Retail/Wholesale Food stocks limped across the finish line in 2010, as the late-year surge in the broader equity market bypassed many of these equities. For the year ahead, the industry is ranked near the middle of the pack in our rankings for Timeliness.

Although the recession in the U.S. technically ended over a year ago, its effects continue to linger on for many food retailers and wholesalers. In fact, in a market characterized by stiff competition, deflationary pressures, and price-sensitive customers, many of these companies are still struggling to get sales and profits moving higher.

Putting 2010 Behind Them

For the most part, 2010 won't be remembered fondly by the food retailing and wholesaling companies. While the current economic recovery has helped to drive profits higher in many industries, evidence of this among food retailers and distributors is much more limited. Deflationary pressures, an increasingly value-conscious consumer, and competition from nontraditional formats (supercenters, dollar stores, etc.) appear to be key factors behind the industry's lackluster performance of late. (Notably, these companies also have virtually no exposure to rapidly growing emerging markets.) The nation's largest supermarket operators, in particular, have struggled with soft sales and narrowing profit margins. We are cautiously optimistic that the food retailers and wholesalers will find smoother sailing in the new year. The progress, though, may well be limited. The economic recovery appears to be gaining traction, but stubbornly high levels of unemployment and weak home prices likely mean that many consumers will remain in recession mode.

Inflation

One of the issues industry participants will be keeping a close watch on in the year ahead is the reemergence of inflation. Inflation would seem like a welcome change for the many food retailers that have struggled with soft same-store sales in the generally deflationary environment of late. We expect top-line results will get a boost from higher prices in the year ahead, which should make it easier for retailers to cover their fixed and semi-fixed costs, such as labor and rent. The bottom-line impact, though, will be tougher to gauge until we get a better sense of whether retailers are yet willing and able to raise prices enough to fully offset higher costs of goods sold. We suspect that supermarket operators will likely find it easier to pass along any higher prices on branded items than on commodity-type goods, such as milk and vegetables. In the case of branded items, any resistance on the part of shoppers would probably provide a boost for comparable private-label items, which typically generate higher profits for the retailer.

Interestingly, one notable exception to the industry's lethargic profit performance of late has been *Whole Foods*. The strong results being posted by this chain of natural and organic-food stores suggest that the more prosperous consumers that typically frequent this upscale format are returning more quickly to their former shopping habits than those further down the economic ladder.

INDUSTRY TIMELINESS: 46 (of 98)

Recent Developments

The news surrounding the industry of late has been fairly negative. In December, for instance, Great Atlantic & Pacific, one of the nation's oldest supermarket operators, announced that it was filing for bankruptcy. The company's money-losing ways pre-date the recent recession, but the weak economic environment likely made it more difficult for management's turnaround strategies to gain traction.

Several other food retailing companies have seen investor support for their stocks erode since our October report, too. Foremost of these is *SUPERVALU*. *SVU* shares slumped badly in early January when the Minneapolis-based food retailer and wholesaler reported weak sales and profits for its November quarter.

Conclusion

The Retail/Wholesale Food Industry is ranked in the middle of the pack for Timeliness. Many of the stocks in the industry, though, carry low betas and get good marks for Price Stability. These attributes may appeal to investors looking for exposure to equities, but concerned that the market may have gotten a little ahead of itself during the recent rally that began in late summer. As can be seen in the Relative Strength chart below, Retail/Wholesale Food stocks fared best in recent years (relative to other industries) during the market melt down of late 2008 and early 2009.

Robert M. Greene, CFA

Composite Statistics: RETAIL/WHOLESALE FOOD INDUSTRY

2006	2007	2008	2009	2010	2011		13-15
242903	262717	286881	276355	***285000***	***300000***	Sales ($mill)	***348000***
22.2%	22.2%	22.1%	22.4%	***22.8%***	***22.8%***	Gross Margin	***23.0%***
5.8%	5.8%	5.5%	5.4%	***5.6%***	***5.7%***	Operating Margin	***6.0%***
8983	9243	11238	11339	***11500***	***11500***	Number of Stores	***12000***
3941.6	4848.1	4944.8	4452.1	***4300***	***4750***	Net Profit ($mill)	***7000***
40.3%	35.9%	35.4%	35.6%	***36.0%***	***35.5%***	Income Tax Rate	***36.5%***
1.6%	1.8%	1.7%	1.6%	***1.5%***	***1.6%***	Net Profit Margin	***2.0%***
1031.3	d331.2	4687.5	7008.5	***5250***	***6250***	Working Cap'l ($mill)	***10750***
30374	30455	31539	30633	***30125***	***27750***	Long-Term Debt ($mill)	***23000***
29135	31193	30552	31105	***31250***	***34000***	Shr. Equity ($mill)	***44000***
8.3%	9.6%	9.6%	8.9%	***9.0%***	***9.0%***	Return on Total Cap'l	***10.0%***
13.5%	15.5%	16.2%	14.3%	***14.0%***	***14.0%***	Return on Shr. Equity	***16.0%***
9.9%	11.7%	11.7%	10.0%	***10.5%***	***11.0%***	Retained to Com Eq	***13.0%***
29%	28%	30%	33%	***24%***	***23%***	All Div'ds to Net Prof	***20%***
20.7	18.1	15.0	13.4			Relative P/E Ratio	***14.0***
1.12	.96	.90	.89	***Bold figures are Value Line estimates***		Avg Ann'l Div'd Yield	***.95***
1.4%	1.5%	1.9%	2.4%			Avg Ann'l Div'd Yield	***1.4%***