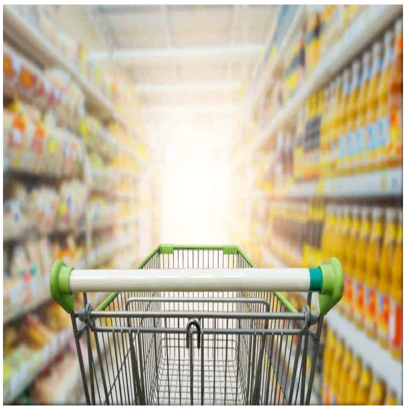

Why Loblaw Is a Safe Bet Today

Description

Loblaw Companies (TSX:L) has emerged as one of the few coronavirus-resilient stocks in the market today. This leading multi-category Canadian retailer managed to remain mostly unscathed from the broad market-wide sell-off in late February and March 2020. Pandemic or not, people require food, household products, and medicine. Loblaw has benefitted from the inelastic demand for essential products.

Changing consumer behaviour is a major tailwind

Although the global economy is now opening up, people still remain apprehensive about mingling with strangers. This will be the new norm until an effective COVID-19 vaccine becomes widely available. People are limiting visits to restaurants and malls to avoid contracting infection. People may also prefer multi-category retailers over specialty retailers, as they look to make larger purchases in fewer shopping visits. Loblaw will most likely benefit from these changes in 2020.

Loblaw's broad retail footprint is also pivotal to faster and more cost-effective functioning in both click-and-collect and home-delivery market segments. Click-and-collect continues to account for a major portion of its online business. The company is also working towards reducing average wait times in the home-delivery segment.

A more permanent change in consumer behaviour seems to be on the horizon. As the global economy increasingly adopts flexible working options, people may opt to cook from scratch. With Loblaw currently selling food and medicines to over 90% Canadians, the company will be an obvious long-term beneficiary of this change.

Loblaw's scale and broad supplier network can help it control product prices. This becomes quintessential, especially in difficult economic environments.

Loblaw's dividend and share-repurchase strategy

Loblaw pays an annual dividend of $1.26 per share, which now translates into a dividend yield of 1.96%. The company has not announced a dividend raise in first quarter but plans to do so in fiscal 2020. Loblaw also repurchased 2.8 million common shares for $188 million in the first quarter.

These risks cannot be ignored

Although Loblaw has posted healthy revenue and earnings growth in the first quarter, there are definitely some challenges that the company will have to overcome in the remaining part of fiscal 2020.

Reduced consumer discretionary spending is affecting the company's top line. Increasing unemployment has forced customers to rein in discretionary spending, a trend that will most likely continue, even after the lockdown restrictions are lifted. However, the company may manage to partly offset the impact. In recessionary times, people are more likely to trade down brands of discretionary items. The company's discount division may benefit from this trend since its product mix is more geared towards general merchandise, apparel, and beauty products.

The second quarter of 2020 may also not be as rosy for Loblaw, even on the margin front. The shift of its product mix towards low-margin pantry items and away from higher-margin general merchandise items will continue to pressure the bottom line. An additional $90 million monthly investment in COVID-19-related expenses is taking a toll on the company's margins. The increased volatility in shopping behaviours in these uncertain times has forced the company to withdraw its 2020 outlook.

Bottom line

Loblaw is definitely not a growth stock and will most likely not make you a millionaire. It is also not the best of income-generating stocks in the market. However, it is definitely one of the best defensive stocks for capital preservation in today's volatile markets.

CATEGORY

1. Coronavirus
2. Investing

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