The Pros and Cons of Owning Empire Company Limited (TSX:EMP.A) Stock

Description

It's been a little over a week since **Empire Company Limited** (TSX:EMP.A) delivered stronger than expected earnings. That's gotten some analysts covering its stock excited about Sobeys's future.

Should you buy EMP.A stock at this point in Empire Company's turnaround? Here are the pros and cons.

The pros of owning EMP.A

Dubbed "Project Sunrise" by CEO Michael Medline and the rest of the Empire management team, the three-year turnaround plan implemented in May 2017, appears to be gaining traction if its fourth-quarter earnings results are any indication.

Analysts were expecting $0.29 per share; Empire delivered $0.35, almost double its result in the same quarter a year earlier. On the top line, revenues increased by 1.5% year over year to $5.9 billion along with flat same-store sales.

In an operating environment in which the company is trying to find $500 million in annual savings by 2020, while also realigning its management structure to reflect a national rather than regional operation, the results in the fourth quarter should be viewed in a positive manner.

Raymond James analyst Kenric Tyghe believes most of the savings in fiscal 2019 will be achieved in the third and fourth quarters, which means investors will have to take a leap of faith that Medline will come through in the second half of the year.

If the competitive marketplace at the moment wasn't so darn difficult, I'd be a lot more confident about Empire's continued success. That said, Fool contributor Kris Knutson reminded investors in June just before earnings that the company's Q3 2018 free cash flow increased by 3.8% over a year earlier.

For the entire year, Empire grew free cash flow by 27% to $857.1 million — the highest in its history. That's very good news.

The cons of owning EMP.A

I believe it all comes down to increasing competition from both its traditional larger opponents — **Metro, Inc.**, **Loblaw Companies Ltd.**, and **Walmart Inc.** — to smaller grocers such as Farm Boy and Longo's in Ontario, and even **Costco Corporation**, who are making concerted efforts to capture an online audience.

My Fool.ca colleague Joey Frenette recently went as far as suggesting Sobeys's lack of uncertainty about who its core customer is makes Empire stock a potential short-sale candidate.

While I'm not nearly as skeptical about Empire Company's stock — I wouldn't short EMP.A — I do think the low-lying fruit has already been picked; it will need to seriously up its game if it wants to gain market share over the final 22 months of Project Sunrise.

While it's generating higher free cash flow, it would be far more impressive if it were doing so while taking market share.

The verdict

At present, Empire Company's free cash flow yield (FCF of $857.1 / enterprise value of $7.65 billion) is 11.2%, well into value territory.

It had a big run in 2017, so it was bound to slow down. With the competitive environment, I'm skeptical that it can gain market share. That said, you simply can't ignore the nearly $1 billion in free cash flow it's generating.

For this reason, I'd suggest buying a half position and then waiting for a correction to buy some more.

CATEGORY

1. Investing

POST TAG

1. Editor's Choice

TICKERS GLOBAL

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

PARTNER-FEEDS

1. Msn
2. Newscred
3. Sharewise
4. Yahoo CA

Category

1. Investing

Tags

1. Editor's Choice

Date
2025/07/27
Date Created
2018/07/05
Author
washworth