Attention: Avoid This 1 Stock…for Now

Description

Loblaw (TSX:L) provides Canadians with grocery, pharmacy, health and beauty, apparel, general merchandise, financial services, and wireless mobile products and services.

The company's controlling shareholder is **George Weston Limited,** which owns 51.8% of Loblaws outstanding common shares. In 2018, Loblaws divested of its interest in **Choice Properties REIT** whereby George Weston Limited received the company's 61.6% effective interest.

The company reports a market capitalization of $24.63 billion with a 52-week high of $76.31 and a 52-week low of $59.86.

Intrinsic price

Based on my calculations using a discounted cash flow (DCF) valuation model, I determined that Loblaw has an intrinsic value of $67.30 per share.

Assuming less than average industry growth, the intrinsic value would be $66.45 per share, and higher than average industry growth would result in an intrinsic value of $68.16 per share.

At the current share price of $67.68, I believe that Loblaw is trading at fair value. Investors looking to add a grocery company to their TFSA or RRSP should add Loblaw to their watch list and wait for an opportunity to buy shares at less than intrinsic value

Loblaw has an enterprise value of $33.4 billion, representing the theoretical price a buyer would pay for all of Loblaw's outstanding shares plus its debt.

One of the good things about Loblaw is its acceptable leverage with debt at 26.9% of total capital versus equity at 73.1% of total capital.

Financial highlights

For the 10 months ended October 5, 2019, the company reports a strong balance sheet with $3.8 billion in retained earnings.

This is a good sign for investors, as it suggests that the company has more years of cumulative net income than cumulative net loss. This money then gets reinvested into the company to fuel business growth.

Loblaw reports cash and equivalents of $944 million with short-term liabilities of $3 billion. This means the company does not have enough cash on hand to cover its short-term obligations.

This is not a problem given its committed credit facility ($1 billion with no amounts drawn). However, I would like to see a company with this history have enough cash on hand to cover its current liabilities.

Overall revenues are up slightly to $36.4 billion from $35.5 billion in 2018 (+2.7%) with an increase in COGS and SG&A expenses of +2.1%, which resulted in operating income of $1.7 billion (up from $1.5 billion in 2018) pretax income of $1.2 billion, up from $1 billion in 2018.

From a cash flow perspective, the company takes a proactive approach to debt management, as indicated by a $365 million pay-down of short-term debt and a $952 million pay-down in long-term debt, offset by a $553 million issuance of long-term debt and $96 million draw on its bank debt in 2019.

In 2018, the company paid down $2.2 billion of long-term debt, which is offset by a $3.9 billion issuance of long-term debt, a $50 million draw on short-term debt and a $156 million draw on bank debt.

The company also spent $774 million in 2019 to repurchase and cancel shares under its normal course issuer bid. This amount was $844 million in 2018.

Foolish takeaway

Investors looking to buy shares of a grocery company should consider buying shares of Loblaw. The company reports positive retained earnings, increasing revenues and increasing profitability. Management is also keen on keeping its debt at low levels, as indicated by its proactive debt management strategy.

At its current price of $67.68, I believe the shares are trading at fair value compared to its intrinsic value of $67.30. Thus, I recommend investors wait for the shares to pull back to below intrinsic value, and then then buy in.

CATEGORY

1. Investing

TICKERS GLOBAL

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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cliu