Empire Company Limited: Patience May Be Key

Description

Empire Company Limited (TSX:EMP.A) is the parent company of Sobeys, Safeway, IGA, Thrifty's, as well as a number of retail gas stations, it has and exposure to real estate via an equity accounted interest in **Crombie REIT**, which owns a portfolio of real estate of retail and office space across Canada. The company's stock price is down more than 50% from its peak last year, and value investors are now considering if investing in Empire is a good long-term play.

Let's take a look.

Grocery business competitive, deflationary

One of the main things long-term investors look for in stable businesses such as food/grocery retailing is profitable growth over time. Other Canadian grocery retailers have seen margins and profitability diminish in recent years due to food deflation — an industry headwind that Empire has felt perhaps more than its competitors of late.

Empire largely competes with **Loblaw Companies Ltd.** and **Metro, Inc.** for market share in the Canadian grocery retail space, and it currently trails behind these industry behemoths on most major fundamentals, including market capitalization.

The company's negative profit margin and very thin gross margin are indicative of the expensive and difficult path to growth that many large grocery retailers have in the Canadian market. Following a string of acquisitions over the past few years, Empire has amassed a significant debt load and integration costs.

As compared with other companies in this space, such as Metro, which has engaged in a number of operational efficiency and margin-creation initiatives, Empire has largely lagged behind its peers in its ability to improve margins and its overall position in the Canadian grocery retail industry.

Bottom line

Empire is in need of a meaningful turnaround before investors with sufficiently long investment horizons should consider this company.

No matter what the industry, profitability matters, and Empire simply doesn't cut my investment criteria for this reason alone. Due to the razor-thin margins in the competitive grocery industry, my belief has always been that the company with the *most profitable* market share, not the most market share, will come out ahead. Right now, that's not Empire.

While Empire's stock price has come down significantly from its peak, the recent run-up in the company's stock price of late has meant investors are saddled with questioning the level at which Empire would appear attractive for long-term investors. Should Empire be able to improve margins, long-term investors may want to take a look at Empire at a lower valuation level — a valuation level that may take time to materialize.

Stay Foolish, my friends.

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