5 Headwinds That Could Hurt Canadian Grocers Over the Long Term

Description

The grocery industry is a tough business to operate in. Margins are razor thin, and if a company is not operating efficiently, things could get really ugly in a hurry, as we've seen with **Empire Company Limited** (TSX:EMP.A), which lost over half of its value from peak to trough a few years ago and is only just starting to recover. **Loblaw Companies Limited** (TSX:L) and **Metro, Inc.** (TSX:MRU) are two well-run grocers that have performed very well, despite the trend of higher food inflation, but I think there are dark times ahead for these two solid grocers.

Here are five headwinds that may hurt the Canadian grocers over the medium to long term.

Amazon is hungry for the grocery space

Amazon.com, Inc. (NASDAQ:AMZN) is something for North American grocers to worry about after its recent deal to acquire Whole Foods Market, Inc. Although most Whole Foods locations are in the U.S., and Amazon's entry into the grocery space is likely only going to affect U.S. grocers over the medium term, I believe Amazon will eventually penetrate the Canadian market when it's ready, and that's really bad news for all Canadian grocers, even if they have e-commerce platforms in place.

Fierce competition from Wal-Mart Stores Inc. (NYSE:WMT)

It's not just Amazon that Canadian grocers should be afraid of. Wal-Mart Canada recently announced that it's driving prices lower to better compete with Canadian competitors. Although Loblaw has more locations and potentially more selection at its stores, the biggest factor that'll influence where the average Canadian will go is the price. Margins are already extremely thin in the grocery space, and they're about to get even thinner as Wal-Mart attempts to steal customers by driving prices to the floor.

The rise of meal-kit delivery services

Meal-kit delivery subscriptions have been trending lately. They deliver recipes and all the ingredients needed to make the perfect meal. The service isn't too expensive, and it eliminates food wastage. For many busy Canadians, meal-kit delivery services are the best thing since sliced bread. It's incredibly convenient for subscribers as they don't need to hunt for items at the grocery store anymore, but for local grocers, that's lost business.

Meal-kit delivery services are still a young model right now, but going forward, I believe they'll become more popular with the general public, and Canada's grocers will need to respond with its own service.

Rising minimum wages and decreased profitability

Minimum wage in Ontario is set to rise to $15 per hour by 2019, and other provinces may follow in Ontario's footsteps. Canadian grocers such as Loblaw and Metro have made it clear that rising minimum wages will hurt long-term profitability.

It's been reported that Ontario's proposed minimum wage increase could put 185,000 jobs at risk.

What does that mean for Canadian grocers?

Less productivity thanks to minimum wage increases

Canadian grocers are going to get less productivity per dollar spent in labour costs. It's likely that grocers will have fewer workers, and that means less service for customers.

Bottom line

The Canadian grocery industry has many headwinds that are mounting and, unfortunately, I believe there's a higher degree of risk involved with investing in any one of Canada's grocers over the next few years. There's a huge cloud of uncertainty right now, and the risk of a sell-off over the next few years appears to have increased significantly.

If you're still keen on investing in Canadian grocers, I'd wait until a larger sell-off presents itself over the next few years because chances are, one or more headwinds could spark a nasty plunge. When a plunge does present itself, I'd opt for better-run grocers like Loblaw or Metro over Empire.

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