


# Are Grocery Stocks Ripe for Picking?

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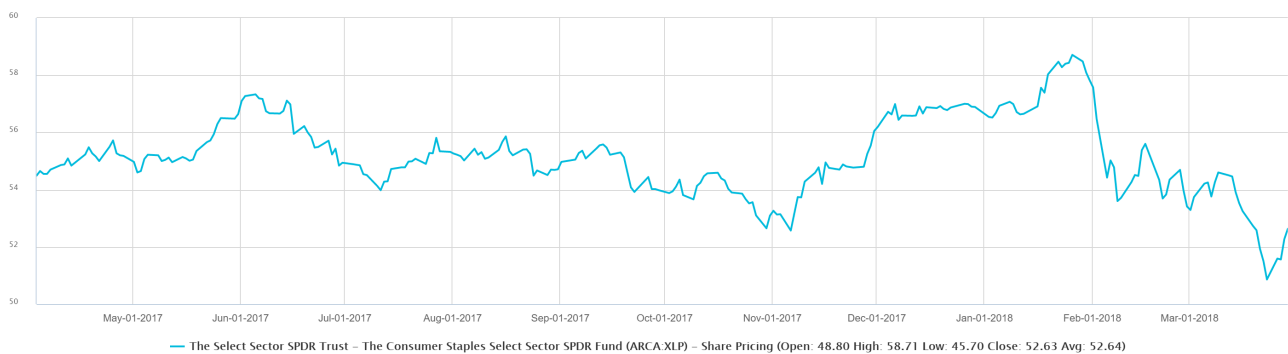
By [Linda McDonough](#) on April 4, 2018

Is the time ripe to buy grocery stocks? Fifteen months ago, at the beginning of 2017, I suggested some bearish positions in the grocery industry. While my timing wasn't perfect in all these trades, many were extremely profitable and many stocks in the group have fallen significantly.

In fact, some stocks in the group have fallen to levels where they trade at some of the lowest valuations in five years. On a few, earnings estimates have stopped falling and seem to be within reach. As many of you know, most stocks won't go up until the companies start beating analysts' estimates.

Alas, like that cryptic cantaloupe that gives you little sign whether it holds sweet or bitter flesh inside, it's not an easy task to decipher the future of these stocks.

My bearish thesis over a year ago was pretty simple; brick and mortar grocery stores were having a hard time generating strong sales. The **Consumer Staples Select Sector ETF (XLP)** is down 3.5% in the past 12 months. Many of the stocks in the indices are down much more.



Consumer tastes were changing rapidly and grocery stores not adjusting their product mix fast enough. Despite decades of consumers having less and less time to shop and cook, grocery stores continued operating as if it were 1988.

Outside of the roasted chicken for sale or the “gourmet” pasta salad showcased behind the deli case, the majority of shelves in a grocery store were (and still are) filled with boxed and jarred food.

It's not as if the stores did nothing to accommodate consumers new tastes. Hundreds of organic and healthy options were added to the cereal aisle. Some of Captain Crunch's space was squeezed back to make way for granola and protein bars.

Hardly a section of the grocery store was left unchanged. Even the pasta aisle received a makeover with wheat and gluten free options shifting their white-flour brethren off to the side.

Increased space at the edge of the store has been reset to include prepared meals and “almost done” options. Even **Blue Apron** ([NSDQ: APRN](#)), the company who heralded itself as a home delivery option for meals, will start selling its meal kits in grocery stores.

## Can't Stay Away

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You see, despite the headlines that shout about home delivery being the holy grail for retailers, the majority of consumers still head to the grocery store at least a few times a month.

This is true. I am one of them. In spite of an Amazon Prime membership that drops paper goods on my doorstep and trials with Instacart and meal kit services, the majority of my grocery shopping is done the old-fashioned way.

According to a recent survey by The Hartman Group, a leading authority on consumer food trends, 85% of consumers had shopped in a brick and mortar grocery store in the past three months.

They note that consumers visit stores in “varying states of need.” Some fill up an entire grocery cart with their week’s worth of food. Others jump in on the way home from work for a few items to throw together for an easy meal.

So while many customers are mixing up their store visits with some home delivery options, the need for a retail store is not disappearing. Perhaps the footprint can be smaller and for sure, the mix of products is changing, but the need for a grocery store is a more enduring need than that for a clothing store perhaps.

The trick, of course, is whether stores can make this shift without tossing profits into the dumpster. I’ve mostly been bearish on the companies that supply packaged foods to the stores. In a race to compete with more desirable nimble brands, these large companies have been bulking up on debt to acquire growing brands.

## Digestion Problems

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Following these stocks is like a game of Pac Man. One buys the other and then the next biggest gobbles that one up. The problem is that fast-growing independent food companies are hard to come by. For this reason, the price paid for these companies is hitting record levels.

**General Mills** ([NYSE: GIS](#)) paid a pricey 25 times EBITDA (a measure of earnings before many non-cash charges) for pet food company **Blue Buffalo** ([NSDQ: BUFF](#)). **Kellogg** ([NYSE: K](#)) paid \$600 million, or five times sales for private company RxBar.

Many of these stocks have come down as well, but I’m not quite comfortable with them yet. Their high debt and a murky path to growth still make me uneasy.

I'm more interested in the stores that benefit from any product that's in demand. The lines of a grocery store are blurring. Is **Target** ([NYSE: TGT](#)) a grocery store? Is **Walmart** ([NYSE: WMT](#))? I'm not biased to one set of stores or the other. My requirement is that they are able to grow profits while maintaining a reasonably healthy balance sheet.

So while the food fight might continue in the aisle of the grocery store, I'll be looking for the winners, whose dented cans and brown avocados are being cleared out for profits. Buying value stocks isn't easy but it's often the safest route during volatile times.

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