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The future for Farm Fresh? Still hazy

By Carolyn Shapiro

After the longtime president of Farm Fresh retired early this month, all eyes turned to parent company Supervalu Inc. to see what changes it might make to the supermarket chain.

Within a week, Supervalu appointed Gaelo de la Fuente to replace Ron Dennis at the helm of Farm Fresh. He has not made himself available to talk about Farm Fresh, and the corporate owner in Eden Prairie, Minn., also has little to say.

"We have no plans to make any immediate changes to that banner as a whole or to any individual stores," said Haley Meyer, a Supervalu spokeswoman.

Since Dennis retired March 5, rumors have swirled about the fate of Farm Fresh. Some have suggested that Supervalu, one of the nation's largest grocery wholesalers, would close weaker stores or sell off the whole chain. Others wonder whether the parent company will replace some Farm Fresh locations with its no-frills, price-driven Save-A-Lot stores.

Even without Dennis' departure, such talk might have surfaced in response to upheaval at Supervalu in the past year. Last spring, the company replaced its CEO and restructured its senior management. It has since sold off supermarkets in Utah and Connecticut. Recently, Wall Street buzzed with speculation that Supervalu could be acquired in a leveraged buyout.

Meanwhile, the company battled faltering sales. For its third quarter that ended Dec. 5, Supervalu announced sales had fallen 9.4 percent from the previous year, to $9.2 billion, and sales from its retail operations dropped at about the same rate, to $7.1 billion.

Sales in comparable stores - those open at least 12 months - slipped 6.5 percent in the quarter. Comparable stores provide the best measure of year-over-year performance.

Supervalu blamed "a challenging economic environment, heightened competitive activity and deflationary pressures."

Farm Fresh has fared better than most of Supervalu's other retail "banners," or regional chains, said Jeff Metzger, publisher of Food World, an industry publication based in Columbia, Md. It has managed that success by keeping a high degree of autonomy and the devotion of both employees and shoppers, he said.

"He's going to have to maintain more independence and be less corporately swayed," Metzger said of de la Fuente. "The challenge for Gaelo is he's got to keep that drive up. He's got to keep that culture empowered."

Supervalu bought Farm Fresh in 1999 when it took over the operations of Richfood Holdings Inc., a Richmond grocery distributor.

For much of its history, Supervalu gleaned most of its revenues from wholesale food distribution, supplying merchandise to mostly independent regional grocery chains such as Ukrop's Super Markets Inc. in Richmond. The rest of its revenues came from the few retail operations it owned.

In the past decade, though, Supervalu has lost wholesale business as its clients shut down or were swallowed by larger operators with their own distribution networks. Ukrop's, for example, was acquired last month by giant Dutch grocer Ahold NV.

In 2006, Supervalu paid $9.7 billion for Albertsons, which had more than 1,100 stores and multiple banners across the country. The deal made it the nation's second largest grocer behind Kroger, with nearly 2,400 stores in 40 states.

The company's emphasis shifted to retailing, with at least 75 percent of its revenues coming from its supermarket divisions.

Supervalu didn't make the smoothest transition from wholesale to retail, analysts and industry observers said.

In many markets, the Albertsons chains needed revamping and had lost customers to more price-oriented competitors. They had failed to justify their higher prices with a better product mix or customer service, Metzger said.

The acquisition also left Supervalu with a huge amount of debt.

It is likely to continue to struggle with price competition and diminishing sales in the coming year, wrote Ajay Jain, an analyst for Hapoalim Securities in New York, in an e-mail.

Supervalu's stock closed Friday at $16.22 a share. It has traded between $12.35 and $17.67 for the past year, well below its high of $49.67 in July 2007.

"Supervalu's financial performance has deteriorated based in part on high debt exposure and declining market share," Jain wrote. "The sales performance has continued to deteriorate across a wide range of geographies."

Craig Herkert aimed to fix these problems when he took over as Supervalu's CEO last May. He came from discount retail giant Wal-Mart Stores Inc. as its president and CEO of the Americas since 2004.

In October, during a discussion of second-quarter earnings with analysts, Herkert laid out his plans for the retail operations.

He said he would centralize buying. Previously, each chain negotiated with vendors independently. Now, the company would leverage its size and buying power to get better deals.

He pledged to streamline merchandise, culling unnecessary product sizes and redundant brands.

"Those attributes that have made our specialty retail banners successful will be zealously guarded," Herkert said at that time. "However, my vision is to instill a common operating approach and philosophy across the country, as it relates to the majority of in-store decisions surrounding category assortments, promotional displays and labor management."

The centralized buying and merchandise-cutting probably have taken place by now at Farm Fresh, said Angie Lessuise, an analyst for Telsey Advisory Group. The company mostly eliminated products from nonfood areas, such as toilet paper and toothpaste, reducing the option of three or four package sizes down to two.

"For the most part, customers don't really notice," Lessuise said.

With most supermarket companies, about 80 percent of the product decisions are now made at the corporate level, with about 20 percent made locally, she said. "But that doesn't necessarily mean that they're pushing all the same things down to the stores."

Herkert has addressed pricing as well, suggesting the need to reduce "everyday" prices and improve the stores' promotion strategies.

Supervalu also has trimmed some retail operations. In July, it sold 36 Albertsons stores in Utah. Last month, it sold 16 Shaw's supermarkets in Connecticut and closed two others.

In January, during Supervalu's discussion of third-quarter results with analysts, Herkert alluded to the possibility of more store sell-offs.

"We will diligently review our existing portfolio and will take action to monetize assets where it makes sense," he said.

Food World publisher Metzger said Farm Fresh's financial strength would garner a good selling price, "but 45 stores is not going to solve their cash needs."

Herkert also said he wants to expand Save-A-Lot, the company's discount grocery chain, which has about 1,180 stores, many operating as franchises. Supervalu has added Save-A-Lots in and around Atlanta, Chicago, Detroit and Dallas.

Herkert said he will focus the concept in markets with large numbers of "customers motivated by price " and those with household incomes that are less than $45,000 a year.

That description would fit Hampton Roads, which has no Save-A-Lot stores.

"We're certainly looking at every market," said Meyer, Supervalu's spokeswoman. "We're currently looking at the landscape and what consumers want and need."