Private Equity's Biggest Retail Gamble: Albertsons-Safeway

November 6, 2019

A report by Private Equity Stakeholder Project &
United Food & Commercial Workers Local 400

Executive Summary

- Albertsons-Safeway is owned by private equity firm Cerberus Capital Management. With 275,000 employees, it is the largest private equity-owned company in the United States.
- Through a series of highly leveraged transactions, Cerberus has nearly quadrupled the size of Albertsons-Safeway while bringing its debt load to over $8.6 billion.
- Cerberus and other owners have extracted hundreds of millions of dollars in fees and dividends.
- Albertsons-Safeway is now refusing to honor a commitment to preserve pension benefits for Albertsons-Safeway employees in the Washington, DC and Baltimore metro areas.
- Cerberus' actions at Albertsons-Safeway come as the private equity industry has come under growing scrutiny from lawmakers, the media, and the public regarding private equity's impact on jobs.

Private equity's destabilizing effect on the retail industry is well documented; over the last 10 years, almost 600,000 people working at private equity-owned retail companies have lost their jobs. Ten out of the 14 largest retail chain bankruptcies since 2012 were at private equity-owned retailers. These layoffs occurred while the total retail industry added over 1 million jobs. As hundreds of thousands of people have lost their jobs, pensions, and health care, the firms that drove these companies into bankruptcy have largely come away unscathed; in fact, some have managed to turn a profit.[1]

Now Albertsons-Safeway, the largest private equity-owned company and second largest grocery chain in the United States is the latest to threaten its employees' wages, pensions, and benefits.

Cerberus' Acquisition of Albertsons-Safeway

Albertsons-Safeway, owned by Cerberus Capital Management, is the largest private equity-owned company and the second largest grocery chain in the United States.[2] As of September 2019, it operated 2,262 retail food and drug stores with 1,733 pharmacies, 401 fuel centers, 23 distribution centers, and 20 manufacturing facilities.[3] It employs approximately 275,000 people in 34 states and the District of Columbia.[4]

Cerberus first bought a piece of Albertsons in 2006 when it led an investor group in buying 655 Albertsons stores during the company's sale to Supervalu.[5] Since then, Albertsons has almost quadrupled in size through a series of highly leveraged acquisitions that have left the company laden with debt.[6]

In 2013, Cerberus took over the rest of Albertsons in a leveraged buyout, purchasing 877 stores from Supervalu for $100 million cash and $3.2 billion in debt.[7]

In January 2015, Cerberus completed the mega-buyout of Safeway for $9.2 billion.[8] It borrowed $7.6 billion to finance the transaction, amounting to 82.5% debt.[9] This pushed Albertsons's debt level to over $12 billion.[10]

Cerberus has attempted to sell the now-combined Albertsons-Safeway multiple times but has been unable to exit its now 13-year investment, in part due to high level of debt it has imposed on the company.

In mid-2015, shortly after the Safeway merger, it attempted to take the company public and abandoned the plan at the last minute due to headwinds in the retail market.[11]

In August 2018, Cerberus called off a planned merger with Rite Aid after failing to generate support from Rite Aid's shareholders.[12] Advisory firms Institutional Shareholder Services (ISS) and Glass Lewis recommended against the merger. ISS wrote "The merger combines two low-margin, overleveraged companies, both of which are facing heightened competitive environments" and Glass Lewis noted that "the board completed a deeply flawed process and employed mediocre procedural safeguards."[13]

"We're the reason our customers come back to Safeway to shop. We're making Cerberus their profits. The workers who stick around and help this company become a multi-billion dollar company need to be taken care of when we retire. The CEO gets a pension and so should we."

Michelle Lee
Safeway employee

Sale-Leaseback Transactions

Over the course of Cerberus' ownership of Albertsons-Safeway, the company has initiated several large-scale sale-leaseback transactions, in which it sold the real estate under its stores to a third party and then leased it back.

In December 2017, Albertsons-Safeway sold the real estate for 71 of its stores for $720 million to CF Albert LLC, an affiliate of private equity firm Fortress Investment Group.[14]

During 2018, the company sold and leased back seven distribution centers for an aggregate price of $950 million.[15]

In the second quarter of 2019 Albertsons-Safeway completed the sale-leaseback of 53 stores and one distribution center for $931 million.[16]

Financial Performance

Throughout Cerberus's ownership, Albertsons-Safeway's financial performance has struggled. Operating income fell substantially for the three years after the aborted IPO in 2015 and bond investors assigned higher levels of risk to the company's bonds.[17]

Due to higher interest rates, higher rent expenses, and lower profits relative to its peers Albertsons' interest coverage ratio of 1.6 is significantly lower than that of Kroger (4.2 times) and less than one-fifth the median food retail company (8.4 times).[18]

However, financial performance appears to be improving. In June 2019, S&P Global Ratings raised its issuer credit rating for Albertsons-Safeway, citing some debt reduction over the last year as well as improved expectations for operating income going into next year.[19]

By the end of 2nd quarter of 2019, the company's long-term debt was $8.63 billion, compared with $10.44 billion at the same time in 2018.[20] The debt reduction is funded in part by Albertsons-Safeway's most recent sale-leaseback of 53 stores and a distribution center, which sold for an aggregate $931.3 million. While the sale-leaseback arrangement freed up cash for the company to pay down some of the debt, the aggregate annual rent payment for the properties will be approximately $53 million and includes 1.50% to 1.75% annual rent increases. The trade-off replaces interest payments with rent payments and reduces real estate assets.[21]

In its 2Q2019 earnings statement, Albertsons-Safeway reported a net income of $294.8 million compared to a net loss of $32.4 million in 2018, and adjusted EBITDA increased 3.5% compared to 2018.[22]

"It's an absolute travesty what's happening with these private equity guys…Institutions that take these stores that are cornerstones of their communities and strip them and take them apart so they can make $1.7 billion instead of $1.3 billion – how on Earth is this legal?"

Matthew Milzman
Safeway employee

Cerberus, Other Owners Collect Fees and Dividends

Despite poor financial performance, Albertsons-Safeway has paid Cerberus and other owners almost $350 million in fees and dividends between 2013 and the end of 2018.

In June 2017 Albertsons-Safeway paid out a $250 million dividend to Cerberus and other owners. It financed the dividend in part from the proceeds of the sale-leaseback arrangement for some of its stores.[23]

During this same period, Cerberus was charging "advisory" and "transactions" fees to Albertsons-Safeway, which cost the company at least $95 million for the period of 2013 to 2018.

In March 2013, Albertsons paid Cerberus a transaction fee of $15 million in connection with the acquisition of New Albertsons Inc. (NAI), the entity that owned the 877 stores Albertsons bought from Supervalu. Albertsons essentially paid Cerberus a fee for its own acquisition.[24]

Beginning in 2013, Cerberus and Albertsons entered into an agreement in which Albertsons paid a Cerberus-led consortium annual management fees of $6 million for a period of 42 months for "strategic advice to management, including with respect to acquisitions and financings."[25] After the Safeway acquisition in 2015, Albertsons-Safeway and Cerberus entered into a new fee arrangement for $13.75 million annually. Because the prior agreement had not yet expired, the Cerberus-led consortium paid itself an additional $9 million for the fees it would have collected for the remaining term of that agreement – i.e. it collected $9 million for advisory services it never provided.[26]

Cerberus also collected over $4.1 million in fees from Albertsons for consulting services between 2014-2018.

Fee Type	Year	Amount	Fee Breakdown
NAI Transaction Fee	2013	$15,000,000	Transaction fee for Cerberus' buyout of Albertsons
Annual management fees ("3rd A&R AB LLC Agreement")	2013-2015	$21,000,000	$6 mil (2013), $6 mil (2014), $9 mil (close out remainder of agreement)
Annual management fees ("4th A&R AB LLC Agreement")	2015-2018	$55,000,000	$13.75 mil x 4 (2015-2018, will continue to 2019)
Consulting services	2014-2018	$4,123,682	$479,618 (2018), $490,693 (2017) and $515,229 (2016), $970,450 (2015), $1,667,692 (2014)

Total fees since 2013: $95,123,682

“I’m 57. I can’t afford to retire now, because I have a son in college and I’m a single mom… Had I known that our pension would be taken away, I never would have invested 36 years of my life in this company. We work to get a pension. Are you telling me all these years were in vain?”

Indiara Smith
Safeway employee

Workers are Paying the Price for Cerberus’ Gamble

While Cerberus paid itself, Albertsons-Safeway is now refusing to keep its promise to protect workers’ benefits.

In the process of renegotiating its union contract with employees in the Washington, DC and Baltimore metro areas, Albertsons-Safeway is refusing to honor a commitment it made to continue to ensure employees receive promised pension benefits. Albertsons-Safeway workers who have been counting on that promise will lose much of their pension benefit if the company has its way. Safeway’s main competitor in DC, Giant Food, has committed to paying employees’ pension benefits.

Albertsons-Safeway is not Cerberus’ first retail investment. In October 2012, Cerberus and another buyout firm agreed to pay $166 million to settle a suit that accused them of stripping assets from now-shuttered retail chain Mervyn’s, where more than 18,000 workers lost their jobs.[27]

Conclusion

The American Investment Council (AIC), private equity's lobby group, recently released a report that touted that 8.8 million people are employed by the private equity industry. That number does not reflect jobs created; it merely reveals how huge the industry has become and the scope of its impact on American workers.[28]

Another recent study by academics at Harvard Business School and the University of Chicago found that private equity takeovers result in significant job losses.[29]

The American Investment Council report and academic study come at a time when the private equity faces increased scrutiny. In July, Senators Elizabeth Warren, Bernie Sanders, and others introduced a bill called the "Stop Wall Street Looting Act" aimed at reigning in some of the most predatory behaviors by private equity firms, including holding them accountable to the pension obligations of companies they buy.[30] In September, leaders of the House Energy and Commerce Committee launched a bipartisan investigation into private equity firms' role in fueling a rise in surprise medical billing.[31] Later this month, the House Financial Services Committee will conduct a hearing into the practices of private equity firms entitled "America for Sale: An Examination of the Practices of Private Funds."[32]

Cerberus' gamble with Albertsons-Safeway has so far taken a page out of the private equity playbook, stripping assets from the retailer while failing to keep promises to employees.

Albertsons-Safeway workers should not pay for Cerberus' actions, especially as the private equity firm continues to pay itself. Safeway workers in the Washington, DC and Baltimore metro areas are standing up to demand that Cerberus and Albertsons-Safeway keeps their promise to workers and the Washington, DC and Baltimore communities.

Endnotes

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