Why I'm Avoiding Empire Company Limited Like the Plague

Description

It's going to be a really tough road ahead for all Canadian grocers, and investors keen on sticking by them should be prepared for things to get ugly in the years ahead. There are headwinds working against Canadian grocers. I find it quite unrealistic for even the best management team to offset the storm that may be coming.

There's no question that headline risk has gone way up since **Amazon.com, Inc.** (NASDAQ:AMZN) announced its entrance into the grocery space. More recently, Amazon announced that it's lowering prices at **Whole Foods Market, Inc.** (NASDAQ:WFM) locations, which sent shockwaves through the grocery industry.

Although there aren't that many Whole Foods locations in Canada, the stocks of Canadian grocers took a hit on the chin following the news.

Why?

It's probably just a matter of time before Amazon makes its move to capture the Canadian grocery market. Amazon is going to war with U.S. grocers, and I find it more likely than not that it'll win this war. Once that's over, Amazon may set its sights on Canada, and that could mean major turmoil for Canadian grocers, especially **Empire Company Limited** (TSX:EMP.A), which has been struggling recently with its own organizational structure.

Systematic risk is real, and as U.S. grocers falter at the hands of Amazon over the next few years, you can be sure Canadian grocers will feel their pain by taking a few steps back themselves.

Empire's recent rally may be overdone

Shares of EMP.A shed half their value due to inefficient organizational concerns, but since Michael Medline took the helm, shares have soared ~38% in 2017. While Mr. Medline's changes may be starting to take form, it's important to note that meaningful long-term changes will probably take at least a year or more. Empire isn't out of the woods yet, and I think the recent rally may be overdone, especially considering that the Canadian grocery space is likely to face major headwinds in the years ahead.

While Empire improves its operational mess, it'll hit many other roadblocks, so Mr. Medline has an extremely tough task ahead of him. Empire's same-store sales have been horrible over the past few years, and they're likely to continue to decline as competition heats up going forward. The company's operating margin has also been abysmal of late at 1.4% over the past year, significantly lower than some of its better-run peers, which have seen their operating margins improve to the ~5% range over the past couple years.

Bottom line

It appears that investors have become too optimistic about Empire's turnaround plan. Although shares are still down ~32% from all-time highs, there are many reasons to believe more downside could be in the cards in the years ahead, even if Mr. Medline meaningfully improves operations ahead of schedule.

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