What to Buy Instead of the Likes of Loblaw Companies Ltd.

Description

Food retail stocks, including **Loblaw Companies Ltd.** (TSX:L), **Metro, Inc.** (TSX:MRU), and **Empire Company Limited** (TSX:EMP.A), have seen weakness lately because of minimum wage hikes. These hikes will increase the costs of running their businesses.

For example, Loblaw estimates that its operating costs will increase by $190 million this year due to the minimum wage hike. The food retailers already operate in a low-margin business and face high competition in the industry. So, it's unlikely they can pass all the increased costs to consumers. In fact, some job cuts have already happened at these companies in direct relation to the minimum wage hikes.

I don't think Loblaw, Metro, and Empire will go away. However, their stocks are unlikely to go much higher in the near term. Investors are probably better off waiting a quarter or two to see how the companies fare with the increased costs. Instead, they might consider this food stock, which has higher margins and a track record of growth.

MTY Food Group Inc. (TSX:MTY) franchises and operates quick-service restaurants primarily in North America. It has had a track record of successful acquisitions and integrations. In the last 15 years, it has acquired and integrated 55 brands. In the last 10 years, the stock has delivered an annualized rate of return of roughly 16%, which is above average.

In the most recent quarter, MTY Food Group had 70 restaurant concepts across more than 5,500 operation locations, of which 98.6% were franchised. Its annual system sales are about $2.5 billion. You'll recognize its brands, including Croissant Plus, Extreme Pita, Jugo Juice, Koryo, Koya, Manchu WOK, etc.

In December, MTY Food Group announced that it was in the midst of acquiring **Imvescor Restaurant Group Inc.** (TSX:IRG), which has 262 locations (of which ~97.3% are franchised), five restaurant concepts, and annual system sales of about $416 million. MTY Food Group management believes the complementary acquisition will help the company to grow faster in North America.

MTY Food Group will pay about 20% in cash and 80% in MTY Food Group shares for the acquisition. In February, Imvescor shareholders will vote on whether they approve of this acquisition or not. If all goes well, the acquisition will close in the first half of the year.

Investor takeaway

I think MTY Food Group is a better long-term investment than the food retailers. MTY Food Group's recent net margin remained high at 21.4%. As well, its recent return on equity and return on asset of ~20.5% and ~7.5%, respectively, were also decent.

Investors may be concerned about the company's spike in financial leverage to 2.6 from the ~1.3 level (the normal historical level). This is mainly due to the company's large acquisition of Kahala Brands in 2016.

However, MTY Food Group's cash flow generation is strong. And if the company wanted to, it could pay off the debt over time. Management seems more focused on growing the company at this time, though.

CATEGORY

1. Dividend Stocks
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1. TSX:EMP.A (Empire Company Limited)
2. TSX:L (Loblaw Companies Limited)
3. TSX:MRU (Metro Inc.)
4. TSX:MTY (MTY Food Group)

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