Forget Empire Company Limited: Buy Metro, Inc.

Description

In an age when grocery retail is under siege from increased competition, reduced margins, and higher-dividend opportunities, picking the Canadian grocery retailer that is right for your portfolio can be a difficult task. That said, only a few large names exist on the TSX, and with a little bit of research, analysis, and scrutiny, it has become clear to me that some are better than others.

I'm going to compare **Empire Company Limited** (TSX:EMP.A) with **Metro, Inc.** (TSX:MRU) and talk about why I believe the former is a riskier play from a long-term perspective.

Business fundamentals

While it may appear that Empire is a better value play than Metro at first glance, looking at the stock charts for both companies over the past year, it is important to remember that short-term movements in a company's stock price should have no bearing for a long-term investor on the investment worthiness of a given investment. As such, looking at the underlying business fundamentals can give an investor a much better idea of how these companies are likely to perform over time.

Assessing the forward price-to-earnings (P/E) ratio of both Empire and Metro will give us an idea of how each firm is valued relative to their expected forward earnings (earnings 12 months from today, based on estimates). We can see that on a comparative basis, Metro is actually substantially cheaper than Empire with a forward P/E of 16.6 compared to 26.6 for Empire.

By looking at each company's operating margin and profit margin (very important in an industry synonymous with razor-thin margins), we can see that Metro comes out ahead again. Metro boasts gross and net margins of 5.8% and 4.5%, respectively, compared with Empire's gross margin of 1.6% and net martin of -3.3%, respectively.

While both companies are diversified in terms of the banners they operate, I like Metro's focus on margin growth and sustainability compared with many of the other large Canadian grocery retailers. Over long periods of time, being consistently profitable is just good business.

One interesting aspect of Empire's business model is that it has a lot of exposure to real estate with an equity accounted position in **Crombie REIT**, meaning an investment in Empire is also an investment in the Canadian real estate sector — one which has been hit quite hard of late.

Finally, after assessing the dividend yields of both companies, I see relatively no difference between the two and believe these small yields are insignificant for a growth investor looking at adding either Empire or Metro to their portfolios.

While 1.95% (Empire) is indeed very different than 1.39% (Metro), especially over a long time horizon, with the growth nature of the business models associated with both companies, the dividend yield is purely a bonus and will continue to fluctuate over time depending on how the corresponding stock prices move.

Bottom line

For those interested in the grocery retail sector, I would recommend Metro as a “top pick” if forced to choose. I believe that on a very long-term time horizon, traditional bricks-and-mortar grocery retail will be disrupted; for the short term, however, investors have a number of options to choose from, and some are clearly better than others.

Stay Foolish, my friends.

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