

Empire Company Limited

Third Quarter 2024 Conference Call

Event Date/Time: March 14, 2024 — 12:00 p.m. E.T.

Length: 54 minutes

"While Cision has used commercially reasonable efforts to produce this transcript, it does not represent or warrant that this transcript is error-free. Cision will not be responsible for any direct, indirect, incidental, special, consequential, loss of profits or other damages or liabilities which may arise out of or result from any use made of this transcript or any error contained therein."

« Bien que Cision ait fait des efforts commercialement raisonnables afin de produire cette transcription, la société ne peut affirmer ou garantir qu'elle ne contient aucune erreur. Cision ne peut être tenue responsable pour toute perte de profits ou autres dommage ou responsabilité causé par ou découlant directement, indirectement, accessoirement ou spécialement de toute erreur liée à l'utilisation de ce texte ou à toute erreur qu'il contiendrait. »

CORPORATE PARTICIPANTS

Katie Brine

Empire Company Limited — Vice President, Investor Relations, Treasury and Pensions

Michael Medline

Empire Company Limited — President and Chief Executive Officer

Matt Reindel

Empire Company Limited — Chief Financial Officer

Pierre St-Laurent

Empire Company Limited — Chief Operating officer

Doug Nathanson

Empire Company Limited — Chief Development Officer and General Counsel

CONFERENCE CALL PARTICIPANTS

George Doumet

Scotiabank — Analyst

Irene Nattel

RBC Capital Markets — Analyst

Mark Petrie

CIBC World Markets — Analyst

Michael Van Aelst

TD Cowen — Analyst

Vishal Shreedhar

National Bank Financial — Analyst

Chris Li

Desjardins Capital Markets — Analyst

Tamy Chen

BMO Capital Market — Analyst

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Empire Third Quarter 2024 Conference Call. (Operator Instructions)

This call is being recorded on Thursday, March 14, 2024.

I would now like to turn the conference over to Katie Brine, VP of Investor Relations. Please go ahead.

Katie Brine

Thank you, Joanna.

Good afternoon and thank you all for joining us for our third quarter conference call. Today, we'll provide summary comments on our results and then open the call for questions. This call is being recorded, and the audio recording will be available on the Company's website at empireco.ca. There is a short summary document outlining the points of our quarter available on our website.

Joining me on the call this afternoon are Michael Medline, President and Chief Executive Officer; Matt Reindel, Chief Financial Officer; Pierre St-Laurent, Chief Operating Officer; and Doug Nathanson, Chief Development Officer and General Counsel.

Today's discussion includes forward-looking statements. We caution that such statements are based on Management's assumptions and beliefs and are subject to uncertainties and other factors that could cause actual results to differ materially. I refer you to our news release and MD&A for more information on these assumptions and facts.

I will now turn the call over to Michael Medline.

Michael Medline

Thanks, Katie, and good afternoon, everyone. In Q3, we saw a continuation of the trends experienced in Q2, with some customers pulling back spending as a result of continued economic uncertainty and pressure on Canadian's wallets. When you peel the onion and work through some of the complexities, we delivered slightly better results than the prior quarter with positive comps and strong margin control. This is a different Empire Company. We have built the capabilities, processes, and disciplines to stay strong through tougher times, and we expect to deliver solid and sustainable results, regardless of the macro environment, as reflected in our Q3 performance.

I'm going to focus on three topics today: key market trends, including a brief update on our plans to help further stabilize food prices in Canada; our Q3 results; and an update on our strategic priorities.

First, market trends. In Q3, we saw the challenging macroeconomic environment continue, with interest rates remaining elevated, and low consumer confidence. While we were pleased to see food inflation decline by 130 basis points in January (versus the prior month) to reach its lowest level since August 2021, ultimately, this offered little relief to struggling Canadians who are trepidatious about

shelter costs amid overall cost of living challenges. Consumers are under pressure, and in this environment, providing value to customers and helping stabilize food prices is a top priority for Empire. We are seeing the number of supplier cost increase requests continue to trend down, and suppliers are generally moving back to their more normal and expected approach of cost increase submissions.

However, there are still sizable increases from select suppliers coming through that will inevitably impact the customer. This is largely driven by some commodities, like sugar and cocoa, continuing to be very volatile due to ongoing climate and geopolitical factors impacting global supply. But as I mentioned last quarter, we have strongly and successfully pushed back on unjustifiable increases and will continue to do so.

When Empire finished its holiday price freeze in February, we doubled down on our promise to bring value to Canadians by launching a new 11-week program to lock or lower prices on approximately 1,000 essential items across our banners nationally. Almost one month in, we're pleased with how it's showing up in our stores and the traction it is gaining with customers.

Turning to our results, I believe that our business performed a bit better in Q3 compared to the prior quarter. Let me explain why. Food retail is our primary focus. However, we often have a strong real estate element to our earnings, which acts as a complementary income stream. If you remove the other income and share of equity earnings, which is relatively stable on an annual basis, but fluctuates quarter-to-quarter, our performance in Q3 was slightly stronger than Q2. There was also some noise in the quarter, such as the temporary strike at our Vaughan distribution facility. Matt will make sense of all that for you in his remarks shortly.

We continue to attract more customers to our stores with higher transaction counts, but we're seeing smaller baskets, consistent with the industry. Our promotions are constantly improving and are attractive to our customers, while still protecting our margins.

Moving to financials, our sales, excluding fuel, grew by 1.3 percent this quarter, with same-store sales of 1.9 percent. We see the same-store sales gap between Full Service and Discount channels at Empire, and in the industry at large, gradually disappearing and expect this trend to continue. We've been expecting, as you know, the gap between Full Serve and Discount to shrink as inflation falls, but even we were surprised by the magnitude of the gap closing this much this quarter. Voilà also continues to grow, with sales up over 15 percent this quarter compared to last year.

SG&A also remains under control and in line with our expectations. While the SG&A rate is higher than we would like, this is a function of the current sales environment. We are actively making decisions to cut overhead in our business. Matt will go into more depth on this in a couple of minutes. Overall, we delivered an adjusted EPS of \$0.62 this quarter.

Now, on to our strategic priorities. When we announced our long-term goal to grow adjusted earnings per share by 8 percent to 11 percent, one of the key pillars to achieve this ambition was a focus on efficiency and cost control. As we announced in Q1, we have been making organizational changes to optimize our structure and reduce costs. This backstage initiative is largely complete, with the full run rates cost savings to be realized in fiscal 2025. Beyond the cost benefits of this program, I am very pleased with the structure of our teams and the critical talent changes we have made to ensure we are better positioned to execute on our strategy and deliver strong results.

This quarter, we also entered into an agreement to purchase a sizable plot of land in Montreal, which remains subject to due diligence. Securing this land was highly strategic, and for the time being, we will landbank it until we decide whether and when to proceed with site development. The opportunity for such a valuable and well-situated piece of land does not come around often. This may increase our CapEx spend from \$775 million to approximately \$885 million this year for this one-time purchase.

Now for an update on some of our key customer and sales-driving initiatives. Voilà continues to gain momentum at each of the three CFCs, with fulfillment rates of 99.5 percent, a broad assortment offering, and excellence in fresh, with customers claiming the produce is delivered as well as if they picked it themselves. It's no surprise that we see the total number of orders increasing, with strong customer retention rates. This continues to be the best grocery e-commerce solution in Canada, and customers continue to give us strong NPS scores quarter-after-quarter, in fact, the highest I've seen in my time in retail. As a reminder, our average basket size on Voilà is over three times the size of a Full-Service store basket, these are highly valuable customers.

Scene+ also continued its strong progress this quarter, and we surpassed 15 million members, a 50 percent increase since Scene+ launched at Empire. Scene+ is now in over 70 percent of Canadian households, with over 2,000 Scene+ card swipes every minute and a redemption every two seconds. The end of this month marks the first full year of Scene+ being launched at Empire banners across Canada, and while we've seen so much growth, this is, of course, just the beginning. We are now rapidly turning our efforts towards personalization to develop a more robust and customized loyalty program.

A topic we haven't spoken about much publicly is our new central kitchen, often referred to as a commissary. First, we'll be opening in Calgary in the first half of F25. In partnership with Crombie REIT, we have built a state-of-the-art facility that will service Alberta and surrounding provinces, bringing an elevated curation of ready to cook, ready to heat, ready to eat meals into our stores. This concept has been developed within our merchandising team, leveraging expertise from Farm Boy, Thrifty Foods, and our internal team to create an offer that will be fresh, delicious, and market leading. We will gradually introduce products from a central kitchen to our store network to provide greater consistency, expanded variety, fresher products, better forecasting, better flexibility, less food waste, and reduced costs for items produced in a highly food safe facility. This opening in Calgary is just the beginning and I look forward to sharing more soon.

Before I hand it over to Matt, one last thing. Just over five years ago we purchased Farm Boy, which has been a fantastic deal and partnership for us both financially and strategically. A small group of key Farm Boy senior management held onto a piece of the company at the time of purchase, and in February, as had always been planned, we acquired the remaining 12 percent. Key management remains at Farm Boy, and we continue to share and benefit from the learnings from them. We are thrilled with what Farm Boy has accomplished in the last five years, growing from 26 locations to 48, with the newest store in Oshawa opening today.

With that, over to Matt.

Matt Reindel

Thank you, Michael. Good afternoon, everyone. I'll provide some additional details on our Q3 results before moving on to your questions.

We delivered adjusted EPS of \$0.62 in Q3 compared to \$0.64 last year. Our results this year were adversely impacted by the strike at our distribution center in Vaughan, Ontario, which ended on January 13, and by the sale of our Western Fuel business back in Q1. These two issues combined for a negative impact of approximately \$0.02. Our performance was slightly better than Q2. While our earnings per share of \$0.62 was lower than the \$0.71 we delivered in Q2, this is mainly due to the timing of real estate earnings in other income and share of equity earnings. As I've explained before, this complementary income stream is a sustainable and an ongoing piece of our business.

Now, while our annual real estate earnings is stable on a year-to-year basis, the nature of this income is bumpy, which causes some volatility in our quarterly results. If you exclude our real estate earnings, which were significantly higher in Q2 than Q3, our adjusted earnings per share was approximately \$0.02 higher than Q2.

We delivered same-store sales, excluding fuel, of 1.9 percent. Our sales performance was largely in line with Q2, as we continued to see tight consumer spending given the uncertain macroeconomic backdrop, namely elevated interest rates and rising household expenses. Even as food inflation continues to stabilize, it will take some time for consumer preferences to normalize.

During these tough times, our key focus has been to protect the fundamentals of the business, to proactively take costs out, and to continue to deliver value to shareholders, all while continuing to invest in the long-term future of the Company. You can see that in each line of the P&L, as I'll now explain.

Our gross margin rate, excluding fuel, grew by 90 basis points versus last year. While approximately one-third of the expansion is due to comping the cyber security event last year, the remainder of the improvement was largely due to lower distribution costs, driven mostly by efficiencies in supply chain, amongst other smaller initiatives.

When we look at SG&A, while our dollar spend was \$66 million higher than last year, we are on track with our plans for the year. This increase was mostly related to planned investments in business expansion and our growth initiatives, but it was also impacted by inflationary cost increases such as higher retail labour costs and was partially offset by a decrease in compensation accruals. As in prior quarters, our SG&A rate increased versus last year due to our SG&A spend outpacing sales growth as we continue to invest in the future.

Our SG&A rate was 23.5 percent in Q3, which was about 90 basis points higher than last year. Excluding one-time restructuring costs and the cyber security adjustment, our SG&A rate was 23.2 percent, but we are not simply waiting for a more favourable economic environment to improve our sales and provide a better leverage against our SG&A. We have to pro-actively take costs out, and we're making good progress. After excluding restructuring costs and other one-time items, our SG&A dollars were slightly lower than Q2, as we began to see some of the benefits from our restructuring initiatives and our work on non-merch procurement.

Now, one quarter doesn't make a trend and the pace of benefits may not be in a straight line, but we will continue to work on mitigating inflationary cost pressures through driving efficiency and cost effectiveness throughout our business, mainly through our initiatives in non-merch procurement, supply chain, and our organizational restructuring.

Looking forward to Q4, we anticipate a very similar quarter to Q3. While it's good to see inflation continuing to come down, we need to see interest rates start to come down as well. This will help improve consumer sentiment and eventually drive a more normalized consumer behaviour. In the meantime, we will continue to invest in our future, protect the fundamentals, and proactively reduce cost.

Now let me turn to the balance sheet, which remains very solid. In fact, our funded debt to Adjusted EBITDA ratio improved from 3.1 times last year to 3.0 times this year. We delivered free cash flow of \$349 million in Q3, which is our strongest free cash flow performance since Q3 of fiscal '22. This strong cash flow generation enables the continued, but controlled, investment in CapEx, as well as our share buyback program. In Q3, our CapEx totaled \$156 million, mainly from store renovations, constructions of new stores, investments in advanced analytics and technology streams, and our Voilà CFCs. We also entered into an agreement to purchase a parcel of land in Montreal. This is a one-off strategic purchase, which, if successful, would occur in Q4 and increase our expected fiscal '24 CapEx from approximately \$775 million to \$885 million.

With regards to our share buybacks, we are well on track with our fiscal '24 goal of \$400 million. As of this week, we've repurchased approximately 9.5 million shares for a total consideration of \$340 million.

Finally, let me take you through the items we excluded from our adjusted results in Q3. There's nothing new versus prior quarters. Firstly, we excluded restructuring expenses of \$18.8 million after tax or \$0.08 of earnings per share. Year to date, we have incurred \$38.3 million after tax, and we do anticipate incurring some additional costs in Q4. We also excluded a very small amount related to the cyber security event. As a reminder, our insurance claims are quite complex, but we do continue to expect further recoveries in Q4. These two adjustments reconcile our reported earnings per share of \$0.54 to our adjusted earnings per share of \$0.62.

With that, I'll hand the call back to Katie for your questions.

Katie Brine

Great. Thank you, Matt. Joanna, you may open the line for questions at this time.

Q & A

Operator

Thank you. (Operator Instructions) First question comes from George Doumet at Scotiabank.

Please go ahead.

George Doumet — Scotiabank

Yes. Good afternoon, guys. Matt, you mentioned Q4 is looking a lot like this quarter. Was that comment directed on the same-store sales as well? I think, Michael, you mentioned that you were surprised by the magnitude of the narrowing gap between Full Serve and Discount. Has that held up, and can you talk a little bit about that as well? Thanks.

Michael Medline

Obviously, I loathe to talk about the quarter we're currently in, because that would not be right, and Matt will say what he can say. I'm not going to comment any more other than I think Pierre expected and was pretty optimistic that the gap would close between Discount and Full Service more than anybody else was, probably in the industry or among even at our table. We'll see how it's going to fluctuate a little bit as we see it over the next quarters, but I think the days of Discount greatly outperforming Full Service are coming to an end. I think at some point, you'll see it flip. That's our belief, and we'll see if that happens.

Matt Reindel

Yes, when we say we're looking at consistency, we're talking about the full net result of the P&L. There will be some movement in sales and in gross margin, there always is. When we say consistency, we're looking, really, at adjusted earnings per share, and yes, our performance has really been quite consistent between Q3, Q2, and Q4.

George Doumet

Okay. Thanks, and excluding the impact of comping the cyber event and mix, it looks like gross margin is still tracking ahead of our 10 basis points to 20 basis points that you've previously talked about. Just wondering what drove that, and is there a line of sight for how long we should expect that expansion to go on for?

Matt Reindel

Yes. Thanks for that question. Yes, as we've said before, my expectation and what we strive for is that ongoing 10 basis points to 20 basis points of margin expansion. Our view hasn't changed on that. Q3, frankly, exceeded our expectations a little bit. I don't think we should assume that increase will be sustainable long term.

For the quarter itself, we had 87 basis points improvement in margin, and we know that about a third of that came from the cyber security event. For the rest, the biggest component was efficiencies in supply chain, but then there was a whole series of other smaller benefits to gross margin in the quarter like space productivity, for example, which really drove that improvement. But like I said, going forward, we strive for that 10 basis points to 20 basis points.

Michael Medline

Yes, it's Michael here. I'll just emphasize one point. That improvement in gross margin is not a result in any way of raising prices. It was all our productivity.

George Doumet

Okay. Thanks for that. Just one last one, if I may. I know you guys have this 8 percent to 11 percent target. I know it's longer term, but as we think about fiscal '25, is it fair to assume that the current macro conditions are likely to get in the way of us delivering this growth?

Michael Medline

I've given up trying to predict the macroeconomic trends a long time ago, and probably everyone should. No, we're not stepping away from that long-term ambition, and we are cautiously optimistic in terms of where we're headed. I think there's two things that are going to be catalysts for us, and we're not insanely optimistic here all the time, but we do think that at some point, interest rates are going to start to fall. We don't think the first fall of interest rates is going to spur everyone on, but as consumers see interest rates start to fall and they get some sort of confidence, that's going to be great for us. That's just obvious.

The second is that we're not waiting for that. We're not standing still. We've got a lot of improvements coming in our business, and I think tough times are an opportunity to make yourself a lot tougher, and we're tougher on the business. We're more demanding, more accountable, greater velocity, and we're taking costs out where they need to be taken out for the Canadian consumer and for our Company.

George Doumet

Okay. Thanks for the comments. Good luck.

Michael Medline

Thank you for the questions, George.

Operator

Thank you. Next question comes from Irene Nattel at RBC Capital Markets. Please go ahead.

Irene Nattel — RBC Capital Markets

Thanks, and good morning, everyone. Really appreciate all the comments so far. Can you talk about what you're seeing around promotional intensity in the basket and in private label and just other types of consumer trade-down behaviour within channels?

Pierre St-Laurent

Pretty consistent with the previous quarter, promo intensity remains the same. Promo penetration is always something we're looking for. I don't see more intensity. I think people are looking for deals, promo penetration is still high, we're managing our promo mix really well. Yes, we continue to see higher penetration in private label. It's a great value for customer. They discovered that more and more and they're using it more and more to manage their budget. No big change compared to the

previous quarter. Promo penetration is high. Utilization of owned brands and private label is still good and growing, which is good news for us, because it's really well managed by the merchandising team.

Irene Nattel

That's helpful. Thank you, and then I was really interested in the comments about the commissary opening in Calgary. Can you give us a little bit more detail around the kinds of products that we should expect, rather; how we should think about the rollout; and when we might see it in other regions?

Pierre St-Laurent

We'll keep the surprise for our customers. It's a nice surprise, but basically, we learned from our past experience with our friends at Farm Boy and Thrifty Foods having Central Kitchen for many years. We're having great results with those products. I think the goal is to bring new products that customers cannot find somewhere else, well manufactured in a safety environment. The frequency of delivery will be amazing for stores, would simplify their life. That will help them to manage retail labour at store level as well. Great consistency, great assortment in a very efficient manner in a safe environment basically is what we're trying to achieve with Central Kitchen.

Irene Nattel

Got you, and any idea when we might expect it in the other regions?

Pierre St-Laurent

Absolutely. It's a national strategy. More to come, but the first centre—we are already have a Central Kitchen at Farm Boy in both Ottawa and Toronto. We have a Central Kitchen in Vancouver Island for our Thrifty banner, and it's our plan to continue to expand that strategy over time.

Irene Nattel

That's great. Thank you.

Operator

Thank you. Next question comes from Mark Petrie at CIBC. Please go ahead.

Mark Petrie — CIBC

Yes, good afternoon. I first just wanted to follow up on the comments with regards to the supply chain and the benefits that you saw in Q3. Could you just expand a little bit on what was driving that exactly. I know you expect sort of more normal 10 basis points to 20 basis points type margin leverage over time, but is that supply chain work stuff that has run its course, or does that still have legs in your business?

Matt Reindel

No, it still has ways to go. I would say we're in the early innings of that. As we said before, during our sunrise and horizon periods, we really didn't touch supply chain. That was one area of the business

that we wanted to make absolutely sure we serviced our stores during that turnaround period. Now we get to look at supply chain in more detail. The type of things we look at are optimizing your routes, your network, freight as a service, how we generate revenues, it's all of those things. I would say we're at the early stages of that. We'll continue to get some benefits moving forward. That's really the key things on supply chain.

Mark Petrie

Great. Okay, and I just wanted to clarify, and my second question was just to clarify with regards to what you mean when you're talking about consistency on the bottom line. Are you talking about the relative performance year-over-year being consistent quarter-to-quarter or the absolute dollar amount, or what do you mean exactly?

Matt Reindel

Yes, we're mainly talking about the sequential performance of the business. We took a really hard look at Q2 versus Q3 this year because last year was so distorted by the cyber security event, and we're very focused on what the current economic trend is with our consumers. Really looking at Q1 versus Q2 versus Q3 versus Q4 and onwards, that's where we're seeing that consistency, Q2, Q3, Q4. I think that will manifest itself, really, in terms of adjusted EPS. Like I said earlier, there will be changes in each of the various lines, but that's really where we see that consistency.

Mark Petrie

Okay. Thanks for all the comments. All the best.

Matt Reindel

Thanks, Mark.

Operator

Thank you. Next question comes from Michael Van Aelst from TD Cowen. Please go ahead.

Michael Van Aelst —TD Cowen

Hi. Good afternoon and thank you. I wanted to ask you about some of the OpEx savings that you're expecting from the transformation and the run rate you're talking about getting into fiscal '25. I don't know if you've quantified that. I don't seem to remember a number being provided, but I guess first of all, can you quantify it, and then have we seen any of those in Q3 and will we see any of it in Q4?

Matt Reindel

Yes, we can quantify it, but we won't do that publicly. We're not going to provide the numbers initiative by initiative. Did we see any of the benefits in Q3? Yes, and again, early innings is probably the best way to explain this. In our efforts to reduce goods not for resale, early innings, we started to see some benefits, and then with the organizational restructuring, same thing. We executed those changes in the November, December and January timeframes and we begin to see some of those benefits hit the P&L.

Michael Van Aelst

Okay. Thank you, and then on Farm Boy, with the key managers selling their minority stake, what's the plan for those managers to stick around? Have they committed to staying in the organization for any period of time?

Michael Medline

Yes, it's Michael. How are you doing? Yes, it's been such a good relationship, so that wasn't very difficult to work out. Obviously, we have a great person running it over there. Shawn Linton is one of our best leaders, a strong leader in our zone and a protégé of J.L.'s, those two get along really well and they challenge each other in the business, and it's a wonderful combination. Shawn was one of the four senior leaders. He's sticking around as the President of Farm Boy, and then he reports to Jean-Louis, who's going to stay around, I hope, for a very long time. We have an agreement for him to stay around, and Shawn will report to him, and then J.L. will report to me, and we have a great relationship.

Same time as well, Jeff York is going to be doing work for us, consulting work for us because he's very strong on all sorts of areas. And the fourth who had shares, Donny Milito, he retired recently, like a year ago, and he was of that age, and he'd been great too. We've retained three of the four, and Farm Boy is still kicking it, and they're doing fantastic, we just don't want any interruption over there. I've got to also say that Jean-Louis has been instrumental, as has Jeff, in working across Empire on fresh, on commissary, and all sorts of things with us, also working with Longo's, and Longo's working with Farm Boy and Longo's working with us. Those divisions just work perfectly in Empire, and they're bringing a lot of value that is beyond even the sales and profitability of their divisions, really happy that worked out. That's been one of, if not the best, partnership I've ever seen- the Farm Boy, Empire partnership, and Longo's is heading in the same direction, just two years later than the Farm Boy one.

Michael Van Aelst

Okay. All right. Thank you for that, Michael.

Michael Medline

More than you wanted, but I get pretty excited when I talked about it.

Michael Van Aelst

That's fine. Then just finally, I wanted to continue the questioning around the gross margin because it was such a strong number. Typically, we don't see Q3 standing out so much from the rest of the year the way we just did, and I'm trying to understand the fact that it was such a strong number, yet you had a price reason that didn't seem to have much of an impact. Then on top of that, you're talking about not all of it being sustainable or not necessarily building that in going forward, so the supply chain benefits that you're getting, are you planning on reinvesting some of them into price, or how do I square this all up?

Michael Medline

We're always reinvesting in price, by the way. What you're seeing is net of reinvesting in price, but go ahead, Matt.

Matt Reindel

Let me just clarify the comment about not being sustainable, the changes that we're making are sustainable. What I was saying is not sustainable is this 87 basis points improvement in margin, we should not expect to get that improvement of margin on a go-forward basis. The sustainable piece is the 10 basis points to 20 basis points that we're aspiring to on an ongoing basis. The changes that we made during the quarter, the benefits that we captured on the supply chain initiatives from space productivity, from the other initiatives that we have going on there, all of those are sustainable. There's none of those benefits that will disappear. When you look at our gross margin rate, again, Q2 to Q3 to Q4, you can expect consistency in that margin, and we aspire to increase that gradually over time.

Michael Van Aelst

Okay, that would point to some pretty significant increases in the first half of next year just to keep this pace, keep margins around this level?

Matt Reindel

Versus last year, yes. The consistency of the margin is what we expect. *[Clarification – margin growth will be consistent – not margin rate.]*

Michael Van Aelst

Okay. Thank you very much.

Matt Reindel

Thanks, Mike.

Operator

Thank you. Next question comes from Vishal Shreedhar from National Bank. Please go ahead.

Vishal Shreedhar — National Bank Financial

Hi. Thanks for taking my questions. Just wanted to get some context on the land purchase. Are you able to provide context on the future intended use of that land? It's unusual, at least in my recollection, for Empire to buy land and hold it, and if you're unable to provide context on the specific use, are you able to reveal how long you'll hold it as a non-producing asset?

Michael Medline

Yes, thanks, Vishal, it's Michael, I'll handle it. Yes, we don't do it every day, but it's not unusual for us to get land for distribution centres or especially stores. We try not to do it too much because it leaves capital there, although buying this kind of real estate doesn't make me too nervous. The idea there was that it was a piece of land that is perfectly situated with perfect size for one of our best banners, the IGA banner, which we expect to continue to grow and continue to be a key piece of our sales and our profitability. I wouldn't say once in a lifetime, because there's always land, but it was a piece of land we could not let fall out of our hands. Now, we still have due diligence coming up. We've got to close this.

At the same time, we are not putting shovels in the ground right now. We, at the correct time in the next few years, will be assessing and probably go ahead with a state-of-the-art automated facility to take down costs when we're ready, when we think it's the right time in terms of the growth of IGA. I

don't like spending capital. I like spending capital in stores, but at the right time, this is going to be a fantastic investment, but I wouldn't start putting it in your model for next year. Is that fair enough, Matt?

Vishal Shreedhar

Yes. Thank you for that, and we're commenting on IGA. Once upon a time, I suspect there was a perception that Quebec was the main driver of Empire in the business. Wondering if you could provide colour on all the changes that you've implemented over the years, how that proportion of earnings has changed throughout the country, and how IGA is defending against this current period of shift towards discount?

Michael Medline

First of all, thank goodness the Sobeys purchased the stores of IGA way back. It's an unbelievable asset, if not one of our best assets. We have a great market share in Quebec and it's a huge driver of our success and will continue to be so. I'll ask Pierre to talk about what's going on and how he's seeing it in Quebec.

Pierre St-Laurent

The business remains extremely strong. We have strong franchisee network over there. We're in full service in Quebec. Yes, they have some headwinds, but generally speaking, the profitability remains extremely strong. Store level, same thing. There's nothing to be worried about. A very strong engagement from dealers, the business continues to be very strong. Of course, like everybody else,

we're growing faster in discount. Discount is adding stronger sales, but overall, we're very pleased with the performance in Quebec. There's nothing broken and we continue to perform very well.

Vishal Shreedhar

Okay, and on the back of that, you can just comment on real estate growth and percentage real estate growth and how we should think about it over the next couple of years. What banners are you focused on growing and what rate should we expect real estate to grow?

Matt Reindel

I think we've said on our capital allocation strategy moving forward that we like that. Again, I keep using the word consistent, but a consistent amount of capital investment. We will always allocate a big piece of that to the stores both through renovations and for new stores. We have already said that we will continue to grow our FreshCo banner in Ontario and in the West where it makes sense. We'll continue to grow Farm Boy. We'll continue to grow Longo's, and we'll continue to grow IGA and Sobeys where it makes sense. We haven't given specific numbers on new stores, but it is definitely our intention to continue to grow that store base.

Vishal Shreedhar

Okay, so should we expect net real estate growth for Empire in the years ahead in terms of square footage?

Michael Medline

Oh, yes. Yes, for sure, but I'll just put a little colour on it. We are becoming draconian with the projects we're doing. We are not taking lower returns. We are not pleased with the increase in construction costs that everyone, especially retailers, face. The increases are ridiculous, and we have Doug Nathanson and Mark Eaton over there and the whole Real Estate team has got to be even more efficient in terms of putting these stores up because we will not take a lower return.

Let me promise you this; we're not going to flush your money down the toilet, okay? We're going to put up stores where they make economic sense and we get the returns, and I don't want to say for sure that we're going to have more stores. Which banners? We're not going to let you know exactly what we're doing there, but we have very distinct plans in every jurisdiction. We're going to make sure we're getting the returns from that, and I think that it's a very, very difficult time to put up new stores with construction costs, we've got to be really smart about it.

Vishal Shreedhar

Thank you very much.

Operator

Thank you. Next question comes from Chris Li at Desjardin. Please go ahead.

Chris Li — Desjardins

Hi. Good afternoon, everyone. My first question is, I think you guys have been quite clear that the slower than expected e-commerce industry adoption has pushed out the timeline for EBITDA

breakeven for Voilà. I guess my first question is, other than the tough economic conditions, why do you think adoption has been a bit slower than expected?

Michael Medline

Yes, it's a great question because for people just tuning in who don't follow this all the time, Canadian e-commerce grocery adoption has been slower than most of the markets that we would look at, like the U.K. or U.S. or some of the other markets. More akin to Australia, I think, when you look at it, and it's a bit bewildering in that it's lower than anyone thought it would be. I think part of it is that we have good grocery stores here and a lot of competition, notwithstanding what some say. Secondly, I do not think we started as early with good e-commerce solutions for our customers, so they didn't get into the game as quickly as the U.S. and the U.K., especially the U.K. Then when a lot of companies got into grocery e-commerce, it was during a pandemic, and it was a bad experience.

We are seeing now some increases in terms of penetration of e-commerce, especially lately. We do believe that it will get to the levels we thought it would be at, although maybe at where U.K. and U.S. are, and it'll just take a bit longer. I'd say it this way, are we going to be happy a little later on? We will be happy. Are we happy now with the penetration and how it's affecting our e-commerce? We are not, so we're doing everything. We're operating it. It got the highest net promoter scale scores I've ever seen. I've said that before, the customers love it. The operations are fantastic. Customer retention is great, and by the way, from what I can understand, we're running it fantastic- the costs, our ability to hold the margins and our ability to attract customers. We just need more customers and to get more throughput through there, and I think you'll see that, and we're working on all aspects of this to get this going. At the same time, we're happy we have it, but I'd like to be a year or two further along.

Chris Li

Great. Thanks, Michael, for that, and just a follow up on that is are you able to share just roughly what is the gap between your current industry penetration versus where industry needs to be for the Voilà model to be breakeven?

Michael Medline

I don't think we've ever disclosed that. You could probably do it back of the envelope, and the penetration now, we recorded 3.5 percent for a while there. I think the penetration, overall—I can't say, look it up somewhere, but is 3.8 percent now.

Chris Li

Okay, and I know the consolidation of the Grocery Gateway has resulted in some nice cost synergies for you guys. I'm just wondering, are there other cost efficiencies that you can perhaps accelerate that will get you to EBITDA breakeven sooner for Voilà?

Michael Medline

I'll answer it in one word, yes.

Chris Li

Okay. Are you able to share some of that?

Michael Medline

That's another one word, no, I'm sorry, I can't. You know me, I want to be transparent, but I can't tell you every single thing because it's either competitive or not disclosed. I'm not about to announce something tomorrow, but we have all sorts of plans, and Pierre, Mohit and the teams are working very, very hard on getting this going. This is a big priority for us. This was a big investment. It's an important part of our business. It's going to be really important when you look out further, for the size of it, it takes an inordinate amount of our time, but it's worth it.

Chris Li

Okay, that's great, and I just have a question for Matt. If same-store sales were to, let's say, hold at the low-single digit rate for next fiscal year, I guess my question is, is that enough to keep your SG&A expense rate at least stable given that you do have some nice cost reduction initiatives flowing through that should help offset some of these incremental growth investments that are still coming through?

Pierre St-Laurent

I'm going to go with this Michael single word of being yes, but the simple answer is yes. The efficiency initiatives we have, with the cost control initiatives we have, that gets us to our financial framework. I don't want to give guidance in terms of fiscal '25. We're finishing our plans, but as Michael said earlier, we remain very optimistic for the medium and long-term future of this Company. We have lots of plans. They're going to deliver significant value moving forward.

Michael Medline

That's a great question, because as you know, we've obviously had some board meetings the last couple of days, and we were talking about this. We're going to sell as much as we can sell, but when we plan, we've got to plan that we're not going to have 10 percent comps or something like that. We've got to be incredibly efficient and be able to drive—what can we control the most? SG&A. What can we control the next most? Margin. Okay, and even at what the numbers you might have been suggesting, we've got to do well on that. Then if things get a little better, it's fantastic for us, and that's the way you've got to plan, and especially in these economic times. That's what we're really drumming into the Company.

Chris Li

That's great, and maybe that leads to my last question is, you said earlier that you guys are cautiously optimistic 8 percent to 11 percent EPS growth is still a good target? I'm just thinking now again for next fiscal year. I'm going to take the other side of that question, which is if economic conditions remain unfavorable and then the trade down and all that continues to be against you for a bit longer, from a net earnings perspective, what is the downside here? Can we actually see negative earnings, or is there more initiatives, everything you just said, Michael and Matt, that will get you at least sort of stable, if not slightly better, earnings, despite, in the worst-case scenario, where conditions remain challenging for much of next fiscal year.

Matt Reindel

I would give you a much rosier picture than that, Chris. First of all, our financial framework is a long-term financial framework, and that's 8 percent to 11 percent long term. That means some years we

may be below, some years we may be above. In terms of as we look forward to fiscal '25, the worst possible period for Empire as a full-service grocer, is this year (fiscal '24). When we look forward to next year, as the same-store sales gap between Full service and Discount continues to narrow, as our consumer confidence begins to gradually increase, only plays into our favour. No, we're not looking at any—that sounds like quite a doomsday prediction. We're not looking that way at all. Again, we remain cautiously optimistic as we look into next year.

Michael Medline

But we hedge against everything now. We owe that to you, our shareholders, that's why we're going after big prizes in SG&A, top decisions that don't affect the customer, but take costs out of the business, and tightening every single screw we've got. In that way, if it's not as rosy as we would hope, we're good. If it's rosy, we're fantastic, and you're all going to wish you bought today at this low valuation. That's the way we've got to manage this Company, and that's what you do in tough times, and I think we've done pretty well. Q1 was a pretty good quarter, and then the consumer hit the brakes a bit, became a bit more trepidatious as we approached Labor Day. Full serve can do really well as recently as Q1, and then after Labor Day.

I think if you talk to most retailers or most businesses, they saw the same thing, because I talked to them, and now if we can start to get some more optimism in the consumer and we can get—people don't want to shop at four or five grocery stores. They don't want a bad shopping experience. They've had to make decisions they don't actually like, and if we could see some better times and less inflation and some construction costs settling down, things like that, we'll be in very good shape. But we've got to

run like it's going to be tough, and then if it's better, great, we make out like bandits, so do our consumers.

Chris Li

Thanks for the answers and all the best.

Michael Medline

Thanks. Great questions.

Operator

Thank you. Next question comes from Tamy Chen at BMO. Please go ahead.

Tamy Chen — BMO

Hi, thanks for the questions. I've just got two quick ones here. First is, sorry, maybe I'm just not understanding this part, but when you said that this quarter the gap between Discount and Full Service narrowed, it sounds like more than you had expected. How come your comp this quarter wasn't better sequentially; it was similar sequentially?

Michael Medline

Thanks for the clarification, first of all, because we're looking at the gap between us and mostly our two major competitors. When you look at it—yes, we went down 10 basis points, which is not a hell of a lot, but it's 10 basis points. I'm not going to give an ad for the two competitors, but if you look at

how their comps are performing and where they were at, as you're seeing inflation coming down, you are seeing palpable differences in that gap, and we're closing the gap. Yes, we're down 10 basis points. You can go look at the others and what they were down. I'm not going to do that work, but that gap is shrinking, and what I was saying, other than Pierre, it shrunk more than we expected.

Tamy Chen

Oh, I see. Okay. Got it. Thanks for clarifying. Thank you, and my other question is, your SG&A, and I'm looking at an adjusted number. I'm stripping out the restructuring costs and the little bit of cyber that was in there. On an adjusted basis, it looks like your SG&A was up about mid-single-digit percentage year-over-year, and I'm wondering if you're able to even qualitatively speak to or rank the buckets. There's the wage inflation. There's the investment in your stores. You've got the new CFC, the third one that's come up. Are you able to speak to, of these different pieces, what were the biggest components behind the adjusted SG&A growth year-over-year? Thank you.

Matt Reindel

Yes, sure. I can certainly walk you through that. Again, adjusted SG&A year-over-year, the biggest buckets of cost increases, first of all, is what we call business expansion. When we have increased the number of stores, where we have a new FreshCo store, a new Farm Boy store, or a new Sobeys store, business expansion is the first piece of it. Retail labour is the second piece of it, as our cost of staffing in the store through regular pay increases, union negotiations, minimum wages, etc., those are the two biggest buckets.

Our depreciation is a little bit higher. We can continue our stable CapEx, which is obviously higher than many years ago, our depreciation is higher. Then probably one thing just to call out, during this quarter of last year when we had the cyber security event, we pretty much shut down everything else. We were focused on making sure that we protected ourselves against that event, our costs, our consulting costs and our project costs are a little bit higher this year than last year. Those are the main buckets of the cost increase year-on-year in dollars, in dollars spent.

Tamy Chen

Got it. Thank you.

Michael Medline

Thanks so much.

Matt Reindel

Thanks, Tamy.

Operator

Thank you. We have no further questions. I will turn the call back over to Katie Brine for closing comments.

Katie Brine

Great. Thank you, Joanna. We appreciate your continued interest in Empire. If there are any unanswered questions, please contact me by phone or email. We look forward to having you join us for our fourth quarter fiscal 2024 conference call on June 20. Talk soon.

Operator

Ladies and gentlemen, this concludes your conference for today. We thank you for participating, and we ask that you please disconnect your lines.