Will Rising Prices Boost Grocery Stocks?

Description

In late 2017, grocery companies across North America were bracing for new challenges with the decade winding down. Grocers will be forced to contend with the e-commerce retail giant **Amazon.com** making its way into the sector in addition to an increasingly competitive environment. Canadian grocers also faced the unique challenge of minimum wage hikes and the rising operating costs that would follow. In Ontario, the minimum wage was moved up to $14/h and was slated to increase to $15/h by January 2019.

The new Ontario PC government has put the latter development on pause for now, but grocers are still navigating a changed sector. Rising fuel costs and an emerging trade spat between the United States and Canada has also complicated matters. Top grocery retailers initially shied away from price increases, even with inflation holding steady above 2% for much of the year. The highly competitive environment prevented any significant price increases.

This situation is set to change in the coming months. CEOs of major Canadian grocery chains are now saying that food price increases are on the way. **Metro** (TSX:MRU) CEO Eric La Fleche has said that his company is already starting to catch up to regular price inflation, and he expects other to follow suit. “Exactly when and how — it’s all about competitive dynamics. Everybody is competitive,” he said. La Fleche also reiterated Metro’s commitment to expanding its e-commerce offerings and said the company may consider using a dedicated facility if it continues to experience large expansion.

Metro sales were up 2.4% year over year in its most recent third-quarter report. This was excluding sales numbers from its Jean Coutu Group acquisition. Adjusted net earnings were up 11.1% from the prior year to $183.4 million. Metro also bumped up its dividend by 10.8% to $0.18 per share, representing a 1.7% dividend yield. Shares have slipped 6.4% over the last three months as of close on September 19.

Loblaw Companies (TSX:L) CEO Galen Weston projected food price inflation between 1% and 1.5%. He said that this was on the lower end compared to the higher 5-6% range, as Canadians have seenat restaurants in 2018. “We don’t see it moving into the mid-single digit levels,” he said. “We don’t thinkit’s likely to do that.”

Loblaw saw its revenue drop 1.4% year over year to $10.9 billion in the second quarter. Food retail same-store sales growth was 0.8%, excluding gas bar operations. Operating income fell 10.5% to $561 million and adjusted net earnings dropped 5.6% to $421 million. On the bright side, Loblaw’s President’s Choice Financial credit card came in at number one in a Canadian consumer survey in September. The company declared a quarterly dividend of $0.295 per share, representing a 1.6% dividend yield.

Back in early March, I’d suggested investors target grocery retailers for a spring comeback. Both Metro and Loblaw reached an annual high in the early summer but have experienced volatility in the months since. Price inflation should work to improve margins, but if Galen Weston’s 1-1.5% range is accurate, it is unlikely to move the needle in the coming quarters.

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