Bad News From an Otherwise Great Stock: What's Next for This Grocer?

Description

When **Loblaw Companies** (TSX:L) announced earlier this month that the company was going to take a whopping $368 million charge from a recent tax ruling, it made some investors jittery and raised plenty of questions.

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In the two weeks since that announcement, the stock has dropped nearly 4%, prompting some investors to question the feasibility of their investment in the company.

More about that tax charge and the impact it could have

Few investors may realize this, but Loblaw actually had a banking subsidiary that was based in Barbados.

The charge stems from a reassessment of tax years that spans back nearly two decades. As a foreign bank, Glenhuron would be exempt from paying tax under Canadian law.

Unfortunately, the federal government didn't see Glenhuron as a foreign bank, despite efforts by Loblaw to make it look like it was.

With the entity not considered a foreign bank, Loblaw's tax liability increases for those years. The court stated that Loblaw having Glenhuron as a bank was beneficial to the company from a taxation standpoint, but any transactions made "were not avoidance transactions."

After taking into account payments that were already made, Loblaw is expected to make a payment of $242 million, which will not have any bearing on any investment or buyback programs in place, nor should it impact Loblaw's dividend.

Loblaw is planning to appeal the decision, which could have resulted in a far worse result had the court not acknowledged that Loblaw's intent did not appear to be intentionally deceiving.

What can we expect from Loblaw?

Taking into consideration the past few quarters of results, the decision may push the company towards the red for its next quarterly announcement.

Fortunately, Loblaw has maintained a strong propensity to generate cash over the past few quarters, even in the midst of other one-time issues. The one-time charge is unlikely to sway several other initiatives at Loblaw, which more than justify the company as a great long-term investment.

Between being both the largest grocer and pharmacy in the country, Loblaw has a steady stream of business coming into its stores. The incredibly personal nature of grocery shopping also provides a defensive moat around the growing fear of online retailers encroaching on the grocery store business as they did to nearly every other segment of retail.

One area in particular that holds incredible upside is in the upcoming legalization of marijuana. Earlier this month, Shoppers Drug Mart received approval to become a licensed medical marijuana producer from Health Canada.

Final thoughts

Grocery stocks like Loblaw are very interesting and potentially lucrative investments owing to one often overlooked factor: we need food. We can protest our wireless bill and forego the morning coffee to tighten our budget, but we need to buy food to survive.

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Another lucrative point worth mentioning is that Health Canada recently granted Shoppers a licence as a medical marijuana producer. This could be significant revenue driver in future, as people that are unaware of where and how they can purchase medical marijuana will ultimately end up asking their local pharmacist.

Throw in the respectable dividend that currently yields 1.77% as well as the welcoming, calm store atmosphere that is designed to keep you shopping, and you have a winning formula for investors.

In short, long-term investors should not fret over recent bad news; rather, take the opportunity to buy what is a great investment at a discounted rate and benefit from the dividend and the upcoming legalization date.

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