Loblaw Companies Ltd. Takes a 3.76% Plunge on Minimum Wage Increases: Time to Sell?

Description

Loblaw Companies Ltd. (TSX:L) nosedived 3.76% in a single trading session following news that the company will see an expected increase to its labour expenses by approximately $190 million next year. The company may also be pressured to spend more on innovation as the rise of technology in the form of digital grocery delivery platforms disrupts the industry over the next few years. Are there too many incoming headwinds to safely hold on to this defensive name? Or does Loblaw have the ability to adapt and offset increased expenses?

Increased minimum wage in Ontario and Alberta will hurt bottom line

Kevin Groh, Loblaw's vice president of corporate affairs and communications, stated, "We're facing significant incremental costs that will require us to look at every one of our cost levers … we're very committed to our strategy and continue to invest in important growth areas like e-commerce."

While the management team will try to cut more costs to offset increased labour costs, I don't think there's much in the way of cost savings at this point. The margins in the grocery business are razor thin and, fortunately for Loblaw, they've already excelled, despite low margins thanks to improvements in operational efficiency over the years.

There's really not much you can do about minimum wage increases, but for Canadian grocers with such a huge presence across many of these affected provinces, the wage hikes couldn't come at a worse time, since additional expenses may be on the horizon.

Fresh food delivery is a serious long-term headwind

Amazon.com, Inc. (NASDAQ:AMZN) and its recent acquisition of Whole Foods Market, Inc. may not seem like it will affect Canada's grocers since most of Whole Foods's locations are in the U.S., but I believe it's the first step of Amazon's plans to take over the industry with its grocery delivery services.

To add more salt in the wound, many meal kit subscription businesses are popping up around Canada, such as Chef's Plate, The Jolly Table, and Fresh Prep. With many Canadians opting to have their meals planned and their groceries delivered, we may find less traffic at grocery stores as meal kit subscription services continue to grow in popularity.

Does Loblaw have a response?

Although Loblaw has invested in a “Click & Collect” platform, I don’t think it will be enough to weather the coming storm of internet grocery delivery services or meal kit subscription services.

The management team at Loblaw is investing in e-commerce, but in the end, there will be pricing pressure, as I do not believe such innovations will be able to completely offset potential losses from grocery delivery platforms over the long term.

Bottom line

The grocery industry is undergoing a transformation, and Loblaw is going to need to spend to innovate in order to adapt. Increased labour costs from minimum wage increases and innovation initiatives will cost the company in the medium term, and, unfortunately for shareholders, this could mean potentially lower or less frequent dividend hikes going forward.

I’m not a huge fan of Loblaw at these levels. Although it will be business as usual in the medium term, I think there are much bigger headwinds to worry about than minimum wage increases.

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