Six Month Manufacturing Sales and Profit Trends

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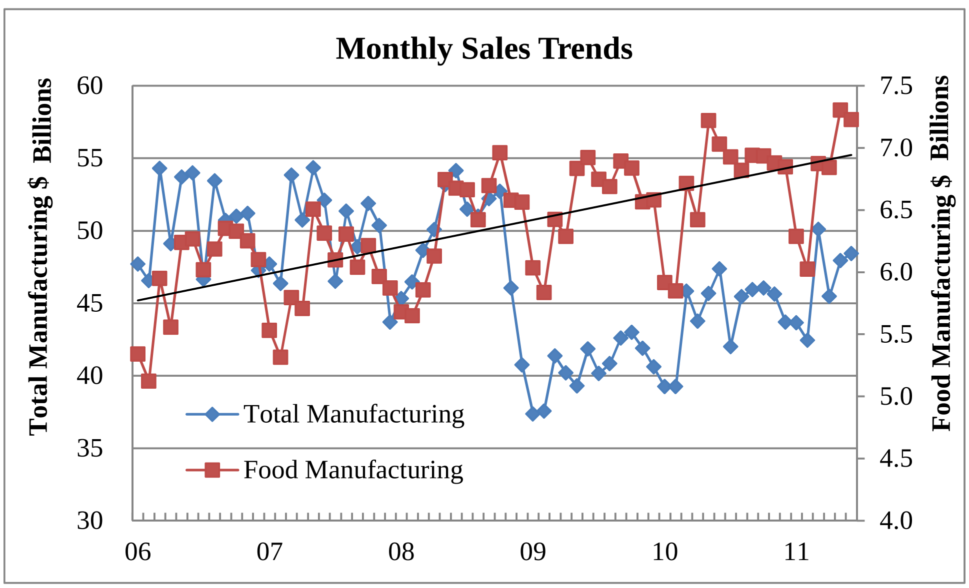
The Canadian food industry is undergoing a series of challenges related to higher commodity costs, the appreciating dollar and a volatile economy. These factors can have a negative impact in both the domestic and export markets. In fact, one of the setbacks for the industry in recent years has been in the area of international trade. Canada appears to be losing share in domestic and export markets. There is little doubt that the appreciating dollar played a role in that development. At the same time, however, while the industry has struggled with higher commodity costs, the appreciating dollar played a role in mitigating some that impact. Given these issues and developments, at this point in the year, it is of interest to assess how the industry is performing from a sales and profitability perspective.

Food Industry Sales

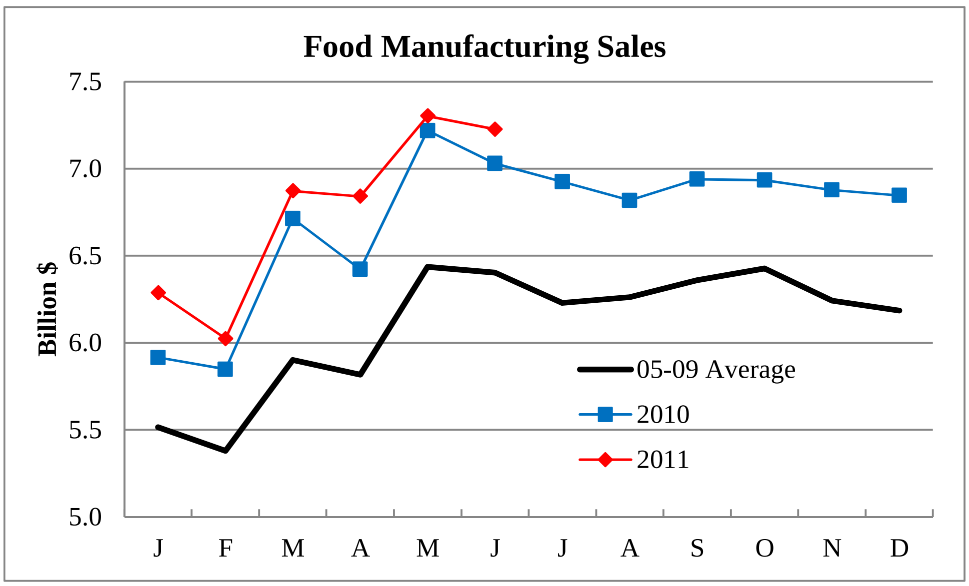
Statistics Canada has released sales data for the first six months of the year for the manufacturing sectors. As of June, sales of all manufacturing industries have increased by 6% while sales for food manufacturing have increased by 4% compared to the first six months of 2010. The following graph shows the monthly sales trends for food manufacturing and total manufacturing from 2006 through June 2011.



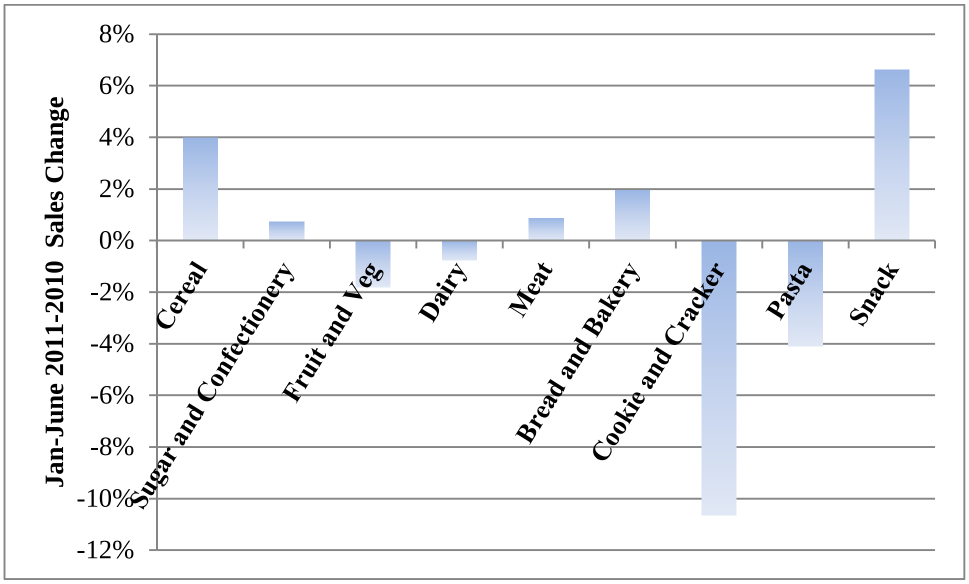
The graph is interesting for a number of reasons. The first is the sharp decline in the manufacturing sector during the global financial crisis of the fourth quarter of 2008 and early 2009. The next point of note is that the manufacturing sector has not yet recovered lost sales from that period. Total manufacturing sales are steadily increasing, but they have not yet matched the pre-recession totals.

The food manufacturing sales performance is interesting due to the consistently increasing sales trend. Not surprisingly, industry sales were largely untouched by recession. Sales have simply steadily increased. Within that context, however, it is of interest to recall that the food manufacturing industry does show seasonality of sales performance during the year. The following graph shows food manufacturing sales for this year, last year and the 2005-2009 five year average.

As can be seen from the five year average performance, sales during the first four months of the year tend to be comparatively low. While those early year sales are low relative to the rest of the year, the month to month trend during the first five months is sharp sales increases. Sales from May through November tend to level off before falling slightly in December. As can be seen from the sales trends of 2010 and 2011, the patterns have been consistent for both years. At least in terms of sales performance, the food manufacturing sector is comparatively predictable and consistent.



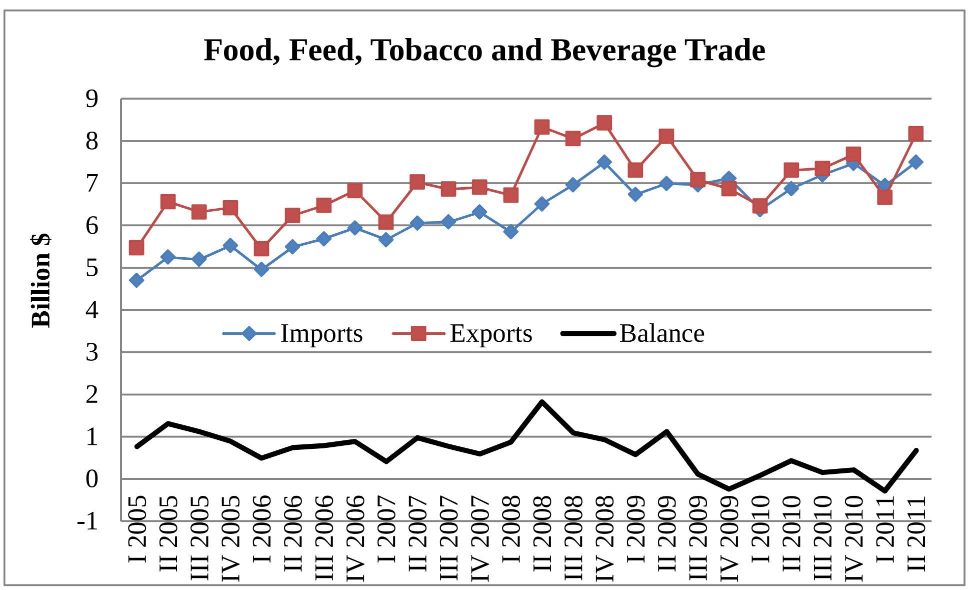
With those points of consistency and predictability noted, it is not wise to generalize too much about the food manufacturing “industry”. It clearly is several sub-industries within the overall food industry. Each sub-industry within the food industry operates on its own terms and conditions. For example, the following graph shows the year over year change in sales for various food industries from January to June 2011 versus 2010.



As can be seen, the cereal and snack food industries have enjoyed strong sales in 2011 compared to 2010. By contrast the pasta and cookie industries have seen sharp declines. Clearly each sector of the food industry faces unique structural and market opportunities and challenges that, in total, result in the overall returns for the food industry.

Trade Performance

The Canadian food industry is an international industry that both imports and exports products, in addition to the domestic sales. The following graph shows the quarterly performance of food, feed, beverages and tobacco from 2005 through the second quarter of 2011.

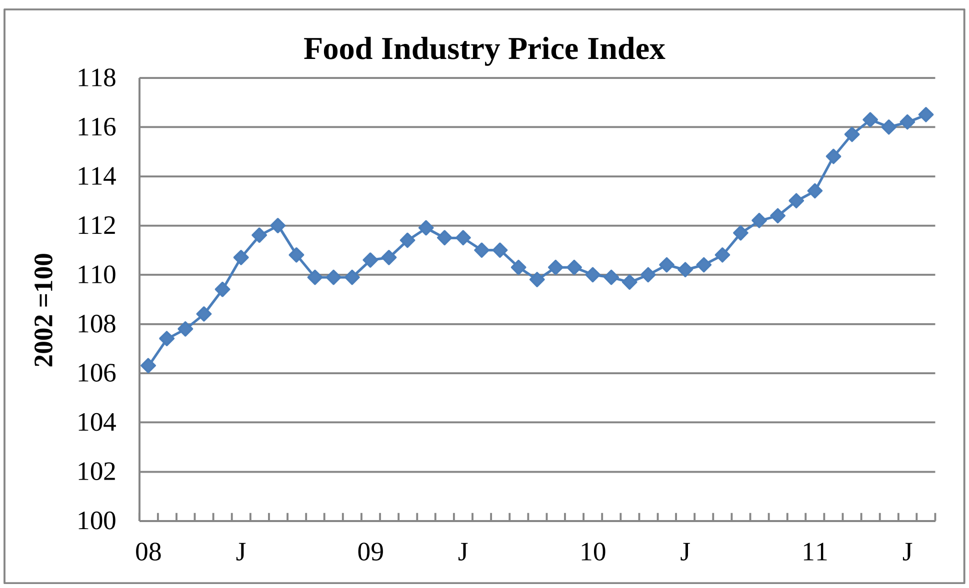


As can be seen, the trade balance moved back into positive territory in the second quarter after briefly going negative in the first quarter. The last and only time the balance was negative was the fourth quarter of 2009. The trend in the balance has been clearly downward from mid-2008. Over that time, exports have been flat to lower, with the interesting exception of the second quarter this year. The second quarter this year saw exports increase by more than 50% over the second quarter 2010. While exports have generally been in decline, however, imports have been slowly and steadily increasing. With regard to imports, based on the StatsCan data, it appears that the penetration has been broadly based. The increase in imports has been across a full array of food industry sectors from meat through to cereals. That is, there are not just one or two sectors that are seeing increased competition, it is across the board.

There could be many factors behind the trade balance decline but the obvious one that stands out is the performance of the Canadian dollar. As it appreciates, it makes Canadian products more expensive in international markets and increases the buying power of importers. At the very least, the appreciated dollar exposes the Canadian cost and labor structure.

Pricing at the Manufacturing Level

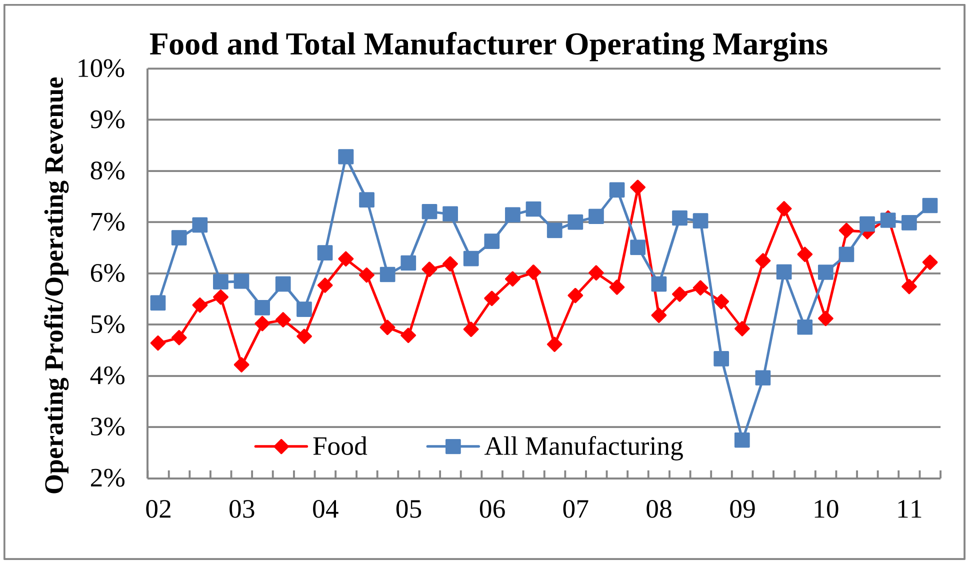
Total sales are comprised of tonnage and price. Prices at the manufacturing level are measured and reported by the Statistics Canada Industry Price Index (IPI). The IPI measures price changes at the manufacturing level. On the pricing front, based on the IPI, during the first six months of the year, total food manufacturing prices have increased by 5% compared to the first six months of 2010. That is, prices at the food manufacturing level have increased faster than the change in total sales, which as noted above was 4%. Meaning that total tonnage declined in food and the increase in sales so far in 2011 has been due to pricing increases. As a point of reference, total manufacturing prices also increased by 5%. That compares to total sales increases of 6% as noted above. The following graph shows the performance of food manufacturer prices on a monthly basis from 2008 through July 2011.



With regard to the sub-industries within the food industry, it is noted that nearly all the sectors saw pricing increases. Even the cookie, cracker and pasta industries, which saw the big sales declines, managed to increase prices at the wholesale level.

Profits and Margins

According to Statistics Canada's Industrial Organization and Finance Division, operating profits increased by 4% in the first half of this year compared to last year. All of the increase, however, occurred in the first quarter. During the second quarter food manufacturer operating profits decreased by 5%. Despite the year over year decline in operating profits during the second quarter, food manufacturer operating margins have remained at a fairly healthy 6%. The following graph shows food industry manufacturing margins in comparison to total manufacturing operating margins on a quarterly basis.

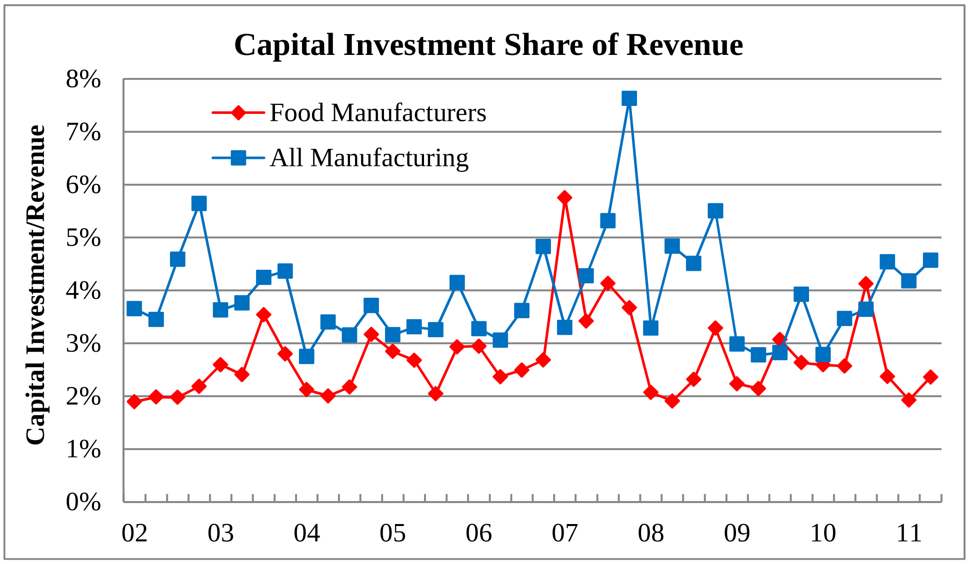


As with sales, the main message of the graph is the stability of food industry operating margins relative to All Manufacturing. The recovery of the All Manufacturing margins since the recession has been consistent and robust.

Capital Investment

Investment trends can signal future growth trends and the level of confidence in an industry. In that regard, the following data from StatsCan's Industrial Organization and Finance Division shows once again a trend of stability. The graph shows food industry and total manufacturing capital investment as a share of total revenues on a quarterly basis from 2002 through the second quarter of 2011. As can be seen from the graph, food industry investment tends to fluctuate between 2% and 4% of revenues. The big jump in the percentage in early 2007 was a statistical anomaly as revenues were temporarily low at a time of higher investment, so that bump should be ignored. Meanwhile total manufacturing investment looks to be recovering from its recessionary declines.

With regard to the performance of this measure over the last four years, there was an up-trend from 2008 to mid-2010, followed by a decline through early 2011. Second quarter 2011 saw an increase again. Actual nominal dollars invested in capital have shown a pattern similar to the ratio on the graph. The bottom line with regard to the signals from investment is relatively mixed but bear watching.



Summary

This brief mid-year overview shows that there are warnings for the industry that are especially noticeable on the trade front. The industry is losing export and import share, slowly. In addition, the challenge of passing along rapidly increasing commodity costs will burden the industry in the coming years. If the Canadian dollar finally stabilizes, industry's cushion to absorb commodity increases will disappear. Generally speaking, however, the Canadian food manufacturing industry is experiencing a reasonably normal year with regards to sales and profits. In that regard the industry appears to be sound from a statistical perspective pertaining to sales and profits.

A version of this report first appeared in the George Morris Centre publication, Grocery Trade Review. If you would like a free, two month trial of Grocery Trade Review, please e-mail Kevin Grier at kevin@georgemorris.org