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# **Empire Company Limited**

**Second Quarter 2021** 

December 10, 2020 - 12:30 p.m. E.T.

Length: 66 minutes

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#### Michael Medline

Empire Company Limited — President & Chief Executive Officer

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Empire Company Limited — Chief Financial Officer

# **Pierre St-Laurent**

Empire Company Limited — Chief Operating Officer, Full Service

#### **CONFERENCE CALL PARTICIPANTS**

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#### **Mark Petrie**

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#### **Peter Sklar**

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### **Irene Nattel**

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#### **Vishal Shreedhar**

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#### **Patricia Baker**

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#### **PRESENTATION**

# Operator

Good afternoon, ladies and gentlemen, and welcome to the Empire Second Quarter, 2021 Conference Call. At this time, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you need assistance, please press star zero for the operator. This call is being recorded on Thursday, December 10, 2020.

I would now like to turn the conference over to Katie Brine, Director Finance, Investor Relations.

Please go ahead.

**Katie Brine** — Director Finance, Investor Relations, Empire Company Limited

Thank you, Joanna. Good afternoon and thank you all for joining us for our second quarter conference call. Today we will provide summary comments on our results, what we are seeing in the industry today, 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 www.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; Michael Vels, Chief Financial Officer; and Pierre St-Laurent, Chief Operating Officer, Full Service.

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 factors.

I will now turn the call over to Michael Medline.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Thanks, Katie, and good afternoon, everyone.

I want to start today by recognizing the incredible efforts of our frontline teammates in our grocery stores, pharmacies, and distribution centres. I am humbled every single day by their tireless efforts to maintain the heightened safety and sanitation protocols to keep our stores safe, coming to work every day to serve Canadians. As this horrible pandemic continues and case counts continue to rise, we are all so thankful for their efforts.

With that in mind, I'll focus on a few key topics today: an update on COVID's impact in our stores, our performance this quarter, and some early updates on Project Horizon. First, COVID. Since we last spoke, the situation around COVID has continued to evolve with increased restrictions being imposed across the country. We're excited by news of potential vaccines but recognize there's a long road ahead. All the trends we saw and foresaw in past quarters remain. I'll speak about this shortly, but first I want to address the actions we continue to take in our stores to protect our teammates and customers.

Even through the summer when case counts declined, we did not let our guard down. Safety and sanitation in our stores continued to be our top priority. With the Canadian winter upon us, it's important that customers can visit our stores safely. With reduced capacity, we have prepared for potential lineups

by repurposing our vestibules for indoor queues. In a small number of locations where we have seen significant queues, we're adding outdoor structural solutions and heaters to keep customers out of the elements. We are also rolling out innovative virtual queuing technology in certain locations, which allows customers to wait their turn to shop in the comfort of their vehicles.

As we committed to earlier this year, when a region returns to a government-mandated lockdown, closing non-essential businesses, we will compensate our frontline and distribution centre teammates for additional pressure they face. When the Manitoba and Ontario governments recently implemented new lockdown restrictions, it triggered our pre-set criteria in lockdown regions. We ensured our stores aligned with updated guidance, particularly capacity restraints, and we implemented a temporary lockdown bonus for our frontline and distribution centre teammates. I am so proud of our team, who were prepared and responded guickly, seamlessly implementing the changes in our stores.

Now an update on the trends we are seeing with COVID. Full service continues to outperform discount in our company and throughout the industry. We provide our customers with excellent value and our full-service stores have the full breadth and depth of product offerings. We believe many customers who switched channels during COVID have come to recognize that value and it will be a reason to continue shopping full service post-pandemic.

As we continue to invest in our value proposition, our industry is seeing material cost pressure on a select number of items. Lettuce and poultry are prime examples. Farmers and suppliers are incurring increased costs associated with poor weather, increased demand, and supply chain challenges due to

COVID. These are real significant commodity increases which are being felt at the store. But outside of that, we are pushing back on price increases and continuing to provide excellent value to customers.

Online grocery penetration remains elevated as customers become more comfortable with grocery delivery. Online grocery sales continue to grow in Canada, although, as we predicted in April, at a slower pace than when the pandemic began. Empire's e-commerce businesses grew 241% this quarter. As we see regions enter government-mandated lockdowns, combined with winter arriving, we are seeing e-commerce sales ramping up in the first part of Q3.

We told you in July that we were accelerating the timing to build another two CFCs in Western Canada and I am pleased to announce our third Voilà customer fulfillment centre in Calgary, Alberta, adjacent to our current Rocky View distribution centre. This will be our first CFC in Western Canada and will service most of Alberta, including Edmonton. We expect this site to start delivering to customers in the first half of 2023, but we will serve the region earlier than that with Ocado's proven store pick solution. Crombie REIT will partner with us in the development of the CFC, similar to our Montreal CFC, and Mike will provide more details shortly.

Now, more about Empire's overall performance this quarter. Results continued to be strong. As in our last two quarters, we see customers shopping in a fundamentally different way due to COVID. We continue to see significantly elevated grocery sales and gains in Empire's national market share. Much of this is attributable to the safe shopping experience we have consistently delivered through COVID that our customers recognize and value; however, we have also made substantial improvements in our store operations, merchandising, and marketing designed to thrill our customers through Project Sunrise and

the beginning of Project Horizon. We have a very strong team in place which is running our business better than ever before. We are highly confident that we will sustain our success as the pandemic subsides.

When we spoke in September we said that same-store sales excluding fuel at that time were sticking with an average range of 8% to 10%. In the last month of Q2 we saw same-store sales accelerate and we ended the quarter at 8.7%. We saw trips slowly increase through the quarter and, while basket sizes remained high, they were slightly less than last quarter. Pharmacy remains stable and while fuel continues to be impacted by consumption, we see gradual improvement. We are now halfway through our third quarter. During the first five weeks of Q3, we have seen same-store sales excluding fuel continue to accelerate. For the quarter to date ending last week, our same-store sales have averaged 11%.

Our gross margin dollars were positively impacted by our increased sales. Our gross margin rate improved 30 basis points over the prior year and was consistent with our strong first quarter. The improvement in margin rate over last year continues to be largely due to our sales mix shifting toward our full service banners, in addition to some early traction on Horizon initiatives.

EBITDA margin this quarter was flat to prior year at 7.4% and our EPS increased to \$0.60. A couple of non-obvious differences from last year affects the comparison. Last year had a few benefits that did not repeat this quarter, most notably Crombie REIT's unusually large property disposal approximately \$0.06 per share after tax. Removing this item, EPS increased 17.6% over prior year and food retail net earnings actually increased 27.3% over prior year.

Finally, I want to share some early progress on Project Horizon, our ambitious three-year strategy that we outlined during our last call. Despite the pandemic, our team recognizes we have a business to

run and a strategy to execute. We are confident in the early progress we are making on our Horizon initiatives. This has taken some heavy lifting, but we are very happy with the performance. The team is meeting our very high expectations.

I want to give an update on three of our important initiatives, winning Canadian grocery e-commerce, expanding Farm Boy, and investing in our store network. Mike will give an update on our cost and margin initiatives. Today I will share some early operating metrics from Voilà. We don't intend to share these every quarter, but want to provide a baseline today to give context on how strong the performance of Voilà has been.

When we partnered with Ocado, we knew we were getting the best grocery e-commerce technology. Accordingly, we set high targets for ourselves. I have been eager to share results since we launched, but we wanted to run the business for several months to confirm early trends. While initial sales and penetration have – in part – been bolstered by COVID, where we have truly been impressed if the customer satisfaction and our operational metrics. To date, our weekly on time delivery score is 98.6%, beating our aggressive target of 95%, and our fulfillment, the percent of products ordered that are delivered, is 99.6%, exceeding even our 98% target. These are best-in-world metrics. We are giving Canadians an e-commerce solution they can trust, will show up when expected, and will deliver the products they ordered. This type of service was not available in the Greater Toronto Area before Voilà and, as we predicted, customers are thrilled.

Our net promoter score, I'm going to give it to you, is an extraordinary 87. We continue to beat our industry best-in-class target score of 70. We are seeing extremely high customer satisfaction and

loyalty. This, along with positive word of mouth referrals and high, very high repeat rates, is translating to strong order volume growth. Early in Q3 we are seeing continued compounded weekly growth as new customers discover Voilà and those who have tried us become repeat users. For those familiar with Ontario, Voilà now covers the Greater Toronto and Hamilton area and has recently extended to include Barrie and Guelph. There are over 100 Voilà delivery vehicles on the road serving approximately 85% of the geography the CFC will ultimately deliver to. Customers can choose from a selection of approximately 17,000 products and we continue to add products daily.

Now turning to Farm Boy, since Q2, we have opened four stores and announced a fifth. Three locations opened in the GTA, including one at the old Art Shoppe building at Yonge and Eglinton in Toronto and we relocated the flagship store at Train Yards in Ottawa. This brings Farm Boy's total amount of store count to 42 stores, with many more to come. The Newmarket, Art Shoppe, and Train Yard stores have extended footprints with larger centre store space to accommodate Farm Boy's exciting and innovative private label products. All new stores exceeded management's early forecasts despite being opened during the pandemic. After the holidays, the Farm Boy team will open two more stores in January at Front & Bathurst in Toronto and in Waterloo. Front & Bathurst will have expanded grocery and hot food offerings in 38,000 square feet. Another conversion and new build are slotted to open early spring for a total of eight store openings in one fiscal year, a historic achievement for Farm Boy management.

Also, over the course of Horizon, we plan to renovate approximately 30% of our Empire store network. This quarter we renovated 18 locations across our network. We continue to develop our network of FreshCo stores to achieve critical mass in Western Canada. There are now 22 FreshCo stores open and operating in the West and another eight in different stages of development. We track every renovation

so we can adjust and learn constantly and so far we are very pleased our renovation program is meeting its financial and strategic objectives.

Last but not least, I want to take a moment to recognize two members of our team, Sandra Sanderson, Senior Vice President of Marketing has been named CMA's Marketer of the Year in Canada. Congratulations, Sandra. And Pierre St-Laurent, who's on the line with me today, our EVP and COO, Full Service, has been named one of Canada's 50 best executives in 2020 by the Globe and Mail's Report on Business. Very deserved. We are all very proud of Sandra and Pierre's accomplishments.

The team at Empire continues to make important strides, moving toward our full sales and earnings potential. There is still significant room to grow, but our team is stronger than ever and dedicated to thrilling our customers and achieving our Project Horizon goals. Through these challenging times, we wish everyone a safe and happy holiday season.

And with that, over to Mike.

Michael Vels — Chief Financial Officer, Empire Company Limited

Thank you, Michael. Good afternoon, everyone. As we progress through our third quarter of fiscal 2021, as Michael said, we're seeing different sales trends than when we spoke to you last September. With the increased restrictions across the country, same-store sales excluding fuel have increased and so far in our quarter have averaged 11% with the range of 8% to 13% over those five weeks ended December 5<sup>th</sup>. Our basket sizes are increasing while customer visits are decreasing as people reduce the number of shops per week.

With our recently instituted lockdown bonus now in effect for Manitoba and certain regions in Ontario, and assuming they continue for the entire quarter, we estimate that the combined cost could be up to \$5 million per quarter. Including this lockdown bonus estimate, under current circumstances, we expect that we will continue to incur approximately \$15 million to \$20 million in SG&A expenses per quarter related to the increased cost of maintaining sanitization and safety measures and other COVID expenditures.

This quarter there were some significant items in SG&A which resulted in our SG&A as a percentage of sales being the same as last year. Not all of these items, however, will occur in the future to the same degree. First, accounting accruals for our store distribution centre and backstage teammate compensation were higher this quarter. Second, our Voilà banner now has its full back office SG&A and supply chain costs reflected in SG&A. Third, COVID costs, as we mentioned, are an increase from last year. And finally, the right-of-use asset depreciation under IFRS 16 is higher than last year. This right-of-use asset depreciation combined with finance costs would previously have been reflected as occupancy costs in our SG&A. Overall, IFRS 16 continues to have a minimal impact on earnings per share. For the first half of the year, the effect of the IFRS 16 standard change was a dilutive earnings effect of about \$0.01.

Earnings per share this quarter included \$0.05 per share of Voilà dilution compared to \$0.01 last year. This is the first full quarter delivering to customers and we're very pleased with the consistent compounded week-over-week growth we're seeing since launch. We continue to expect dilution of approximately \$0.20 per share for fiscal 2021 and, of course, are hopeful of improving somewhat on that number in the second half depending on the rate of sales growth.

The effective tax rate for the quarter was 26.5%, in line with the statutory rate. Excluding the effect of any unusual transactions or differing tax rates on property sales, we estimate that the effective income tax rate for fiscal 2021 will be between 26% and 28%.

Equity earnings decreased year over year, principally as a result of decreased equity earnings from Crombie REIT. As Michael mentioned, this was largely due to the prior year gain in Crombie on the disposal of a parcel of assets which positively impacted our EPS comparison last year by \$0.06 after tax. Overall, I'd note the Crombie's results have been outstanding comparative to many others through the pandemic.

Cash flow generation continues to be strong. This has enabled debt repayments of over \$525 million during and after our quarter end that has fully retired two debt facilities. Additionally, we began repurchasing shares in October and as of this week we have repurchased approximately 810,000 shares for consideration of \$29.4 million. We will continue to repurchase shares through the remainder of the year, taking into account market conditions.

Project Horizon is now into its second quarter. We've had some delays in a few initiatives as we invested in additional costs to keep our teammates and customers safe. As COVID starts to dissipate, we'll see these costs reduce. Margin rates have expanded. Part of this due to sales mix, but also due to early wins on Horizon initiatives. This quarter we've had some early wins from our promotion optimization programs and our investments in advanced analytics to help drive a compelling customer value proposition. We continue to feel very positive and encouraged by the value that our small team of data engineers is providing to our merchandising group. We also continued to see efficiencies and cost reductions from our strategic sourcing program.

Lastly, on Voilà, we announced our third CFC in Calgary, Alberta today. We are partnered with Crombie and, similar to the Montreal CFC, Crombie will build the site to our specifications and we will lease it from them. The CFC will be slightly smaller than both the GTA and Montreal CFCs, as it serves a smaller population in Alberta. Crombie will purchase the land and the cost to build the CFC will be split between Crombie and Empire. We have not as yet fully finalized the total cost of the facility or the Crombie/Empire split and should be able to provide more specific updates on this in our third quarter.

We're now halfway through fiscal 2021. The team is working hard keeping stores safe and progressing Project Horizon. There's much to see in the back half and we look forward to continued progression of our results.

With that, please have a safe and happy holiday season. And Katie, I'll hand the call back to you for questions.

Katie Brine — Director Finance, Investor Relations, Empire Company Limited

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

#### Q & A

#### Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the star followed by the one on your touchtone phone. You will hear a three-tone prompt acknowledging your request. If you are using a speakerphone, please lift the handset before pressing any keys.

Your first question comes from Karen Short at Barclays. Please go ahead.

**Renato Basanta** — Analyst, Barclays

Hi. Good afternoon. This is actually Renato Basanta on for Karen. Thanks for taking our questions. So my first question is on e-commerce, and thanks for all that detail you've already given with respect to Voilà, but just curious if you could provide some colour around who the customer is who you're gaining online, maybe how that customer stacks up against your traditional customer with respect to demographics or shopping patterns or any other notable differences. Any colour there would be helpful.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Mike, why don't you start, I doubt you'll miss anything, but if you do, I'll chime in.

Michael Vels — Chief Financial Officer, Empire Company Limited

Thanks, Renato. Good question.

The customers that we're targeting for Voilà are our full shop customers, so our intention is to capture as much of the weekly shop as possible. It's busy families and families filling up their full shop for the week. And that is reflected in basket sizes. The basket size for us is very significant and we're not targeting the smaller, high velocity, same-day shop online order that some others might be.

I'd say the demographics are split right across the board. We're not a premium service. Our prices are very consistent to grocery stores. Our promotions, while different online, are also targeting value, and so we're not targeting any specific demographic. We are delivering via both downtown to dense high-rise

condos to suburban shoppers and families and the consistent feedback has been that people are very comfortable with the assortment, they like the value, and they really like the fact that they can do a high percentage of their grocery shop from home.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

I think that was very good, obviously, but the only thing I'd add is statistics to date show almost no cannibalization of our own business and our own stores, which is what we expected and said, but we're seeing that as well. So, it's either right on or better on every number than what we expected, and we are very, very pleased.

Renato Basanta — Analyst, Barclays

That's helpful. And then just wondering if you can speak to what actual sales penetration has been for e-commerce in Ontario or I guess for whatever the actual region is that your Voilà CFC covers. And then any colour you can provide on utilization of that facility, sort of where you are now and how that continues to ramp, that would be helpful.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

I'll take the first one and then Mike will take the second one. But on the first one, I don't have in front of me all the numbers for the entire province and the whole industry, I think it's quite clear that we're probably growing at the highest pace because we put Voilà in this period, but I'd have to get back to you. So, Katie will get back to you on what we have. Some of it is public and so we'll be able to share that.

### Michael Vels — Chief Financial Officer, Empire Company Limited

From a capacity perspective, we're not disclosing the usage of capacity at this point. It's early days, though. And as we said before, we think it's going to take at least two years to fill or at least to add capacity to the facility to the point that we start becoming profitable. And so we're going to spend the next two years filling capacity and at this point we're not tracking the percentage of utilization. But it's very, very early days so I think it'd be safe to say that we've barely made a dent at this point in the full capacity of the OFC.

#### **Renato Basanta** — Analyst, Barclays

Okay, thanks. And then last one. I'm just curious if you can speak to the performance gap between conventional and discount and how that's sort of trended versus Q1. And then specifically any colour around the margin in the discount business would also be helpful. Thank you.

### Michael Medline — President & Chief Executive Officer, Empire Company Limited

So Mike will either answer or not answer your second question. I'll answer the first one. From an overall industry perspective, full service banners saw significant gains in COVID and, as I said, the ability to do that one-stop shop, the fact that we were able to make customers very safe and comfortable. Over the summer, we saw discount gradually start to come back a bit and then we saw full service pick up again. I think we'll have to see later on how much of this will stick, but some will stick. This has been a real boon for full service over discount. We also have discount banners and we're proud of how they're doing, but the full service in our company in almost every region and certainly national is a big difference between

full service and discount. So that's what we're seeing and we've seen that we've consistently been growing market share.

Michael Vels — Chief Financial Officer, Empire Company Limited

And then the question on the margins. As you know, the gross margin on discount is structurally lower than full service. I think, and correct me if I'm wrong, I think what you're asking for is how comfortable are we with the margins compared to last year in each of those businesses? The short answer is we're happy with margins in both businesses. We're seeing, as we said in our press release, very stable margins. Our margins actually in the West in our discount business are improving, as we said they would, from the early starts, as many of those stores are now mature. We're seeing improvements in our gross margins as we settle into a cadence and also become more effective and efficient with our labour utilization. So, very comfortable with the margins in both businesses at this point.

**Renato Basanta** — Analyst, Barclays

That's great. Thanks for the colour. Best of luck.

### Operator

The next question comes from Mark Petrie at CIBC World Markets. Please go ahead.

Mark Petrie — Analyst, CIBC World Markets

Good afternoon. You spoke about this at a high level, but I'm interested to hear your commentary around how consumer behaviour has evolved with the latest round of lockdowns, but specifically inside

the store. So perhaps you could contrast it with sort of earlier in the pandemic, but kind of curious where you've seen growth, underperformance. And I guess two areas I'm specifically interested in would be prepared food and private label.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Great question. Pierre is going to take it.

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

Yes, obviously, we're still seeing very different behaviour than pre-COVID. We have very strong sales in grocery, because people are doing their full shop in our stores, so that's a much higher growth than we were used to seeing in our stores. So the ratio between non-fresh and fresh is a bit different than it was last year. In fresh, because we have been extremely focused on safety during COVID, we closed our service counters to keep our teammates safe. We reopened it this summer and since we reopened, we're seeing a positive trend in deli, bakery, and HMR. At the peak of the pandemic, HMR was very, very soft, but it's regaining customers back gradually every week. But we're still lower than we were pre-COVID. We remained extremely strong in meat and seafood. To recap, grocery is very strong, we're strong in fresh meat and seafood, and we are gradually recovering in HMR, bakery, and deli. That is the current situation.

Mark Petrie — Analyst, CIBC World Markets

And Pierre, could you just talk about the private label business? Or maybe it's for Michael or Mike. But the private label business, obviously there's a lot of moving parts there. You guys are in the midst of a pretty significant re-launch on that program and, you know, it's a core part of what you're trying to do

in Horizon, but also just consumer preferences have shifted through the pandemic. Just wondering how you sort of slice through all that and how the private label rollout or renewal is going for you guys.

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

Good question. We knew private label was a huge opportunity for us coast to coast. We gained more in private label than the industry pre-COVID and, as you can imagine, during COVID we gained even more because people are buying private label more than ever. We were in good shape before COVID and now we're doing extremely well. As you saw, we did the Compliments rebrand last year. We had a strong, effective marketing campaign this fall that had very good results. We have a very strong plan for private label. We identified the private label opportunity a couple years ago and it is a key initiative for us in Horizon.

Now we have a very disciplined approach, looking at private label category by category, like we did with category resets in Sunrise. It was a very successful program for us and we're doing exactly the same thing with private label. We want to make sure that we have a very strong strategy, category by category, with our new brands along with strong support from marketing. We have an ambitious target in private label and so far, we are pleased with progress and we will continue to work on this. So, yes, you saw the same thing that our customers saw, and we're pleased with the results so far. We have a very disciplined approach in private label; we need to make sure that it matters in every category and that is exactly what the team is doing.

Mark Petrie — Analyst, CIBC World Markets

Are you able to quantify where you're at today in terms of penetration and how that might have changed from a year ago and then where you're headed?

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

It varies by province. I don't have numbers in front of me, but we're gaining percentage and share of private penetration rate. We were lower than the industry, but we're catching up. But I'm not a big fan of just talking about penetration rate. The most important thing for us is to make sure that private label is playing a specific role in every single category. In some categories having private label has no impact. In other categories it's more relevant. So, penetration is one indicator, but ensuring every single product in every single category has a purpose, is what we're focusing on.

Mark Petrie — Analyst, CIBC World Markets

Okay. I'll pass the line, but thank you for all your comments. And if I don't get back on, all the best over the holidays.

#### Operator

The next question comes from Peter Sklar at BMO Capital Markets. Please go ahead.

**Peter Sklar** — Analyst, BMO Capital Markets

Good afternoon. Sorry, back to Voilà, just one question there. Mike, you had said that you anticipate it'll take two years to achieve capacity, which is, I think, consistent with what you've been saying before. And how do we think about capacity? Do you think about it in terms of orders per week? And I think you've mentioned in the past that capacity is 60,000 orders per week. Is that the way to think about it?

Michael Vels — Chief Financial Officer, Empire Company Limited

We're not disclosing our capacity metric, but our disclosure has been that we should expect earnings dilution for two years at least as we ramp up the capacity in the facility. After two years, there's still more capacity left, so we wouldn't be at full capacity after two years. So we anticipate a rapid build, but that's a very large facility and it's going to service the entirety of the GTA. So it'll certainly take more than two years to get to capacity, but we'll have overcome significant amounts of the fixed cost curve by the end of the two years.

**Peter Sklar** — Analyst, BMO Capital Markets

Okay. And two questions. Is all the capital in place now or are you going to be adding capital incrementally? And then also, do you expect that the dilution will be less in year two than it is in year one?

#### Michael Vels — Chief Financial Officer, Empire Company Limited

We're not going to speculate on that. We'd like to see a little more about our rates of growth and margins. So I think we're going to hold that for subsequent disclosure. We've been consistent in saying that \$0.20 is a number we're comfortable with for this year. We'd like to see if we can improve on it, but it's going to be pretty close to that. And the second year we'd hope would be somewhat better but, again, we're still working up a pretty significant fixed cost curve and we'd hope to do better, but at this point we're not counting on it. We're investing in incremental spokes to service the entire GTA more efficiently. And those do add some measure of capital in our numbers for this year and next, but it's relatively immaterial compared to the cost of the CFC. As the capacity of ramps up, we do pay incremental capacity fees to Ocado, but those are expensed. They're not capital. And we will lease more vehicles for delivery. So the only real increment in capital for the CFC would be the spokes that we're building but, as I said, they're relatively immaterial compared to the big distribution warehouse.

### **Peter Sklar** — Analyst, BMO Capital Markets

Okay. And at Ocado, I'm sure you know this, they've had trouble with their app and their app has been down. I'm not too sure if it's due to they don't have the capacity or if they have technology issues, but I'm just wondering has the issues that they have with their app – I'm sure that you're licensing a lot of the technology behind the app – has that affected your app at all?

### Michael Vels — Chief Financial Officer, Empire Company Limited

Well, I think what we're seeing in the UK, and I don't want to speak for them, obviously, they run their business, but for sure they have some very significant order volumes and, you know, as a more mature business, they're working all the time to improve bottlenecks and try and handle the increased order capacity. So I think a lot of the press we're seeing is just the inability to take on that much volume.

Solely from our perspective, it's not an issue about scalability with the app that we're using. It's working very well for us. We did have the advantage of observing what was happening in the UK and other places as the first wave came and so we were able, with their help actually, we were able to install some queuing technology on our website in case we needed it. As it turned out, we didn't. But those are some of the changes they had to make to handle the press of new volume to their website and actually we benefitted from that because we were able to install and invest in that after they did. We're not seeing any issues with the software. It's very scalable, it's running fine, and I'm very happy with it.

#### **Peter Sklar** — Analyst, BMO Capital Markets

Okay. And then lastly, I just wanted to ask you about the strong November that you're seeing with the 11% comp. Michael, I'd like to hear you reflect a little bit on that on what you think is happening. Are you having a particularly strong promotional calendar or is it just consumers are shopping early for Christmas so they're stretching it out? I'd be really interested to hear your thinking on this.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Thank you. Thanks for giving me the opportunity to answer that question, because I think

sometimes COVID overshadows and is overshadowing, which maybe is great that we're going under the

radar right now, the unbelievably much better merch operations and marketing that we have going on

across Empire Company in all of our banners. Having said that, I think that some of the increases are, as

we saw fear of this terrible virus grow, we can see it in our sales, and they don't only manifest themselves

in completely locked down regions. Canadians watch the news and they feel for each other and that you

can watch The National or CTV every night or whatever you watch, and you can see how people are very,

very concerned right now for their safety and for their family's safety. And so it's that combination, I think,

of a better execution by us and by, unfortunately, fear of COVID that is spurring on what we're seeing

now. Having said that, I do not see this as an overly promotional atmosphere and we didn't go chasing

any sales, it's always competitive, but we're sticking to our game plan here on that. So, I wouldn't say it's

being driven by higher promotional intensity.

**Peter Sklar** — Analyst, BMO Capital Markets

Okay. Thanks for your comments. That's all I have.

Operator

Your next question comes from Irene Nattel at RBC Capital Markets. Please go ahead.

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### **Irene Nattel** — Analyst, RBC Capital Markets

Thanks and good afternoon, everyone. Just want to beat the Voilà cost or the e-commerce cost drum just a bit more, because one of the things that I'm thinking about is we talked a great deal about year one and year two, but as we get into year three and the Montreal CFC opens and then we add on Calgary, and in the interim we've got the curb-side delivery, just wondering how we should be thinking about the cost cadence. Is the \$0.20 sort of the fully-loaded number each year for the next few years or can it be higher? How should we be thinking about that?

### Michael Vels — Chief Financial Officer, Empire Company Limited

So, you're correct that as Montreal goes live, it's same dynamic about needing to add volume to get up the cost curve. Having said that, we are transferring across a fairly significant number of customers that already exist through IGA.net, which is helpful. And then when we start up in Calgary, same thing, high fixed costs and you're starting with low volume. So, each of those following CFCs are going to be dilutive as they start up. But having said that, at the same time, to your point, Toronto, for example, it will be coming off, call it, the ramp up the fixed cost curve and the variable earnings will become more and more significant.

What we did say when we started here is that we felt that our ramp up and the way we were going to build our e-commerce business was going to be very manageable from a cash flow perspective and from an income statement perspective. So, we weren't going to ask our shareholders to endure significant reductions in our earnings to fund an e-commerce start-up. We still feel that way and we're still very confident that we can manage our annual income statements in a way that's responsible, and secondly,

in total, through the Horizon timeframe, is still going to deliver double-digit earnings per share increases every year.

So, I think that would probably lead you to the conclusion that, whether it's \$0.20 or slightly more or slightly less, we're going to try and manage very closely to a fairly consistent income statement and we wouldn't anticipate or expect material changes or material negative changes as a result of bringing the next two CFCs up, because we are managing to bring them up at the same time as the early ones go profitable.

**Irene Nattel** — Analyst, RBC Capital Markets

That's really helpful. Thank you very much, Mike. And then just sort of thinking through the near term with the rolling COVID shutdowns and the challenges of managing lower store traffic even as we're probably going to have higher demand over the Christmas period. You talked a little bit about some of the initiatives that you're putting in place, how should we be thinking about that? How are you thinking about tonnage growth as we come through this?

**Pierre St-Laurent** — Chief Operating Officer, Full Service, Empire Company Limited

So far, so good I would say. We early implemented maximum customer in our stores across the country. These metrics were defined store by store based on square footage and cashiers, it was not the same number for every single store. It was done store by store based on their own capacity. So it's already in place. Obviously, in Alberta at 15%, we need to revise some of these metrics, but it won't affect a lot of stores. And like Michael said in his introduction, we already have solutions, physical sort of solutions with

infrastructures and virtual queuing will be very helpful if it's required. We have less transactions, so when we have less transactions it's good for the efficiency in store than when we have multiple transactions. The challenge is to exit customers. It's not when they're inside the store. We're not seeing any big issue with that. We're ready to serve customers. I don't feel nervous about that.

**Irene Nattel** — Analyst, RBC Capital Markets

That's really helpful. Thank you. And as a customer, I thank you for the option of being able to sit in my car and not freeze.

I know it's a very near-term question, but just thinking about Christmas itself, are you changing at all the way in which you're stocking the stores just in anticipation of a greater number of smaller gatherings and possibly higher sell-through of more premium products?

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

That's an interesting question every time we're facing a holiday. We had that question for Labour Day, we had that question for Thanksgiving, and honestly, we were positively surprised at our sales for all of these events, because in theory people are not all together and there's no big family dinner, but we did much better in sales. Even on Halloween our sell-through was higher than last year, which is interesting. I think people will just start to do their shopping earlier. And the good news is all of our stores are ready, across the country, since October 31<sup>st</sup>. And I think if you walk our stores across the country you will see all have good merchandising in place. We're ready for stock up. Based on what we observed on the

previous holidays, I think we'll be impressed by sales again. I hope. We're ready. I think people will have more frequent good dinners than just the big one.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Interestingly, we're seeing demand for smaller turkeys outpacing normal demand for larger turkeys, which means people are planning on smaller events, and we saw that at Thanksgiving to a large extent. And so there's some shifts like that we see, but overall, in terms of tonnage and some of the other metrics we would look at, I think Pierre is absolutely right, that people need something to celebrate and they're going to do it a different way but they're going to celebrate safely, hopefully, but still, you know, we have a lot to be grateful for still, I guess.

**Irene Nattel** — Analyst, RBC Capital Markets

Absolutely. Thanks. I'll get back in the queue. But thank you and happy holidays and stay safe.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Thanks, Irene.

#### Operator

Your next question comes from Vishal Shreedhar from National Bank. Please go ahead.

**Vishal Shreedhar** — Analyst, National Bank Financial

Hi. Thanks for taking my questions and I guess I'll just continue the trend about asking on Voilà.

Obviously, management is very happy with the growth numbers that were indicated, and I was wondering

if you had a sense of what's driving the growth this early, or at least if you can prioritize it for me. Is it the

high net promoter score? Is it your SKU additions? Is it marketing? Operational improvement? Is there

something that stands out?

Michael Medline — President & Chief Executive Officer, Empire Company Limited

So, the question is why are we seeing such good results right away?

**Vishal Shreedhar** — Analyst, National Bank Financial

Yeah, exactly.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

I think it's a multitude of things, some of which you talked about. Voilà was going to do great

whether there was a coronavirus or no coronavirus, because as I like to say, it's the best mousetrap. It's

the best in the world. And so people are going to figure that out. Unfortunately, there was a virus and

more people wanted to shop online and tried it initially and then once they try it they become hooked. I

think the fact that it is robot picked has helped us, not just from an efficiency but because it feels and is

safer.

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At the end of the day, the net promoter score, which is kind of an amalgamation of everything, is because people do not have access to a reliable service that treats the customer with respect. And I've got to also give credit to the amazing men and women who drive the trucks and deliver the products. They are even more popular than our cute little robots. They are phenomenal and they're passionate, because they believe in what they're doing and the level service is extremely high. So I'd say that the Ocado system is the best in the world, but the way that we put that in and the decisions we made in terms of how we price competitively, how we have the best delivery price, how our teammates are friendly and passionate and safe, and how we market and go-to-market, it's all those things together. So it's not just the system. It's the business as well as the system.

**Vishal Shreedhar** — Analyst, National Bank Financial

Okay. Thank you for that. And maybe just switching topics here a little bit, stock markets have started to look to a day when COVID-19 is behind us. Presumably at that time restaurants, travel will start coming back, and that might place a little bit of pressure on grocery demand. Looking in the future, is there anything that a grocer can do with costs, merchandising, marketing, data analytics, so on and so forth, to keep customers excited and coming back during that time period?

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Yeah, it's called Project Horizon and all the things we're doing. But I'd say, let me go back on that one, which is, you know, hope to god that everything comes back to normal and that restaurants start being frequented and that Canadians can get back. We were doing just fine, thank you very much, at Empire Company without any pandemic and this is no fun for us. We're glad we're an essential service.

We're proud of our competitors and the whole industry, to be honest with you, but we're especially proud of how we performed and kept our values. But I think that we'll be able to show how far we've come even more when the pandemic is over.

There will be some lasting changes in customer behaviour, but we'll also be rolling into Project Horizon and some of the other operational improvements we're putting in place right now. So, can't wait for it to be over and can't wait for you to see what kind of company we are when this is over.

**Vishal Shreedhar** — Analyst, National Bank Financial

Okay. And I think you may have touched on this, but just one of your peers commented on the price competitiveness of the industry and suggested that discount might be heating up a little bit. Wondering what you're seeing on your side.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

It's always a competitive marketplace. We're not seeing any difference today than we have historically seen at all.

**Vishal Shreedhar** — Analyst, National Bank Financial

Okay. Thanks for that colour.

# Operator

The next question comes from Patricia Baker at Scotiabank. Please go ahead.

**Patricia Baker** — Analyst, Scotiabank

Good afternoon, everyone. Thanks for taking my questions. Michael, you indicated that, despite

COVID, the company is very, very focused on Project Horizon and you're pleased with how that's

progressing. And one of the elements of Project Horizon of course is the store renovations. You noted that

you did 18 stores in the quarter. Can you just provide us with an overview of what specifically the

renovation projects encompass, what are the elements, so that we can have kind of a visualization of how

the stores are different?

Michael Medline — President & Chief Executive Officer, Empire Company Limited

I'll turn it to Mike and then, if Pierre has anything to add, he'll add it.

**Patricia Baker** — Analyst, Scotiabank

Wonderful.

Michael Vels — Chief Financial Officer, Empire Company Limited

Sure. We're running out of time and I think we're going to go a bit over, we'll try and see if we can

cover all the questions, so I'll try not to have my habitual long answer here.

So the short answer is all the renovations are different. We've actually split them into four tiers,

tier one, two, three, four renovation. A tier one would be a complete rework of the store, both the façade,

the interior, the fixtures, fittings, a whole bunch of maintenance, and those would be for stores that are

either looking particularly tired or in high-growth areas where we believe that that extensive of a

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renovation will pay back and return the IRR to us. All the way down to a tier-four renovation, which is still fairly expensive. It's not just a coat of paint. It focuses on the façade, focuses on the common areas that customers value, there would be fixture changes, et cetera.

So what I'm trying to say is it's not a one size fits all. What is however consistent about them is that we've done a lot of work on our banner brands and strategies and our go-to-market positioning. And on every one of the renovations you'll see new elevations on our storefronts. It'll be consistent with the colours and lock and the modern projection of the new Safeway brand or the new Sobeys look and feel that we've rolled out in every market. Same with Foodland, a very successful banner for us. We really, really liked that banner, mostly rural, but very successful, motivated group of franchisees, and we're putting quite a bit of money into Foodland franchises as well.

So, not sure if that answers your question, Patricia.

Patricia Baker — Analyst, Scotiabank

No, it does, Mike. It's very helpful. And just what has been your experience with the three stores in the Nova Scotia market where you're doing the click-and-collect? And you indicated that you would be taking that to Alberta in advance of the CFC. Is that something that will roll out to Alberta this fiscal year or later?

Michael Vels — Chief Financial Officer, Empire Company Limited

It's early days in Nova Scotia. They were pilots. So we're just bedding down our operational procedures and making sure that the front end works and the Ocado software connections to our systems

were properly built. So, having said that, you know, small beginning, but very, very pleased with the outcomes. Customers love it. They really liked the alternative. They're still in our stores, but also shopping online, which is clearly something we wanted to achieve. So we feel very good about it. We'll start, I think, next February, March rolling out in earnest across the other stores and that would include out West.

**Patricia Baker** — Analyst, Scotiabank

Okay. Excellent. Thanks a lot, Mike.

#### Operator

Your next guestion comes from Michael Van Aelst from TD Securities. Please go ahead.

Michael Van Aelst — Analyst, TD Securities

Thank you. I'll try and keep them brief. I guess a quick one to start, the bonus accruals that you took in Q2, I believe you're catching up from Q1, if I'm correct, but are they going to continue at around, I guess, maybe half the pace in the second half of the year?

Michael Vels — Chief Financial Officer, Empire Company Limited

It's hard to say. It depends on outcomes and it depends on results. But those costs are likely to be elevated for the rest of the year. To your point, not at the same level. I can't say it'll be exactly half, because we can't at this point fully understand exactly what our results will be. And these are required accounting accruals that we have to make. I think, as most people understand, in fact our last fiscal year we ended up with one quarter's worth of COVID results and, as a result, our store associates and our distribution

associates were paid incremental compensation as a result of that, in addition to the very significant hero pay that we paid all our people. But, at the same time, we capped the compensation for management and back office people.

This year similar dynamics and we're going to have to make those decisions at the end of the year, we're only halfway through it, but we're going to be required, under the terms of our plans, to accrue these amounts all year, albeit, as you point out, at a lower level. And final compensation will depend on how well our people have done compared to their Horizon objectives and how they perform throughout the year.

# Michael Van Aelst — Analyst, TD Securities

Okay. Thank you. And then the net promoter score of, I think it was 87 you quoted, where are you sourcing that from and how has that changed over the few months that you've been in operation?

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Hi, it's Michael. That's our own internal, obviously, survey of our customers. They fill out survey forms with us all the time. We do that in all of our businesses. And how has it changed? It has not changed one iota from the first delivery onward. We are continuing, even as we expand and we have more deliveries, and we are seeing consistently, best I've ever seen, best-in-class net promoter scores.

#### Michael Van Aelst — Analyst, TD Securities

Okay. All right. And then just finally on the market share gains, I've asked this to the other guys as well, but everybody is claiming market share gains, but there's quite a bit different same-store sales performance from your immediate peers, Costco and others. So how do you measure this and who do you think you're taking it from?

Michael Medline — President & Chief Executive Officer, Empire Company Limited

Well, we take it from third-party sources. I wouldn't say anything that's not backed up and Mike Vels and Pierre definitely would never do that either. So these are third-party sources. We're taking market share. I don't throw competitors under the bus.

# Michael Van Aelst — Analyst, TD Securities

I don't want specific names, but do you think you're taking it from the larger players? From independents? Other channels?

Michael Medline — President & Chief Executive Officer, Empire Company Limited

If I look at the national results all over, and there's different competitors in different regions, obviously, as you know, we're taking it from almost everyone, but we're taking more from the some of the larger players.

Michael Van Aelst — Analyst, TD Securities

All right. Thank you.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

And if they are listening to this, you made me say that.

# Operator

The next question comes from Chris Li from Desjardins. Please go ahead.

**Chris Li** — Analyst, Desjardins Securities

Thanks for squeezing me in. Just a couple of quick ones. Maybe first for Michael: How is the private label performing on Voilà? It seems like online is the channel that can really raise customer awareness of private label.

Michael Medline — President & Chief Executive Officer, Empire Company Limited

You're absolutely right. We're highlighting our Compliments products especially on Voilà and it's got its own page. Incredibly good traffic. Great traction. And the other page that stands out is the Farm Boy page as well. So, absolutely great penetration on private label and it's a great way to expose our super and growing private label platform to more customers.

**Chris Li** — Analyst, Desjardins Securities

Okay. That's helpful. And then maybe one for Mike. As we look out the next few quarters, as you start to lap the positive margin impact from sales mix, do you believe margin will continue to grow as the Horizon benefits start to accelerate so that you can achieve your goal of 100 basis point improvement by fiscal 2022?

Michael Vels — Chief Financial Officer, Empire Company Limited

That's our plan.

**Chris Li** — Analyst, Desjardins Securities

Okay. So you're still confident in that. And then in terms of the share buyback, do you have a target? I remember last time I think you did about \$100 million. Are you targeting a similar level this time around?

Michael Vels — Chief Financial Officer, Empire Company Limited

Yeah, we're not going to put a target out there. Same as we didn't last time. But what I can point out to you is that our current NCIB that we have filed, dependent on stock price obviously, would enable us to purchase probably up to about \$180 million. So that would be, again, depending on the stock price, would be a maximum allowable under the current NCIB.

**Chris Li** — Analyst, Desjardins Securities

Great. Thanks. Merry Christmas and all the best for next year.

Michael Vels — Chief Financial Officer, Empire Company Limited

Thanks, Chris. Same to you.

# Operator

Thank you. That concludes today's question-and-answer session. I will now turn the call back over to Katie Brine for closing comments.

Katie Brine — Director Finance, Investor Relations, Empire Company Limited

Great. Thank you, Joanna. Ladies and gentlemen, 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 third quarter of fiscal 2021 conference call on March 10<sup>th</sup>. Talk soon.

#### Operator

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