Investors in the Retail/Wholesale Food Industry will likely be hoping that the new year looks a lot like the old one. While 2011 was a rather forgettable year for equities, most of the stocks in this group racked up strong, double-digit gains.

The food retailers and wholesalers have generally been turning in solid results of late. Inflationary pressures have pushed up operating costs, but the competitive environment has remained stable enough to allow for most companies to offset this through price increases and expense reduction measures.

Strong Shareholder Returns

From an investment perspective, 2011 was a strong bounce back year for the industry, which had been a noticeable laggard since the latest stock-market rally began in early 2009. We suspect the shift in sentiment can be at least partly attributed to the relatively noncyclical nature of the industry, as investors favored more stable businesses amid increasing concerns about the durability of the current economic recovery. The industry also has little meaningful exposure to Europe, where the economic outlook now appears to be cloudiest. In fact, most of these companies operate exclusively in North America.

Inflation

One of the big influences on the industry over the past year has been inflation. The uptick in inflationary pressure has had a positive impact on the top line, with revenue growth at a number of companies picking up in response to price hikes. The trend was most evident at businesses that operate gasoline service stations, particularly the convenience-store chains, *Casey's* and *The Pantry*, but also, to a lesser extent, many supermarket operators, such as *Kroger* and *Safeway*. Consumers also had to pay higher prices inside of their local food stores, which further boosted revenues within the industry.

The bottom-line impact of inflation, though not so clear cut, also looks to have been generally positive. Raising prices at a time when consumers are confronted with persistently high unemployment is a delicate business. Still, most companies seem to have been able to implement price hikes that were sufficient to offset increases in their operating costs, without setting off an exodus of customers to competitors.

Composite Statistics: RETAIL/WHOLESALE FOOD INDUSTRY

2007	2008	2009	2010	2011	2012		14-16
268278	292926	282887	291731	*304750*	*316250*	Sales ($mill)	*370000*
21.9%	21.8%	22.0%	21.8%	*21.7%*	*21.8%*	Gross Margin	*22.0%*
5.7%	5.4%	5.3%	5.2%	*5.2%*	*5.3%*	Operating Margin	*5.5%*
9243	11238	11339	11528	*11600*	*11700*	Number of Stores	*12250*
4872.2	4962.7	4499.4	4482	*4925*	*5450*	Net Profit ($mill)	*7700*
35.9%	35.3%	35.6%	35.2%	*35.5%*	*35.5%*	Income Tax Rate	*36.0%*
1.8%	1.7%	1.6%	1.5%	*1.6%*	*1.7%*	Net Profit Margin	*2.1%*
d95.2	4926.0	7285.5	5739.3	*7250*	*8000*	Working Cap'l ($mill)	*12000*
30485	31570	30653	29976	*29500*	*28250*	Long-Term Debt ($mill)	*26000*
31460	30826	31436	30282	*32750*	*35500*	Shr. Equity ($mill)	*46000*
9.6%	9.6%	8.9%	9.1%	*9.5%*	*9.5%*	Return on Total Cap'l	*10.5%*
15.5%	16.1%	14.3%	14.8%	*15.0%*	*15.5%*	Return on Shr. Equity	*16.5%*
11.6%	11.6%	10.1%	10.4%	*10.0%*	*11.0%*	Retained to Com Eq	*12.5%*
27%	30%	32%	32%	*32%*	*30%*	All Div'ds to Net Prof	*25%*
18.1	15.0	13.3	15.7	*Bold figures are Value Line estimates*		P/E Ratio	*14.0*
.96	.90	.89	1.00			Relative P/E Ratio	*.95*
1.5%	1.9%	2.4%	2.0%			Avg Ann'l Div'd Yield	*1.8%*

INDUSTRY TIMELINESS: 18 (of 98)

The *Winn-Dixie* Deal

In mid-December, Florida-based *Winn-Dixie Stores* reached a deal to be acquired by BI-LO, a privately held supermarket operator based in South Carolina. The all-cash purchase price of $9.50 a share represents a roughly 75% premium over where WINN shares were trading prior to the deal's announcement. Aside from this, however, *Winn-Dixie*, in its latest incarnation as a publicly traded company, has provided few bright spots for shareholders. The stock got out of the gate quickly after emerging from bankruptcy in 2006, but support for it has eroded steadily in recent years. The current takeover offer, in fact, is still modestly below where this equity traded following its IPO.

Meanwhile, the market doesn't seem to feel that this deal portends a wave of merger-and-acquisition activity. Small-cap stocks (market capitalization of under $1 billion) in the industry would seem to be the biggest beneficiaries of any uptick in takeover speculation, but these equities have performed no better than the broader market since the *Winn-Dixie* deal was announced.

We suspect the market's lackluster response partly reflects the fact that the largest supermarket operators have been fairly quiet on the acquisition front. Aside from natural-foods chain *Whole Foods*, the industry's biggest names haven't been placing much of a priority on new-store development, either. In fact, both *Kroger* and *Safeway* operate roughly the same number of supermarkets that they did a decade ago. Instead, these two companies have been focused on returning capital to shareholders through regular increases in the dividend and aggressive share repurchase programs.

Conclusion

The Retail/Wholesale Food Industry's strong stock-market performance during 2011 has helped it to secure a lofty position in our Timeliness Ranks. It now stands at 18th out of roughly 100 industries for relative price performance in the year ahead. Overall, we think the group will have the most appeal with more conservative investors. Investors seeking high-quality stocks that also provide an above-average dividend yield will find a number of Retail/Wholesale Food equities worthy of consideration.

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