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## Safeway, Inc. Q4 2008 Earnings Call Transcript

### Question-and-Answer Session

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#### Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) Our first question comes from John Heinbockel. You may ask your question. Please state your company name.

#### John Heinbockel - Goldman Sachs

Yes, Goldman Sachs. Steve, a couple of things. How will deflation or moderating inflation impact gross margin, particularly, how do you think branded pricing will play through that, vendor trade spend, price rollback? And then, is there a lot of benefit to be had on margin on the self-manufactured private label product as those commodity costs come down?

#### Steve Burd

Okay. On the deflation, on what we're experiencing; we're experiencing a combination of things. We do have some national brand vendors that have rolled back prices. You've also heard other national brand vendors comment that they intend to hold the line. I say, wait and see, because we're going to chew them up on corporate brand. And we're just going to keep driving corporate brands, and that is always been a disciplined mechanism on the national brands. And so I think they either have to contend with market share declines, which they will not like, while we make higher margins on corporate brands. We're quite comfortable with that.

So there's some deflation there although I think if you look across all national brands, I would not regard that as deflationary at this point. But it's fair to say, we're not seeing inflation levels that others predicted. The two categories that we have seen the most deflation right now would be the dairy category, which is a pure commodity, and you may have read that there's a movement underfoot to bring supply and demand back into balance by slaughtering some of the dairy herd. So, that will eventually return to normalcy, but I can't predict when.

But, we're seeing more deflation in that category in the first quarter than what we saw in the fourth quarter, by a considerable amount. And then also, we've seen very significant declines in the produce category. Of course this time of year, you're getting a lot of your products from places like Chile. Now, that could reverse. You're probably familiar with the rainfall conditions on the West Coast, which are a major source of produce, and things are picking up there, but, if we continue to have a drought year, that might flip those numbers.

Still, my view, John, would be, that 2009 is not going to be the kind of inflation that we experienced in the past couple of years, which is going to help us out, I'm confident on the LIFO line. But this economy is so peculiar; I think to all of us, that we're anticipating some deflation in the near term. I'm anticipating as we build our corporate brand market share, we'll see some softening on the national brand side. So, I expect this to be a year of somewhat moderate inflation. I'll predict it here. I think it will be in the 0% to 1% range, which is more normal. But, if not, we'll have a heyday in corporate brands.

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