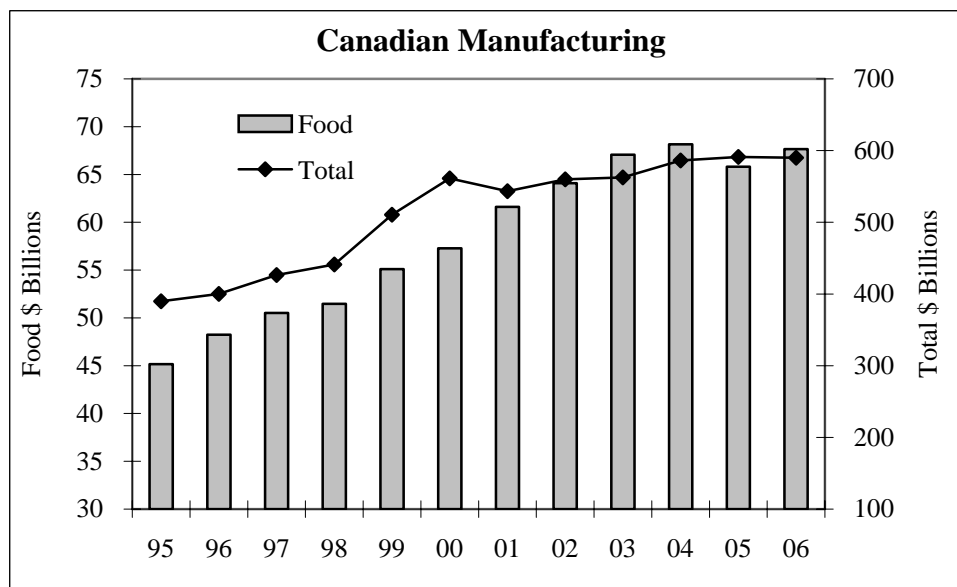


## 2006 Food Industry Review

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This report examines the overall 2006 performance of Canadian food manufacturers, distributors, and retailers, and provides a comparative analysis of sales, profits, and the challenges of inventory management for each segment of the industry.

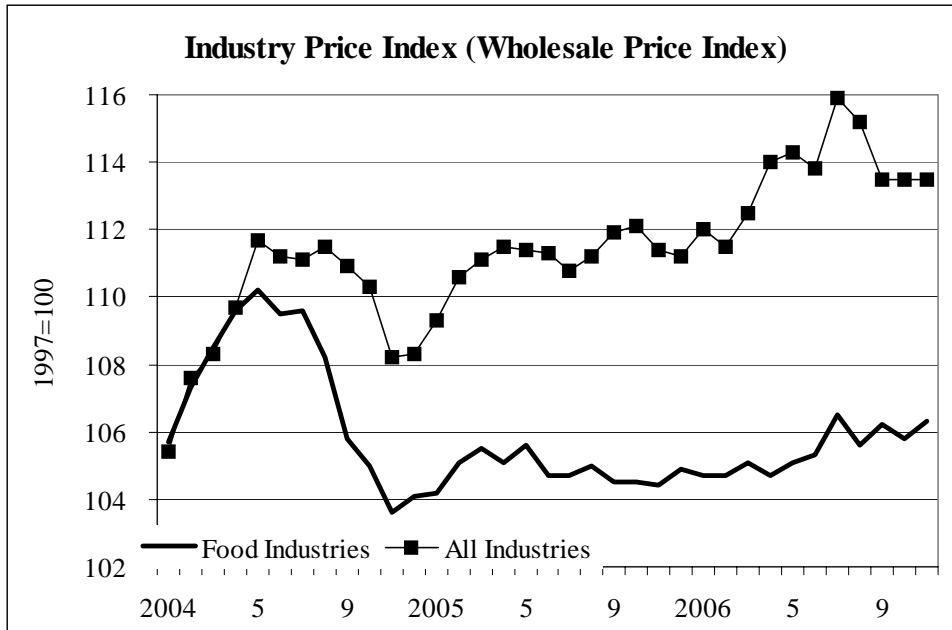


**Figure 1**                      **Source: Statistics Canada**

Canadian food manufacturer sales are likely to amount to just under \$68 billion dollars in 2006, an increase of nearly 3% over 2005.<sup>1</sup> That increase comes after a 3% decline in sales was experienced by the food manufacturing sector in 2005. Growth in 2006 in the food manufacturing sector stands in contrast to the flat, or slightly lower performance of the total Canadian manufacturing sector. The graph above (figure 1) shows total sales trends for the past 11 years in the food and total manufacturing sectors in Canada.

It appears that the bulk of the food industry sales increase was derived from volume, as opposed to pricing increases. The following graph (figure 2) shows the performance of the Industry Price Index, which is the wholesale price index for manufacturer sales. As can be seen, food industry pricing has been very flat for the past two years. In fact, the average index from 2005 to 2006 was essentially unchanged.

<sup>1</sup> Based on the first 10 months of data from Statistics Canada's Census of Manufacturers.

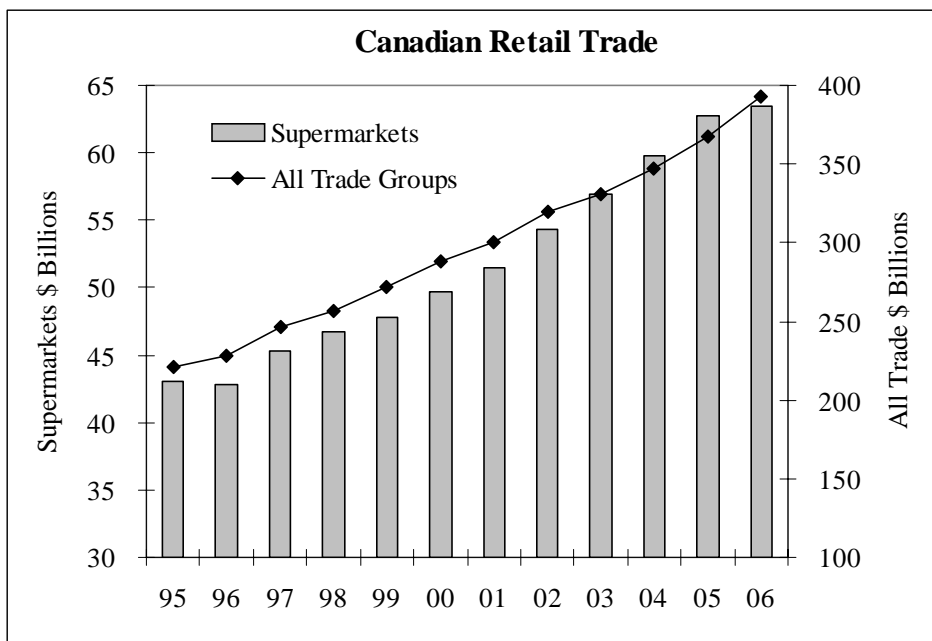


**Figure 2** Source: Statistics Canada

By contrast, total manufacturer industry prices increased by about 2% in 2006 compared to 2005. Volume increases are always positive but a pricing increase would also provide a needed balance for food manufacturing operations.

### Supermarket Performance

For its part, the supermarket industry in Canada experienced almost no growth as sales hit about \$63.4 billion, an increase of just over 1% compared to 2005. That relatively flat performance comes on the heels of a growth rate of around 5% for each of the previous four years. To further compound the relative lethargy of 2006, it is noted that the total retail (food, hardware, clothing etc.) sector saw its sales jump by nearly 7% to \$393 billion. The following graph (figure 3) shows the performance of the Canadian supermarket industry relative to the total retail industry from 1995 through 2006.



**Figure 3** Source: Statistics Canada

According to the Consumer Price Index, the prices of food purchased from grocery stores increased by about 2% in 2006 compared to 2005. That is roughly equal to the rate of increase in all items in 2006. By contrast, the price of food purchased from restaurants increased by about 3% in 2006. The graph in figure 4 shows the rate of increase in food purchased in grocery stores and restaurants as well as the total CPI. The two percent increase in pricing at grocery stores combined with the shallow one percent increase in grocery sales, means that real sales tonnage at retail actually declined last year. As noted, the total retail sector saw sales increases of about 7%.

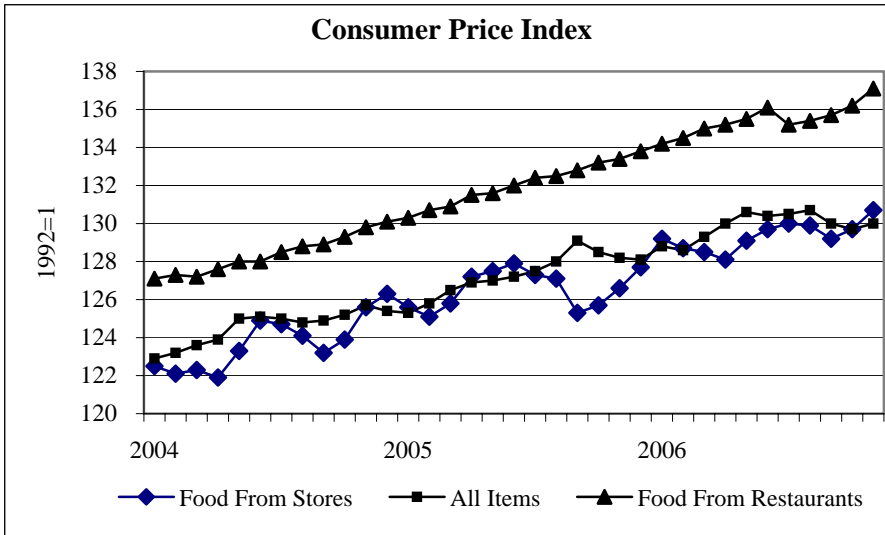


Figure 4 Source: Statistics Canada

The direct competitors to the supermarkets generally had a favourable 2006. Convenience stores, drug stores and general merchandise operations saw sales increase by 4%, 11%, and 7.5% respectively. Figure 5 shows the monthly sales trends for supermarkets, drug stores, convenience stores and general merchandise for 2005 and the first 10 months of 2006.

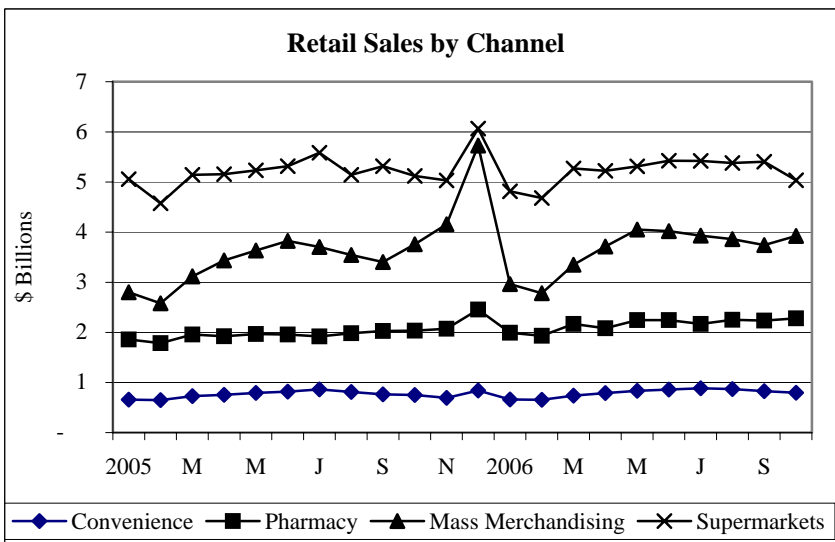
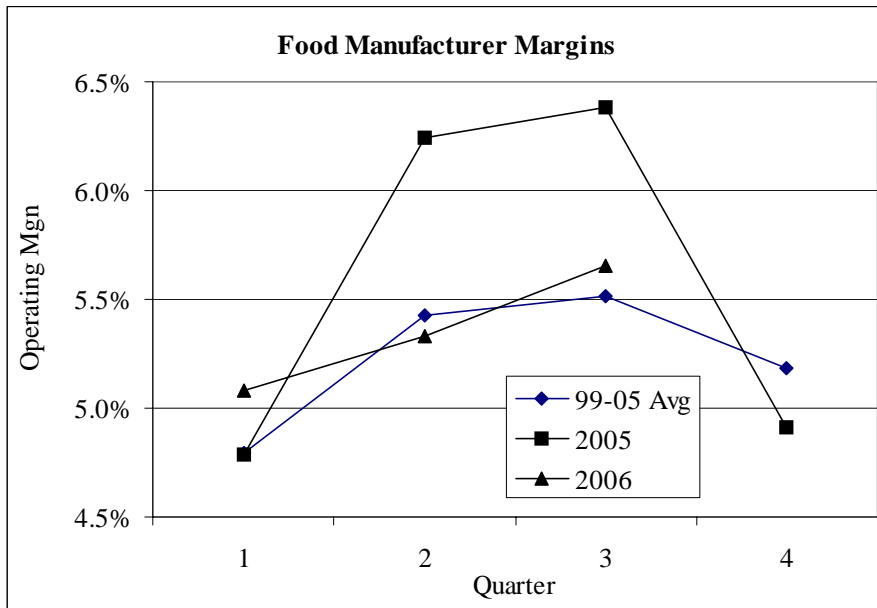


Figure 5 Source: Statistics Canada

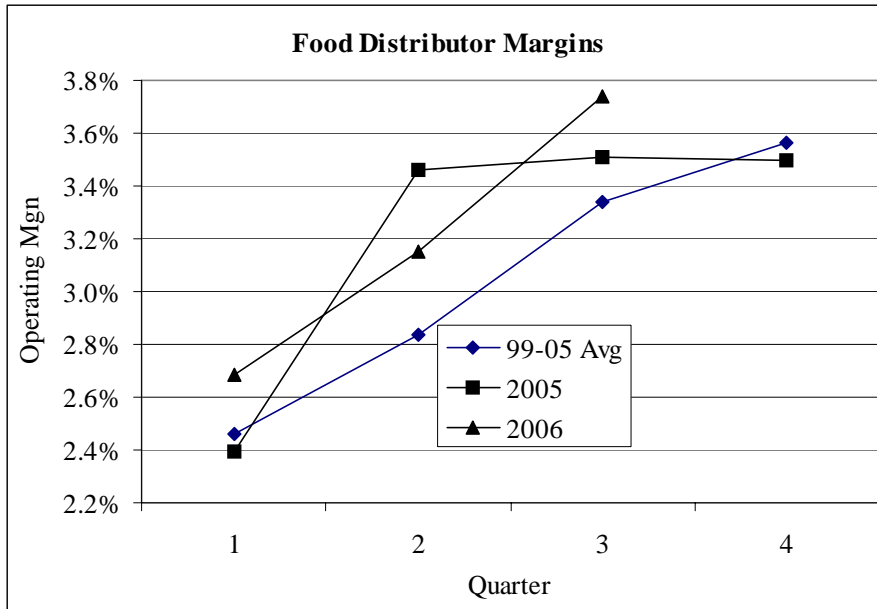
While final fourth quarter Statistics Canada profit reports are not yet available, the first three quarters of the year do provide adequate perspective on performance. Food manufacturers saw operating profits increase a solid seven percent from the second to the third quarter. On a year over year basis, however, food manufacturer operating profits decreased by over 5%. Based on the StatsCan data, it appears that 2005 was an exceptional year overall for the food industry. The following graph (figure 6) shows food industry operating margins for this year, last year and the previous five-year average.



**Figure 6** Source: Statistics Canada

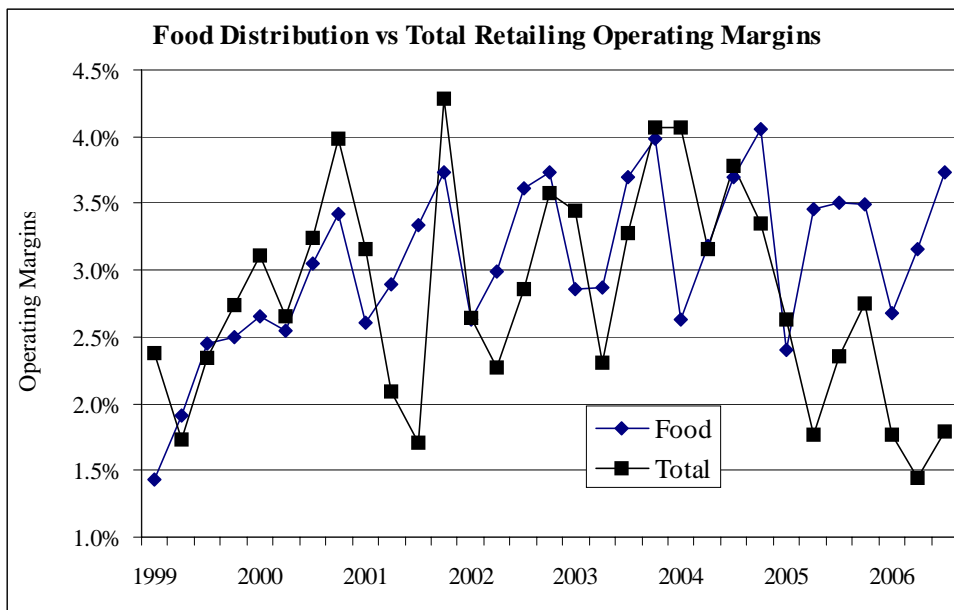
As can be seen, 2005 margins were well above average, at least for the second and third quarters. Overall manufacturing industry margins tend to be greater than food manufacturer margins. The StatsCan data shows that since 1999, food manufacturer margins have tended to fluctuate around 5%. Total manufacturing, however, has tended to be more volatile but still higher than food. Since 1999, total manufacturing margins have averaged near 7%. In the last couple of years, however, the average has been just over 6%.

Food distributors (food retailers and wholesalers) saw operating profits increase by a whopping 31% between the second and third quarters. Operating margins increased by 16% between the third quarters of last year and this year. On an operating margin basis, it appears that 2006 is shaping up to be a very good year for food distributors. The following graph (figure 7) shows food distribution margins for this year, last year and the five-year average.



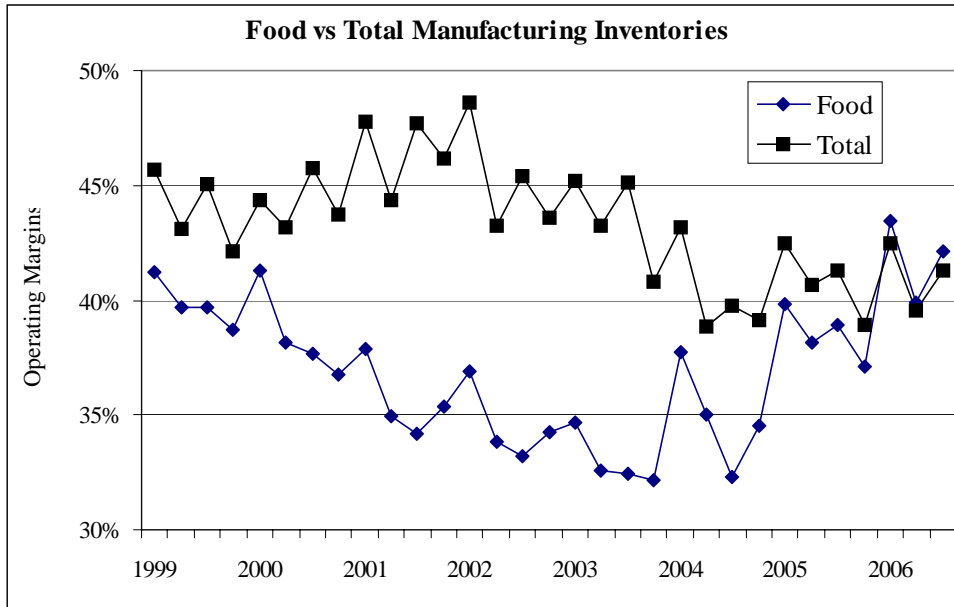
**Figure 7** Source: Statistics Canada

As can be seen, in the first three quarters, margins have been better than average. The 2006 third quarter operating margin of 3.7% is one of the better margins in the last six years. Only two times have margins for the industry been 4% or more, although they have been at 3.7% four other times. From 1999 through the third quarter of 2006, food distributor margins have averaged just over 3%. That compares to total retailer margins for all commodities at an average just under 3%. The following graph (figure 8) shows food distribution margins compared to total retail margins from 1999 through 2006. As can be seen, it has only been since 2005 that food margins have been materially higher than total retail margins.



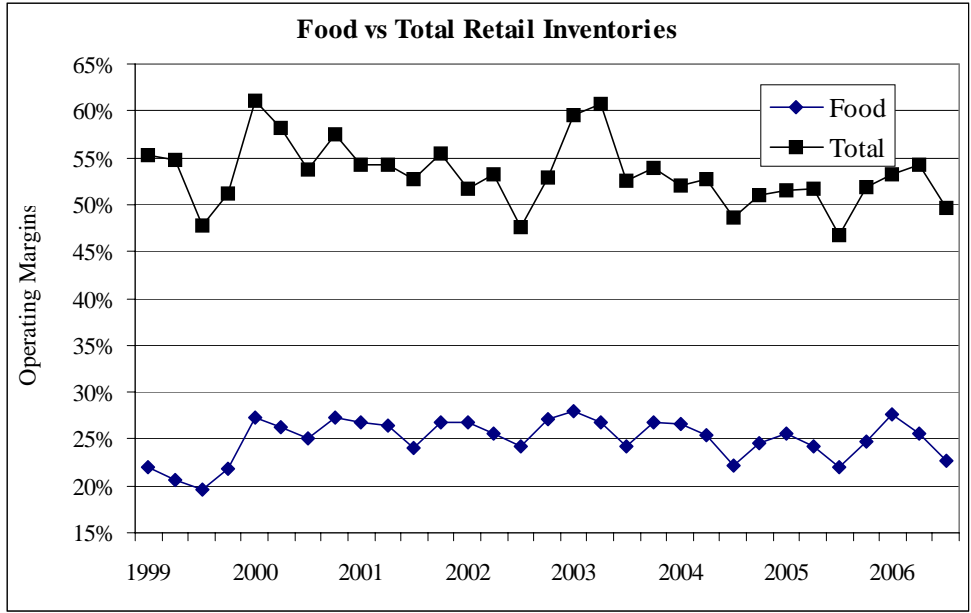
**Figure 8** Source: Statistics Canada

Inventory levels are always an interesting component of the manufacturer-retailer interchange. With regard to inventories, the following graph (figure 9) shows the ratio of manufacturer inventories to total revenues. From 1999 through 2004, food inventory levels had been steadily declining. From 2004 through the third quarter of 2006, however, inventories as a share of revenues have been increasing. As of 2006, food inventory levels have risen to roughly equal those of total manufacturing.



**Figure 9** Source: Statistics Canada

Finally, it is interesting to note the relative inventory management performance of food retailers compared to total retail (figure 10). Generally speaking total retail carries inventory levels far in excess of food retailers and wholesalers. Of course the challenge of handling perishable goods can explain a great deal of the difference. It is of interest, however, that while food distributors have managed to keep inventory levels much lower than total retail, there has not been a great deal of improvement in that regard. That is, food distributor inventory levels have remained relatively stagnant as a percentage of total revenues.



**Figure 10** Source: Statistics Canada

In summary, 2006 will be seen as a year in which food manufacturers saw decent sales gains primarily due to volume. That is, while industry sales rose by a respectable 3%, most of the increase was due to volume as opposed to pricing increases. Food manufacturers continue to struggle to pass along price increases. With regard to industry margins, food manufacturers appear to have experienced an average year in 2006. That is in contrast to an exceptionally strong performance in 2005.

Grocery distributors appear to have struggled in 2006. While margins were above average, sales were basically flat. The weak sales performance stands in contrast to sales jump of 7% for the total retail sector. Furthermore, the direct competitors to the grocery retailers, including drug, convenience and general merchandise operations all saw sales far in excess of grocery.

*The previous analysis first appeared in the George Morris Centre publication, Grocery Trade Review. If you are interested in a free two month trial subscription to Grocery Trade Review, or any of our market reports, please visit our website at [www.georgemorris.org](http://www.georgemorris.org) or e-mail Pat Dares at [pat@georgemorris.org](mailto:pat@georgemorris.org)*