Empire Company Limited CEO Hire Comes With Risk

Description

Almost six months to the day that former Sobeys and **Empire Company Limited** (TSX:EMP.A) CEO Marc Poulin was given his walking papers, the family-controlled company announced his replacement January 12.

It's none other than Michael Medline, the former CEO of **Canadian Tire Corporation Limited** (TSX:CTC.A), who ironically was himself relieved of his duties at Canadian Tire less than a week after Poulin.

What goes around, comes around.

And while the recycling of leaders is a norm in professional sports leagues, it's not necessarily a recipe for success when it comes to turnarounds.

In mid-December I argued that Empire's stock wasn't permanently broken and that aggressive investors should consider buying it while holding back a little dry powder for a future correction. At the end of the day, the Sobey family knows too much about the grocery business to let the Safeway acquisition destroy a company that's 110 years old in 2017.

The company, as would be expected, was quite complimentary in its praise for Medline.

"Michael Medline is an outstanding Canadian retailer who brings a passion for the customer experience and a proven ability to drive strong operating and financial performance within national organizations and across multiple brands," said James Dickson, chair of Empire. "After an extensive international search, the Board is unanimous in its determination that Michael is the right choice to create long-term value for all our stakeholders."

Michael Medline is best known for making the Sport Chek acquisition happen back in 2011 when he was head of Canadian Tire's automotive retail business. Medline came up with the idea — I believe to this day that the $771 million acquisition of Forzani Group is one of the best acquisitions in terms of strategic fit in Canadian corporate history — and subsequently headed up Sport Chek, Mark's Work Wearhouse, and the rest of the Forzani brands included in the deal.

In fact, people I know inside Canadian Tire suggest he was ousted as CEO because he spent a little too much time on Sport Chek and not enough time on Canadian Tire's legacy business.

But that's water under the bridge.

The big concern for Empire investors should be whether or not Medline is up to the task. Identifying and making a brilliant strategic acquisition is completely different from fixing an operational disaster in all parts of the country, not just in its Canada West business which was acquired in the Safeway deal.

"Mr. Medline brings an inclusive leadership style and solid experience working within a family-controlled organization," **Bank of Nova Scotia** analyst Patricia Barker wrote in a note to investors. "While Mr. Medline has extensive experience and a deep understanding of Canadian retail, he will be new to the unique dynamics of the Canadian grocery industry."

Clearly, he has an understanding of how a family-controlled enterprise works; he's swapped the Billes family for the Sobey family as his ultimate employer. These types of businesses require kit gloves as egos often clash between generations.

Unfortunately, as Ms. Barker suggests, Medline has no grocery experience, and that's a big deal when you're dealing with paper-thin margins. In Empire's best days, prior to the Safeway acquisition, it had operating margins of 3.3%. Canadian Tire, by comparison, has operating margins of 8.6% and growing.

There are no acquisitions for Medline, a lawyer by training, to get Sobeys out of its dilemma. Only a keen eye for operational efficiency stands a chance of righting the ship. That said, Medline can certainly go out and recruit those people, because if they existed at Sobeys prior to his hiring, one of them would have already been appointed CEO.

So, you've got to decide if Medline is capable of finding the talent necessary to do this.

I believe he is, but that doesn't mean an investment in Empire Company stock doesn't come with significant risk. It sure does, because if Medline fails to right the ship, 12-24 months will have passed, further deteriorating the Sobeys brand.

Brendan Caldwell, CEO of Caldwell Investment Management, termed the move a "Hail Mary pass" in an interview with BNN. He's not wrong.

At this point, only aggressive investors ought to consider Empire stock. It's cheap for a reason.

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Date
2025/08/19
Date Created
2017/01/16
Author

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