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North West Avoids Target by Dominating Arctic: Corporate

By Katia Dmitrieva on April 22, 2013

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North West Company Inc. (NWC), the oldest Canadian grocer, is trading at a record high as its dominance of remote markets from the Arctic to the South Pacific shields it from U.S. competitors such as Target Corp. (TGT)

The Winnipeg-based company has carved out a market niche in northwest Canada where a pack of gum can cost C\$7, as well as Alaska, the Caribbean and islands such as Samoa. Shares in North West, which was formed in 1779 and originally sold fur on canoes, closed up 1.1 percent to C\$24.48 today in Toronto, eclipsing an April 15 peak and reaching the highest since it went public in 1990.

“North West Co. will not be impacted negatively by the U.S. retailers’ moves into Canada,” Andrew Hamlin, a fund manager at Aston Hill Financial Inc. (AHF), which manages C\$6.7 billion (\$6.5 billion), including North West shares. “There is no competition where it operates.”

Minneapolis-based Target, the second-largest U.S. food distributor which began operating in Canada in March, plans to open 125 to 135 stores in 2013, increasing pressure on retailers such as Loblaw Cos Ltd. (L) Wal-Mart Stores Inc., the world’s largest retailer, said Jan. 22 it will spend C\$450 million to renovate and add at least 37 superstores to 379 locations in Canada in the next year. The Bentonville, Arkansas-based retailer will also expand fresh food options, said Shelley Broader, chief executive officer of the Canadian unit.

Nunavut, Fiji

North West’s 146 Northern stores sell food, financial services and general merchandise in Canadian cities such as Iqaluit, Nunavut, where temperatures reached minus 24 degrees Celsius (minus 11 Fahrenheit) last week. It also has 36 Giant Tiger discount stores in urban areas in western Canada, 31 AC Value Centers in Alaska and 12 Cost-U-Less warehouse stores in islands such as Grand Cayman, Hawaii and Fiji.

“These communities are hard to reach and we have relationships with these communities, aboriginal residents, we partner with local organizations,” CEO Edward Kennedy said in a phone interview from Winnipeg. “If you’re a larger retailer -- keep in mind these are still small markets -- all that trouble and effort to acclimatize yourself culturally to the community to put in a fairly small store in a very high cost of doing business environment, it doesn’t look very attractive.”

North West closed at C\$24.22 at 4 p.m. in Toronto on April 19, for a market value of C\$1.12 billion. It has gained 71 percent in the five years through yesterday, including reinvested dividends, compared with a 2 percent loss for the broad Standard & Poor’s/TSX Composite index.

Target gained 22 percent this year and Wal-Mart has risen 26 percent.

Competitive Dividend

The company's estimated dividend yield of 5 percent outpaces its closest competitor Safeway Inc. (SWY) at 3 percent, Jennifer Bartashus, a food retail analyst at Bloomberg Industries said in an April 10 note.

Safeway gained (SWY) 21 percent this year and had revenue of \$44.2 billion last year.

North West's profit rose 12 percent to C\$65.15 million in the year ended Jan. 31, as sales increased 1.2 percent to C\$1.51 billion.

Wal-Mart is reaching into the north through the Web. The number of items shipped by the retailer to the Yukon, Northwest Territories, and Nunavut has increased 300 percent over the same time last year and Wal-Mart expects even higher growth for this region in 2013, according to Alex Robertson, director of corporate affairs for Wal-Mart Canada.

Northern Access

"It's a priority for us to provide access for our products to remote communities and we're continuing to focus on that as an area of growth," Robertson said in a phone interview. "We are seeing an increase in searches on our website from Nunavut and the Territories."

While barriers to entry have protected North West's merchandising dominance in the north, its high prices in areas where many aboriginal communities live in poverty and where the company's stores are sometimes the only option, have also drawn criticism from residents.

The not-for-profit group Feeding My Family held a protest in June outside a North West store in Nunavut and one of their members, Israel Máblick, said that she paid C\$17.99 for a 12-pack of Pepsi and C\$20.39 for a bag of frozen vegetables at a North West store this year. A similar box of PepsiCo Inc. (PEP) soft drinks sold at Loblaw this week for C\$4.99 in Toronto while a bag of vegetables was C\$2.99. Aboriginals face "deep and severe food insecurity" due to high costs, the United Nations said last year. While First Nations communities across Canada face chronic food problems, the remoteness of towns like Iqaluit, which can only be reached by air or ship, exacerbates the problem.

Lightning Rod

"We are a lightning rod, no question, compared to Wal-Mart, which sells into the North, has no physical presence, employs no one, donates nothing, pays no taxes in the North, but it ships to the North," Kennedy said. Other retailers "may be worried about Target but we're more thinking about community perception and how we can bring them the best. It's a risk in our business that's somewhat unique to what other retailers are facing."

"We've passed through every nickel of cost efficiency to the customer," Kennedy said.

Wal-Mart donated \$2.5 million over five years to Evergreen, a community environmental group that operates across the country, including in Nunavut. "Our primary function and our social value is helping Canadians lower their cost of living," Robertson said.

Though Northern stores will drive revenue growth in 2013, the company will open “a couple new” Giant Tiger junior discount stores this year, Kennedy said. North West last year closed six of these discount outlets, which sell clothing, household products and food in rural markets.

Inuit Art

“In retail today the urban marketplace is getting more and more crowded and it’s harder to differentiate,” Kennedy said. “We like rural. We like remote. We like second-world, third- world infrastructure. We’re more comfortable dealing in those situations. That’s our expertise.”

Focusing on the north is good strategy, said Neil Linsdell, analyst at Industrial Alliance Securities in Toronto. The company’s general merchandise sales, which made up 20 percent of revenue last year, are volatile. North West has a wide geographic presence in the north through its ownership of Inuit Marketing Service, Canada’s largest distributor of Inuit art, and Sealift Express, a food catalog service for northern residents.

Safe Dividend

“The locations of North West’s stores in remote regions of Alaska and Canada, combined with the extent of its operations, provide significant barriers to new entrants,” Linsdell wrote in a March 21 note to clients when he initiated coverage of the company. He rates the stock a buy and has a price target of C\$25. The dividend is “healthy and sustainable,” Linsdell said.

The stock has two buys and five holds with an average price target of C\$24.33 from six of the seven analysts who cover it, according to data compiled by Bloomberg.

“If we can keep driving down costs, and keep finding ways to reduce prices, it creates more disposable income for customers and we can capture more of that,” Kennedy said. “It’s a virtuous circle.”

To contact the reporter on this story: Katia Dmitrieva in Toronto at edmitrieva1@bloomberg.net

To contact the editor responsible for this story: Jacqueline Thorpe at jthorpe23@bloomberg.net

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