular generic drugs would be discounted by up to 90% of what Canadians would otherwise pay for brand-name alternatives. The impact on Loblaw's Shoppers Drug Mart subsidiary and Metro's recently acquired Jean Coutu has been quantified by Desjardins as a potential $190 million headwind — a fact which moved to reduce its target price for Loblaw to $76 and cut its recommendation to "hold."

I have held concern about Loblaw for some time now, and while I remain bullish on the long-term prospects of Metro when I compare this company to its peers, it appears that the potential for growth within the pharmacy segments of these two companies is likely to be much more negatively impacted from these new pharmaceutical regulations than would otherwise have been the case, given strong investor optimism surrounding the ability of Canadian pharmacies to sell cannabis in the months to come.

Bottom line

The recent pharmaceutical changes have been welcomed by consumer advocates for some time, as Canadians continue to pay very high prices for pharmaceuticals — attacking the affordability issue at the generic level makes a heck of a lot of sense, and as such, these headwinds are likely to persist in this sector long term. If forced to choose, I would suggest investors consider Metro as a long-term play; however, for now it may make sense to stay on the sidelines and see where valuations go from here.

Stay Foolish, my friends.

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