

Empire Company Limited

Second Quarter 2023 Conference Call

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PRESENTATION

Operator

Welcome to the Empire Second Quarter 2023 Conference Call. At this time, all lines are in listenonly mode. Following the presentation, we will conduct a question-and-answer session. If at any time
during the conference you require immediate assistance, please press *, 0 for the Operator. A reminder
that today's call is being recorded, Thursday, December 15, 2022, and I would now like to turn the
conference over to Katie Brine. Please go ahead, Katie.

Katie Brine

Thank you, Michelle. Good afternoon and thank you all for joining us for our second quarter conference call. Today we will provide summary comments on our results and then open the call for questions. This call is being recorded and an 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; and Pierre St-Laurent, Chief Operating Officer.

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

Thanks, Katie. Good afternoon, everyone.

We're pleased with our Q2 performance. Despite the challenging economic environment, we delivered strong financial performance with much-improved same-store sales, including our full service banners, continued improvement in our gross margins, and strong execution against our strategic priorities.

Today, I'll focus on three topics: the IT systems issues we have been dealing with, our Q2 results, and the continued rollout of our Scene+ loyalty program.

Let me start with the IT systems issues. On Friday, November 4th, we experienced some IT systems issues related to a cybersecurity event. As soon as we became aware of the issue, we immediately implemented our incident response and business continuity plans, including the engagement of world-class experts.

On the morning of Monday, November 7th, we sent out a press release concerning our systems issues. Following the advice of our advisors, that release was as specific as we could make it due to security reasons. We are now in a position where we can provide more details. However, we will not elucidate further on this subject beyond these prepared remarks in our published disclosure.

After discovering the intrusion, we immediately began to isolate the source and shut down certain systems to prevent further spread and to protect our operations and our data. This ensured that we were able to run our stores with little disruption and with thankfully, no interruption to our supply chain.

But this event and our precautionary response did cause some temporary problems. For example, we shut down many of our pharmacy services but, fortunately, only for four days. And some of our in-store services were impacted for a very limited time in areas such as self-checkout, gift cards, and the redemption of Scene+ points.

Despite this, and thanks to the incredible people who run our business day in and day out, our customers would have noticed very few changes to their usual shopping experience. We have been able to fully serve customers for several weeks now, and we are in a very good position to help customers celebrate the holidays.

As you can appreciate, this has been a challenging time for our teams. There were a lot of workarounds and in-the-moment solutions that carried us through, many built and implemented by our incredible frontline teams. I'd like to thank all of our stakeholders, specifically our teammates, customers, franchisees, supplier partners, and shareholders for their patience and understanding as we put this behind us.

Matt will provide more details shortly, but this matter had almost no negative impact on our Q2 results, coming as late as it did in the quarter.

Now on to our second quarter results. It was a good quarter. Our sales grew 4.4 percent including same-store sales of 3.1 percent, which was 440 basis points higher than last year and 270 basis points higher than Q1.

As you would expect in this inflationary environment, our discount business is very strong with double-digit same-store sales. But what might surprise you is that our full-service business is more than holding its own with solid and positive same-store sales.

Our full-service stores are satisfying the needs of the value-seeking customer through an excellent assortment of Own Brands products, strong and relevant promotions, better personalized offers, and great quality of service. We are seeing the positive impact that Scene+ has had on our Atlantic and Western Canada businesses already this quarter, with well over 1 million new members joining the program since we launched.

We continue to see higher transaction counts and a smaller basket size versus the prior year but not back to pre-pandemic levels. And as customers look for value, it's not surprising that promotional penetration increased this quarter, and we saw double-digit sales growth in our Own Brands portfolio.

As well, our Longo's banner performed very well this quarter, realizing its highest same-store sales growth since our acquisition in spring 2021.

I'm pleased to see that both our discount and Own Brands businesses are outperforming the market and gaining share to deliver value to customers when they need it most. We have launched over 240 new private label SKUs in the past 12 months and have another 200-plus SKUs planned to launch in the next year to ensure we maintain this momentum.

Overall, our e-commerce grew 4.6 percent. Our Voilà business continues to grow with comparable sales of 14.4 percent, driven by particularly strong growth in Toronto. Voilà is also performing very well in Quebec and is now materially larger than our prior IGA net business year over year.

Grocery Gateway is down 14.1 percent from last year, reflecting the lower performance of most e-commerce businesses post-pandemic, with the exception of Voilà. Having said that, Grocery Gateway's three-year stacked sales growth is still 12.3 percent.

Our gross margin performance continues to improve. Our margin rate grew 29 basis points and, excluding fuel, it grew by 58 basis points. This growth was largely due to our Horizon initiatives, notably promotional optimization and Own Brands. Inflation actually hurt this margin number.

If our full-services store can deliver positive same-store sales and margin expansion as it did this quarter during these periods of high inflation, you can see why we are confident that our performance will be even stronger as inflation eases. Our team is executing consistently, and we've continued momentum as we head into the final two quarters of Horizon.

Now an update on our Scene+ loyalty program. We launched in Atlantic Canada in August, then Western Canada in September, and most recently, Ontario in November. We are extremely pleased with the rate the customers are signing up for the program and the week-over-week growth that we are seeing in our on-card sales penetration.

Our launch in the West marked the first time that our discount banner, FreshCo, has had a loyalty program. Their on-card sales penetration out of the gate has exceeded all of our targets. As FreshCo continues to build presence and brand equity in the market, particularly in the West, loyalty is a meaningful addition to provide our customers with even more value.

Our most recent launch in Ontario was our biggest yet, including four banners and reaching over 5 million households. Although it is still early days, we have been very pleased with its performance and early customer traction. We will complete the Scene+ rollout across our remaining banners in early 2023 and look forward to offering our customers from coast to coast the exceptional value and benefits of this program.

Before handing it over to Matt, I also wanted to mention that today, we announced the sale of all of our retail fuel sites in Western Canada to Shell Canada for approximately \$100 million. We expect this transaction to close in the first quarter of fiscal '24.

In reviewing our portfolio, we determined that our fuel business in the West, which does not have a meaningful convenience store business, is not core to our offering. This sale allows us to realize the value of these assets while continuing to benefit from the foot traffic generated by these sites. Shell is a good partner and, through their investment in these sites, we expect to see increased benefits to both their business and our nearby grocery stores.

We wish everyone a safe and happy holiday season and, with that, over to Matt.

Matt Reindel

Thank you, Michael. Good afternoon, everyone. I'll provide some additional colour on our results, the cybersecurity event, and then move on to your questions.

Gross margin performance was strong again in Q2. If you remove the impact of fuel, our gross margin rates increased by 58 basis points.

At the beginning of Horizon, we said that the benefits would be back-end loaded, and we continue to see that come to fruition as the initiatives we have worked on over the past six years through Sunrise and Horizon continue to deliver expansion of both gross margin dollars and rate.

As you know, we are focused on the financial sustainability of our growth initiatives. These initiatives have been embedded into the core of our business, and we expect them to continue to generate growth in the years ahead.

Our SG&A was 21.8 percent in Q2. That's 59 basis points higher and \$114 million higher than last year. However, it is closely aligned to our plan for fiscal '23, which includes continued investment in our key current and future initiatives. To achieve sustainable future sales, margin, and profitability, we continue to invest in our growth initiatives, which requires an upfront investment in SG&A. I'll take you through a few examples.

First, our current Horizon initiatives. So since Q2 of last year, we have put up 12 new FreshCo stores in the West, five new Farm Boy stores, significantly increased sales from our Toronto CFC, and started operations at our Montreal CFC. These initiatives immediately increase our SG&A dollars, and our SG&A rate is adversely impacted until they ramp up the sales.

Second, we are investing in new initiatives that will generate future growth, such as personalization, loyalty, and space productivity. These initiatives require upfront SG&A investment and will generate significant returns in the future. We're very excited for the benefits that they will deliver, and we've proven over the last six years that these type of investments provide great returns to our shareholders.

Now, not all of the increase in SG&A is related to these initiatives. Like others, we are facing inflationary pressures on utility rates, particularly in Western Canada, as well as labour rates, transportation, and supplies. In addition, our depreciation is higher than last year, mainly due to an increase in right-of-use depreciation and IFRS 16, reflecting an increase in occupancy costs. But ultimately, the vast majority of the increase in SG&A is planned investments in current and future key initiatives and very much in line with our plans.

Our equity earnings this quarter were higher than last year, mostly due to higher Crombie earnings, partly offset by lower earnings from Genstar. These movements are due to the timing of property sales in both fiscal '23 and fiscal '22, which fluctuate throughout the year. So we're very pleased with our Q2 results. Our earnings per share of \$0.73 represents growth of 10.6 percent over the prior year.

Our balance sheet remains strong. We renewed our credit facilities for both Sobeys and Empire for another five years, confirming our banking syndicate's confidence in our business. This provides ample liquidity for our capital allocation strategy. Year to date, we have invested \$410 million in capital. This quarter, we renovated 14 stores, opened our 45th Farm Boy, and opened our 42nd FreshCo store in the West.

With regard to our share buybacks, as of this week, we have repurchased approximately 4.4 million shares in fiscal '23 for a total consideration of \$169 million.

Now some further details on the cybersecurity event. As Michael noted, it had almost no impact on our Q2 results as it happened two days before the end of the quarter.

For the balance of the year, we are still assessing the impact, but we do not expect it to be material. Based on our latest assessment, we estimate that the total aggravation after insurance recoveries will be approximately \$25 million.

Due to the accounting rules for insurance claims, there may be some timing differences between when we record the costs and when we record the insurance recovery. That may impact Q3 and Q4. But at the end of the day, we are estimating a net impact of \$25 million to net earnings. This estimate includes certain business losses, such as shrink and additional labour, and then direct costs, such as IT professional expenses and legal expenses.

This is an early view, and we will provide more details with our Q3 results. We consider this to be a one-time exceptional item, and it will be excluded from our assessment of Project Horizon.

Looking forward operationally, our customer-facing operations are back to normal. We continue to systematically bring our information and administrative systems back online in a controlled, phased approach. This event has reinforced the importance of the investments already made in the cybersecurity area, as well as our upcoming investments in our IT systems and people.

Well, we're now halfway through fiscal '23. It has been an eventful first half of the year with the launch of Scene+ and the sale of our Western fuel assets, not to mention effectively managing through inflation, Hurricane Fiona, and this cybersecurity event. But regardless, we enter Q3 with strong momentum, and we remain on track to hit our Horizon targets.

And with that, I want to wish you all a safe and happy holiday season. Katie, I'll hand the call back to you for questions.

Katie Brine

Thank you, Matt. Michelle, 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. If you would like to ask a question, please press *, followed by the number 1 on your telephone keypad. If your question has been answered and you would like to withdraw from the queue, please press *, followed by the number 2. Please stand by while we compile the roster.

Your first question will come from George Doumet of Scotiabank. Please go ahead.

George Doumet — Scotiabank

Yeah. Hi. Good afternoon. I want to talk a little bit about the positive same-store sales trend for our first full-service business. Could you talk to maybe how the performance was interquarter? And maybe some puts and takes from our areas of operation, so perhaps east versus west? Maybe any colour you can provide there. Thanks.

Matt Reindel

I think the key point for us really is the positive performance of full service. I think it's very well known how well discount's performing, but we're really happy with full service. And the strength of full service, again, comes from within the store.

So we talk about the economic conditions of consumers trading down. We see that, but we are dealing with that very well within the store. Within the full-service store, with our great portfolio of Own Brands, our value pricing, we're really catering well to that particular consumer.

I would say our performance in full service is improving, certainly versus what we saw in Q1. So our momentum is improving. And then on a geographic basis, we're seeing that pretty much across the board from full service across the country.

Michael Medline

Yeah. I pointed out in my script in the beginning part that Atlantic and West were maybe a tiny bit stronger, and I think some of that was because of Scene+ coming in. But it was pretty consistent across the quarter; maybe a little stronger, like Matt said, as we got to the second half. But across the country, usually you do see some different results from across country. It was very consistent this quarter.

George Doumet

Thanks a lot, Michael.

Michael Medline

And welcome, by the way, George.

George Doumet

Thank you. Appreciate it. Michael, last quarter you gave us some colour on updates with I guess the negotiations with the vendors on kind of price increases. It looks like the CPI maybe has peaked, but I was just wondering if you could maybe give us an update there in terms of how it's going with vendors and on price increases.

Michael Medline

Sure. And I'm going to ask Pierre to do that because he's been dealing with it quite a bit lately.

Pierre St-Laurent

Good question. We continue to see price increase asks from vendors at the same level in both numbers and rates right now, we're not seeing it slowing down. However, we are crossing a high inflation period last year. So we hope that will start coming down in terms of rates, but we still have a lot of price increases.

We have our national sourcing team who is doing an excellent job right now to challenge every single cost increase. It's a balancing act between accepting cost increases when it's justified and pushing back when we believe that it could hurt customers, and it's not justified. So the team is extremely rigorous on that because we need to protect our relationship with vendors, and, at the same time, we need to protect our customer.

George Doumet

Great. Thanks for the colour. I'll pass the line.

Operator

Your next question comes from Kenric Tyghe of ATB Capital Markets. Please go ahead.

Kenric Tyghe — ATB Capital Markets

Thank you and good afternoon. Very strong growth in quarter at Voilà. I'm wondering if you could just speak to the dynamics of the Voilà basket just on that broader assortment. What was the extent of the trade down within the online basket? How are you managing it?

And then the follow-up there would also be to speak to the delivery passes. How important are those in terms of managing the macro pressures? And to the extent you're able or willing to comment, what is the penetration of those delivery passes or attachment to the delivery passes within the Voilà business?

Michael Medline

Well, with the inflation, we're seeing a little bit of trading down but not nearly as much in the online business as we would see in our bricks and mortar business.

What was the second part of the question, Kenric?

Kenric Tyghe

Just the delivery passes, Michael. How important are they as a tool? And what's the attachment or penetration?

Michael Medline

Yeah. I mean we do so many different things—and I'll give you some statistics in a second—to attract and retain customers. The delivery passes, as you've seen, we've found is a good way to serve our customers, and, obviously, they create a very sticky customer relationship. One, because if you're going to sign up for it, you really do love Voilà, and secondly, if you've signed up you want to use it more. So I think we're good there.

But all these things together, and delivery passes is only one of them, we're gaining about 1,000 new customers a week at Voilà. Our retention rates are extremely high; the highest I've ever seen in ecommerce.

We have strong ratings on our products, and we have more and more SKUs coming online as well, Kenric, which is also helping. So that plus all the other good things that Voilà naturally has, but people really like Voilà. The promoter scores are off the chart. And when they try it, they're hooked. But I think it's a good question. The delivery passes are a very good way to serve our customers, and they create quite a good relationship.

Kenric Tyghe

Thank you, Michael. I appreciate the colour there.

If I could just switch to Scene quickly. While your partner is carrying a lot of the costs associated with the transition, there appears to be little to no dislocation from the early stages of the transition. Can you speak to how reflective of reality that perception is? And how you would expect that to evolve as the Scene offering ramps both within the markets it's already in, but also as it sort of ramps as a national program?

Michael Medline

When you say dislocation, I just want to make sure we're answering it correctly. What did you mean by that?

Kenric Tyghe

The consumer response, the uncertainty sort of being a little caught between two stores, the noise around a transitional loyalty program that often creates some dislocation for consumers.

Michael Medline

Oh, okay. Good. So you're talking about how we left one program and went to another and how's it going?

Kenric Tyghe

Yeah. Essentially. Thanks.

Michael Medline

Okay. Yeah. I mean first of all, you should know that—investors on the line—this is a very disciplined, process-driven company you've now invested in. And we have been working on transition for years now and making plans, challenging each other. And I got to point out that Pierre was especially the most challenging to all of us in terms of making sure that this was as simple a way to transition over to a new program and as attractive a new program as we could possibly do.

I'd say that—August 11th, that night when we changed over, it was a long night for many of us because we wanted to make sure the cutover worked really well, that the stores were all ready, and that all the offers were working. And that worked great in Atlantic. It worked better in the West. And it worked even better in Ontario. So the physical, the operational cutover was fantastic.

And then the customer take-up, and we'd gone through every scenario and every concern we had and tried to dot every i, cross every t on this, and I think that our pre-work and the discipline we showed on that has really, really worked out well.

And really, there's not been too many hiccups, our customers, by every measurement, have enjoyed the experience. We are tracking customer sentiment both by survey, by social media, by sales, by products, every way you can do this, and really it's exceeding all of my expectations for this program at this point.

However, this is a decades-long program, and we're four months in. So a lot of the real strength of this program in terms of having even more loyal customers than we do today or being able to personalize offerings to customers or to be able to serve customers even better by understanding them better through the loyalty program and use of data, are still to come.

So right now, we just want to throw them with a new program, give them really good offers, make it exciting. And by the way, we have great partners, and then we got another great partner, Home Hardware, joining next summer. So that's the way we're doing it.

But you're absolutely right. Like any change in a retailer, especially a grocer, even in the store when you move a product from one end to another, that causes dislocation, to use your word. In this case, this is a change to customers, and we treated them with respect, transparency, good communication, and a great new program.

Matt, do you want to say anything else?

Matt Reindel

Yeah. Just to add to that financially. So you see the announcement that Scotiabank made in terms of how much partner support they provided to us through this transition. To Michael's point, as we transition from one program to another, that was a significant investment in cost in order to make sure that these transitions were effective.

You will not see that impact in our P&L because we are offsetting those investments dollar for dollar from our partner at Scotiabank. That's the reason that we were able to negotiate the deal that we did, it was to give us that strength of leverage during this transitional period. It again, talks to the strength of the deal and the quality of the program we're putting in place.

Kenric Tyghe

Great colour. Thanks so much. Happy holidays, and I'll get back in queue.

Michael Medline

You too. Thanks.

Operator

Your next question comes from Mark Petrie of CIBC. Please go ahead.

Mark Petrie — CIBC

Yeah. Thanks. Good afternoon. I wanted to follow up on your comments just with regards to the performance in the full service banners on same-store sales. And you called out Longo's specifically as sort of having I think you said the best same-store sales results since you acquired it. And I know you don't give specifics, but hoping you could also just talk about Farm Boy and, at least in the Ontario market, Sobeys sort of the relative performance across the different banners.

Michael Medline

Yeah. You're right. We don't usually specify that. I gave a little bit of detail, which maybe now I won't give anymore because then you're going to ask me more, but no. I'm kidding, Mark, by the way.

I'd say that we're pleased with all our banners. Farm Boy being pretty well as full serve as any banner out there, and the way they conduct business is always strong, but I called out Longo's because that was the best quarter since they joined us. This is certainly not the best quarter of course since Farm Boy joined us because they've been around a longer time and they've put up big numbers and inflation does affect them a little bit.

I think one of the great success stories that we've had—Pierre, you can correct me — but over the last few years is actually Sobeys Ontario and the strength and the growth in Sobeys Ontario, both the brand strength, but especially the sales growth. So that's been good.

And we never talk about it, but a shout out to our teammates at Foodland and our franchisees at Foodland, which is a much stronger and larger banner than I think people know, and that's partly my fault because we don't talk about it all the time. It's just there doing well.

So the Ontario market, which we really wanted to grow in starting five-and-a-half years ago, everything's working for us right now. Much greater strength at Sobeys; the addition of partners like Farm Boy and Longo's, Voilà, and now we put the loyalty program on top of it all and with a great Foodland banner that we always had.

And the other thing we've done too and don't talk enough about are the renovations and the improvements to these key stores in the Ontario market. And we're not done yet. But these renovations are really helping our sales and our attraction to the customers.

And I didn't even mention FreshCo. And FreshCo, obviously, is kicking it right now, their strongest quarters over the last couple of quarters in their history. Part of that is because people have turned to discount in the time of inflation, and part of it is darn good execution and strength all over, but especially in the multicultural area.

So there, you asked one question, and you got like five answers there, Mark. Probably not the one you were looking for, but I hope that's helpful.

Mark Petrie

No. It definitely was helpful and don't let a pesky little question from me dissuade you from that type of disclosure.

Michael Medline

But it's a good question and thank you.

Mark Petrie

Yeah. And so I guess just following up then. On full service, do you have a view if you're gaining share within the full-service channel?

Pierre St-Laurent

I'll take this one. So, obviously, we won't disclose market share per banner and things like that. But the thing we are also looking at, it's the transaction count, and I think we said that at the beginning, where in all our full-service banners across the country, we are seeing growth in transaction counts. So customers continue to go in our stores, which is a good sign.

Even some banners in the country are seeing higher household penetration. So that means for us that people like our full-service store. They appreciate our promotion. We're doing our best with the tools we have. Own Brands is performing extremely well right now.

I don't think it's true to say that customers are shifting from one format to another one. They are just shopping more stores. But the good news is they remain extremely active in our full-service banners. It's why we're very pleased with our results.

Michael Medline

Pierre, just to follow up on Mark's question because that was a good answer. But would you say that, seeing the statistics you see, do you think we're losing, gaining, or holding our market share in just full service versus full service?

Pierre St-Laurent

We're always comparing our numbers versus previous years. So if we look at our market share pre pandemic versus now, we feel really good about our market share.

Mark Petrie

Yeah. That definitely is helpful. I appreciate that, Pierre. Thank you.

I guess one other one just to follow up again, also on Scene+, be helpful just to sort of understand maybe a little bit better about how that program is actually managed. I mean, are there sort of specific stewards for Scene+ across Empire that coordinate across the banners? Or like is it within the banners? Because there are sort of different approaches, it seems like, in the different banners. So just curious how that program actually gets managed and leveraged.

Matt Reindel

Sure. I'll take that. Great question. So the Scene+ program is its own entity as an independent entity. And then sat on top of that entity, you have a management board that comprises each of the three owners of the program.

So the entity runs. It's provided guidance. It's provided direction from that management oversight committee. And that committee makes the key decisions on budgeting, points, strategy, communication, marketing, all of those types of things.

So now that's on the Scene+ side. Internally, on our side, our marketing organization, obviously, has a very strong link to the Scene+ team so that we can make sure that the program is delivering on our internal objectives in terms of marketing within our store, making sure that we have good sign-ups, making sure we have good points issuance, and ultimately good levels of point redemptions. It's a combination of the two. That's the governance on top of Scene+ but then our own internal resources, predominantly in marketing, who really drive the program.

Mark Petrie

That's super helpful. Thank you. I'll get back in queue, and if we don't speak again, happy holidays.

Michael Medline

Thanks, Mark.

Operator

Your next question comes from Peter Sklar of BMO Capital Markets. Please go ahead.

Peter Sklar — BMO Capital Markets

Okay. Thank you. On this gross margin performance, which was up about 60 basis points ex-fuel, you talked about promotional optimization and the contribution from Own Brands. Can you talk about like some of these other factors and how they would affect the margin? So for example, the trade down from conventional to discount, I would assume discount structurally has lower gross margin. Pharmacy, I would think in your pharmacy, particularly out West, I think all the Safeways have pharmacy front store would be very strong.

And then, Michael, you said something very interesting in your commentary that inflation is hurting your gross margin. And what does that mean? Does that mean you're unable to pass it all through?

So if you could just talk about some of these other factors.

Michael Medline

I'll start. Then I'm going to send it to Matt on the other questions. Just the one that I said.

When we do our numbers and we take apart everything and take a look at it, when we take out all the other factors and when we look and isolate what happened in terms of being able to pass on the cost and also looking at the margin and what happened there, we can't pass it all on. And we don't pass it all on.

And so you start knowing every quarter that—at our company at least, I can't speak for anybody else—that you're a little bit behind the eight ball in terms of inflation right away. And I think, fortunately for us, that we had Project Sunrise, then we had Project Horizon, which we're finishing, not all of which will finish right at the year-end. And we have all these great initiatives and improvements in our stores that are going on that can overcome that inflation headwind by being able to operate stores better.

So that's why it'll surprise many, but we pray for the end of inflation. One, the first reason is because it's just not good for Canadians or consumers. It's just a horrible thing. Nobody wants to pay more for anything. And we feel that. And the second part is, it's not good for our business. And so we want the end of inflation. But when you take it apart, inflation does not help our margin. It does not help our company.

Peter Sklar

Okay. Got it.

Matt Reindel

And then to answer the second question, Peter, you're absolutely right. When we look at our gross margin evolution, we're calling out what the two major drivers are, being promotional optimization and Own Brands, but there's many other drivers that impact margin. And you're absolutely right.

So the higher discount sales is dilutive because obviously discount has a lower gross margin. Pharmacy is slightly higher, so that helps us. Longo's is slightly higher, so that helps us. And Voilà is slightly higher, so that helps us. And then we also have some hits from transportation costs and shrink.

So there's many other variables within that gross margin calculation. But two major points as we're seeing right now is, from a business unit mix perspective, it's basically flat, which has not been the case in prior quarters. And all of the other factors that I just listed kind of net out. So the two major drivers for the quarter are the two that we listed being promo optimization and Own Brands.

Peter Sklar

Okay. And, Matt, you obviously are seeing the asks from your CPG suppliers that I understand get implemented early in the new year in February. So do you have a view on retail food inflation? Not necessarily for Empire, but just for what the industry is going to be in the first half of calendar 2023. You must have some number in mind that you use for budgeting and planning purposes.

Pierre St-Laurent

That's a great question that we have in mind all the time, but it's very tough to predict. The situation is still very volatile. But yes. At the same time last year, we had high inflation. We expect a lower inflation rate than we're having right now. So probably a couple of points, maybe more, lower than the highest we've had this year.

So because it's evaluating a lot, the last two quarters have been very intense. Last year at the beginning of December, January, that's where we saw a big spike in the inflation. So by crossing it next year, we expect to see a lower inflation rate than the one we had to deal with over the last couple of months.

Peter Sklar

Okay. Thanks, Pierre. And then just my last question, just switching gears to Voilà in terms of the fiscal '24 outlook, I know you're not providing any guidance. But is this the right framework to think about it in terms of the losses at Voilà is that Toronto and Montreal will be ramping. So their losses will be less. But on the other hand, Calgary will be introduced. So there will be losses associated with that. And then they're just going to kind of net out to each other. And like is that, on the net basis, is that all going to be a positive or a negative impact?

Matt Reindel

Yeah, so your summation is right. We expect it to be positive, for sure. The growth in sales and as we've talked about before, that model is a top-line-driven model. So yes. CFC 1 will continue to grow. CFC 2 will continue to grow. And we'll have offsetting that, the start-up costs for CFC 3. So yes. You're absolutely right.

Peter Sklar

And, Matt, would you hazard a guess as to net-net how that's going to fall out?

Matt Reindel

It's a good try, Peter. No. We're not going to comment on that at the moment. We're still working on that.

Peter Sklar

Okay. Understand. Thank you for all your comments.

Michael Medline

Thanks, Peter.

Operator

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

Irene Nattel — RBC Capital Markets

Thanks and good afternoon, everyone. Just continuing the discussion around gross margin, where in the trajectory of project optimization do you think you are? I don't know, Michael, if you want to talk about it in periods of hockey or innings of baseball or whichever sports analogy you like. But really, how much more is there yet to come?

Michael Medline

You always know I'm going to answer it if you ask me that way. When you say that, you're talking about not just Horizon, but other initiatives that we're introducing and are going to be coming in the years ahead?

Irene Nattel

Around promo optimization? Yes.

Michael Medline

So just promo?

Irene Nattel

Or whatever you'd like to share, Michael.

Michael Medline

Well, there's some other ones that are really in the early innings that we're pretty excited about, too. But promo, what inning do you think we're at in promo, Pierre?

Pierre St-Laurent

Promo optimization, there's always continuous improvement that we will capture over time. But most of the benefit has been captured because the tool is really well embedded in the daily work but will continue because the data will continue to evolve. So the promo optimization tool will remain a good weapon for our team. So it is very tough to isolate the promo optimization benefit going forward.

We have benefit, for sure, versus having no tools. The team is working really well and improving their ability to play with that, but right now, we need more than promo optimization. We need good professional judgment because there's a lot of volatility in the market. It's very tough. The big benefits have been captured, but we expect to continue to capture additional benefits because that tool is so well embedded and well managed, and there's always opportunity to capture and to improve our performance.

Irene Nattel

That's very helpful. So as I look at the performance for Q2, it's interesting, so the gross margin gains, it sounds as though a lot of that should be sustainable, putting aside the distortion from fuel. But yet the OpEx rate is going up as you're investing. So is it best to kind of look at those two as one, perhaps, offsetting the other? Or how should we be thinking about the run rate on OpEx on a go-forward basis?

Matt Reindel

I don't look at the two of them together. I think I've said many times that the gross margin is the true kind of test of our sustainable performance. We're very, very focused on gross margin rates. So the 58-basis points improvement is a really good testament to what we're doing there.

On SG&A, it's a little bit of a different story because our SG&A rate is higher, and, as I said in my script, the dollars are higher and the vast majority of that is due to these strategic investments. We have a very good track record of delivering great returns from these investments. So we're not going to back off on that.

What we do have is strong cost control. We have to manage our costs. We're doing a good job of that. We have a good strategic sourcing team and a good real estate team that is really looking at controlling our costs and making sure that we have good cost control and a good lean mindset within the Company. But the vast majority of the increase is investments that will pay dividends in the future. So we're not going to back off those investments.

Michael Medline

I think it's fair to say, Matt, that going forward, we're looking at fewer, more impactful initiatives to drive sales and margin and that SG&A is going to be more and more a focus of this company in coming years. And as you know, Irene, as well as anyone that this has been a company that's been in a six-year turnaround, which we're ending, and that we had to invest probably more than others did in terms of getting ourselves to that place where we can really compete and put in everything we want to put in.

That's not to say we won't invest anymore, but I think as we enter this seventh year of all these programs, we're a much more mature company that is going to be able to operate and drive business through normal channels in the business and have fewer initiatives going on while investing in our stores and our people and our supply chain more and more but not so many of the sort of initiatives we needed to be competitive and to actually put in all the assets we have.

So as we mature and we end this sort of six-year turnaround period, the eye will turn to SG&A more and more. And that's just to be more efficient. I think we did a very good job in Sunrise in terms of being efficient in terms of structure and headcount. This is to take some of the costs out that we've been spending in terms of on initiatives or on some consulting help that we had in other places. So that's what we're going to be even more disciplined on as we go forward over the next number of years.

Matt Reindel

And what you'll see, Irene, from a rate perspective, as these initiatives start to pay dividends in terms of increased sales, we'll get a better leverage of our sales. And then to combine with what Michael said about cost control, that's when you'll start to see that SG&A rate start to come down.

Irene Nattel

That's really helpful. And then just a couple of housekeeping questions if I might. The stores that you sold in Western Canada, the gas stations, are those the ones that were co-located on the Safeway sites? Or are these others?

Matt Reindel

They are the ones we acquired in the Safeway acquisition a while ago. So, yes, they are colocated.

Irene Nattel

Okay. That's great. Thank you. And then just thinking through the cyber impact, that \$25 million, I guess it'll kind of show up on most lines on the P&L in Q3 and Q4?

Matt Reindel

Yeah, good question. So it will appear in basically two lines, which is margin and SG&A. So if you think about the two buckets of costs that we're incurring, one is business-continuity-type costs, so shrink, a little bit of higher labour, but the shrink piece of it hits margin. And the second piece of it is direct costs, so professional fees, IT fees, and they would hit SG&A. So it's going to hit both of those lines, margin and SG&A.

Irene Nattel

Okay. And so I guess you'll just call out sort of the aggregate impact and sort of what you think it was in each of those lines?

Matt Reindel

Yeah, that's the intention. As I said, we'll have much more information by the time we get to Q3, but we will guide you accordingly.

Irene Nattel

That's great. Thank you so much, and happy holidays to all.

Matt Reindel

Same to you.

Operator

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

Vishal Shreedhar — National Bank Financial

Hi. Thanks for taking my questions. On the \$25 million impact related to the cyber attack, that's a net of insurance recoveries. But given that the insurance recoveries may or may not come in the upcoming quarter, can you also give us the gross amount? Or is that not available at this time?

Matt Reindel

So no. We're not going to provide the gross amount. And you're right. Because of the timing difference that might be applicable to us in Q3, we don't know the answer to that yet by the way, so there might be a timing difference between Q3 and Q4 in terms of when we can actually book the recovery. But no. We don't intend to share the gross number.

Vishal Shreedhar

Okay. And just changing topics here. Michael, you indicated that, after this period of heightened investment related to getting your business back up to the competitive level that it needs to be to compete on a sustainable basis with peers, you'll turn your eye more fulsomely at cost-saving opportunities.

Given that the first Project Sunrise, there was a significant amount of cost taken out and I think you even exceeded the number that you initially provided, wondering if you do see in the business more big buckets of cost opportunity in there. And maybe if you can give us a sense of where management might be looking to get those types of savings.

Michael Medline

I think we'll be able to give you a lot more detail on that in next six months.

My experience is that you do what we did in Sunrise and then every five years or so you got to go back and make sure that you're efficient and you're productive and that you're using your resources in the best way. And if you don't do that, then you're silly. So it's time to do that.

We're still going to invest in things that make us stronger and make our shareholders more money and thrill our customers. We're going to continue to invest in our stores and our supply chain. We have great people, and we got to make sure that we're optimizing that, especially in new areas like data analytics or our really strong growth kind of e-commerce businesses. But you have to go back and do that.

And one of the things Matt wanted to do when he was relatively early in his tenure is get to this. And he and some of the other executives are looking at it and saying okay. What can we do to take costs out of the business—and I don't think it's going to be a people exercise to be honest. It's going to be taking costs out of the business where they can be taken out and really emphasizing that even more than we do—we've been a pretty good cost control company over the last little while, as you've seen. But now that we've got that turnaround behind us, now is the time to be mature and constantly be taking costs out. And really great retailers grow their company and they watch their costs, and we have to continue to do so.

Vishal Shreedhar

Okay. And just to follow up on another question asked, and, Michael, you already elaborated on this, but the balance between investment and that SG&A line, the sales line, a little bit hit to EBITDA here.

And I think Matt referenced that we'll see some of that leverage starting to come through as some of those initiatives that you're working on continue to and bear more fruit.

So is this a short-term timing lag? Or do you expect this timing lag to persist between the high SG&A and offsetting the good gross margin and top-line performance?

Matt Reindel

Well, I'll take a first pass at that. I mean it's not something that you would expect to see a notable reduction in the next six months. I mean these projects are long-term projects. When you think about Scene, for example, this is a multiyear project. Same with space productivity. Same with personalization. So we expect that to appear into the P&L gradually over time. I wouldn't expect to see a step change reduction. Yeah, these are long-term projects. There's gradual improvement.

Michael Medline

By the way, I'm not apologizing at all for our SG&A. It didn't get away from us or anything like that. We're just getting some projects that are going to pay off for us in place. There area couple of them, and then some inflationary cost pressure that's affecting all retailers, let me assure you.

And there's two ways of doing this, as you know, Vishal, better than anyone: grow your sales and take down your costs and thrill your customers at all times. It's a simple business, and that's what we're going to be doing.

Vishal Shreedhar

Thanks for that colour.

Michael Medline

Thanks, Vishal.

Operator

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

Michael Van Aelst — TD Securities

Hi. Good afternoon. I wanted to follow up on the OpEx. So one area that you didn't really bring out much was labour pressures, and that's an area that a lot of, not just retailers, but companies in general are talking a lot about the labour wage rates, the pressures, and how that's driving OpEx inflation. Yet it doesn't seem like it's one of the more material ones for you.

So I'm wondering is this because of offsets coming from efficiencies? Or is it just earlier on in the process, given the timing of some of your contract negotiations?

Pierre St-Laurent

That's a really good question. We're always looking at efficiency, so probably some improvement has been implemented. The other thing we have to consider is the rate is going up. The pressure on wages is going up. But at the same time, we're facing labour shortages. So in some regions of the country, we have empty roles that we're not able to fill, especially in BC and in Quebec. So it's probably neutral right now. But yes, over time, that could hurt us, but efficiency will offset those increases. That's our goal.

Michael Van Aelst

Okay. That's interesting. Thank you. And then I noticed on the cybersecurity impact, you called out the gross margin in the OpEx areas. But do you not expect it to have any noticeable impact on your revenue line?

Matt Reindel

Yeah. Some. Obviously, there was a period of time when our pharmacies were down for four days on an ongoing basis in full service during that period. Did we have the perfect mix of products in store? So it'd be hard to say that it was zero, but it was very, very limited, I would say.

Michael Van Aelst

Okay. And then the non-controlling interest, I'm always a little confused by how that line is working for you, but it was down 36 percent, which means some area of your business was down, I'd assume, in their profits as well. So yeah. I believe Longo's and Farm Boy are in there and probably some of your franchises. So I'm wondering what area is being impacted that's seeing their profit push down and showing up in a lower NCI?

Matt Reindel

Yeah. Well, I'm glad to know you look at our P&L in such great detail. You're exactly right. That line is lower. It's mainly due to our franchisees. So you're right. All those things are in that line. But again, if you think about the amount of profitability that was generated during COVID, so those levels of profitability are a little bit lower this year as we return to normal. So the main driver of that is franchisees.

Michael Van Aelst

Okay. That's helpful. And then just lastly, in your outlook statement, it's pretty much the same as it was last quarter. I think you dropped the EPS number or EPS CAGR in the outlook statement, but you still have it there in the Horizon commentary where you're looking for your 15 percent CAGR.

So is the difference between the two, is it simply just you expect to hit your 15 percent EPS CAGR still driven by Horizon, but the cybersecurity attack will prevent you from doing it on a consolidated basis, I guess?

Matt Reindel

So just to clarify, we haven't changed any of our outlook to do with Horizon. We still expect to hit our Horizon numbers including the 15 percent increase in CAGR. What we have said is that the net impact of the cybersecurity event is we will not include that in our assessment of Horizon.

So as we said at the start of Horizon, we would take significant one-time items out. We would not include anything to do with COVID, orLongo's. So we wouldn't include Longo's in that calculation, and we will not include the cyber event.. But we have not changed the guidance on Horizon. We still expect to achieve that 15 percent EPS CAGR.

Michael Van Aelst

Okay. That's helpful. So you had a benefit in Q2 from the timing of some of the property sales at Crombie. Do you see this balancing out in the back half of the year? Or do you expect that there could be some benefits in the back half as well on a year-over-year basis?

Matt Reindel

Yeah. I mean look. We do expect it to balance out. It's hard when we talk about these with Crombie and Genstar because the nature of property sales is not as stable as food retailing would be. So it all depends on the timing of property sales both this year and last year.

Yes. In Q2, we benefitted a little bit, so \$0.04, I think, versus last year. But on a year-to-date basis, we're basically flat. And on a full-year basis, it's going to be about the same. And we have a sustainable stream of revenue from these equity investments that we expect to continue.

Michael Van Aelst

Excellent. Thank you very much. Happy holidays.

Michael Medline

You too, Michael. Thanks.

Operator

Your next question comes from Chris Li of Desjardins Capital Markets. Please go ahead.

Chris Li — Desjardins Capital Markets

Hi. Good afternoon, everyone. Hi, Michael. In your opening remarks, you mentioned that Voilà is gaining about 1,000 customers per week. I'm just curious to see is that mainly coming from existing markets where Voilà has been available for some time? Or is some of that gain coming from Voilà expanding its service coverage?

Michael Medline

No. I mean it's almost all coming, if not all coming, from just new customers rather than regions. I'm trying to think back on the quarter if we expanded a couple of small regions, but mostly I don't think we did. So these are new customers in the same place. So for the most part, what we would call comparable or same-store, same-customer regions. So that's what we're gaining. We're gaining real customers, not just regional expansion.

Chris Li

Perfect. Okay. That's helpful. And then you also mentioned that Voilà retention rate is much better than the industry. Would you be able to share what the industry average would be so we can get a sense of how good Voilà is performing?

Michael Medline

No. I think you can look it up. And I think others are disclosing it. So I've read some of the reports from others, but we took a look. We're pretty careful here with what we say, so we're very sure we're right. But you'll have to take a look yourself.

Chris Li

Okay. No worries. And then in terms of the Voilà dilution for the quarter, I know you don't disclose it anymore. But I'm just wondering, given the very strong sales results in the quarter, did the dilution perhaps come better than maybe your internal expectation during the quarter?

Matt Reindel

Well, you're right on the first part that we're not going to talk about quarterly dilution anymore. What I would say is, we're sticking with that same guidance that we've given earlier in the year that we expect the full year dilution to be approximately the same as what we did last year, but we're not going to give quarterly numbers, Chris.

Chris Li

Okay. No. That's fine. And Matt, just in terms of the breakout in the cost related to cybersecurity, Would you be able to, just for modelling purposes, like how much of that would be in gross profit versus SG&A for next quarter? Is that roughly 50–50? Just more for modelling purposes?

Matt Reindel

I realize you need it for modelling, but it's too early for us to really say on that. Like I said, we're still at the early stages of that assessment. I'd rather not give a number at this point. Like I said, we'll give you much more clarity in Q3 when we know ourselves. I'd rather do that than give you a number and have to change it.

Chris Li

Okay. No. That's fine. And my last question, just in terms of the proceeds from the fuel site sale, \$100 million I know is not a very big number, given the size of your company. Just wondering, what will you use the proceeds for? Is it going to be for debt reduction? Would you increase your capital return?

Matt Reindel

Yeah. I mean I think you're right; \$100 million in the scheme of things for Empire is relatively small. We said we're just going to use it for general corporate purposes, which is the standard answer. But what that basically means is we're not going to specifically use that \$100 million in the next quarter for X and Y. It'll just go into the general coffers.

Michael Medline

I never disagree with Matt, but \$100 million is never small to me. Thank you. Well, I'm not an accountant, so.

Chris Li

And then I did maybe want to confirm also the sites that you have out East, they are considered core for now. Right? Is that fair?

Michael Medline

Yeah. That's a very different proposition in terms of how it's related to our businesses and how it's tied with our businesses. So we have no current intention of selling those assets.

Chris Li

Great. Thanks a lot, and happy holidays to everyone as well.

Michael Medline

You too, Chris. Thank you so much.

Operator

At this time, there are no further questions. I would like to turn the call back to Katie Brine for any closing remarks.

Katie Brine

Thank you, Michelle. 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 fiscal 2023 conference call on March 16th. Talk soon.

Operator

Ladies and gentlemen, this does conclude your conference call for this afternoon. We would like to thank you all for participating and ask you to please disconnect your lines.