



Is Kevin O'Leary Right About Canada's Grocers?

Description

Kevin O'Leary is perhaps Canada's best-known business personality.

O'Leary started off as Business News Network's Investor at Large before leveraging his popularity into his own show with co-host Amanda Lang, titled *Squeeze Play*. The program was consistently one of BNN's highest-rated shows, even after both O'Leary and Lang left to do a similar show on CBC Newsworld.

Many Canadians also know O'Leary as his role as one of the dragons on *Dragons' Den*, a role he held for eight seasons. O'Leary currently appears on the U.S. version of the show, *Shark Tank*, in a similar role.

Additionally, most expect him to run for leadership of the Conservative Party of Canada.

Needless to say, when O'Leary talks, people listen, which is why I paid extra attention when he was on BNN recently, talking about the grocery sector.

The problem with retail

O'Leary didn't mince words about the retail business.

He told host Catherine Murray, "I don't buy grocers, not because one is better than the other or they're mismanaged ... The margins are just horrible in that business. It's a horrible business."

He went on to say, "I don't know of a worse business for margins than food. You're talking single-digit margins; it's just miserable. If you lived badly on earth and you go to hell in perpetuity, your job is running a grocery store ... Can I take capital and find more interesting opportunities in the other 11 sectors or 10 sectors? Yeah."

O'Leary's comments are nothing new. That criticism has followed the industry for decades now. The fact is, the grocery sector in Canada is fiercely competitive with a number of major players. And if that weren't enough, it has also attracted the attention of **Wal-Mart**, the world's biggest retailer.

Remember that **Target**, one of the United States's biggest retailers, came to Canada and only lasted a couple of years before being forced to shut down.

It's extremely tough to differentiate yourself in the grocery business. How can one chain justify selling a box of cereal for more than a competitor? It's the exact same product. Thus, the whole sector becomes a race to the bottom.

In such a competitive situation, any problem gets magnified. Back in 2012, **Loblaw Companies Limited** ([TSX:L](#)) shares sank below \$35 each due to a number of issues. The biggest problem was its distribution network. Customers were reporting empty shelves caused by bottlenecks in the system, which was impacting earnings.

Empire Company Limited ([TSX:EMP.A](#)) is experiencing something similar today. The company has struggled to integrate its 2013 Safeway acquisition, and sales have been weak in western Canada. Safeway customers also revolted when Empire took away much beloved Safeway store brand products and axed its longtime loyalty program.

Empire shares are down more than 50% versus their 2015 peak. If the company was in an industry with higher margins, perhaps investors would have been more patient with its problems.

Should you own grocery stocks?

The grocery business isn't all bad, however. There's a case to be made for owning at least one grocer in your portfolio.

Here's the way I look at it.

Consumer staple stocks can be lucrative investments if you buy them when the market hates them.

There are countless examples of grocery turnaround stories. Loblaw's supply chain issues are barely a memory. **Supervalu**, a U.S. chain, was also in a precarious spot in 2012. Three years later, shares were up some 500%. Even **Tesco**, the U.K.'s leading grocer, is up significantly from August lows.

Empire is probably the most interesting grocer in Canada today. It trades at a lower valuation than its peers using almost every important metric, and struggling stores in Alberta and Saskatchewan will recover again. It's only a matter of time.

The bottom line

For the most part, I agree with O'Leary. The grocery business has low margins, which further exposes weakness during tough times.

But unlike O'Leary, I won't write off the sector completely. Investors can make money if they buy at the point of maximum pessimism. I think we're pretty close to that with Empire Company.

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1. Investing

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2. TSX:L (Loblaw Companies Limited)

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