

Safeway, Inc.'s Leveraged Buyout – Case Questions

These questions should guide your answer. You do not need to specifically answer each question in sequence. Instead they should guide the way you think about the issues you should consider when answering the question: How did the leveraged buyout add or destroy value for Safeway?

- 1) **Safeway's competitive position.** Evaluate Safeway's competitive position. Why did Safeway become a takeover target? Was it a poorly run company?
- 2) **Wage costs.** How big of an issue were rising employee wage costs at Safeway before the buyout? The case presents simple comparisons of wage rates at Safeway to industry averages. Why do these comparisons overstate the problem? Table 3 shows that labor-related expenses account for only 12% of Safeway's total costs. Were these expenses too small to matter? Using data in Table 7, calculate by what amount prices at Safeway's Alpha division could be undercut by an aggressive competitor paying competitive wages? Assume that employees work on average 1800 hours a year.
- 3) **Sources of value creation in the LBO.** The LBO took place at a \$1.8 billion premium (\$4.1 billion for the equity versus the pre-announcement market value of \$2.3 billion), which represents a 78% increase in equity value. How will the buyers in the LBO realize this value?
- 4) **Asset sales.** What was management's strategy in dealing with the unions through the asset sale process? Why did Safeway renegotiate union contracts before selling a division? Why did the local and international unions disagree over what should happen in Dallas?
- 5) **Was the LBO necessary?** Was the LBO necessary or could Safeway have resolved its problems as an independent publicly-traded company? Why or why not?

After answering these questions, read the Wall Street Journal article (included in your case packet), entitled "The Reckoning: Safeway LBO Yields Vast Profits but Exacts a Heavy Human Toll." The article is from the time period of the Safeway case, and it describes some of the human fallout from the LBO. The article won the Pulitzer Prize. Do the events described in the article affect any of the conclusions you reached above?