

# Grocery Trade Report



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Market Analysis and Consulting Inc.

Make Informed Decisions

April 2018

## Canadian Food Industry Statistical Snapshot

### Consumer Prices

Change vs 2015	CPI All Items	CPI Food from Stores	CPI Restaurants	Packaged Foods*
March	2.3%	0.5%	4.4%	-0.2%
Latest 12-month YOY	1.6%	0.3%	3.0%	-0.4%

### Manufacturing Industry Raw Costs and Goods Prices

Change vs 2014	Raw Crop-Based Materials Costs	Raw Animal-Based Materials Costs	All Manufactured and Processed Food Costs	Packaged Foods* Price
March	2.4%	-3.5%	0.3%	1.1%
Latest 12-mon YOY	-0.5%	3.6%	1.3%	0.8%

### Retail Sales Revenue

Change vs Prior Yr	Supermarkets	Convenience	Drug	General Merchandise
February	-0.6%	2.3%	-0.9%	4.4%
Latest 12-mon YOY	2.8%	4.9%	3.7%	5.8%

### Manufacturer Sales Revenue

Change vs Prior Yr	Total Manufacturing	All Food	Soft Drinks	Packaged Foods*
February	4.8%	1.3%	3.8%	-100.0%
Latest 12-month YOY	6.1%	4.1%	-1.7%	7.1%

\* Packaged does not include meat, poultry, seafood, dairy, eggs or produce

## Report Highlights

- E-commerce sales would amount to about \$17.6 billion or nearly 4% of total non-vehicle retail sales
- Food on-line sales by Canadian grocers amounts to a fraction of a percent of total supermarket food sales.
- In the fourth quarter, food stores saw zero sales growth while the general merchandisers, which means Walmart and Costco, but also dollar stores, saw their food sales grow by 12%.
- The data show that for the fourth quarter and for 2017, the erosion of food sales through food stores and the growth of food through the general merchandisers is continuing.
- Raw materials prices do not portend packaged food inflation in the next six months.
- During February (latest) the gross margin for food manufacturers increased by 3% compared to the same month last year. The rolling 12 month average increase was 5%. Food retailers gross margin year over year declined by 1% in February while the rolling 12 month average increase was 3%.

## E-Commerce Snapshot

Statistics Canada defines 'on-line retail sales' as sales of goods or services where the order is received and the commitment to purchase is made via the Internet, even if payment is made by other means. StatsCan's measure of on-line retail sales is an estimate of the sales made on-line by Canadian retailers, whether to domestic or foreign consumers. It does not include the on-line purchases made by Canadian consumers from retailers located outside of Canada.

In addition, on-line sales by businesses not classified as retailers according to the North American Industry Classification System (NAICS) are excluded for this measure of on-line retail sales. While most goods and services familiar to consumers, such as food, clothing, electronics, and household goods, are sold by retailers, there are a number of goods and services sold on-line which are not typically sold by retailers. Examples include, but are not limited to:

- Hotel accommodations
- Travel services, including purchasing of airline tickets
- Sports or entertainment ticket sales...

StatsCan separates the retail industry into two broad categories, store and non-store retailers. Store retailers, often referred to as 'brick and mortar' retailers, operate fixed point-of-sale establishments. These retailers primarily register sales of their goods or services at their physical stores. Non-store retailers also sell goods to the general public, but not from fixed, physical stores.

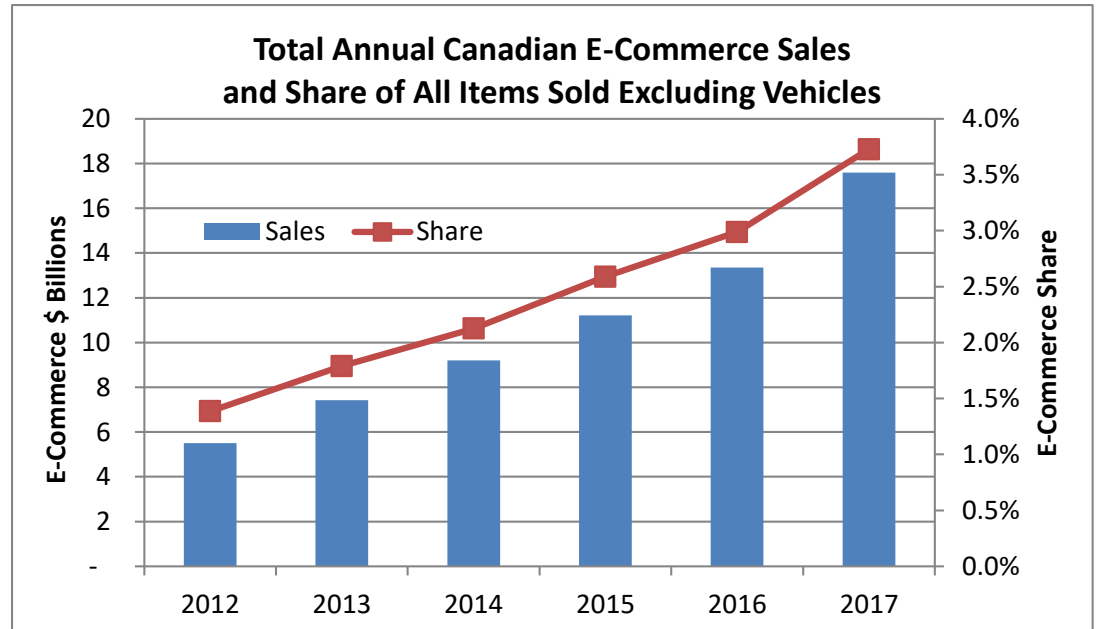
### E-Commerce Share is Tiny but Growing

As of now, StatsCan does not yet have annual retail data for 2017. Based on the sum of its monthly sales, total retail sales in Canada of all products from cars, to food, to shoes through all venues amounted to about \$631 billion. Of that total it is likely that about \$18.5 billion were e-commerce sales. That would put e-commerce at just under 3% of total retail sales in 2017. If motor vehicle sales are removed from the total, ecommerce sales would amount to about \$17.6 billion or nearly 4% of total non-vehicle retail sales.

From 2012-2016 total e-commerce sales, not counting vehicles grew at a compound annual rate of 25%. In 2017 it is likely that e-sales growth was 30%.

The sales data on food sold via ecommerce is less robust in terms of availability and history. StatsCan says that in 2016, Canadian supermarket operators reported total e-commerce sales of \$134 million. That is the total e-sales of the Canadian supermarket operators. There are no other sales data from 2012 to 2015 and 2017 is not yet available.





For 2016 the e-commerce sales by grocery retailers amount to less than one half of one percent of total supermarket sales of nearly \$86 billion. For 2017 I estimate that total sales for supermarkets amounted to \$86.7 billion, roughly. If e-commerce sales at grocery grew at the same 30% rate as total e-commerce, which may or may not be the case, that would put e-sales at \$174 million in 2017. That would still amount to 0.2% of total grocery sales.

### Retailer Food Sales are in Infancy

Of course Canadians do not just purchase on-line food from Canadian supermarkets. There are other Canadian on-line providers. Another way to look at e-commerce and food is that according to StatsCan, total food sales at retail through all channels including supermarkets, drug stores, general merchandisers etc., amounted to \$98 billion in 2017. As noted above, e-commerce represents less than 4% of total non-vehicle sales. If total food e-commerce was 4% that would be roughly \$3.9 billion. It is likely that food e-commerce sales in total are much less than the 4% share. At the same time, it is also likely that e-sales of food are more than the 0.2% of total supermarket sales. That is to say, on-line food sales by Canadian retailers is somewhere between \$175 million and \$3.9 billion. That is a very wide estimation range.

There have been various published estimates of online food sales. The academic publication, [TheConversation.com](http://TheConversation.com), November 20, 2017, says that "Total online grocery expenditure is estimated at approximately \$2 billion with growth predicted to climb to almost \$4 billion in the next couple of years." [Macleans.ca](http://Macleans.ca), February 8, 2018 says that "Today, online delivery in Canada accounts for less than two per cent of fast-moving consumer goods—staple supermarket items like packaged foods, toiletries and beverages—according to data from Nielsen Canada."





The [TheConversation.com](#) article noted above, goes on to say that “Globally, 70 per cent of consumers prefer to get their groceries by visiting stores, but that number is 81 per cent for Canadians. There are lots of reasons why shoppers prefer picking up groceries in person, including cost, the ability to choose products on impulse and the issue of scheduling and waiting for delivery.” The point here is that the on-line sales are probably on the lighter side as a share of total sales compared to other countries.

While total on-line food sales might amount to \$2 billion as noted above, I doubt it is that large. If it does amount to \$2 billion, it would include a great deal that is not generated by Canadian retailers. As noted above the sales generated on-line by supermarkets alone in Canada are probably less than \$200 million, based on the StatsCan data.

The point is that e-commerce food sales, certainly those sales generated by Canadian retailers, is tiny. If it is in any stage of growth, it could be classified as infancy.

Furthermore, as noted in a March 10 [Wall Street Journal](#) article, supermarkets are finding a new identity as a social hub helping singles find romance. “Grocery stores are fulfilling the new role as traditional gathering spots....” It goes on to say that, “Many (grocers) are reinventing themselves as destination spots....Simply roaming the aisles can inspire friendships, and even love.”

You can’t find romance food shopping if you shop on line. That alone could slow grocery e-commerce in Canada.

### **Why it Matters**

**The last part above was included for fun but road ahead is going to be expensive and risky for Canadian food retailers as they pursue e-commerce. This would be the case even without the romance challenges. They will struggle to find the right formula and methods. In the end, it is likely that there will be many methods of e-commerce with no one single method that is overwhelmingly preferred by Canadians.**

## **Channel Food Shares**

Statistics Canada recently released the fourth quarter 2017 food sales by channel. That data set measures the sales of food through retail in general as well as through the various channels such as food stores, drug stores and general merchandisers. The data show that for the fourth quarter and for the year, the erosion of food sales through food stores and the growth through the general merchandisers is continuing. In fact the erosion and growth of the two channels respectively became more pronounced last year.

Food stores, of which supermarkets comprise the overwhelming majority of sales, saw zero sales growth in the last quarter of 2017. The general



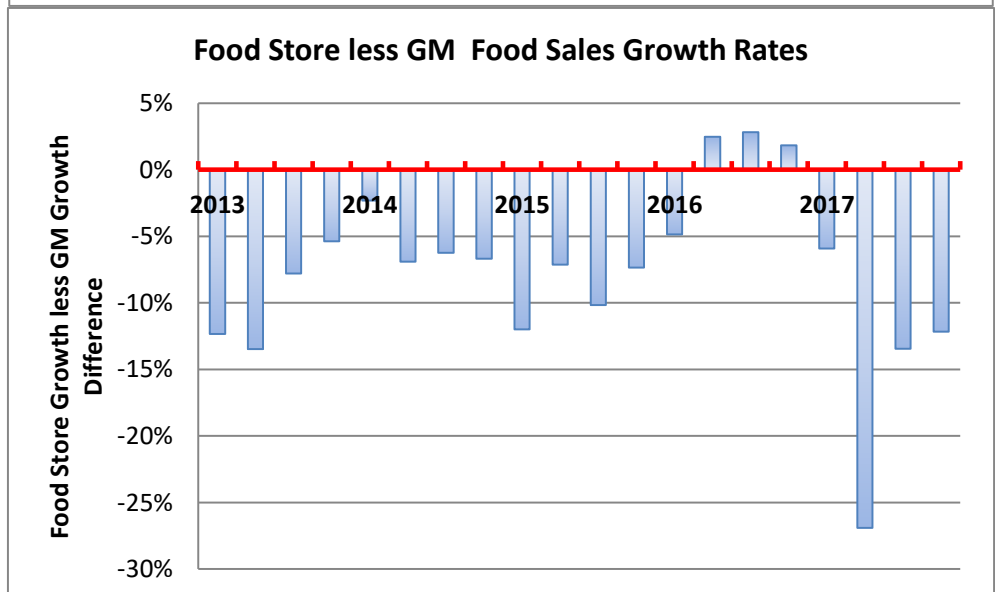
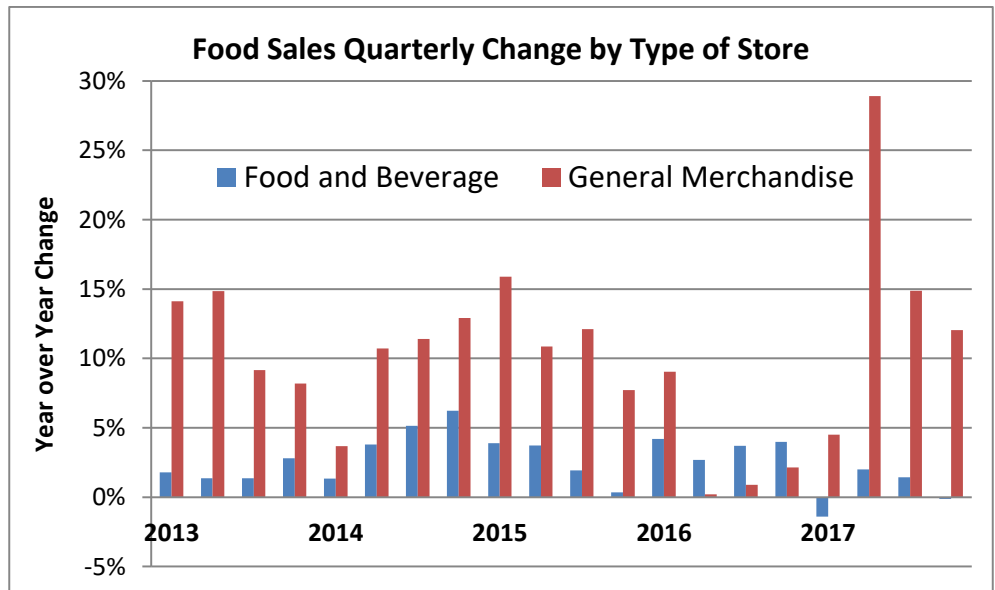


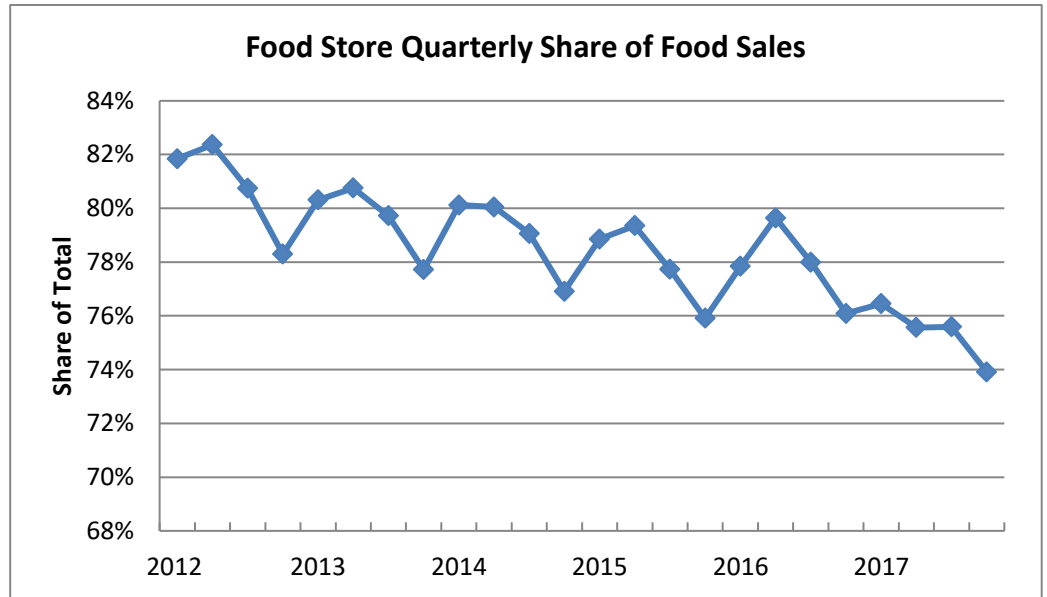
merchandisers (GM), which means Walmart and Costco but also dollar stores, saw their food sales grow by 12%.

During 2016 in three of the four quarters, food stores' sales of food outpaced the food sales of the GM channels. The sales that year lead me to believe that the erosion of the food store channel and the growth of the GM channels might be reversing. It is clear now based on the 2017 data that 2016 was an aberration. It appears that 2016 was an interruption in the longer term trend.

### Disturbing Trendline for Grocers

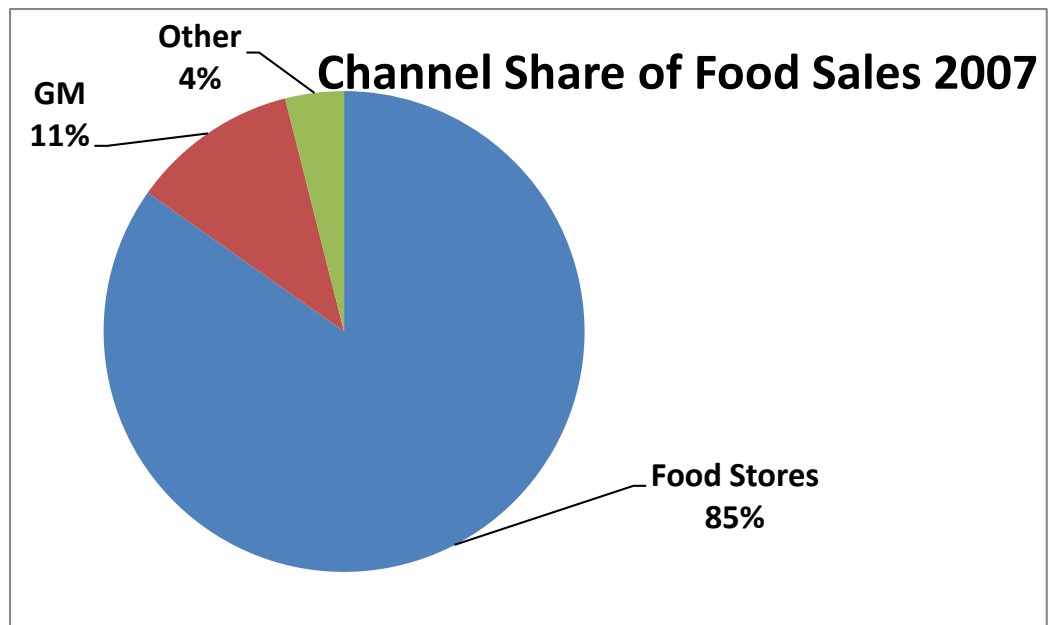
With regard to the trendline, in 2012, food stores had an 82% share of Canadian food sales. By the fourth quarter of last year, that share had dipped to just 74%.

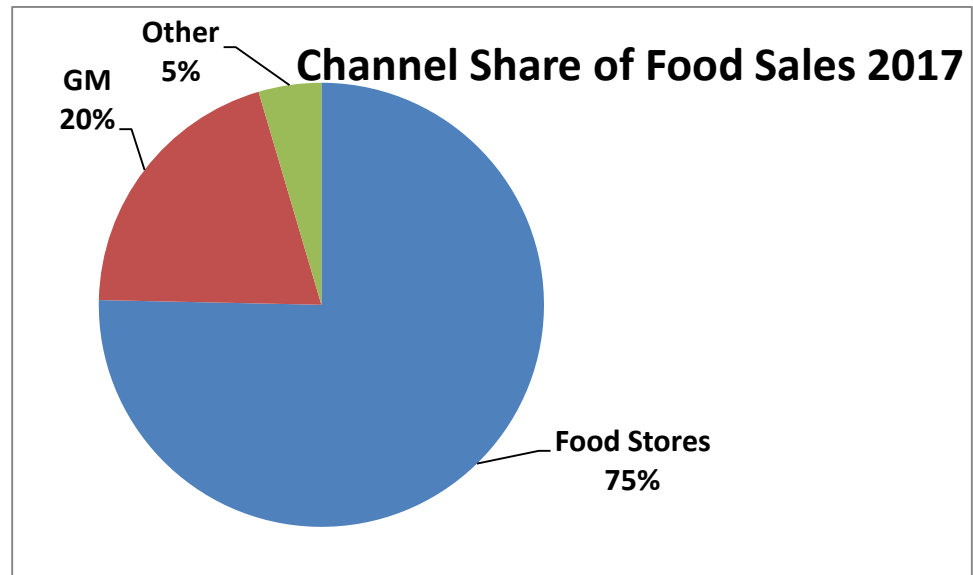




## GM Food Sales More than Double

On an annual basis, food sales through all retail channels amounted to \$98 billion in 2017. Those total sales increased by 4%. The sales through food stores only increased by half a percent, while the GM sales increased by 15%. The GM sales of food fell just short of \$20 billion. The GM sales total has more than doubled since the \$9.2 billion in 2009, just eight years ago.





#### **Why it Matters**

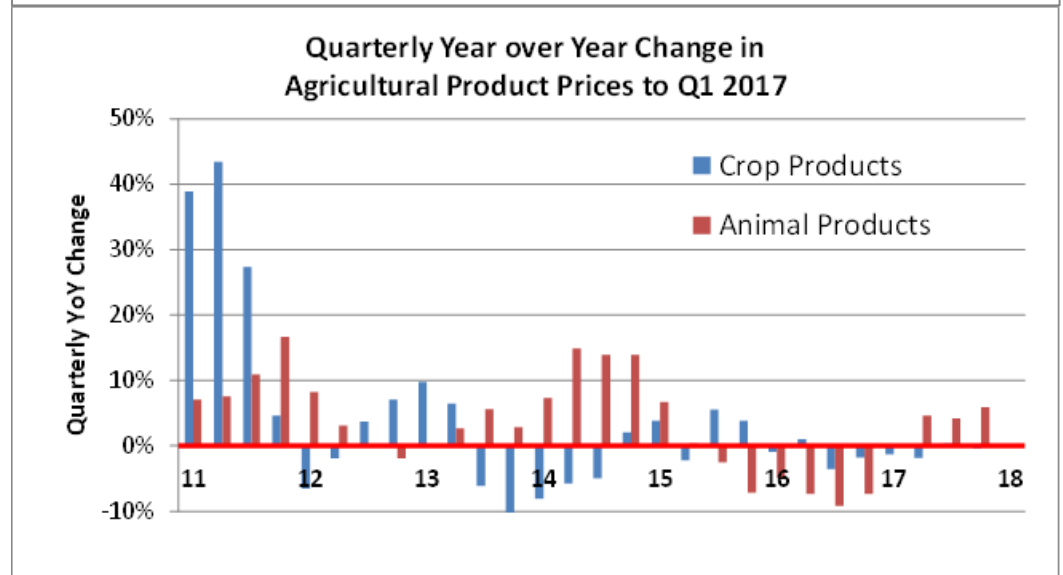
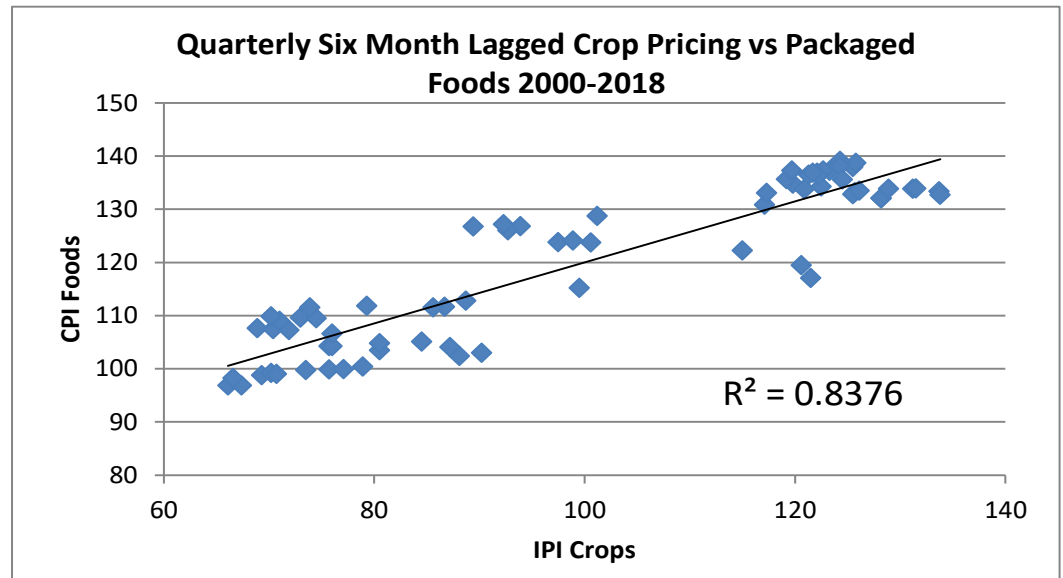
There is often commentary about the dominance and market power of the big grocers. The reality is not so clear. There are four large national competitors, including Walmart and Costco as well as Sobey and Loblaw. In addition there are robust regional players such as Metro, Overwaitea and the Coops. In any given market there will be at least three large retailers either national or regional as well as smaller grocers and alternative channels. There is little sign of dominance based on the fluidity of shares.

## **No Warnings of Inflation in Crop Prices**

Raw materials prices do not portend packaged food inflation in the next six months. There is a fairly strong correlation between raw material agricultural prices and food prices. That might not be surprising when considering fresh meats and produce. It could be expected that there would be strong relationships between cattle prices and striploins or California lettuce crops and lettuce on the shelf. This is expected given the immediate production and marketing timelines and supply chain relationships. Fresh product is going to be based much more on supply and demand conditions. Packaged foods on the other hand will have a raw material component to the price but there are other factors that also are important. Those other factors include production costs and marketing.

Nevertheless, there is even a strong correlation between crop prices and packaged food prices when lagged by six months. That is, crop prices can be an indicator of consumer prices of packaged foods six months later. In that regard the trends in crop product prices have been mostly steady or even lower over the past several quarters. StatsCan raw materials prices for crops shows that year over year changes in those prices have been unchanged for three quarters after falling for four quarters in a row.





### **Why it Matters**

There are two key drivers to food inflation: raw materials prices and competition between grocers. The raw materials prices are not flagging inflation in the Canadian grocery industry.

## **Monthly GDP Tabulation**

Each month Statistics Canada publishes Gross Domestic Product (GDP)-by-industry. GDP by industry is the value added of an industry according to the U.S. Bureau of Economic Analysis. It is the contribution of a private industry to overall GDP. The components of value added consist of compensation of employees, taxes on production and imports less subsidies, and gross operating surplus.



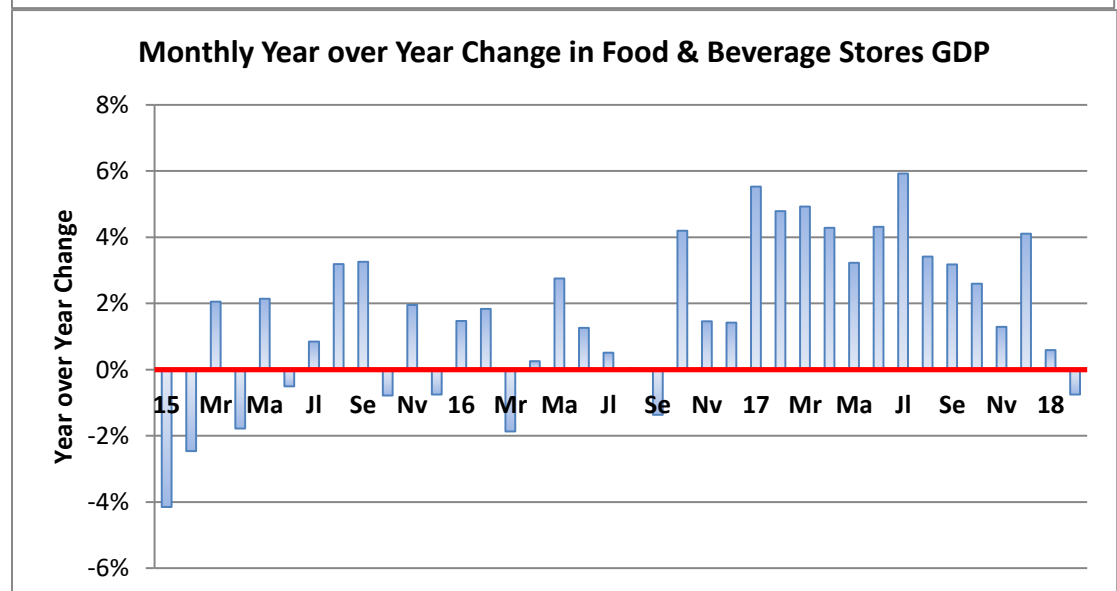
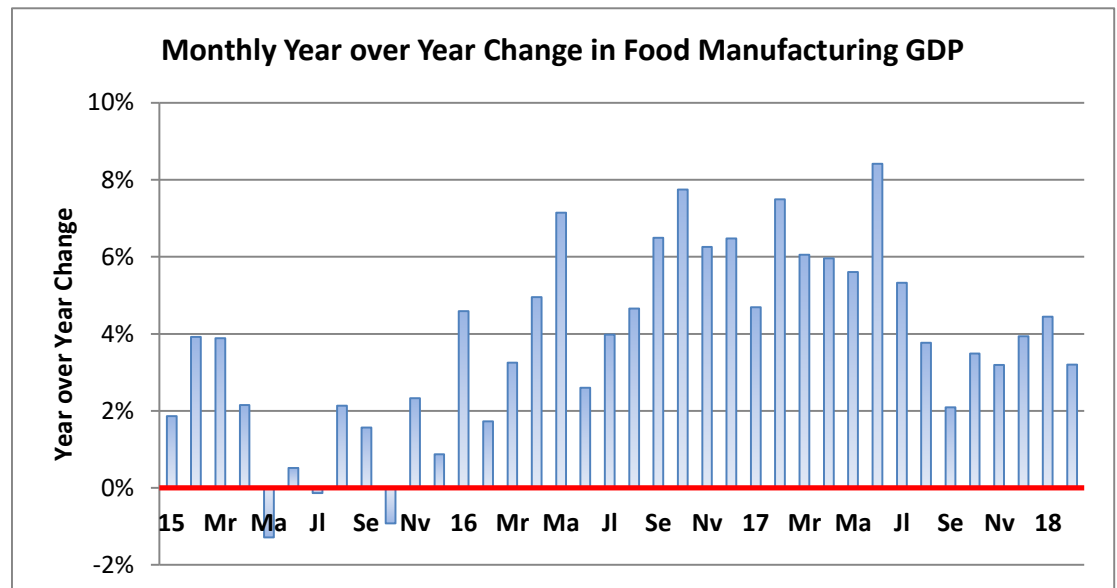




*Based on that definition, the GDP by industry could also be regarded as a general approximation of the gross margin of an industry before operating costs.*

During February (latest) the gross margin for food manufacturers increased by 3% compared to the same month last year. The rolling 12 month average increase was 5%.

Food retailers gross margin year over year declined by 1% in February while the rolling 12 month average increase was 3%.

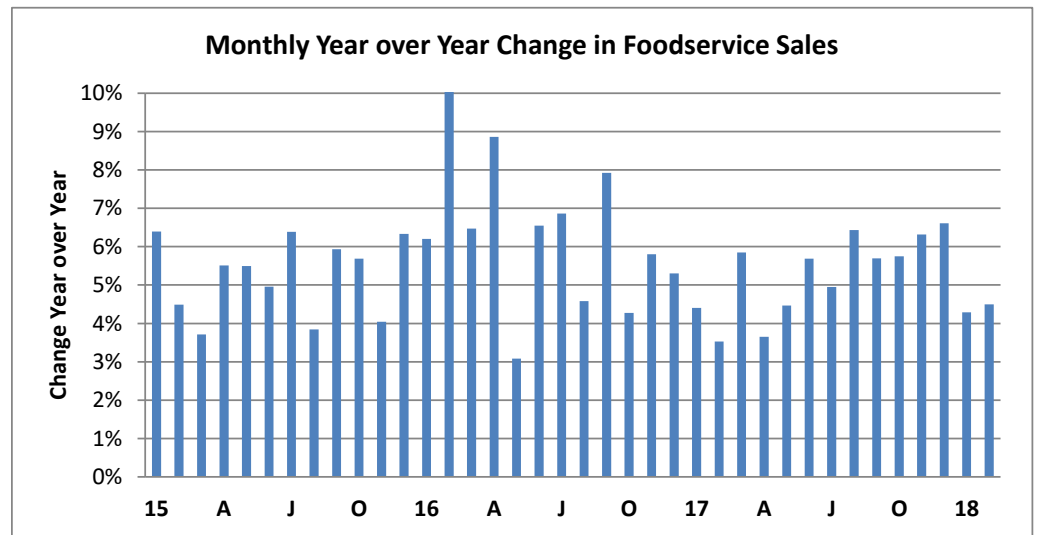




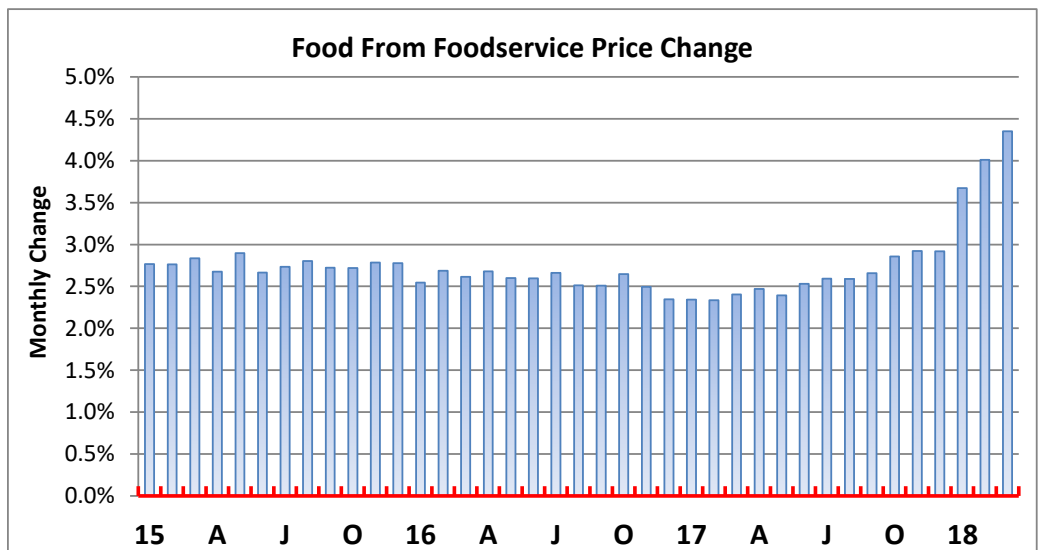
## Monthly Statistical Highlight

### Food Service Sales Slow

The latest StatsCan data for foodservice sales is February. That data shows that the year over year change in foodservice sales is just over 4%. By most measures that is a robust rate of growth. By Canadian foodservice standards however, the rate of growth is somewhat slow. Anecdotal reports indicate that the winter was disappointing in terms of traffic and overall business conditions.



At least part of the reason for the slower sales might be the increase in prices at foodservice. Higher prices could have hindered purchases. Inflation at foodservice has been very predictable at about 2.5% for the last few years. In 2018 however, the rate of inflation at foodservice increased by over 4%. It is likely that at least part, if not a large part, of the reason for the increase is the hike in the minimum wage in Ontario and Alberta.



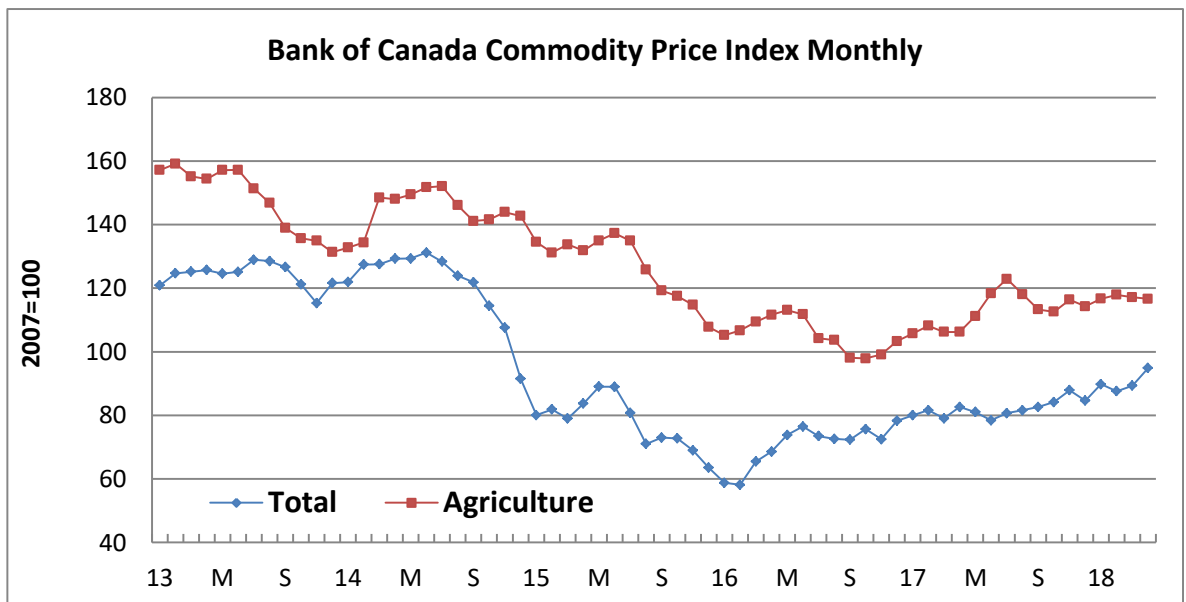


### Why it Matters

Foodservice sales are likely to pick up with better weather. With that said the pricing increases, due to minimum wage are going to stick. The grocers are impacted by the wage increase but likely not to the same extent as foodservice. Grocers will stand to gain in this zero sum game.

## Commodity Watch

The Bank of Canada Commodity Futures Index for all commodities was up 15% this April compared to the same month last year. The agriculture index was flat in April compared to the previous month and up 10% compared to the same month last year. Generally speaking, the agriculture commodities have been slowly increasing but they remain very low by recent standards. There is modest upward pressure on the ag commodities.

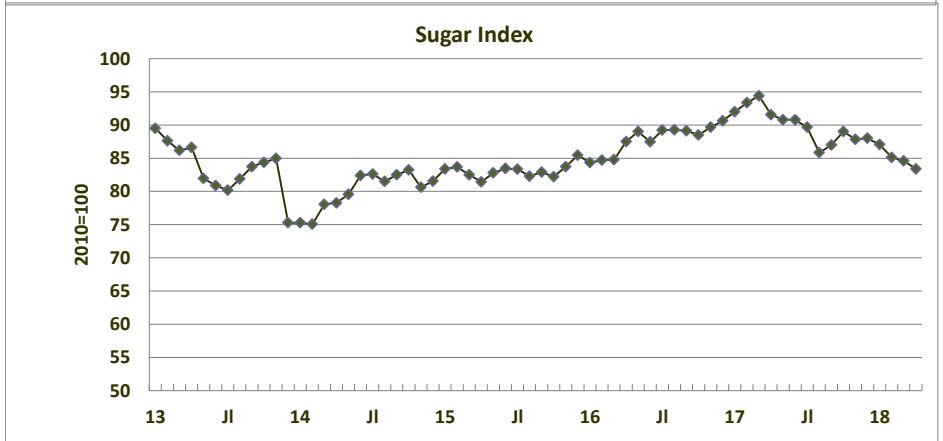
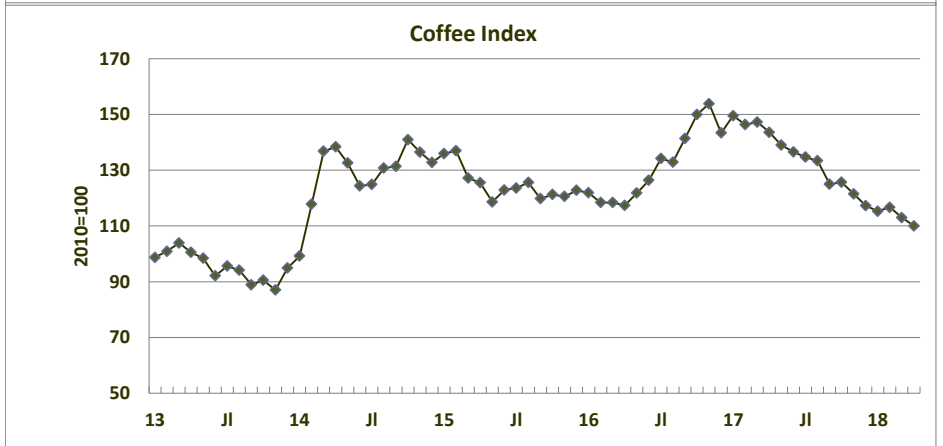
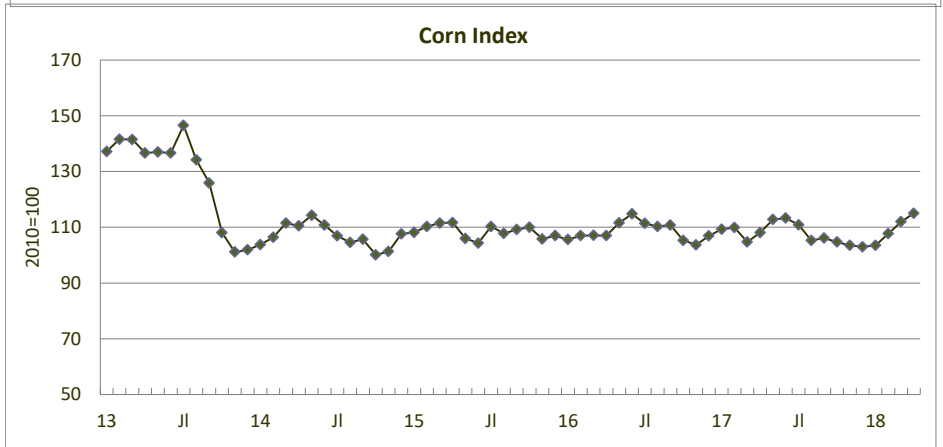
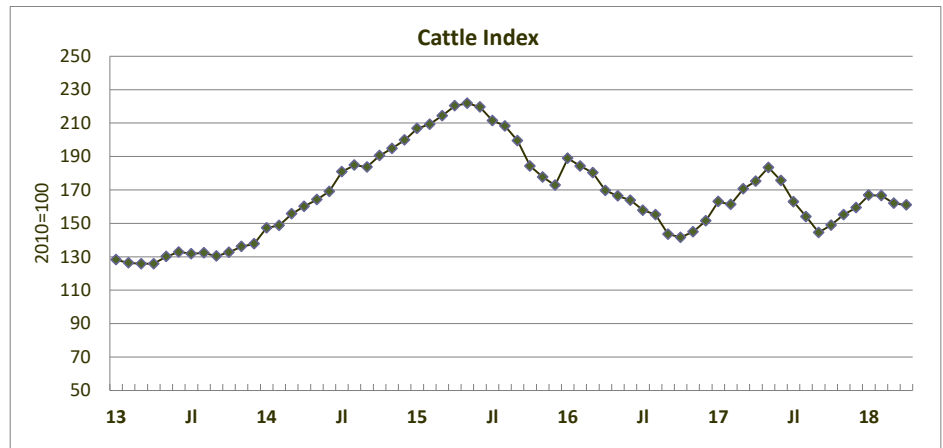


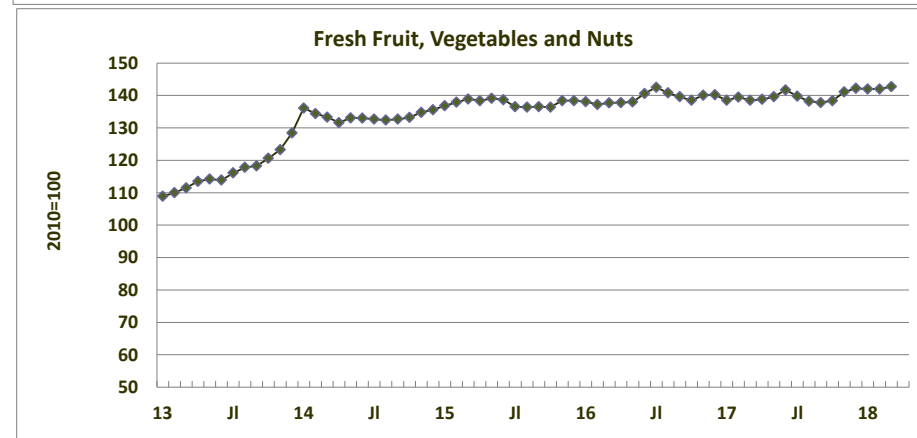
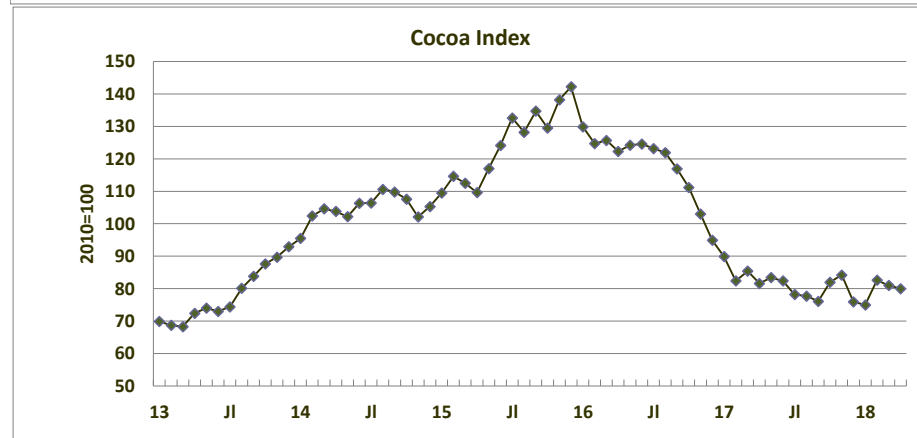
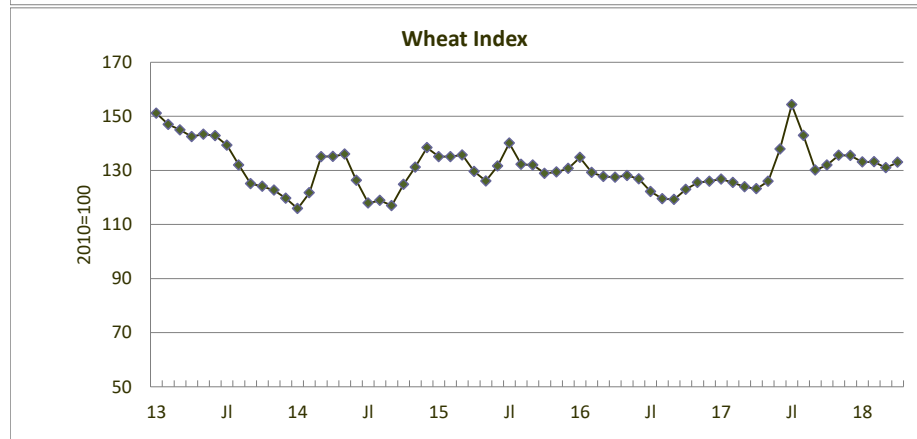
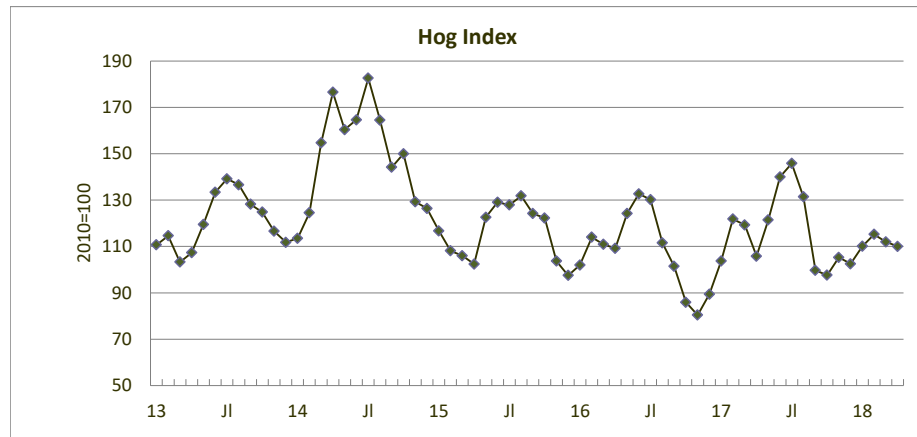
The graphs on the next two pages show the monthly pricing performance for some of the key agricultural and raw food commodities in Canada from 2013 to present based on the StatsCan Raw Materials Price Index.





- 1 Kevin Grier Market Analysis and Consulting
- 2 Grocery Trade Report, May, 2018







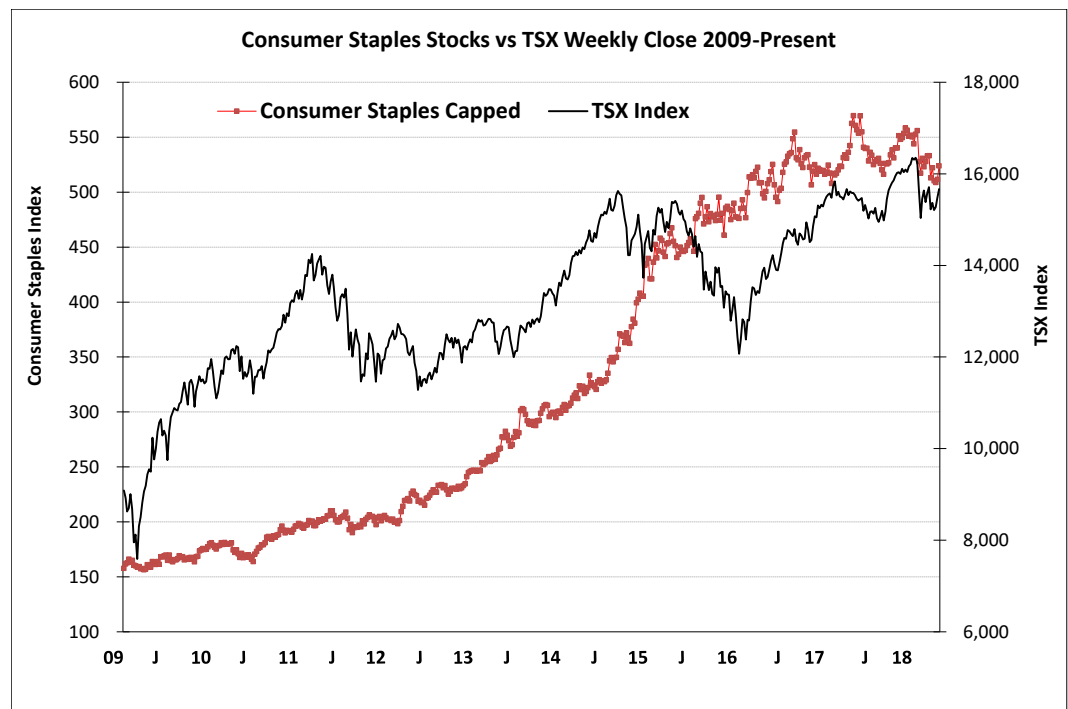
## Stock Market Performance

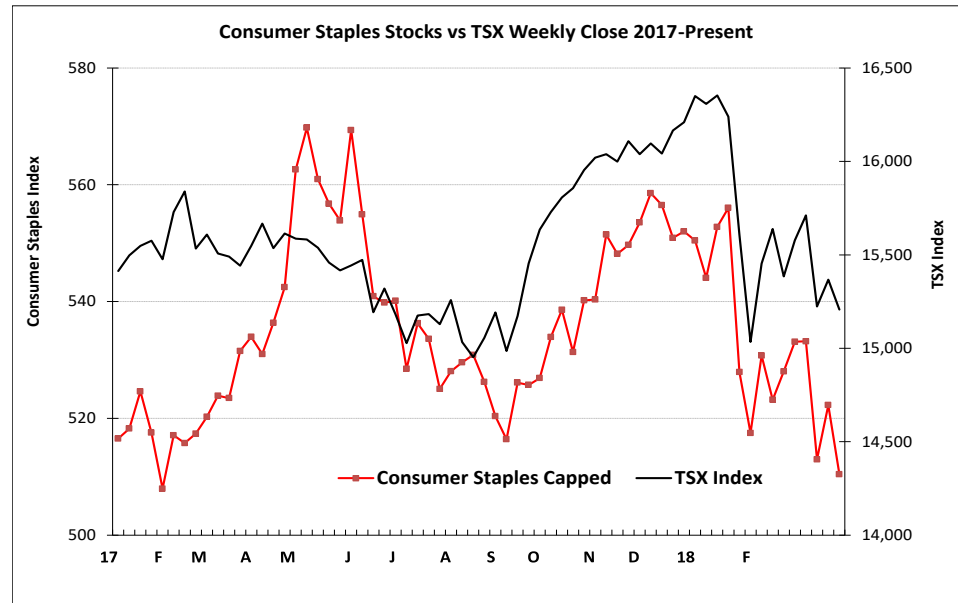
This section provides a review of the consumer staples and discretionary stocks in Canada. The Consumer Staples Index classification of companies listed on the TSX is a cross section of ten manufacturers and retailers: Alimentation Couche-Tard, Cott, Empire, George Weston, Jean Coutu Group, Loblaw, Maple Leaf Foods, Metro, Saputo, and The North West Company. The Consumer Discretionary Index stocks include diverse companies like Dollarama, Hudson's Bay, Restaurant Brands International, Canadian Tire, Linamar and Magna International.

The following table shows the changes in the values of the TSX as a whole as well as consumer staples, and consumer discretionary.

	Apr 2018 vs 2017	52 week vs Previous 52
<b>TSX</b>	-1%	5%
<b>Consumer Staples</b>	-5%	3%
<b>Consumer Discretionary</b>	8%	16%

The following two graphs show the longer and shorter term performance of the consumer staples versus the TSX as a whole.

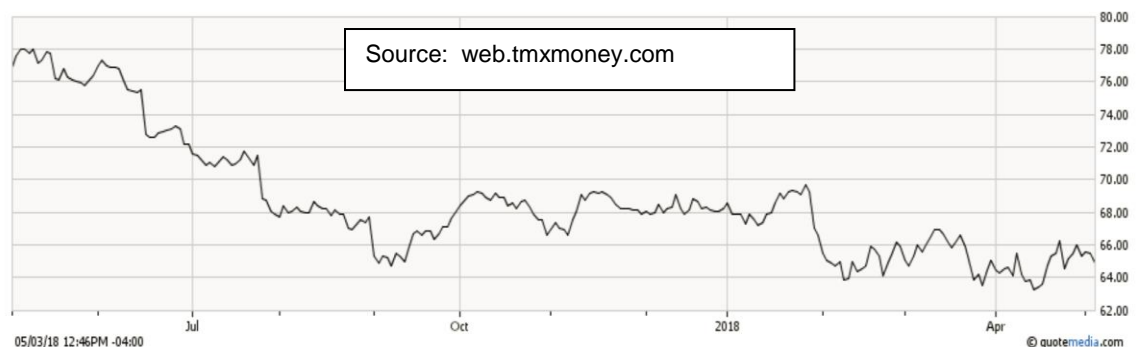




## Corporate Stock Focus: Loblaw Companies Limited

**CIBC Institutional Equity Research**, (CIBC-IER) May 2, says that grocery tonnage was helped by the \$25 gift card program, but driven more by accelerated price investments, which highlight the competitive challenges in grocery today. The researchers say “Despite these issues, and continued drug reform, the machine chugs on, with tightening cost controls and massive cash flow increasingly returned to shareholders. Largely owing to this resiliency in a tough market, we rate Loblaw Outperformer with a \$78 (was \$79) price target.”

Charting for Loblaw Companies Limited



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