Safeway's Merger Loss Eclipses Labor Woes

Michael Hiltzik for the LA TIMES October 23, 2003

No one could accuse Steven A. Burd, the chairman and chief executive of **Safeway** Inc., of shrinking from his role of chief spear carrier for the supermarket companies in their battle with unionized workers in Southern California.

Burd has been a most articulate spokesman for the notion that rising labor costs represent a mortal threat to the industry's profitability. He has backed up that position with hardball negotiations at Vons and other Safeway chains in the U.S. and Canada, sometimes even following through on a threat to shut stores if their unions don't fall into line.

During a recent conference call with a claque of Wall Street analysts, he characterized the employers' attempt to hold down labor costs as "an investment in our future" and predicted that lost sales during the present work stoppage would prove to be "infinitesimal, compared to the cost of not doing this." Capitulating on this contract, he said, could cost Safeway as much as $130 million over its three-year term.

Burd's math inspired me to do some arithmetic of my own. Assuming his figure is right (and I have no reason to doubt it), I calculated that by these terms it would take the company's local unionized workforce the better part of three decades to do as much damage to Safeway's bottom line as Burd did with a single merger deal in 1998.

I am speaking of Safeway's notorious acquisition of the 113-store Dominick's supermarket chain in Chicago. Dominick's was a modestly upscale grocery when Safeway bought it from **Yucaipa** Cos., a Los Angeles company run by grocery magnate Ron Burkle, for $1.8 billion in cash and assumed debt.

For Yucaipa, which had purchased the chain three years earlier for $693 million, this deal was a windfall. Under its management, sales had grown steadily, although they were flattening out a bit in 1997-98, just before Safeway took over. From that point on, as Safeway later disclosed, business at Dominick's headed straight down.

By the time it placed the chain up for sale last November, Safeway was valuing Dominick's on its own books at about $315 million. That suggests the company squandered more than $1 billion of its shareholders' money on this deal. Compared with that sum, the $130 million that Burd is trying to shave from the local union contract may not exactly be "infinitesimal." But it is, well, *way* smaller.

I don't wish to suggest by this that the supermarkets give the union everything it wants to settle the current conflict. As I have written before, both sides will probably have to give in on some cherished principles to reach a fair result.

Nor is Safeway the only employer involved. **Albertsons** Inc. and **Kroger** Co.'s Ralphs chain are also participating, and both have taken a hard line against their unions here and elsewhere. All three complain that their markets have been invaded by warehouse stores, nonunion groceries and the penny pincher **Wal-Mart**, and there's no point in denying that these competitors represent a genuine threat.

But there's always more than one way to address a business challenge, and some managements handle them better than others.

That brings us back to Dominick's. Some analysts believe that Burd's first mistake was overpaying. Safeway maintains that it paid a fair market multiple. But by the reckoning of Andrew Wolf, an industry analyst at BB&T Capital Markets in Richmond, Va., who has been a Safeway skeptic, the price came to more than $16 million per store — compared with the $11.3 million per store Safeway paid for Vons in 1997.

That price, Wolf surmises, may have pushed Burd to recover costs quickly by cutting staff and replacing familiar local brands with Safeway house brands. "They took labor out of the stores and put their private-label products in because they get a few more cents' margin from those," Wolf says. "Do that too fast, and it's not going to work."

While shoppers abandoned Dominick's, Safeway's financial reports, which don't normally break out individual chain results, spoke of sunny companywide sales gains, same-store improvements, rising overall profit. But in May 2002, an accounting change forced Safeway to disclose that it had reduced its estimate of Dominick's book value by $589 million since the acquisition.

Six months later, Safeway dropped the other shoe, disclosing that same-store sales and operating profit at Dominick's had been falling steadily for almost as long as Safeway had been in charge. Burd said he would sell the chain unless its workers accepted a pay cut to match the scale at the chain's biggest local competitor.

Safeway wrote down the chain by an additional $788 million, reducing its value to $315 million, and solicited purchase offers. One of these came from Ron Burkle, whose Yucaipa Cos. offered about $350 million to take the limping business off Burd's hands.

(Safeway rejected Yucaipa's bid as inadequate, leading to a lawsuit in which Yucaipa contends that Safeway never intended to take its bid seriously because it would be too embarrassed to return the chain to the original owner at a huge loss.)

Throughout most of this period, by the way, the same Wall Street analysts who now clamor for a lid on Safeway's labor costs gave Burd the benefit of the doubt. With the exception of a few analysts like Wolf, who downgraded Safeway in 2001, most have continued to rate it a buy. This may be a holdover from 1999-2000, when the company's stock doubled to a peak of $62.50. But from there they have ridden the stock down to the current price of about $22.

It's curious how few of these analysts treat the Dominick's debacle as a blot on Burd's management, especially because at least two other Safeway acquisitions — Texas-based Randall's Food Markets and Genuardi's Family Markets in the Philadelphia area — have similarly failed to thrive under its ownership. To be fair, Safeway notes that two other major acquisitions have been quite successful (Vons and Carrs, an Alaska chain) and says the strategic missteps at Randall's and Genuardi's are being worked out.

Still, while Safeway pleads that the poor economy and changes in the supermarket business are the culprits for the profit crunch, Burd is starting to look like the guy who's been through a few ugly divorces: The point comes when you have to wonder whether maybe *he's* the problem. At a recent round table sponsored by a trade journal, the moderator asked whether it was time for Burd to "step aside." (The consensus was that he still deserves a chance to turn things around in an upbeat economic environment.)

One possible trouble spot is Burd's scorched-earth approach to labor relations, which often boils down to his threatening store closures if he doesn't win. On occasion, this negotiating ploy has worked, although its obvious limitation is that Safeway might eventually run out of stores to close.

But there are signs that it is hampering Safeway's attempt to unload Dominick's. A pending deal with an unidentified buyer reputed to be a Minneapolis grocery chain depends on the union's cooperation, but talks have broken down. Rumors are circulating that Safeway may be planning to keep Dominick's after all, although that would mean dealing again with a highly suspicious union.

If that happens, what would Safeway have gained by treating labor so truculently? Dominick's enjoyed labor peace for years before its acquisition by Safeway; just before the merger, it even stated publicly that it had "never experienced a work stoppage and considers its relations with its employees to be good."

After five years of Safeway management, that idyllic world was a distant memory. Is this really the only way to get costs under control?