

Empire Company Limited

Second Quarter 2022 Conference Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Empire Second Quarter 2022 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 the call you require immediate assistance, please press *, 0 for the Operator. Also note that the call is being recorded on Thursday, December 9, 2021.

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

Katie Brine

Thank you, Sylvie. Good afternoon and thank you 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 the audio recording will be available on the Company's website at empireco.ca.

There is a short summary document outlining the points of our quarter available on our website.

Joining me on the call this afternoon are Michael Medline, President and Chief Executive Officer; Matt Reindel, Chief Financial Officer; Michael Vels, Chief Development 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'll 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, and good afternoon, everyone.

Before I jump into the quarter, our thoughts continue to be with all those affected by the ongoing disaster in British Columbia. We will continue to work with our local supplier partners as they navigate the impact to the food supply chain and infrastructure. We are extremely proud of our teammates who have navigated the crises in British Columbia and Newfoundland and Labrador over the last several weeks.

I also want to take a moment to welcome Matt Reindel, our new CFO, to this call. Matt has been with Empire for the past two years. He has been absolutely critical in setting up Project Horizon for success and has led our Longo's partnership. Matt joined Empire with extensive experience from Nestlé.

I also want to thank Mike Vels for his great run as CFO. As you know, Mike is an exceptional leader, and we are thrilled he has stepped into the Chief Development Officer role. Mike will now focus his many talents on continuous improvement in our execution, delivering our Project Horizon targets, and our growing ambitions beyond Horizon.

Now let's talk about the business. It was a straight-up good quarter, well executed by our teams across the country. We are consistently putting numbers on the board. We have strong underlying momentum, and in only four-and-a-half months, we will be entering our crucial final year of Project Horizon, which we're feeling very good about.

Today, I want to cover four topics: our continued strong performance, how we're managing inflation, how we're seeing the full-service versus discount split, and e-commerce.

First, our results. This was another strong quarter for Empire. Our sales grew 4.9 percent this quarter while same-store sales grew 90 basis points from Q1 to negative 1.3 percent. As we and many others have said, year-over-year comparables do not tell the entire story as we lap strong COVID sales. Our same-store sales have grown 6.8 percent over the last two years.

Our e-commerce sales, excluding Grocery Gateway, were up 1.8 percent, but this number disguises the fact that Voilà has continued to grow, while being partly offset by our IGA.net and Thrifty Foods businesses, comping strong COVID-driven sales. If we included Grocery Gateway, our total e-commerce sales are up 33 percent.

Sales are up as we continue to execute on key occasions. Our merchants and operators did an exceptional job delivering great value to our customers for Thanksgiving and Halloween. We did this with a great customer experience, in-store and online, exceptional assortment, and great promotions. I'll speak more to inflation in a moment but continuing to offer our customers meaningful value through promotions is more important than ever right now. We have enjoyed significant momentum with these big seasonal events.

On top of that, our investments in our renovations and Own Brands are paying off, especially in our full-service stores. Our renovated stores look and perform in an excellent fashion, and you'll see this continue to accelerate our performance. This successful and significant investment in the interior and exterior of our stores sometimes flies under the radar, but I'm convinced this improvement in store experience will be a game changer for Empire. And continuing to improve on our Own Brands offering is giving our customers increasing opportunities to save money without compromising on quality.

We're very pleased with the progress we've made and expect this will pay off in the current inflationary environment.

Empire's gross margin is strong and improving. Excluding the impact to fuel, we improved our gross margin rate by 72 basis points. This is on top of last year's strong margins and is largely due to our continued progress against Project Horizon, the addition of Longo's, and our business mix returning a little bit more to normal.

Linked to our robust gross margin results, our SG&A rate went up 27 basis points. This is because our higher-margin businesses, full-service, Farm Boy, Longo's, are becoming more and more successful. These businesses have higher gross margins but also higher SG&A, which is why it is critical to look at our bottom line, which is showing solid improvement. Overall, our SG&A expenses were very well managed.

Our EBITDA margin grew year over year by an impressive 36 basis points to 7.7 percent. Our EPS performance was similarly strong at \$0.66, up \$0.06 from last year. Even more dramatic is our two-year EPS growth, which is up 29 percent when we remove the impact of Crombie's unusually large property disposal of \$0.06 in fiscal '20.

I'm also very pleased to report that our free cash flow grew 72 percent over last year, even after funding a very healthy capital reinvestment program.

Our strategy is working. We're growing sales. We're improving margins. We're managing costs. We're generating strong cash flows. We're delivering for our shareholders. We're halfway through Horizon, and we have momentum and still the most upside in the industry. There is so much more to come as we get into fiscal '23.

Next, I'd like to dig into inflation and how we're managing it. Inflation is unusually high right now. The rising cost of doing business is a reality that all businesses across the globe are facing, not just in grocery, but we're managing it well.

Our merchants and supplier partners are out there every day fighting to keep prices low for our customers. Our merchants are doing a fantastic job working with our data to utilize the effect of inflation on our customers, an example of how we're utilizing more and more data throughout our company.

And many of you are familiar with our unique but successful approach to managing our relationships with our supplier partners. With our approach, we have risen to be ranked number two in the annual advantage supplier survey of the top six grocers in Canada. We were at the bottom of the ranking only a few short years ago.

We are working diligently and respectfully together with our supplier partners to manage the cost increases coming through. It's actually because of these powerful relationships that we have been so successful in managing inflation and navigating any supply chain issues so far. Having relationships based on trust and transparency helps us keep conversations focused only on the real unavoidable cost increases so we can maintain the best value for our customers.

And where inflation does impact us, our full-service network is in the best position to manage it. First, our higher-margin model is more adept at mitigating cost increases. And second, our broader assortment gives value-conscious customers a myriad of substitutions. Where we've had unavoidable price increases, we see customers sometimes substituting products within their baskets but not leaving our stores.

Now over to the full-service versus discount split, a topic that has been popular recently. As we've accurately prognosticated quarter after quarter, we expect discount will return almost to pre-pandemic levels but slowly. In other words, we are not seeing fast significant changes. And in fact, we continue to see a lot of stickiness in our full-service banners.

As we look ahead, we believe our full-service stores will keep momentum coming out of COVID. While customer occasions are starting to change, including more business to restaurants, we are seeing a structural change in consumption of food at home. Over the past 22 months, customers have seen and experienced the affordability and convenience in eating at home with their families. We believe there is permanence in this shift.

We're seeing this is how customers are shopping. Prior to COVID, customers shopped an average of eight food stores a month. During COVID, that dropped to one or two, and today, that number is steady at five to six stores. Despite this, our customers continue to favour larger shops and full-service stores.

While some of this is COVID, we've also made significant improvements in the last five years to thrill our customers. We improved our offering, strengthened our price perception, renovated our stores to deliver an exceptional in-store experience. Our customers are giving us credit for it, and it's why we think full-service will be sticky. There's an equilibrium in supply and demand between full-service and discount stores. And our full-service stores have never provided such value and service.

Finally, I want to touch briefly on e-commerce. E-commerce is a small fraction of the market today but is growing quickly and is top of mind right now. For our customers, we believe it will be critical to have the best omni-channel experience that includes e-commerce. And for our shareholders, it will be critical that we do this profitably.

We've run click-and-collect for years in Quebec and British Columbia. At best, it's an okay experience for customers, and we know it's not profitable at scale.

Ocado developed best-in-world technology that thrills our customers and is a profitable solution at scale. And reaching scale is not the same as reaching capacity. We'll get to scale much sooner than that.

We were confident in our investment in Voilà in 2018, and now, after running in the GTA for over a year and seeing the results, we are more confident in it than ever, especially after seeing how little progress non-Ocado technology has made across the globe.

I'll pass it over to Matt in a moment, but as you can see, there's a lot of momentum at Empire. In a couple of quarters from now, we will be done lapping COVID results, as will our peers. We performed extraordinarily well when the chips were down during COVID. Very soon the playing field will be level again, and that's good for Empire.

I've said many times that the second year of a three-year strategy is the hardest. We're making investments, great investments, that are improving our business and not yet seeing all of the benefits. Next year, we expect our investors will see those benefits even more clearly.

With that, I'll pass the call over to Matt for his inaugural report as CFO of Empire.

Over to you, Matt, and congratulations.

Matt Reindel

Thanks, Michael, and good afternoon, everyone. So before I jump into our performance, firstly, let me say how pleased I am to have joined Empire's executive team. And I also want to take a moment to express my thanks to Mike Vels, who has given me the best possible transition into Empire over the past two years.

There's no question that I have some very large shoes to fill, but the great news for Empire is that Mike is still with us in his new role, and together, we will ensure that the CFO transition is extremely smooth.

I'm also extremely happy that for my first quarterly earnings release, I get to talk about such strong performance. So let me provide some additional colour on our results, and then we can jump right into your questions.

Gross margin was 25.3 percent. And if we exclude fuel, this represents a 72-basis-points increase versus last year. Our promotional optimizational tools continue to expand margin, along with the addition of the higher-margin Longo's business. We continue to sustainably improve our gross margin performance. And we're expecting more upside in fiscal '23 from our Horizon initiatives.

Our SG&A was 21.2 percent, which was 27 basis points higher than last year. There's a number of puts and takes which drove this increase. First, Longo's had higher SG&A than our average, and we'll continue to see this mix impact until we comp their results next year.

Second, our depreciation is higher, mainly due to an increase in right-of-use asset depreciation and IFRS 16 reflecting an increase in occupancy costs. These increases were partially offset by lower incentive compensation accrual in the quarter.

Our EBITDA increased by 36 basis points to 7.7 percent, driven by our strong gross margin performance, which was fueled by Project Horizon. We are now halfway through Horizon and on track, and we will continue to see Horizon benefits for the rest of this year and even more so in fiscal '23.

The effective income tax rate for the quarter was 26.2 percent, which is slightly lower than our statutory rate, primarily due to our consolidated, structured entities that are taxed at lower rates. We are still expecting that the effective tax rate for fiscal '22 will be between 26 percent and 28 percent, excluding the effect of any unusual transactions or differential tax rates on property sales.

Earnings per share was \$0.66, which included Voilà dilution of \$0.07 for the quarter. Our e-commerce platforms had combined sales growth of 33 percent over last year, but excluding the acquired Grocery Gateway business, our e-commerce sales grew 1.8 percent. This is primarily driven by the continued growth of Voilà, partially offset by the COVID-related declines in IGA.net and Thriftys.

Equity earnings increased year over year, mostly due to a higher level of activity from our Genstar real estate developments. Property lot sales in California accounted for the highest contribution this quarter. But, as we said in the past, timing plays an important element in these Genstar sales, and this quarter is not necessarily indicative of an increasing trend.

Crombie also had higher earnings due to reductions in their bad debt levels compared to last year, which was impacted by COVID.

Our cash flow generation and balance sheet remain strong. Free cash flow generation increased 72 percent over last year despite the continued investment in our stores.

This also allowed for our continued share buyback program. And as of this week, we have repurchased approximately 4.8 million shares in fiscal '22 for a total consideration of approximately \$190 million.

Also, even with the Longo's acquisition, we have maintained our net funded debt-to-net total capital ratio at 3.3 times.

Strong cash flows allow us to continue investing in our store network. During Q2, we improved 45 stores through renovation, redevelopment, or conversion. This included one new FreshCo store, with seven more to open over the next few months.

We also opened one new Farm Boy in the quarter and two more locations subsequent to the quarter, including one new and one converted site.

Finally, I'd like to congratulate Farm Boy on their 40th anniversary last week. They've come a long way from a 300-square-foot produce store in Cornwall, Ontario to now a network of 42 stores and counting. Tomorrow marks the third anniversary since we welcomed Farm Boy into the Empire family, and we are extremely pleased with the progress we've been able to make together.

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. Sylvie, you may open the line for questions at this time.

Q&A

Operator

Thank you. Ladies and gentlemen, if you do have a question, please press *, followed by 1 on your touch-tone phone. You will then hear a three-tone prompt acknowledging your request. And if you would like to remove yourself from the question queue, please press *, followed by 2. And if you are using a speakerphone, we do ask that you please lift the handset before pressing any key. Please go ahead and press *, 1 now if you do have a question.

And your first question will be from Patricia Baker at Scotiabank. Please go ahead.

Patricia Baker — Scotiabank

Well, thank you very much, Operator, and good afternoon, everyone. Michael, I have one question and then a follow-up. And my first question is directed at you. I would like to unpack a little bit your assertion that there's a structural shift to more eating at home. And interestingly enough, we've heard very similar comments, in fact, that very phrase from Rod McMullen last week on their earnings call. I'd love if you could just share with us your thoughts and what is the thinking. What is it that has led you to that conclusion? And then, obviously, if that is the case, it will be a nice tailwind over the next several years for the grocers in general.

Michael Medline

Yeah. I won't bore you with how many pieces of data we look up to make that conclusion in our business and the way we look at it and how our understanding of Canadian customers and the market. And we also look at our own results.

And we're seeing basket sizes remain at elevated levels to the extent that we believe all these data points plus what we're seeing in basket size are indicating, not only a sticky situation, but in some cases, probably a permanent shift. And so yeah. I agree with Rodney that that's happening in Canada as well as the United States.

Patricia Baker

Okay. Thank you for that. And then my follow-up, just as I'm not sure if it's for Matt, Mike, or yourself. But just in the press release this morning, you reiterated the fact that in fiscal 2022, you anticipate that the dilution from Voilà will be in that range of \$0.25 to \$0.30 per share, which is a number that you've given us several quarters ago. And secondly, also confirmed that you believe that this will be the peak year for Voilà dilution.

So just looking at the fact you didn't change anything there, am I right in assuming that that is indicating that you're seeing exactly what you want to see with respect to Voilà and the first facility and the progress that you're making cost-wise, et cetera in Montreal? That things are going as you had anticipated, and there's no change that would cause you to have any different viewpoint or outlook or how you think that's going to perform over the longer term.

Matt Reindel

Yes. Patricia, I'll take that. I mean the very simple answer to your question is yes. So our dilution for the year is expected to be \$0.25 to \$0.30, within that range, and at Fiscal 22 will be the peak of the dilution. So nothing's changed from our expectations.

Michael Medline

I'll just add on. It's Michael, now that we have Grocery Gateway every year, with Voilà, probably, in the GTA, no one has a better view of what actually goes on in e-commerce across the landscape than we do, and I think people don't quite understand e-commerce sometimes and the seasonal shifts you see in e-commerce. And so, we have a very good understanding what's going on in the business and our confidence level remains very high.

Patricia Baker

Okay. Thank you very much for that, both of you.

Michael Medline

Thank you, Patricia. Have a good holiday.

Patricia Baker

You too.

Operator

Thank you. Next question will be from Karen Short at Barclays. Please go ahead.

Karen Short — Barclays

Hi. A couple questions. First of all, wondering if you could provide what the actual inflation number was in the quarter and what your thoughts are as we go into calendar '22. And then within that, you talked about customer behaviour and strength in private label. So maybe triangulate that with behaviour from the customer perspective.

Matt Reindel

Well, I'll kick that off and then hand you over to Pierre for the Own Brands piece. Consistent with what we've said in the past, Karen, we're not going to give our internal inflation number. That's not something we normally provide.

Pierre St-Laurent

No. I think it's obvious that our Own Brands is a very strong option for customers to mitigate inflation. And our relaunch of this brand couldn't have come at a better time for us. And we did the rebranding more than a year ago. We did the rebuild in many categories already. So, we're really pleased with the progress we've made there.

Even though penetration is not the main metric we're looking as I said in the past, we need to make sure that, Own Brands are playing a key role and a meaningful role in every single category. We're seeing our penetration grow period after period, which is a good sign for how it's accepted by our customers, and how relevant our offer is. And it's really good for our financials, as we strongly believe it's a good margin generator for us.

Karen Short

Are you seeing trading down as a result of inflation and/or are you passing on all cost inflation?

Could you provide any colour on that?

Pierre St-Laurent

There's a cost increase pressure on both Own Brands and national brands. However, we have more leverage to mitigate those costs on Own Brands than on national brands. We're both facing the same issues. The cost of ingredients doesn't change, the cost of packaging doesn't change, the pressure, the inflationary pressure doesn't change. But because it's our Own Brands, we have more levers to mitigate those increases. It's why Own Brands is a more and more popular option for customers and it's good for our bottom line as well. It's a win-win situation for both our customers and us.

Karen Short

Okay. And then it's been over a year in terms of GTA with Voilà. I'm just wondering if you could give a little colour on what that, specifically in GTA, what e-commerce is as a percent of sales and then how you see that trending over time generally speaking. And I'm only specifically asking for GTA obviously.

Michael Vels

Sure. It's Mike Vels. The market has grown clearly through COVID. As we've come off COVID, there's been some return to stores but Canadians and particularly our Voilà customers are much more comfortable about ordering online, and we continue to be bullish about the penetration of our bottom-line grocery, particularly in the urban centres.

We're not currently providing a breakdown of our sales, but I will tell you that for us, it's obviously growing and has been growing since we opened the facility. We've been growing our assortment consecutively every month and that business has good momentum.

Karen Short

Okay. Thank you. Happy holidays.

Michael Medline

You too.

Operator

Thank you. Next question will be from Kenric Tyghe at ATB Capital Markets. Please go ahead.

Kenric Tyghe — ATB Capital Markets

Thank you and good afternoon. Michael, I wonder if you could speak—two-part question on promotion intensity. So the first one would be could you speak to the increase in promotional intensity in quarter and perhaps where in store it is most pronounced.

And the second piece of that question would be how much smarter across the market has promotional activity become? And how much smarter do you think you are? And how much room is there on that journey?

Michael Medline

Sorry. What was the second? I'm probably going to answer that we're smarter somehow. But what was the question?

Kenric Tyghe

How much smarter has the market become in terms of its promotional activity, promotional programs? And in that context, do you think you're tracking ahead or behind in terms of that increase in how much smarter the market becomes?

Michael Medline

Okay. I'll just answer the first part, and then I'll see if Pierre has anything to add. But in terms of competitive intensity, promotional intensity, we're seeing no difference from pre-pandemic times. Pierre, did you have anything to add?

Pierre St-Laurent

No. But we are dealing with a lot more volatility right now for various reasons such as supply chain, on inflation. But now we're using more and more data and tools. So that's really helpful to manage the situation. We're using data that a human alone would not be able to generate.

We have a good outcome from the tools that we implemented over the last year. It's why we have been able to quickly adjust our mix, our promotions, and our promotions remain extremely relevant for customers, and it's why our margins continue to grow in that very volatile environment.

Kenric Tyghe

Thank you. And then if I could, just on supply chain and supply chain related to the pressures, can you just speak to, with respect to your build out West, any potential risks? Or do you see that as being fairly well contained from a timing perspective?

Michael Medline

You're talking about store builds?

Kenric Tyghe

Yes.

Michael Medline

Okay. Mike, you've got real estate.

Michael Vels

The program is really moving ahead according to our expectations. Having said that, the most significant challenge that we're facing and I'm sure anybody who's tried to build anything or do anything that involves logistics and materials these days will agree that it's becoming more complex and harder to stay on time.

So we're mostly making sure that in our store renovation program, we order well in advance. And that program is still managing very well. On CFC 2, we finished our part of that build some time ago and handed it over to Ocado, and they are well on track to be finished on time.

Kenric Tyghe

Great. Thank you. I'll leave it there and get back in the queue and happy holidays, folks.

Michael Medline

You too, Kenric. Thank you.

Operator

And your next question will be from Irene Nattel at RBC Capital Markets. Please go ahead.

Irene Nattel — RBC Capital Markets

Thanks and good afternoon, everyone. Just wondering what you're seeing in the marketplace around competitive intensity, certainly, as consumers become a little bit more aware and sensitive to the rising inflation.

Pierre St-Laurent

We're not seeing more intensity from our competitors. I think we are seeing everybody trying to play around the high volatility. It's why it could be different year over year, but I think we're all facing the same issue. But we're not facing a more competitive intensity right now. And the inflation varies by category. In some periods of time it's high in one category. In another period of time it's high in another category. That's what we're seeing, in term of change, when we look at competitors. But overall, I think we remain extremely competitive like we have been over the last many, many years. We're always competing.

Irene Nattel

That's great. Thank you. And then just on a slightly different topic. I wanted to come back to the whole gross margin SG&A. So if we were to kind of put aside the mix changes resulting from Longo's and the like, and surface also the impact of e-commerce, what would be the cadence on the underlying business with respect to both gross margin, SG&A?

Matt Reindel

Well, let's take gross margin first. So the biggest driver of gross margin, our gross margin enhancement, is promotional optimization through our Horizon tools. So that's something that improved our margins last year, improved our margins this year, and we will continue to expect that that will enhance our margin next year, particularly as our teams get more and more comfortable with using that tool.

And then on SG&A, as we said in the script, there's quite a few moving pieces within SG&A. So it's hard to predict that. I think in those higher SG&A businesses, which are also a higher-margin businesses like full service and Farm Boy, will continue to grow. So that will increase that rate. But then our ongoing cost control, which is very strong in the Company, should mitigate that. So we may have reached the point of a run rate of SG&A for the foreseeable future.

Irene Nattel

That's great. Thank you very much, and happy holidays.

Michael Medline

Thanks, Irene. Have a good one.

Operator

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

Mark Petrie — CIBC

Yeah. Good afternoon. Just had a few follow-ups actually with regards to e-commerce. Just regarding the Voila dilution, it was a step up from what we saw in Q1. Is that a reflection of the preparation in Montreal? Or was there any change in the dilution of the Toronto CFC as growth rates have evolved?

Michael Vels

Hi, Mark. That's primarily as we add costs into our system to prepare for Montreal. So as I just mentioned to Kenric, we've pretty well completed our construction. Ocado was pretty well done with the inside of the facility. We'll be starting to inbound our product fairly soon. And as you can imagine, there's costs that come with that, both Ocado fees and also, we're hiring to ensure that we're ready for our go-live. So that would be the primary reason for the increases in dilution this quarter and going forward.

Mark Petrie

Yeah. Okay. And then just related to that, obviously, the ramp-up in Montreal is going to look a lot different than it was in Ontario simply because of you're bringing customers over from IGA. So how should we think about the dilution progressing in sort of Q3, Q4? Or should Q3 be higher than Q4?

Michael Vels

Well, I think if you do the math, our range is 25 to 30. So far, we've got 12 cents to date. And so I think, depending on how the volumes and the winter period goes with the GTA facility, I think the math would tell you that we'd be at a slightly higher than the Q2 dilution rate.

Mark Petrie

Yeah. Sorry. I was just trying to gauge Q3 versus Q4. That's all.

Michael Vels

Oh, I see. Thank you. Sorry. Again, to some extent, very responsive to volumes in the first CFC, but the cost would be ramping up in Montreal. So you'd expect all things being equal, that there'd be a higher number in Q4 than Q3.

Mark Petrie

Okay. And then you highlighted the importance of sort of seasonal in the in-store business. And I'm just wondering how Voilà performed around those types of occasions.

Do you see a shift in sort of the relative popularity of e-commerce versus store shopping? And is there a shift in basket composition online? Is it different from what you would see in-store?

Michael Medline

I'm just trying to think. And Voilà's only gone through one series of this, so I'm trying to think about it through. But I'd say that it's yes. You'd see seasonal shifts, obviously, in basket and baskets get larger. But I'd have to check, Mark, in terms of whether it's all the way up to what you see in stores. Maybe a tiny bit less amplitude up and down seasonality from occasion. But there is quite a bit of seasonality in terms of volume two times of the year.

Mark Petrie

Okay. Thanks.

Michael Medline

Thank you. Good question.

Mark Petrie

Yeah. Okay. And then one more, if I just could. Just with regards to Farm Boy, I just want to sort of—are you seeing the same trends in that banner in terms of elevated demand for full-service store. I mean I know it's not quite full service the same way as a Sobeys, but in that direction.

And also have the different formats that you guys have kind of tested performed? And I think these are the first conversions from Sobeys stores that are happening now. But if that's not the case, how have those performed? And how are you feeling about the opportunities for that going forward?

Michael Medline

First question, absolutely. We feel the same way about Farm Boy in terms of full service, as you mentioned.

The second is Ottawa was our first. I can't remember when it opened, but I went and visited it. So it was a little while ago. And I'd say the biggest surprise to us is we knew we could convert Sobeys, especially Urban Fresh, but others, Sobeys to Farm Boy. But I think that we found more locations, which have been more successful than we imagined is the way I would put it. So when we did the model, we bought it, we knew there would be some, but we wanted to test it before we got too excited. And the ones that we have converted, very, very pleased with the results and what we're seeing from the Farm Boy.

Mark Petrie

Okay. Excellent. Thank you very much and all the best.

Michael Medline

Thanks, Mark.

Operator

Next question will be from Michael Van Aelst at TD Securities. Please go ahead.

Michael Van Aelst — TD Securities

Hi. Good afternoon. I wanted to just finish up on the e-commerce because, in response to Mark's question, it was implied that the dilution would increase in kind of Q3, Q4. So let's say that you're running closer to \$0.09 by Q4. On an annualized basis that's like \$0.36, but your saying peaks dilution will be in fiscal '22.

So as we go through fiscal '23, what causes that to come down, that dilution? Is it because Montreal ramped up much quicker because of the existing business and, therefore, only stays more diluted initially because of the ramp-up? Or is it a combination of that and, of course, Toronto coming to breakeven?

Matt Reindel

No. Like I said, the primary driver of that is absolutely CFC 1. As that CFC continues to grow volumes and get more efficient, the dilution decreases for CFC 1. That's the main driver.

Michael Van Aelst

Okay. And should Montreal dilution follow a similar pattern as what we've seen in Toronto?

Michael Vels

I'll tell you, Michael, we're battling for the microphone here. It'll be less on an absolute basis for two reasons. First of all, as you've correctly pointed out, we have an existing base of customers, and we're also starting with an exceptional assortment, which is different from how we started in Toronto. And we also have many of our back office and infrastructure costs in Toronto, which we don't have to replicate in Montreal. So it's a lighter absolute number than the CFC 1 experience.

Michael Van Aelst

Okay. Great. Thank you for that. And then, on the inflation, one of indications are pointing to a spike starting in January. I don't know if you could comment on that based on what you're seeing, but is there a level of inflation that you believe, it becomes problematic for margins and that once you get beyond that level, it starts to put pressure on margins because you can't pass it all through?

Pierre St-Laurent

Yes. At some point, as we've said, if inflation is too high, customers can leave the product or the category for a substitution. And it's why we believe in our full-service business with our large assortment, there are many, many options for customers to mitigate that.

We have asks from suppliers, we're working with them, we're working in collaboration. We even teach them or coach them to look at the potential impact of the rising cost of prices too fast because if you lose a customer in a category, it could take a lot of time to recover that customer.

So yes. Everybody is concerned about it, suppliers and us. But I think we'll always find it's an industry issue. It's a world-wide issue. We're working really well, in fact, in the food industry to mitigate cost increases. If we compare how we manage inflation right now compared to other industries, I think we're doing a pretty good job. And that's because the relationship we have, the strong relationship we have with suppliers, and we're looking at our business for the long term. But at this point in time, there's no sign that it will have an impact on our margin.

Michael Van Aelst

Okay. And like would 5 percent, 6 percent be the kind of inflection point?

Pierre St-Laurent

If I can predict that, I will be more rich for sure. But no. I think it's very tough to predict and, once again, varied by category. So that's the trigger. Over the last couple of months, inflation was very high in meat. We are seeing going down slightly. Now we're seeing more inflation in produce. So it's volatized by category, so very tough to predict over time. It depends the weight of the category into the basket and into the format. I, personally, hate averages for that reason.

Michael Van Aelst

Okay. All right. Thank you. And just finally, on the NCIB, you only bought about 600,000 shares in Q2 but 3.3 million in Q1. So should we look at the on average, you're on pace to get pretty close to your full buybacks? Should we expect you to get close to that? Like pick it up in the second half and be something similar to what you had for all of the first half?

Matt Reindel

Well, so on NCIB, I mean we're always balancing the cash flow needs of the Company in terms of how many shares we buy back in a specific quarter. So that's the main reason to the difference between Q1 and Q2. We still see share buybacks as a great use of cash. So we'll continue to do that, but, again, we'll balance our cash flows for the balance of the year. But we expect it to go up. We would expect it to be higher, certainly, versus what we did in Q2 and Q3 and Q4.

Michael Van Aelst

Right. Thank you. Have a great holiday.

Michael Medline

You too.

Operator

Thank you, and your next question will be from Peter Sklar at BMO Capital Markets. Please go ahead.

Peter Sklar — BMO Capital Markets

Good afternoon. On a couple of questions, like you've already touched on this, which is your analytical promotional optimization, which is really facilitating your margin improvement. So can you just elaborate a little bit on what you're doing and what has changed? Is it you have more data? You have more software? More training for your merchants? So when you use that expression, maybe just elaborate a little bit on what you've accomplished there.

Pierre St-Laurent

We're just leveraging more and more data than we have had in hand in the past. So I think that's the improvement. It's the quantity of data we had in hand in the past was just amazing. We are just able to leverage it more now than we did in the past. And the team has better, I would say, recommendation insights than in the past. And better information means better decisions, and we continue to rely on people. But with the quality of information they have to make decisions, it's much better than it was in the past.

Michael Medline

Sorry. If I may interject, I think Pierre is being a little modest. I think he and his team and our merchants have completely and utterly embraced the fact that this is better for customers and better for our business, that we have a data analytics team that works hand in hand with our merchants and others in Pierre's group.

And it was really, Pierre's right, we always had the data. We told you that we had it. We're going to have better and better data. It's just a matter of the merchants and others having confidence in our plans, and they do. And they see the ramifications and the results, and they're embracing it more and more. So we're not nearly done here.

But I think it's putting the data in good order, but it's really having that data analytics team and then merchants embracing it.

Peter Sklar

Okay.

Michael Medline

And we've seen that, and that's why we're getting the results we're getting.

Peter Sklar

Okay. That makes sense. Can you talk a little bit about the Olympics? Was there any spend in Q2? And will we see accelerated spend in the next couple of quarters as we go into the Olympics? And will it be noticeable in terms of as your results unfold?

Michael Medline

Well, we're really excited. We really liked what happened at the December Olympics and what we saw in terms of how we performed against competition in terms of perception of our customers. And I think the marketing team did an extraordinary job for their first Olympics. They've even gained some better ideas for the upcoming games. So we're really excited.

Oddly, both games fall in the same fiscal year, which is odd and probably will never happen again. I think you'll see maybe a little bit of extra SG&A in terms of marketing, but I wouldn't worry too much about it. We move our spend around and concentrate on different things, and so we'll put more emphasis on the Olympics; maybe a bit less emphasis on a few other things.

Peter Sklar

Okay.

Michael Medline

Thanks. Good question.

Peter Sklar

And then just my last question. You've explained how the ramps work for GTA on the CFCs for GTA in Montreal. What's your sense of timing on Calgary? And like have you broken ground there? And when do we start to see the dilutive impacts of Calgary?

Michael Vels

We have started construction in Calgary. We're planning to be open in Calgary F'23, first half. So similar to Montreal, probably a couple of quarters before that open.

Peter Sklar

Okay. Great. That's all I have. Thank you.

Operator

Thank you, and your next question will be from Vishal Shreedhar at National Bank. Please go ahead.

Vishal Shreedhar — National Bank

Hi. Thanks for taking my questions. Most of my questions have been answered, but maybe I'll start with just the longer-term strategic question. This management team has been pretty bold, and they made some big bets on the future. And so I'm wondering, as you look at your entire business, two businesses that I don't hear as much talk about quarter to quarter are your C-store business and your Lawtons pharmacy business.

I'm wondering if management's looking at if they consider those businesses to be core? Or if you're looking at the attractive in multiples in the market and you could take that capital and reallocate elsewhere?

Michael Medline

I think I've had the same answer for what is next month, five years, which is we like these businesses. They make us money. We will always assess all of our assets on behalf of our owners, our investors, to ensure that we're putting our capital in the right way. And I would say as long as you're with us and you're part of the family, you're core.

But if we assess that there are new members of the family like we've brought on or that we can monetize assets going forward, it makes sense to us and it's good for our business and good for our owners, many of whom are on the line today, then we'll do it. We'll make all the right decisions. But right now, these are core businesses, and we're happy with their performance.

Vishal Shreedhar

Okay. And switching gears here. Obviously, quarter to quarter, management's showing progress with Project Horizon. You've indicated that you're pleased with the progress to date. At the time that Project Horizon was indicated, it was pre-COVID, and it was a \$500 million growth of EBITDA by fiscal 2023, but that base doesn't include Longo's. It doesn't include the structural potential benefit that we may see in the market.

So as management evaluates that target, and I know last time with the Sunrise you took another look at it, and you've actually increased that kind of expectation. So what does management need to see to get more confident that perhaps there's upside to that target? Or is it a question of market volatility?

Michael Medline

It's a good question, but I'm going to Groundhog Day here and answer the same thing I said basically at the same time in the second year of Sunrise, which is we have a target. We're going to hit that target, and if we can beat that target, we'll beat it.

I am so proud of the team to still be on Horizon that we're so confident on Horizon at this point, which was pre-COVID, pre this inflation, pre some of the labour, the wages issues, and some of the other things that they're facing, and to face all that, still be on target for that \$500 million, and then we'll see from there. But just like I said during Sunrise, the team knows what its goals are. If they can overachieve, they shall do so.

Vishal Shreedhar

Thanks for the comment.

Michael Medline

Thanks, Vishal.

Operator

Thank you. Next question will be from Chris Li at Desjardins. Please go ahead.

Chris Li — Desjardins

Oh, hi. Good afternoon. Let me start with a question on Own Brands. Can you remind us, are you pretty much done with the reset?

Pierre St-Laurent

More than halfway I would say. And as you know, developing a new product takes more time. To list a product is faster. So some elements of the rebuild are already done. We're already seeing positive trends on both penetration and rate, which is good sign, and it's just the beginning because the rebuild has been done. A part of the categories has been done last quarter. We are now working on another group of categories. We'll continue to grow. We are just at the beginning. I would say maybe one-third of the benefit has been captured on an annualized basis and could continue to grow.

Chris Li

Okay. And maybe just follow up onto that. Just are you able to provide us with some data on what the penetration is for private label? If not the absolute level, maybe just the growth now versus, say two years ago before the project started just to give a sense of just how well the program's doing from a customer perspective.

Pierre St-Laurent

Once again, I don't like that KPI for obvious reasons. And once again, it depends by category. In some categories, the penetration is much higher because I think own brand is meaningful in that category. In other categories, there is no need to have our own brand. So, once again, because I hate averages, I won't go there. It really depends on the category, and it will continue to grow overall compared to where we are.

We are using a lot of exclusivity as well. So depending on the definition of private label, I think an exclusive brand to us, if it's not Compliments or Panache, it could be considered as a Own Brands. So we have many, many strong partnerships like that with suppliers. We're exclusive with many suppliers for products that the customers really enjoy. So, overall, I think we have a good assortment unique to us to be loyalty with our customers.

Chris Li

Perfect. I'll take away. And then maybe just a question on Ocado. I believe that the US International Trade Commission is in the process of reviewing the patent infringement lawsuit brought on by AutoStore against Ocado. I guess my question is, in the event of an unfavourable ruling against Ocado, would that in any way kind of impact the service or the rollout plan for Sobeys in Canada? Thank you.

Michael Medline

We won't comment on the first part of the question, but the answer is no. It won't impact it.

Chris Li

Okay. Thanks, Michael, and all the best for the holiday.

Michael Medline

Thank you. You too, and thanks too, I think you might be the last question, Chris. So before the Operator comes on, I want to thank the investment community, and the Sell Side for everything during the year and wish you all a great holiday, and a safe holiday and a fun one with your family and friends. Appreciate your keeping track of Empire and your questions keeping us honest. Thanks so much. Appreciate it.

Operator

Thank you, and at this time, I would like to turn the call back over to Katie Brine.

Katie Brine

Great. Thank you, Sylvie. We appreciate the 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 '22 conference call on March 9th. Happy holidays.

Operator

Thank you. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending, and at this time, we do ask that you please disconnect your lines.