Is Loblaw Companies Ltd. (TSX:L) Stock on a Super Sale?

Description

Loblaw Companies (TSX:L) stock fell as much as 20% on Friday. The stock popped nearly 5% on Monday as the market digested the news.

Why Loblaw went from trading at about $65 to $55 per share

Loblaw announced that it had spun out its stake in **Choice Properties REIT** (TSX:CHP.UN), in which it had 61.6% interest. Loblaw can now focus on its retail business as Canada's largest retailer.

To be more specific, Loblaw has about 2,500 corporate, franchised and associate-owned locations that range from discount stores to specialty stores. It has full-service pharmacies in more than 1,300 Shoppers Drug Mart stores.

Prior to the reorganization, **George Weston** (TSX:WN) already had about 3.8% interest in Choice Properties via its majority ownership in Loblaw. Now it has about 65.4% in the REIT.

Existing Loblaw shareholders would receive 0.135 of a common share in George Weston unless they sold Loblaw stock between October 30 and November 1. Beginning November 2, Loblaw resumed regular trading with the company having sold the Choice Properties investment.

Is Loblaw stock on a super sale?

Based on George Weston's Monday market close price, it implies Loblaw shareholders who are getting a piece of George Weston will receive about $12.55 per Loblaw common share (the form of George Weston common stock, which is a tax-free transaction). This is roughly the same drop that was experienced on Friday.

So, new investors in Loblaw aren't getting a sale on the stock from the huge drop, which is due to Loblaw selling its stake in Choice Properties. That said, because Loblaw no longer owns a stake in real estate, its debt ratio (calculated by net debt to adjusted EBITDA) has improved from 3.3 times to 2.7 times.

Choice Properties' impact on Loblaw

To get an idea of the spin out of Choice Properties on Loblaw, let's see what the REIT's impact is on Loblaw's operating results in the first half of 2018. Specifically, the REIT contributed revenue of $510 million (2.4% of Loblaw's total revenue), adjusted earnings before interest, taxes, depreciation, and amortization (EBITDA) of $341 million (17.9% of total adjusted EBITDA), net income of $306 million, and funds from operations (FFO) of $262 million.

Choice Properties

Investors can consider Choice Properties for income, as the diversified REIT offers a high 6.24% yield with a recent sustainable FFO payout ratio of about 70%.

Choice Properties' high-quality portfolio consists of 757 properties (primarily retail properties) totaling 67.0 million square feet of gross leasable area. It also has industrial and office properties and has been developing mixed-use properties.

Choice Properties maintained high occupancies of +98% from 2015 to 2017 and increased its FFO and cash distribution on a per-unit basis by 5.3% and approximately 6%, respectively.

George Weston

Before Loblaw's spinout of Choice Properties, George Weston owned a small piece of Choice Properties via its stake in Loblaw. After the spinout, George Weston became a more balanced company, owning about 65% in Choice Properties, 50% in Loblaw, and 100% of Weston Foods, which roughly make up 35%, 61%, and 4%, respectively, of its market cap instead of 2%, 93%, and 5% previously. George Weston has also become a more liquid company as its public float has increased by about 57% to roughly $7.3 billion.

Investor takeaway

Loblaw is not trading at a huge discount. It just passed off its Choice Property stake to George Weston in a tax-free transaction in the perspective of Loblaw shareholders. In return, existing Loblaw shareholders got George Weston common stock.

CATEGORY

1. Dividend Stocks
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1. TSX:CHP.UN (Choice Properties Real Estate Investment Trust)
2. TSX:L (Loblaw Companies Limited)
3. TSX:WN (George Weston Limited)

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Date
2025/08/23
Date Created
2018/11/06
Author
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