

Industry Analysis

Alimentation Couche-Tard TSX: ATDB.TO

Retail/Wholesale Food Rank: 22

Industry: RETAIL/WHOLESALE FOOD INDUSTRY Pubdate: July 19, 2019 Page Number:

1945{/STORY;grocery}{industry} Investors continue to display a limited appetite for the Retail/Wholesale Food Industry. The group has noticeably underperformed the broader market over the past several years, and most of these equities have again struggled to keep pace with the healthy gains posted by the leading stock market indices so far in calendar 2019. Meanwhile, earnings at most of these companies appear to be tracking higher in 2019, though we expect the full-year gains in many cases will prove to be relatively modest. The Convenience Stores For investors, the convenience store space has been a clear bright spot amid the otherwise lackluster returns in the broader Retail/Wholesale Food Industry. The share prices of Alimentation Couche-Tard, Casey's General Stores, and Core-Mark Holding have all advanced at least 35% over the past year. The largest of these companies, Couche-Tard, has a long and enviable record of delivering strong profit growth. For its 2018 fiscal year, which ended on April 28th, the Quebec-based company benefited from high fuel margins and solid trends in merchandise sales, as well as incremental contributions from the 2017 CST acquisition. In all, earnings finished at C\$4.39 a share, up 16% from the prior year and nearly triple its fiscal 2013 performance. The positive momentum should continue, as well, with share net likely climbing at a low double-digit clip over the next two fiscal years. Meanwhile, the long-term track records for Casey's General Stores and Core-Mark aren't nearly as impressive as that of Couche-Tard, though trends appear to be moving in the right direction. Both companies struggled during their respective 2017 fiscal years, but earnings rebounded strongly during fiscal 2018 and modest, mid-single-digit gains appear likely for each in the current year. The Bargain Bin At the other end of the investment spectrum stand two of our group's food wholesalers. The shares of SpartanNash and United Natural Foods have lost 57% and 78% of their value, respectively, over the past year. SpartanNash, for its part, is looking to rebound from a difficult 2018 during which the operating margin shrank roughly 60 basis points and earnings declined nearly 50% year over year. There don't appear to be any quick fixes in store there, however. In fact, profits were off another 38% in the March quarter and the negative comparisons will likely persist through the September period. Meanwhile, the recent results of United Natural Foods have been similarly disconcerting. Last fall's acquisition of SUPERVALU has caused revenues to more than double, but earnings are likely to move in the opposite direction, at least in the near term. Markdowns In The Grocery Aisle The shares of grocery store operators have also been notable laggards in the Retail/Wholesale Food Industry. Kroger, Sprouts, Village Super Market, and Weis Markets are all trading at least 10% below where they stood last summer. On the positive side, these companies have limited direct exposure to the ongoing trade tiff between the U.S. and China. Investors, though, are likely more focused on the competitive pressures facing grocery chains, and recent operating results, which have been generally characterized by limited same-store sales growth and narrower gross margins, haven't provided much cause for optimism. Competitive threats include long-time rivals, such as Walmart, Target, and Costco. Notably, investors have been rather bullish over the past year about all three of these large, discount-oriented retailers. The grocery store operators also must keep an eye on newer threats, such as Lidl. This Germany-based retailer entered the U.S. market two years ago and plans to open another 25 of its deep-discount stores in various East Coast markets by next spring. Meanwhile, California-based Grocery Outlet, which completed its initial public offering last month, currently has about 325 extreme

value stores and aims to increase this number 10% annually. Finally, the prospect of e-commerce becoming a bigger part of food retailing is likely another development limiting investor enthusiasm for grocery-store operators. Amazon.com made a big splash in this space with its 2017 acquisition of Whole Foods, and Walmart, Target, and others also have been pushing into online food retailing. Kroger, as well, has been investing heavily in its digital capabilities. In fact, more than 90% of the retailer's customers can now access its pick-up or delivery services. Still, there appear to be considerable questions about whether these offerings can become meaningful profit drivers or merely represent another added cost in an already low-margin business. The Retail/Wholesale Food Industry has slipped a bit in our Timeliness Ranking System, and now stands 27th (down 7 spots from our April report) out of 97 industries for relative price performance in the year ahead. For investors with a near-term performance orientation, the shares of Couche-Tard and Metro, Inc., which are both timely selections, are likely worth a closer look. Longer term, investors will need to remain vigilant for any changes in the industry's competitive dynamics that could cause notable deterioration in profit margins for supermarket operators and wholesalers in the 3 to 5 years ahead. In particular, we have some concerns that the battle for market share may well heat up further, as Walmart, Kroger, and other long-standing players in food retailing look to counter Amazon's push into this space.

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Name	Safety TM	Timeliness TM
Core Mark Hold...	3	3
Ali. Couche-Ta...	3	2
Caseys General...	3	1
Empire Company...	3	1
Chefs' Warehou...	3	3
Metro Inc	2	1
TravelCenters ...	--	--
Performance Fo...	3	2
AMCON Distribu...	--	--
Sysco Corp	1	2
Loblaw Cos. Lt...	2	--
Ingles Markets...	3	3
George Weston ...	2	1
US Foods Hldg.	3	1
Sprouts Farmer...	3	4

Natural Grocer...	--	--
Village Super ...	3	3
Kroger Co	3	4
Weis Markets	3	3
SpartanNash Co...	3	5
United Natural...	4	5
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