Back at 2012 Levels: Is Empire Company Limited a Bargain?

Description

Empire Company Limited (TSX:EMP.A) has fallen more than 35% from $30 per share in 2015 to $19 per share a year later.

The last time Empire traded at the $19 level was in 2012.

The business

Empire has been in the food-retailing business since 1907. It has 1,500 owned, affiliated, or franchised stores across all 10 provinces under the retail banners of Sobeys, Safeway, IGA, Foodland, FreshCo, Thrifty Foods, and Lawton's Drug Stores, as well as more than 350 retail fuel locations.

Empire also owns a 40% interest in **Crombie REIT** and interests in various real estate partnerships.

Why has it been on a decline?

Since acquiring Safeway in 2013, Empire continues to experience operational challenges in western Canada under the Safeway banner.

There have been organizational, training, and educational gaps related to the information technology system and process integration of Safeway.

Merchandising issues such as the private-label conversion and produce-supply-chain issues have impacted the offerings being made to customers.

Further, the challenging economic environment in Alberta and Saskatchewan hasn't been helping either.

Together, these issues negatively affected the customer experience, and same-store sales decreased 1.8% in the fourth quarter.

For fiscal 2016, Empire recognized impairment losses of $2,878.5 million in the West business unit. As well, earnings before interest, taxes, depreciation, and amortization (EBITDA) decreased $3,169.6

million.

Excluding items not indicative of the underlying business performance, the adjusted EBITDA was 12.1% lower from last year to $1,161.4 million.

Is Empire a bargain today?

At $19.25 per share, Empire trades at 12.9 times its fiscal 2016's adjusted earnings per share (EPS) of $1.49. Investors should also note that the company's adjusted EPS fell 20% in fiscal 2016.

If the Safeway integration continues to be a challenge, Empire's shares can fall further.

In the past decade, Empire has normally traded at a multiple of 13.2. So, the company is within fair-value range.

Dividend

Empire prudently raised its dividend by 2.5% this year. This is a small raise compared to 2015's hike of 11.1%, but it is the right move.

Empire's payout ratio is less than 28% based on its fiscal year 2016's adjusted earnings. So, there's a margin of safety for Empire's dividend yield of 2.1%.

That said, this is Empire's highest payout ratio in the last decade, in which it was between 18% and 22%.

Conclusion

Even after falling about 35% from the 2015 level, Empire is not necessarily a bargain. At best, it's fairly valued today.

It has multiple challenges to overcome (primarily, the Safeway integration) before earnings will recover and shares go sustainably higher.

CATEGORY

1. Dividend Stocks
2. Investing

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1. TSX:EMP.A (Empire Company Limited)

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