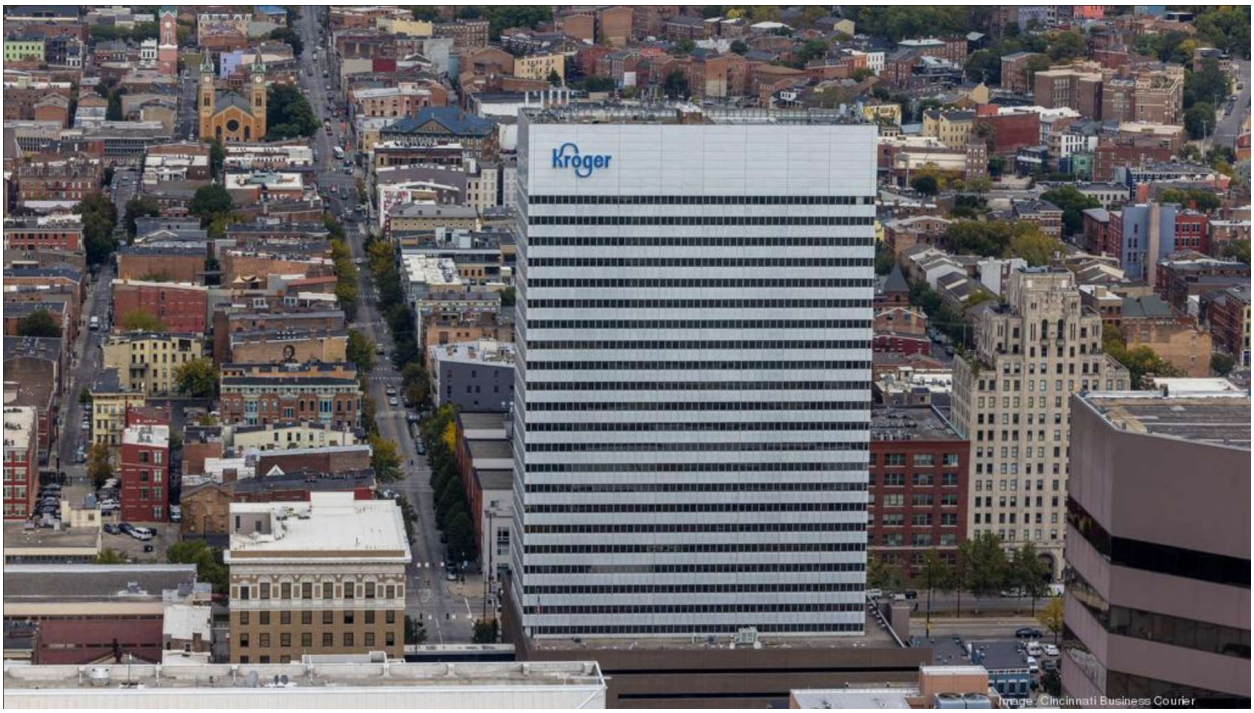
CINCINNATI BUSINESS COURIER

Plum choice

If a proposed acquisition of Albertsons goes through, Kroger 2.0 would control 16% of market share and serve 85 million households. But the feds may not buy in. Here's what it means for shoppers as well as the city.



On Oct. 14, Kroger announced plans to purchase rival grocer Albertsons, potentially upping its revenue to $200 billion and employing over 700,000. But some insiders aren't convinced the deal will pass muster with regulators. Corrie Schaffeld | CBC

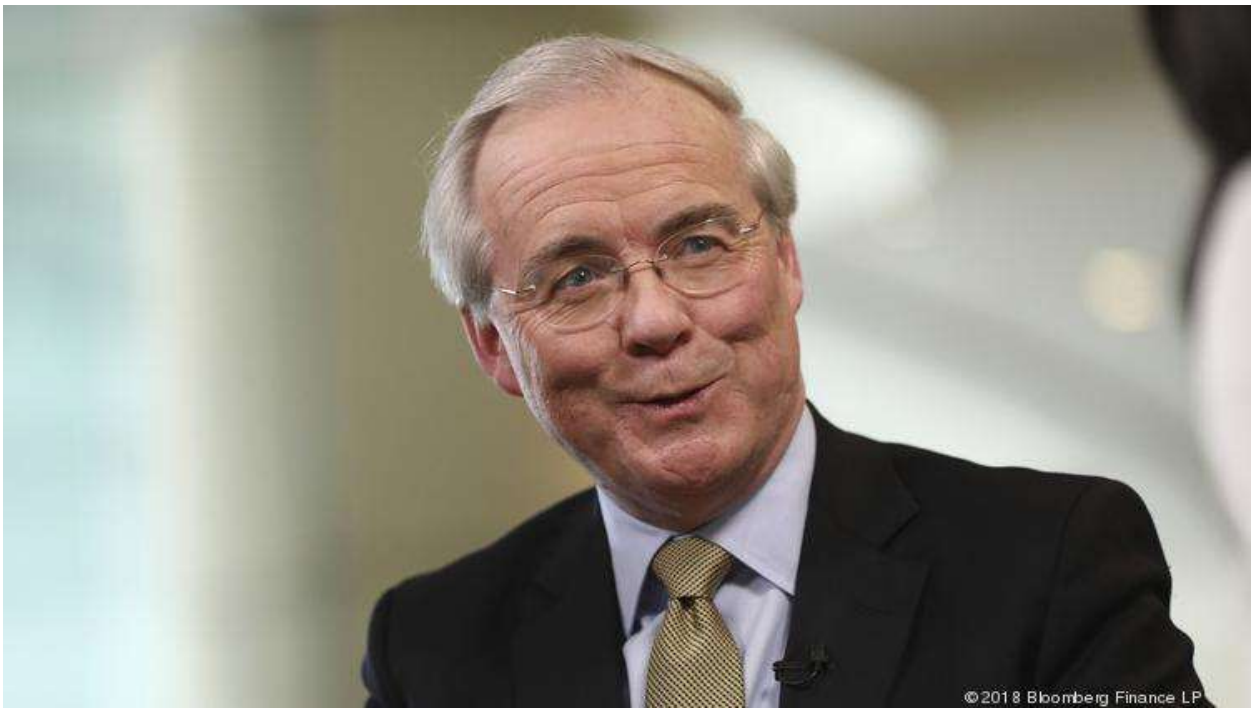
By Steve Watkins – Staff reporter, Cincinnati Business Courier - Oct 21, 2022

Kroger's ever-subdued Rodney McMullen calls the Cincinnati grocer's $25 billion plan to buy rival Albertsons a "major milestone," but that still might be one of the biggest understatements the CEO has made in his nine years at the helm.

It's so much more. Having spent the past four years scaling its digital prowess and home delivery system to better compete with Amazon, Walmart and others, Kroger is back on familiar ground. If the agreement to merge with Boise, Idaho-based Albertsons goes through, Kroger will become the first true national grocer.

The acquisition, announced Oct. 14, is expected to close in early 2024. It combines the country's two largest operators of traditional supermarkets and would make Kroger a behemoth that would likely top $200 billion in annual revenue, placing it among the nation's largest companies. It would serve 85 million households and employ more than 700,000 people.

The Albertsons deal would be the largest acquisition by a Cincinnati company since Procter & Gamble bought Gillette in 2005 for $57 billion. But it also comes with a lot of questions. Federal regulators will have their say about potential antitrust issues. Shoppers will see differences, both in stores and online. And Kroger's Cincinnati headquarters and local operations could see changes as well. Here are answers to four key questions surrounding Kroger's acquisition.



Rodney McMullen, chairman and chief executive officer of Kroger Co., will run the combined company, if the deal is approved. Getty Images

Why does Kroger want Albertsons?

First, it gives Kroger national coverage. It was already the No. 1 traditional grocer, with 2,726 stores across 38 states. (Walmart is still bigger by far). But its coverage map had gaps, particularly in the Northeast, parts of the Northwest and northern California. Albertsons has those areas covered; it operates in 34 states under names like Safeway, Jewel-Osco, and, of course, Albertsons.

The combined company would have about 5,000 stores, before any required divestitures, and a presence in every state but Minnesota and Oklahoma.

McMullen, who will remain CEO of the combined company, was clear about Kroger's motivation when he spoke to analysts and investors on a conference call Oct. 14, the day the deal was announced. The acquisition, McMullen said, would put Kroger, "darn close to everybody in the United States." Its new size would also give the chain buying power approaching Walmart's.

Kroger expects earnings to improve. It predicts the deal will add profits in the first year, ultimately boosting earnings by more than 10% by year No. 4.

"A national footprint may be exactly what they need to compete with Walmart in the future," said Thom Guidi, investment manager at Kenwood-based investment advisory firm Foster & Motley. "They're not thinking just a couple years ahead. They're thinking far ahead about how you compete with the behemoths.

Since Amazon bought Whole Foods in 2017, Kroger has invested billions to expand its digital capabilities. The chain has also opened huge automated warehouse and distribution centers around the country and improved its technology and personalization of digital offers.

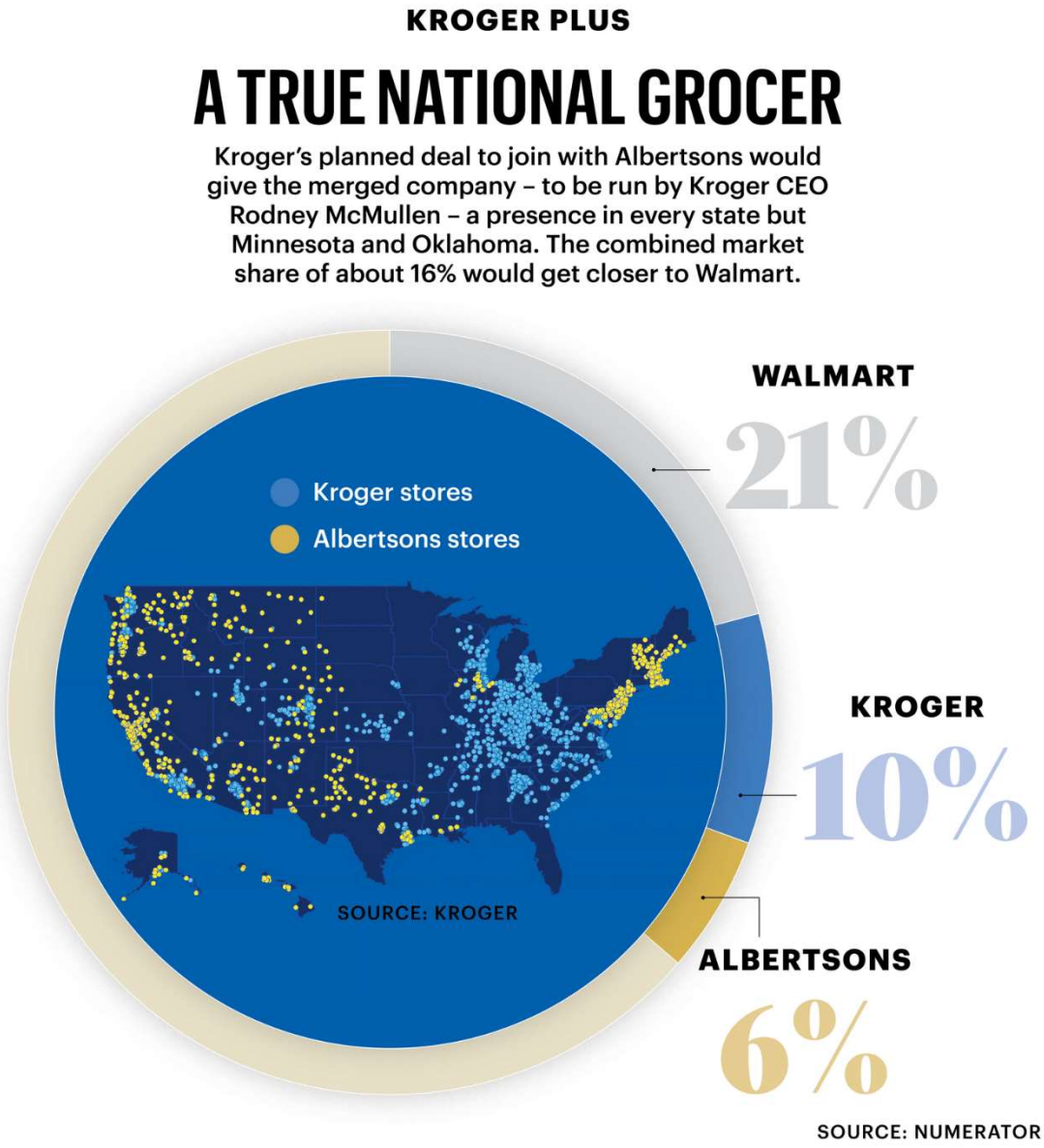
But the potential merger with Albertsons doesn't represent a total reversal of that digital strategy, said James Lewis, equity research analyst at downtown-based Bartlett Wealth Management.

"This would be a complement to what Kroger is doing digitally," he said, adding that its technology strategy would be "more profitable, more quickly."

Kroger could greatly increase membership in its Boost program, similar to Amazon's Prime membership, that enables customers to get unlimited delivery for an annual subscription fee. Walmart has launched a comparable program, and Kroger introduced its version in July.

"That's one of the highlights," Lewis said. "This is an answer to Amazon Prime as well as Walmart+."

It's also an opportunity to greatly expand Kroger's store brands, which it calls Our Brands. Kroger has emphasized that high-margin business for years and generates $28 billion in annual sales in that sector. Albertsons' in-house brands are also robust. The combination would put stores brands at $43 billion in sales a year, making Kroger 2.0 one of the largest consumer product companies.



"I think they're better at that than just about anybody," Guidi said.

Kroger has been a leader in gathering and utilizing data on its customers to personalize offers and market digital information to others.

"I'm pretty sure Kroger knows more about me than my wife," Guidi said. "They know what we buy and how often we buy it."

Produce and other fresh products have been another key Kroger emphasis. It has $34 billion in annual sales in that area. With Albertsons, that would jump to $59 billion.

McMullen said the deal would allow Kroger to deliver fresher products at a better value. He added that the two companies complement one another.

“Each of us has categories that we do meaningfully better than the other,” he said.

McMullen pointed to several Kroger brands, including its Murray’s Cheese shop sections, as well as the Albertsons for U rewards program and how it fits with Kroger’s fuel rewards program.

The deal adds to Kroger’s fast-growing array of Ocado automated customer fulfillment centers. Kroger plans 17 within the next couple of years – it has six now – plus a dozen “spoke” locations near the initial sites. Those fit well with Albertsons’ seven micro-fulfillment centers.

Not to be ignored, Kroger expects to save about $1 billion a year in costs, CFO Gary Millerchip said. And it sees total shareholder return exceeding its longtime goal of 8% to 11% a year during the first four years once the deal is complete.

Will regulators approve the acquisition?

It’s not a foregone conclusion. The deal combines the nation’s two largest operators of traditional supermarkets; Kroger and Albertsons are second and fourth, respectively, in national grocery market share. Walmart still tops the list, while warehouse membership chain Costco comes in at No. 3.

The Federal Trade Commission will look closely at antitrust issues. It’s less concerned about the national presence — combined, the companies would still maintain only about 16% of the grocery market share, trailing Walmart’s 21%. But in certain markets, such as Seattle, Denver, Phoenix and Portland, Ore., they would (combined) hold more than 40% local market share.

Kroger will almost certainly divest some stores, having already suggested it will spin off up to 375 locations into a separate company.

Still, Kroger expects regulators to give the go-ahead. “We believe we have a clear path to achieve regulatory approval with divestitures,” Millerchip said.

But some analysts question whether the deal will survive FTC scrutiny.

Morgan Stanley analyst Simeon Gutman said the stock market put the odds at less than 50% that the deal goes through. That’s based on how Albertsons stock reacted the day of the announcement, Oct. 14, when it fell 8% to $26.21. That left it 23% below the offer price.

But Barlett’s Lewis anticipates Kroger has already completed due diligence.

“It does sound like Kroger has done their homework,” he said.

Jim Cramer, host of CNBC's "Mad Money," said on his Oct. 17 show that he first thought the deal wouldn't pass muster with regulators.

"The FTC and the antitrust division of the Justice Department are hardliners now," he said. "They think corporate consolidation is a problem, something that causes consumers to get hurt by higher prices."

But after additional reporting, his reaction changed.

"Now I think there is a good case to be made that Kroger could make this deal happen."

Either way, Ed Kelly, analyst at Wells Fargo, wonders if the amount of stores sold off might jeopardize the hoped-for benefits.

"Divestiture risk looks high, even if it clears the FTC hurdle, making the merged company difficult to model," he wrote in a recent report, referencing the statistical modeling analysts used to determine outcome. "Kroger is buying an asset that we believe needs a sustained period of investment to reach the company's standards."

But he's not all negative, either.

"We see a scenario where the deal could be good for Kroger and Albertsons if it closes with an acceptable divestiture outcome and Kroger slowly invests in the acquired assets over time," Kelly wrote. "That said, there is significant uncertainty. It's hard to see a meaningful upside at the moment."

Kelly has the equivalent of a "sell" rating on Kroger.

What does it mean for shoppers?

Lower prices. At least, that's Kroger's goal. Larger scale should increase efficiency as Kroger can spread costs across a much wider store and customer base.

"You might see lower prices," Lewis said. "They're going to have to show some benefit to the consumer."

Of course, Kroger wants regulators to see that, too. Lower prices would help alleviate the concern that the transaction would hurt consumers. Whether it truly results in cheaper goods remains to be seen.

Guidi is skeptical. "Realistically, probably not," he said of long-term lower prices. "They're saying that to sell it to regulators."

Although the array of private label goods will expand as Albertsons brands are added to shelves, the effect will likely be more powerful at Albertsons stores with the addition of Kroger house brands.

What does it mean for Cincinnati?

Kroger has yet to comment on how the deal will impact jobs. But in most cases, the acquiring company – Kroger, in this case – is more likely to keep its people while the acquired company – Albertsons – could lose out. Those jobs would mostly be at the headquarters level.

"We think Cincinnati will emerge as the center of gravity for this new company," John Boyd, principal of Boca Raton, Fla.-based site selection consulting firm the Boyd Co., told me.

Cincinnati is more centrally located to most of the country than Boise. When Kroger removes redundancies in back-office operations such as human resources and other administrative services, it's likely to keep those in Cincinnati. It could even add jobs here.

Lewis notes that in deals he's tracked, the buyer typically looks to eliminate job redundancies. Kroger might also add people at its 84.51 data analytics operation in downtown Cincinnati, he

said. It will potentially need more analysts to handle dramatically more data as it adds millions of new customers. “The end result will probably benefit Cincinnati and hurt Boise.”

The move could increase air service to and from Cincinnati too, Boyd said. Executives will travel to new locations where Albertsons has a presence but Kroger does not. “This could create momentum for more air service.”