



Kevin Grier

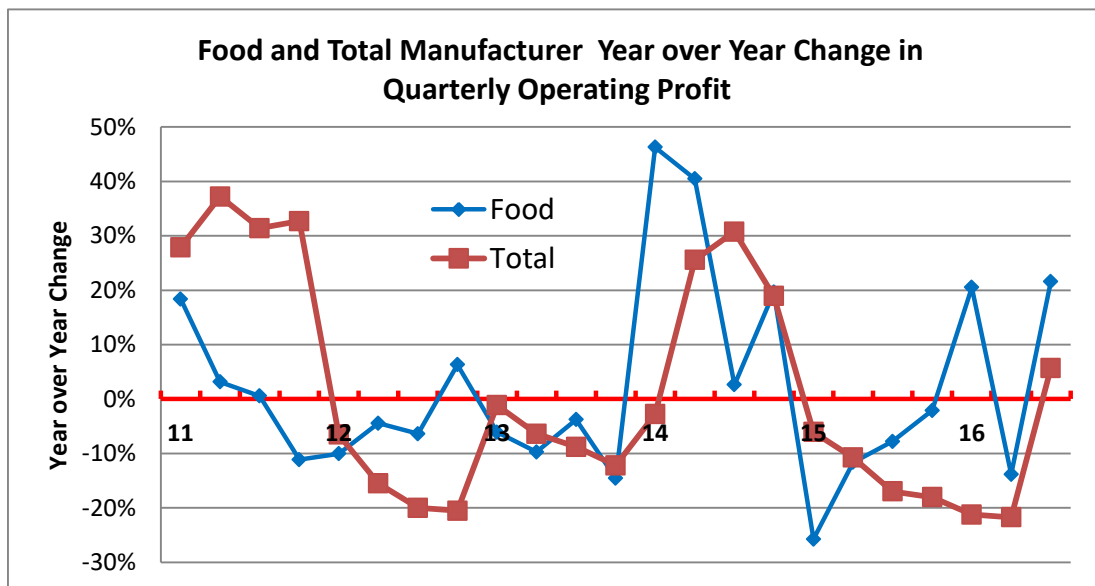
Market Analysis and Consulting Inc.

Third Quarter Margin Review

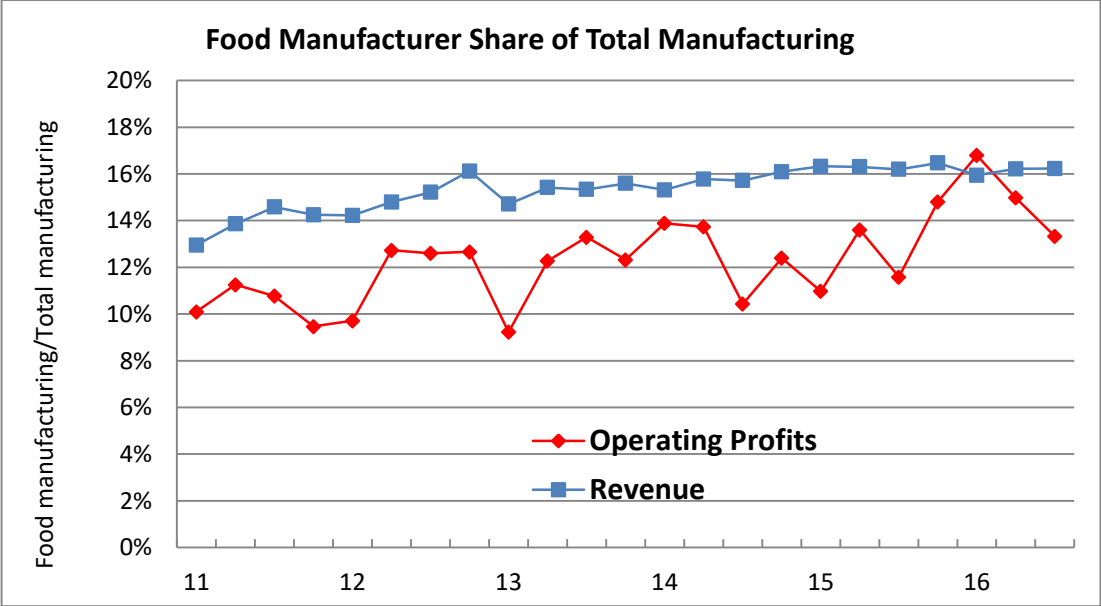
Food Manufacturer Profits Surge

Statistics Canada recently released the Quarterly Financial Statistics for Enterprises dataset for the third quarter of 2016. The data showed that Canadian food manufacturer operating profits increased by 22% in the third quarter 2016 compared to the third quarter of 2015. For the last four quarters ending in the third quarter compared to the four quarters ending in Q3 2015, operating profits were up by 5%. For total or all manufacturing in Canada, the third quarter 2016 saw operating profits increase by 6% and decline by 14% for the rolling four quarters.

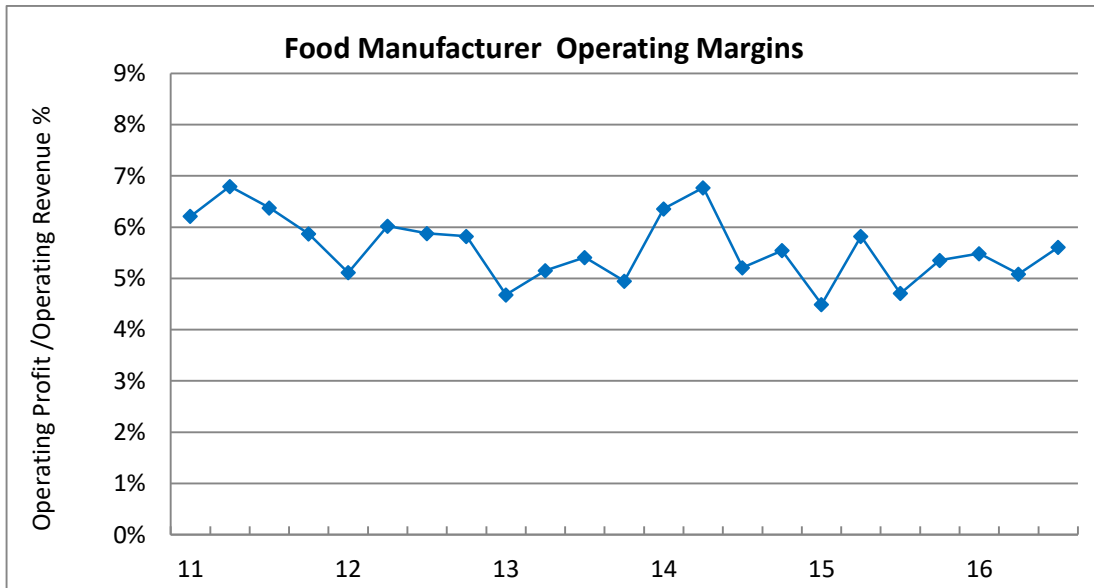
Based on the graph below it bears noting again the food manufacturers are experiencing significant variability in operating profit on a year over year basis. The food industry is known for stability but the operating profits have been highly volatile over the past two years. It is also of note from the graph below that total manufacturing in Canada just saw its first operating profit increase in the third quarter after six quarterly declines.



There is also change occurring for food versus total manufacturing regarding the relative shares of revenues and profits. As can be seen on the graph below, over the past three-four years, food manufacturer share of total manufacturer operating profits have been increasing. In other words, food manufacturing represents an increasing share of total Canadian manufacturing operating profits. At the beginning of 2013, food operating profits were about 10% of total manufacturer operating profits while revenues were about 15%. As of the third quarter of 2016, food operating profits are about 14% of the total while revenues are at 16%. While both the profit and revenues are gaining share for food in total manufacturing, the profit share is growing faster.

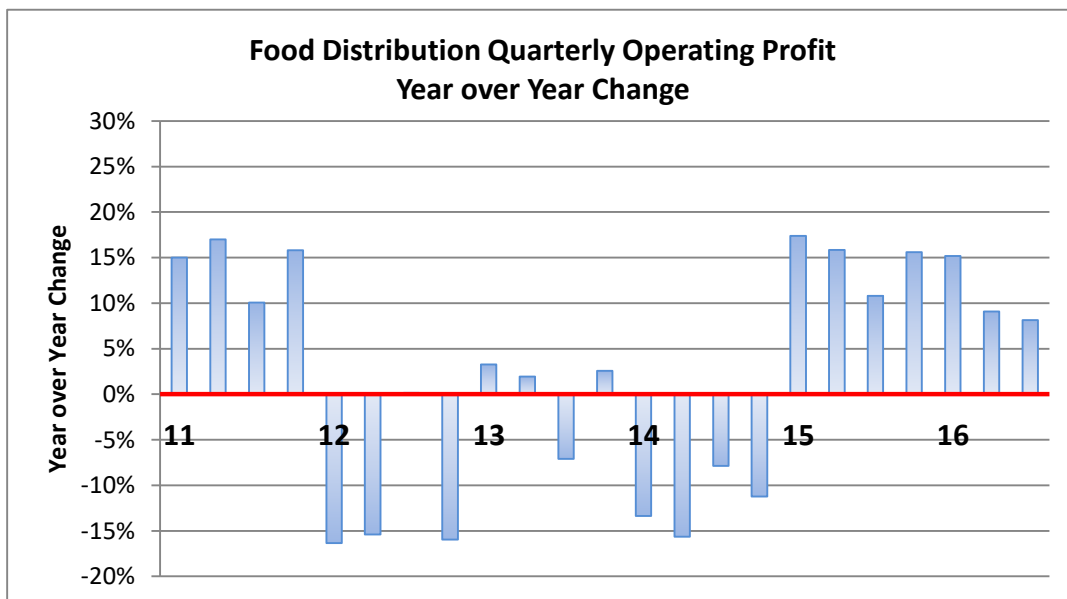


Food manufacturer operating margins were 5.6% in the third quarter of 2016. That compares to the five year 2011-2015 average of 5.6% and a 5.1% average in 2015. As can be seen on the graph below, Canadian food manufacturer operating margins have been slowly declining over the past five years, although 2016 appears to be bottoming.

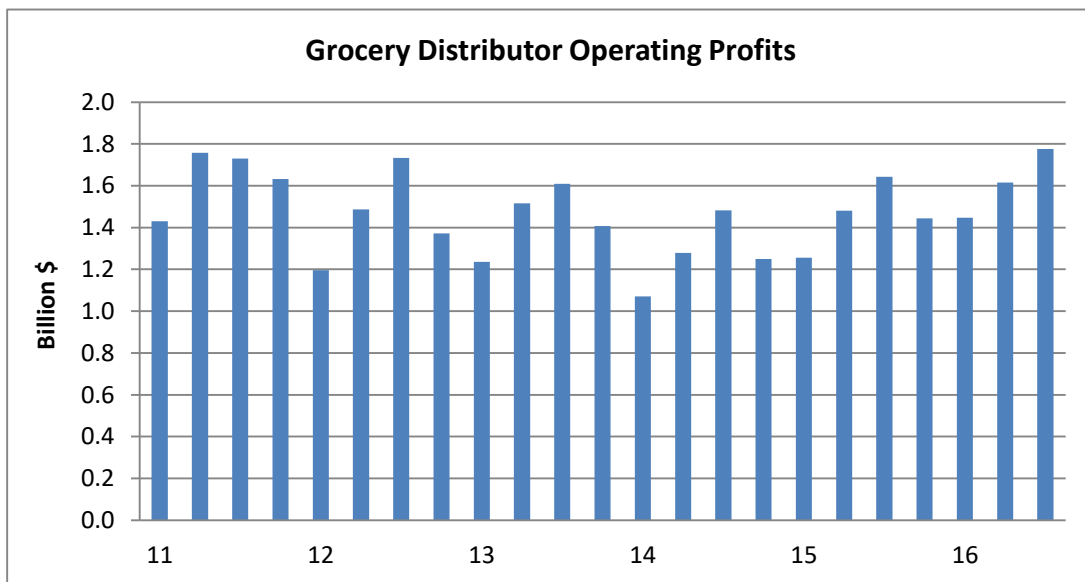
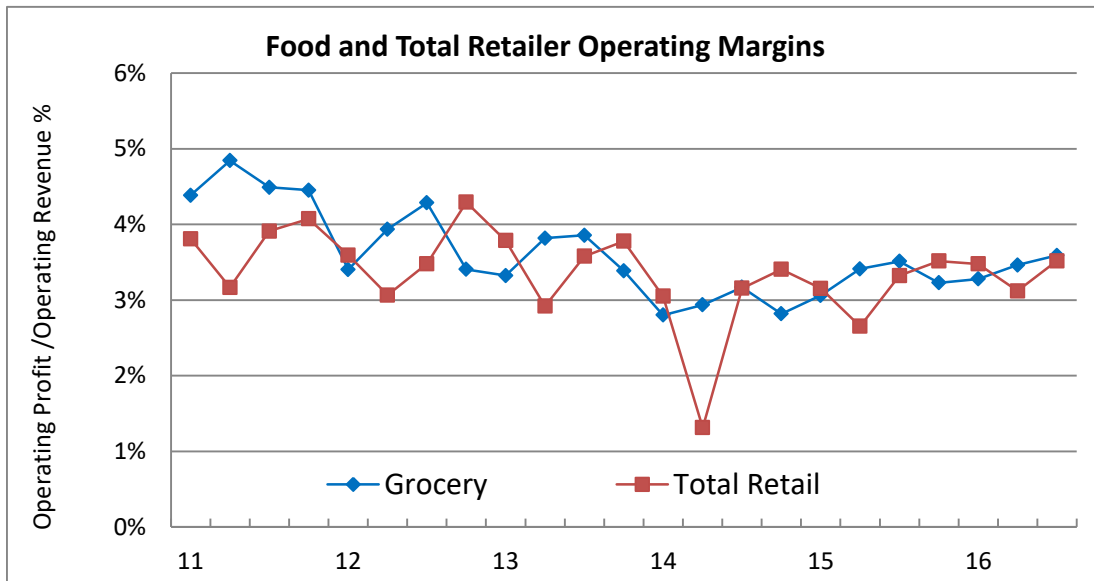


Food Distribution Margins are Staying Robust

Statistics Canada reports data for food stores and the wholesalers. The data are combined here and defined as grocery distributors. In the third quarter operating profits jumped by 8% compared to the third quarter of 2015. For the most recent rolling four quarters, grocery distributor operating profits increased by 12%. By comparison total retail operating profits increased by 9% in the third quarter and by 13% for the most recent four quarters compared to the previous four quarters. The food distributors in Canada have seen operating profits increase for seven quarters in a row. That performance stands in sharp contrast to the declines or paltry increases during the three years from 2012-2014.



During the third quarter this year, food distributors had operating margins of 3.6%. That margin is in comparison to the 3.6% average during the five years 2011-2015. Total retailers in Canada had operating margins of 3.5% in the third quarter compared to an average margin of 3.4% in 2011-2015. As can be seen below, the overall trend in operating margins for food distributors as well as total retail has been sliding lower since 2011. With that noted food distributors seem to have reversed that trend starting in late 2014 and going into the second quarter of this year. Not surprisingly the stronger profits as shown on the second graph below have translated in to better margins, or vice versa.



Why it Matters

The performance of grocer profitability according to the StatsCan data is continuing to be robust. While these results do not reflect the recent months of food deflation, the performance is impressive nonetheless. That is, while food prices only recently started to decrease, the pricing has been weak for several months. Based on the operating profit performance, it suggests that grocers are keeping materials and operating costs in line.

Furthermore, while I have been talking a great deal about increased grocer competition, as of the third quarter it has not negatively impacted profit performance. The logical expectation is that margins will be easing lower the last quarter of 2016 and into 2017.

The overall positive StatsCan results also provide a fairly stark perspective on Sobey's disappointing results in their most recent quarter. The StatsCan data are however consistent with Loblaw's impressive returns.

The following appeared in the November edition of Grocery Trade Review. For a free trial contact Kevin@kevingrier.com