Will Canadian Grocers Suffer From a Whole Foods Market, Inc. Price Cut?

Description

Amazon.com, Inc. (NASDAQ:AMZN) cut prices at **Whole Foods Market, Inc.** (NASDAQ:WFM) locations by as much as 76% in some cases on its first day of ownership. The company chose to send a sharp message to the supermarket industry in all of North America: Amazon plans to shake up the grocery game in the same way it radically transformed brick-and-mortar retail.

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There are currently 13 Whole Foods locations in Canada — the majority of which are concentrated in the major metropolitan areas in Toronto and Vancouver. Compare this to the over 400 locations in the United States, and it should give investors some pause in evaluating the immediate risk for Canadian grocers.

Metro, Inc. (TSX:MRU) stock has declined 6% since the original announcement that Amazon would purchase Whole Foods on June 16. Metro released its third-quarter results on August 15. Fully diluted net earnings per share were up 8.3% to $0.78. Net earnings were up 3.7% from Q3 2016 to $183 million. Sales were up 1.2%, but same-store sales saw a 0.2% decline. In a statement, Metro said the challenging environment was due to increased competition and food price deflation.

Canadian grocers were also hit with bad news when Ontario announced that it would steadily raise the minimum wage to $15 by January 2019. The impact will be felt in 2018 when the first raise comes into effect of $14/hour. In August, Metro announced that it would accelerate its automation drive in order to cut costs. The company estimated that the minimum wage hike could cost up to $50 million in 2018.

Loblaw Companies Ltd. (TSX:L) projected that it would sustain a $190 million loss in light of the minimum wage hike and revealed that it was also looking at cost-cutting measures. The stock has seen a 10% decline since the day before the Amazon-Whole Foods deal was announced. The company released its second-quarter earnings on July 26 and saw revenue and retail sales jump 3.2% from Q2 2016. Food retail saw a 1% increase compared to 3.7% for drug retail locations. The company took note that, excluding the jump in Easter activity, sales were relatively flat.

Amazon launched the initiative at Whole Foods complete with the promise: “This is just the beginning.” Whole Foods will maintain an upscale reputation for the foreseeable future, and even after the aforementioned price cuts, the grocer is still on the pricier side compared to its competition.

Canadian grocers are likely to respond with marginal cuts and loyalty plays. The industry faced a similar challenge in the past with the rise of cheaper options at **Wal-Mart Stores Inc.** locations over a decade ago. The long-term threat for conventional grocers lies in the Amazon business model, which seeks to pry consumers away from brick-and-mortar stores. This is a revolutionary model and a bold expectation even for the 21st-century buyer.

Metro and Loblaw Companies offer 1.5% dividend yields, but the challenges facing both in the form of the Amazon experiment and Ontario policy should prompt investors to turn elsewhere in the short and medium term.

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