3 Reasons to Be Wary of George Weston Ltd. and Loblaw Companies Ltd. in the Second Half of 2018

Description

The grocery industry entered 2018 facing a number of challenges that drove down investor sentiment to start the year. Food prices in grocery stores have remained flat in 2018 as retailers find themselves in an extremely competitive marketplace. As of close on May 22, **George Weston Ltd.** (TSX:WN) and **Loblaw Companies Ltd.** (TSX:L) have dropped 5.3% and 3.9% in 2018, respectively.

Grocers will undoubtedly be watching the results of the Ontario election intently. The pro-business PCs have slipped in the polls of late, and the progressive NDP has been the beneficiary of the collapse of the Ontario Liberals.

Below are three troubling factors that could contribute to a further decline in the second half of 2018.

Walmart Canada Corp. makes a sweeping cut

In May, **Walmart Inc.**'s Canadian division announced that it would cut Weston Foods as a bread supplier. The company said that this was not because of the recent bread-price fixing scandal that struck Weston Foods and Loblaws, but for "commercial reasons."

Canadian grocers face growing competition from Walmart, as well as **Amazon.com, Inc.** and the threat of its dominant e-commerce model. According to a report from Kevin Grier Analysis and Consulting, sales of food at traditional grocery and convenience stores were flat in Canada in 2017, while food sales at general merchants like Walmart and **Costco Wholesale Corporation** were up 15%. Walmart has been particularly aggressive with its pricing in recent years as it pushes to gobble up market share.

Intense competition in the drive for e-commerce growth

Grocery retailers like Loblaws have moved to bolster online grocery business in an attempt to stave off the looming threat from Amazon and some of its domestic competitors. The company recently announced its intention to "blanket the country" with online grocery services in 2018. Loblaws also plans to expand its click-and-collect program, which enables customers to order groceries online and retrieve them at a pick-up location.

By the end of 2018, Loblaws aims for over 70% of Canadians to be able to access its click-and-collect and home delivery services. This is encouraging, but companies like **Metro Inc.** and **Empire Company Ltd.** have also made strides in these areas. Pricing will continue to be a key challenge and political developments could dramatically impact grocers going forward.

Earnings take a tumble in the first quarter

Loblaw Companies released its first-quarter results on May 2. Revenue fell 0.4% year-over-year to

$10.36 billion and retail segment sales dropped 0.6% to $10.10 billion. Operating income fell 3% to $480 million and adjusted net earnings shed $5 million from the prior year. However, Loblaws did hike its quarterly dividend by 9.3% to $0.27 per share, thereby representing a 1.6% dividend yield.

George Weston released its first-quarter results on May 8. Sales dropped 0.5% to $10.74 billion and operating income fell 2.1% to $502 million. In 2017, Weston projected that the Ontario minimum wage hike would result in a challenging year for his companies as grocers fought to lower operating costs. The company declared a quarterly dividend of $0.455 per share, representing a 1.7% dividend yield.

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