Sobeys' Battle for Margins

Description

Sobeys, a division of **Empire Company Limited** (TSX:EMP.A), has come off of its first official quarter with the assets of Safeway on its books. Now that operations have begun to merge, the question is whether Sobeys can fulfill its pledge to investors to slash $200 million in annual costs within three years.

In this first quarter the company has managed to trim operating costs by $6 million, far behind the $25 million it had projected to achieve by now. This lack of immediate savings may force the company to sell some of its non-core assets to give it an immediate boost as it tries to trim its bottom line.

One of these core assets comes in the form of Safeway-owned Lucerne Foods Plant (ice cream and cheese) in Winnipeg. The company will be shifting operations to Edmonton. There has also been an announcement that 50 to 60 accounting roles in Calgary Alberta and Quebec will be eliminated. There are also plans to close at least one distribution plant in Ontario.

Sobey's lays down the law to its suppliers

Another way the company has tried to rein in costs has been in its demands to suppliers to cease and desist from raising prices. Back in December Sobeys sent out a memo to its suppliers ordering them to retroactively reduce prices by 1% (with some exceptions). The company also prohibited suppliers from increasing prices at all during 2014.

These actions set off a domino effect in the industry with **Loblaw** (TSX:L) and Overwaitea Food Group following suit. Overwaitea Food Group even went as far to impose a "new store startup fee", demanding one free case of every listed item that will be carried by its new stores acquired from Sobeys.

Suppliers are fighting back

Sobeys' quest to lower margins has taken a new (and unexpected by Sobeys) turn as suppliers have begun to stand up against its demands. Companies such as Smucker Foods of Canada Corp, ConAgra Foods Canada Inc, Nestlé Canada Inc and **Coca-Cola** have threatened to pull funding for flyers and other promotions for the products. They have also threatened in some cases to suspend or limit product shipments if Sobeys (and other grocers) fail to agree with the new pricing policies.

Another tactic being introduced by suppliers is “minimum advertised prices” on select goods. Failure to adhere to these prices could result suspensions of supply or will no longer receive promotional funding.

Foolish bottom line

Revenues in the last quarter for the Sobeys segment of Empire Company were $6 billion, up from $4.2 billion last year; $1.6 billion of the quarter’s sales came from newly acquired Safeway. The company still as a lot of work ahead to complete this merger and make the best of its newest assets. However this standoff between Sobeys and its suppliers could quickly turn into a battle with investors, who will pressure both sides to work together.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:EMP.A (Empire Company Limited)
2. TSX:L (Loblaw Companies Limited)

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