Maybe it's Time to Sell Loblaw Companies Ltd.

Description

Loblaw Companies Ltd. (TSX:L) reported second-quarter earnings July 26. Revenues, same-store sales growth, and earnings all experienced healthy increases from Q2 2016.

Is all good at Loblaw? Perhaps.

However, there are troubling storm clouds on the horizon with the minimum wage rising to $15 per hour in Alberta and Ontario. Loblaw's management says the increase will cost the company $190 million in additional labour costs in 2018 alone.

"Beyond 2017, the recent announcements of minimum wage increases in Ontario and Alberta … will negatively impact the company's net earnings," stated Loblaw's press release. "The expected incremental impact of minimum wage increases on labour expenses is approximately $190 million in 2018 … The company is currently assessing how to mitigate these impacts."

That might seem like a lot, but spread over four quarters, the projected additional labour costs work out to a 3.7% increase in its selling, general, and administrative (SG&a) expenses in this year's second quarter. As revenues grow, the $190 million will represent even less of an increase in SG&A expenses.

This commentary, while necessary as part of its reporting compliance, is also a shot across the bow of the Alberta and Ontario provincial governments.

"How dare you rob shareholders of profits?" scream the capitalists. And that's what's got me worried about Loblaw's future.

While there's an argument to be made that both governments should take longer to phase in the $15 minimum wage, because it gives small businesses a chance to plan for the additional labour costs, there's a counter argument that delaying the inevitable does nobody any good.

A living wage is good business

The idea of a living wage is not going away. We were not returning to the beginning of the industrial revolution when child labour was a common practice.

Loblaw is not a small business. It's a giant food conglomerate controlled by one of Canada's richest families. I doubt any of the Westons have trouble paying for their grocery bills at Loblaw, but many in-store employees probably do.

Putting more money in the hands of its lowest-paid workers will add revenue typically lost to lower-priced grocery chains while also adding productivity through a happier, engaged workforce.

"Raising the minimum wage boosts the economy, as low-wage workers are the most likely to spend any additional pay," said Holly Sklar, founder and CEO of Business for a Fair Minimum Wage, a network of U.S. business owners and executives who believe a fair minimum wage makes good business sense. "Their increased buying power translates into more purchases at businesses large and small, and helps boost aggregate consumer demand."

Pay peanuts, get monkeys

Costco Wholesale Corporation (NASDAQ:COST) knows a thing or two about living on razor-thin margins. Its gross margins are half those at Loblaw, yet its operating margin of 3.1% in the last 12 months was only 150 basis points fewer.

Costco in the U.S. and Canada has consistently paid its in-store employees higher wages than its peers, resulting in happier staff who remain with the company for years, reducing its cost of training new hires.

Costco's business model is simple.

It keeps prices as low as possible, passing on any savings from suppliers to its customers in the form of lower prices. A significant portion of its profits come from its annual membership fees.

Costco pays its hourly workers more than it has to because it makes good business sense. It remains one of a handful of large companies that are still loyal to its employees.

"Until 1980, increases in productivity were shared with the workers who had created those gains," wrote *Forbes* contributor Steve Denning recently. "After 1980, almost all the gains went to the shareholders and the executives."

Bottom line on Loblaw and minimum wage

If you're a current shareholder of Loblaw, you ought to be very concerned that the company is not embracing the idea of paying its hardest-working employees better wages, but instead is focusing on how much it's going to cost.

I've long heard rumours that Loblaw is a terrible employer, but I always rejected them as comments from disgruntled former employees.

The company's preoccupation with cost makes me wonder if it's time to sell its stock.

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2. TSX:L (Loblaw Companies Limited)

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