Metro Inc.'s Excellent Operating Performance Translates to Earnings Beat

Description

Canada's largest grocery chains have had a difficult time of late generating profits amid deflationary pressure on prices due to increased competition and price wars among Canada's largest grocers. While the Canadian consumer has largely come out ahead, the consumer price index (CPI) numbers for Q1 2017 have highlighted how difficult the situation has become for grocery retailers looking to turn a profit.

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Despite deflation doubling in Q1 2017 to 2% for an average basket of grocery items from 1% for the first quarter last year, **Metro Inc.** (TSX:MRU) has been able to beat earnings expectations, with net income coming in at $0.56 per share, beating analyst estimates of $0.53 per share, and topping last year's quarterly numbers by $0.05.

What has the company done differently?

As the competitive environment has become more competitive, Metro has focused on operational excellence as its core differentiator over the past year. While other retailers such as **Loblaw Companies Ltd.** have been expanding capital expenditure budgets and planning for increased growth and additional price cuts to take away market share, Metro has instead focused on profitability and increasing earnings and its return on assets relative to its peers – a strategy I happen to be very fond of.

Growth is great, and capturing market share can be a good thing, as long as a company is able to convert growth into profit at some point in the value chain. What Metro has done is combine strategic cost-cutting measures with marketing and operational strategies targeting the mix of products its customers buy, thereby reducing the effect of deflationary prices on its bottom line.

The results are clear: the CPI for Canadian grocery items declined by approximately 3.5% since thefirst quarter of last year, and Metro has only experienced 2% deflation for the same basket of goods. In essence, Metro has been able to steer customers toward grocery items that have shown price stability or price increases, while discouraging customers from its worst-performing categories such asproduce, which saw some of the largest percentage price deflation among the categories studied.

By improving its non-produce offerings, and expanding its chain of specialty Mediterranean supermarkets (under its Adonis umbrella), Metro has been able to maintain or in some cases raise prices in a market where competitors are slashing away at margins.

Bottom line

Grocery is a cut-throat, long-term game with competitive price pressures that have historically meant slim margins for national grocery retailers. Metro's operational strategy stands out to me as one that positions the company well for profitable growth in the future – with the emphasis on profitable.

Stay Foolish, my friends.

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