Ontario May Have Struck a Blow to Canadian Grocers With its New Policy

Description

On July 26 **Loblaw Companies Ltd.** (TSX:L) expressed concern over the coming minimum wage hike in Ontario and Alberta during its earnings conference call. The company estimated that the wage hike would increase labour expenses by $190 million in 2018. In response, Loblaw will be forced to cut costs. Prolonged food deflation has forced Loblaw and competitors to introduce discounts and promotions to draw customers and sell more products.

Premier Kathleen Wynne has introduced a rise in the minimum wage by 32% which is set to roll out over the next 18 months. It is expected to move to $14 in January 2018 and finally to $15 in January 2019 — this is from the current minimum wage of $11.40.

Loblaw chief executive officer Galen G. Weston said the company will be forced to speed up its cost-trimming plan that was already in place. The company will move to make more manual processes digital and use its tools to point out discounts.

A positive earnings beat was not enough to overcome the warnings from senior management. Revenue grew by 3.2% to $11.1 billion, and EBITDA by 6.6%. Adjusted net earnings saw an 8% increase, and earnings per share grew by 9.9% year over year. Same-store sales saw growth of 1.2%; the conference call clarified this and said growth was flat, excluding gas and an Easter boon.

More bad news after threat from Amazon

The June announcement that **Amazon Inc.** had purchased **Whole Foods Market, Inc.** has put increasing downward pressure on Loblaw and competitor **Metro, Inc.** (TSX:MRU). In the case of Metro, the company has seen its stock drop 10% since early May. Loblaw has experienced a decline of 9% since the June 16th announcement.

The threat of e-commerce for grocers is still primarily speculative, while the move by the Ontario government has put losses in real terms for these two rivals. Still, grocers are confident that new strategies will be able to effectively respond to these changes. Cost cutting by the two companies will no doubt include more automation in stores and the expansion of online services. This may present opportunities for grocers to get ahead of the game and aggressively modernize in anticipation of the services Amazon is set to put forward with the e-commerce experiment.

Loblaw stock offers a dividend of $0.27 per share with a yield of 1.59%. Metro has a lower dividend of $0.16 per share and a dividend yield of 1.53%.

The short- and medium-term ramifications of the Ontario minimum wage hike should give investors pause when looking at Canada's retail grocers. The challenge from Amazon has yet to fully manifest itself, but increased costs could chew into earnings and create downward pressure until the full effect of both wage hikes is felt. I would recommend these stocks for longs in the market for income.

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Date
2025/08/26
Date Created
2017/08/04
Author
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