Canadian Grocers: Measuring “Greed” in the Era of Consumer Distrust

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Introduction

The Competition Bureau of Canada recently announced their study into grocer anti-competition practices. With more Canadians accessing food banks and food inflation in September was sitting at 10.3%, the study offers hope to Canadians concerned about food affordability.

It is not just food prices that have Canadian consumers concerned. The Bank of Canada announced another increase to the prime interest rate, while average natural gas and electricity bills this winter are expected to increase between 50 and 100 percent. Canadians will likely continue to feel the impact when looking to satisfy their basic needs for utilities, shelter, and food.

While utilities are owned or regulated by the government, and the government influences housing prices by setting prime interest rates and lending guidelines, the food industry’s competitive landscape remains subject to overwhelming oligopolistic pressures. As such, the Competition Bureau of Canada decided to probe and study the grocery sector in Canada. Only five retailers’ control most of the food retail sales in Canada. The influence some grocers have on the retail market and within their own supply chain is significant.

Nonetheless, the pressure for Canadian grocers to deliver quality, safe food to Canadians is immense. They are faced with seemingly unending pressures to provide goods to consumers through war, shipping disruptions, and inflationary challenges. It should also be underscored that, given its vastness, Canada is also a relatively challenging market to service which is why we have not seen many new entrants in recent years.

For consumers, it is difficult to see prices for everyday goods at grocery stores continue to increase steadily. Canadians feel the financial pressure to provide healthy options for their families, whether it is the bread used to pack kids’ lunches or the cost of Sunday night dinner.

Many have accused grocers of ‘Greedflation’ – that is, taking advantage of high inflationary times to earn excessive profits at the expense of consumers who have limited choices when grocery shopping. Companies need to make a profit to survive, and the capitalistic nature of our economy incentivizes innovation and funds food safety. But when food inflation reaches record levels, knowing what the threshold of moral acceptability for profits is for the sector would be key.

We have opted to look at the past five years’ performance of the three largest grocers and compare their historical results to how they have been doing thus far this year.

Method

First, we used publicly available data to look at the gross profit (revenue less cost of revenue) for each of the three big Canadian grocers, Empire/Sobeys, Metro, and Loblaws. We then calculated their respective "best" and "average" performances for the past five years. Next, we compared each company's most recent two quarters of 2022 against their best and average years' performance and quantified the excess (deficit).

Results & Discussion

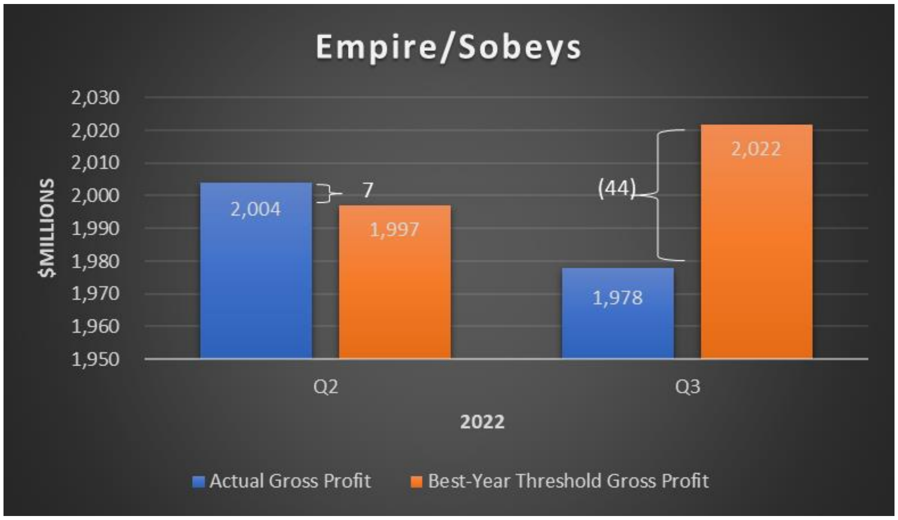
We found the best and average gross profit for the most recent five years were 25.47% and 24.88% for Empire/Sobeys,19.99% and 19.82% for Metro, and 31.47% and 30.45% for Loblaw. We compared this historical performance against each company's most recent two quarters, and our findings are in table 1.

	Empire/Sobeys		Metro		Loblaw	
CAD in Millions	**22-Apr**	**22-Jul**	**22-Mar**	**22-Jun**	**22-Mar**	**22-Jun**
Revenue	$ 7,840.8	$ 7,937.6	$ 4,274.2	$ 5,865.5	$ 12,262.0	$ 12,847.0
Cost of Revenue	$ 5,836.8	$ 5,959.7	$ 3,416.8	$ 4,706.8	$ 8,335.0	$ 8,692.0
Gross Profit	$ 2,004.0	$ 1,977.9	$ 857.4	$ 1,158.7	$ 3,927.0	$ 4,155.0
Gross Profit % - Actual	**25.56%**	**24.92%**	**20.06%**	**19.75%**	**32.03%**	**32.34%**
Gross Profit % - 5-Year Average Threshold	24.88%	24.88%	19.82%	19.82%	30.45%	30.45%
Gross Profit in Excess of 5-Year Average Threshold (%)	0.68%	0.04%	0.24%	-0.07%	1.58%	1.89%
Gross Profit in Excess of 5-Year Average Threshold ($)	**$ 53.2**	**$ 3.0**	**$ 10.3**	**-$ 3.8**	**$ 193.2**	**$ 243.1**
Gross Profit % - 5-Year Best Threshold	25.47%	25.47%	19.99%	19.99%	31.47%	31.47%
Gross Profit in Excess of **5-Year Best** Threshold (%)	0.09%	-0.55%	0.07%	-0.24%	0.56%	0.87%
Gross Profit in Excess of 5-Year Best Threshold ($)	**$ 6.9**	**-$ 43.8**	**$ 3.0**	**-$ 13.8**	**$ 68.1**	**$ 112.0**

Table 1. Canadian Grocers' Current Performance Relative to their Historical Performance

All large grocers have an increase in gross profit in 2022 relative to their average past performance: Empire/Sobeys earned an excess of $56 million; Metro earned an excess of $7 million, and Loblaw earned an excess of $436 million.

However, a lot has happened in the past five years, which can skew grocers' average gross profit margins. As such, we wanted to compare each grocer's performance relative to its *best* gross profit from the past five years.



We observed Empire/Sobeys' performance in 2022 was overperforming relative to their best years in Q2 by $7 million, while their Q3 numbers had them underperforming by $44 million. For the most recent two quarters of 2022, Empire/Sobeys had a net deficit of $37 million relative to their best years' performance.

When looking at Metros' 2022 performance relative to its best years, we noted they were overperforming in Q1 by $3 million and underperforming by $14 million in Q2. For the most recent two quarters of 2022, Metro Inc. had a net deficit of $11 million relative to their best years' performance.

In Q1 2022, Loblaw outperformed their best years' performance equivalent to $68 million; in Q2 2022, they outperformed their best years' performance by $112 million. In total, Loblaws' gross profit thus far in 2022 outperforms its best performance of the past five years by $180 million.

We acknowledge that Loblaw Companies Limited is the largest Canadian grocer and that $180 million in 'excess' profit over six months is 'only' about a million dollars a day for them. That, relative to their $12.9 billion in quarterly revenue, it would be reasonable for company executives to be annoyed at our analysis. After all, we maintain that public companies have a mandate to their shareholders to earn profit.

However, grocers' margins have been historically relatively small. Squeezing out gross profits through moderate price increases translates directly to net income. In theory, had Loblaw earned gross profits equal to their best years' relative performance, they would have still made pre-tax net income of $528 million (Q1) and $478 million (Q2) in 2022.

While Loblaws recently announced they will freeze prices on their No Name products until January 31, 2023, recent news suggests there may be limitations to those promises. Such a price freeze may leave Canadians wondering what impact they can expect on their grocery bills in February 2023 once the price freeze ends.

Notes to the Financial Statements

To gain more insights into the cause of Loblaw's irregularly strong performance, we looked at their more recent audited annual financial statements. Retail sales are made of "several operating segments comprised primarily of food retail and Associate-owned drug stores, and also includes in-store pharmacies and other health and beauty products, apparel and other general merchandise." While "retail operating segments are subject to similar competitive pressures such as price and product innovation" and are subject to "similar economic characteristics also include the provision of centralized, common functions such as marketing and information technology ("IT") across all retail operating segments."

Canadian publicly listed companies like Loblaw Companies Limited are required to report under International Financial Reporting Standards (IFRS). Per IFRS 8.12, companies may aggregate operating segments with economically similar characteristics. This means **operating segments must be similar in all respects**: (*a) the nature of the products and services; (b) the nature of the production processes; (c) the type or class of customer for their products and services; (d) the methods used to distribute their products or provide their services; and (e) if applicable,* the nature of the regulatory environment*, for example, banking, insurance or public utilities.*

Loblaws combines food, health, beauty, apparel, and other general merchandise into one category. Loblaw's 2022 Q2 News Release attributes its increase in sales to an increase in same-store sales for food retail (0.9%) and drug retail (5.6%). This does not necessarily mean that the increase in gross profit (revenues less cost of revenues) is due to the same mix of gross profits of food and drug retail. Loblaws is not required to disclose this information.

Limitations

Readers of Loblaw Companies Limited's financial statements cannot definitively say whether or not an increase in non-food sales has driven the bulk of the 'excess' gross profit.

Should Canadian regulators decide the food industry should be subject to regulation, then companies like Loblaws may be required to report their food operations separately from their non-food operations. We find it interesting that Loblaws can justify food and non-food (healthy, beauty, apparel, and other general merchandise) as a combined operating segment which satisfies both IFRS 8.12(a) the nature of the product and services, and IFRS 8.12(b) the nature of the production process. It is unclear how food retail and drug retail are similar in nature, sales or production.

However, what we can observe from Loblaw's most recent quarterly financial statements is that their 2022 performance has increased from Q1 to Q2:

Loblaw Companies Limited 2022

	Q1	Q2	Change
Revenue	$ 12,262	$ 12,847	4.77%
Cost of Revenue	8,335	8,692	4.28%
Gross Profit	$ 3,927	$ 4,155	5.81%

Revenues have increased by 4.77%, while the cost of revenues has increased by a lesser relative amount, 4.28%. This has resulted in an overall increase in gross profit of 5.81% from Q1 to Q2 2022, driven by a rise in revenues relative to the cost of revenues.

AGRI-FOOD ANALYTICS LAB/LABORATOIRE DE SCIENCES ANALYTIQUES EN AGROALIMENTAIRE

https://www.dal.ca/sites/agri-food.html

The cost of revenues includes store labour, transport, storage, and the amounts paid to producers and suppliers. We noted no evidence of increased gross profits relative to past performance for major Canadian producers (e.g., agricultural and meat) or large United States consumer goods (e.g., cereal, granola bars, juice).

Conclusion

We based our analysis on publicly available data, aggregated such that we will likely never be able to prove or disprove Greedflation amongst Canadian grocers. This will remain the case until they are willing to open their books for additional analysis, something not even Canada's Competition Bureau can compel them to do.

Our report does not find Loblaw, nor any of the other large Canadian grocers, guilty of 'Greedflation.' Rather, we conclude that based on the performance of their gross profit, Loblaw Companies Limited are outperforming even their best gross profit performance in recent years. While at the same time, many Canadians face tremendous financial hardship attempting to satisfy their basic needs of heat, shelter, and food.