



Are Grocery Stocks a Buy?

Description

While the stock market might be down, there is one area right now that still manages to hold high: grocery stocks. The entire world has been looking to grocery companies to be on top of bulk ordering, and most have met the challenge.

However, that also means that while there are a lot of opportunities in today's market, it's unclear whether grocery stocks are one of them.

That's because stocks like **Loblaw Companies Ltd.** ([TSX:L](#)) and **Metro Inc.** ([TSX:MRU](#)) have been trading high while everything else has plummeted. In fact, both are trading near all-time highs at the moment.

So with that in mind, should grocery stocks be considered a defensive play in today's market? Or will a crash eventually come?

Loblaw stock

As one of the largest grocery chains in Canada, Loblaw was practically the [first to respond](#) to the COVID-19 pandemic. The company announced that customers didn't need to worry. There would be no food shortages, safety precautions would be met, and no, the company would not run out of toilet paper.

Since then, the stock has traded ever higher. Loblaw stock initially fell after the pandemic crisis, in fact it fell twice. First, Loblaw stock plummeted 18% and then again by 9%.

Since that last drop, however, the stock has been climbing back to all-time highs in the \$70 range. As of writing, the stock trades at about \$74 per share, an increase of 25% since the last dip.

While initial bullishness seems to have occurred with Loblaw stock, I don't think investors should believe this will last long term. COVID-19 and social distancing are unfortunately here to stay for the time being. That means that even through all those good intentions, Loblaw can't help but feel the

impact on its bottom line.

Even with all of the banners of No Frills and Shoppers Drug Mart under the Loblaw name, each company will be heavily impacted by the crisis.

As earnings reports come in, I expect investors should see further drops in Loblaw stock price. Loblaw already operates in a competitive environment despite having the top two private labels in Canada, and its cost of capital is rarely covered by its returns on capital.

Add the push to increase the minimum wage in both Ontario and Alberta and Loblaw could have some serious trouble on its hands as its customers continue to go to cheaper stores like **Wal-Mart** and **Costco**, not to mention the increasing use of meal kits.

Metro stock

While analysts aren't that [bullish about the future](#) of Loblaw, Metro stock is a different story. The stock also fell twice, by 12% and 9%, respectively, but has since bounced back by 15% to around \$60 per share.

Metro is still within the highly competitive industry, but has a lot more room to grow out of its main banners. But if you're going to buy up a stock like Metro, here are a few words of warning.

Metro is under the same pressures as Loblaw, with Wal-Mart, Costco and others all putting strain on the grocery stock. Metro simply does not have the resources that its competitors have at the moment — and that's unlikely to change in the next decade. But where Metro might just have an edge is through its modernization investment.

The company recently spent \$400 million to modernize and automate its facilities. In a post-pandemic world, this could be highly beneficial to get customers in and out of the door as quickly as possible.

With more automated programs in place, this will leave funds available to reinvestment and bring in more customers. While this won't spur a lot of growth in the near future, Metro might be ahead of the curve in the long term.

But whether Metro will get to this point is up to debate. Online grocery stores, discount operators and meal kit expansion could seriously hurt Metro's earnings.

All of these areas could see some increased growth, with consumers getting used to online shopping, which leaves Metro needing to find other areas for keeping up its earnings.

CATEGORY

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1. TSX:L (Loblaw Companies Limited)
2. TSX:MRU (Metro Inc.)

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