

Empire Company Limited

Empire Third Quarter 2022 Conference Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Empire Third Quarter 2022 Conference Call.

Please note that the call is being recorded on March 10, 2022.

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

Katie Brine

Thank you, Sylvie.

Good afternoon, and thank you all for joining us for our third 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.

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.

Our thoughts today are with all those impacted by the awful crisis in the Ukraine. There's obviously a large and proud community of Canadian Ukrainians, many of whom are our teammates and our customers. We stand solidly with them.

Now on to our third quarter results. Our team delivered another outstanding quarter. Earnings per share of \$0.77. This is our highest EPS in memory, and we achieved it navigating some of the choppiest waters we've seen in a long time, floods in BC and other global and local events that disrupted the communities and the supply chain. The Omicron surge presented new challenges in labour, and the inflationary environment continued to impact our industry. Through it all, our team delivered historic performance.

Free cash flow is up 75 percent this quarter. DBRS upgraded our credit rating trend from stable to positive, and we substantially completed our Fiscal '22 share buyback target. Meanwhile, Horizon remains on track, including the \$500 million of incremental EBITDA by the end of Fiscal '23.

Earlier this week, Voilà launched its second CFC in Montreal to the public. We have never felt better about our business or our future, and the most encouraging thing is that there is no silver bullet here. Our performance is just based on strong execution across the board.

Today, I'll focus on just three topics: our results, how we're successfully managing our business, and what the future holds for Empire.

First, results. Sales grew 5.1 percent this quarter. Same-store sales were negative 1.7 percent as we comped severe lockdowns across much of the country last year, but we're up a strong 8.3 percent over the last two years. E-commerce sales increased 17 percent over last year with the addition of Grocery Gateway and continued growth in Voilà, partially offset by declines in our other e-commerce platforms due to the significant stock-up that happened during last year's lockdown.

We continue to improve our gross margin, which was not a foregone conclusion this quarter. We faced a difficult comp as we drove exceptional gross margin improvement last year when we started to capture the benefits of our promotional optimization tool.

In addition, this year, we faced cost pressures with the timing of inflation pass-throughs, increased fuel prices and supply chain disruptions that forced us to rely on alternative supply, typically at a lower margin. Not only did we sustain our strong margins – we improved them. Our gross margin rate, excluding fuel, grew by 41 basis points, and this is exactly the kind of performance that gives us confidence in our future.

EBITDA margin also grew 50 basis points this quarter to 8.1 percent. This reflects the benefits of our Horizon initiatives, the addition of Longo's and an elevated contribution from Crombie. Delivering results like this is possible thanks to the underlying strength we have built in our business. With that in mind, I would like to spend a few minutes speaking to how we're successfully managing our business to deliver current performance and position ourselves for the future.

Every day, our team continues to sharpen our execution and find new ways to bring Empire to the next level. Last year, we further evolved our national structure to centralize all sourcing responsibilities, and this team is already producing tremendous results. Without this structure, we'd be hard pressed to navigate the inflationary pressure and supply chain disruptions our business is facing.

We have received an unprecedented number of supplier cost increases over the last few months. Not only has our team managed to keep prices as low as possible for our customers, but we've also seamlessly executed the required price changes and minimized the impact on our performance. All the while, our merchants are innovating the customer experience and delivering value through more impactful promotions and private label.

Our strong supplier partnerships combined with the prodigious efforts of our teammates to ensure products get on shelves are helping us mitigate some of the supply chain challenges our industry is facing. We received an industry report that tracks on-shelf availability; effectively, how stocked a retailer shelves are. We have continued to keep our shelves stock better than the market average over the last 13 tumultuous weeks, as we have through most of the pandemic. Customers can find and purchase more products in more instances in our stores, and this provides customers a more effective, and just plain better, shopping experience.

In addition, we recently promoted Pierre St-Laurent to the role of Chief Operating Officer, now overseeing all our Full-service, Discount and E-commerce grocery operations. These teams are working more closely together, finding efficiencies, and focusing on solid execution day in and day out. They're streamlining all our grocery operations, supply chain, and merchandising to win the customer with every tool in our arsenal while driving efficiencies throughout the Company. As we find new ways to simplify and focus our operations, it further improves our execution on Horizon by giving our teams even more runway to focus on achieving those goals.

Now shifting to look ahead to our future. I feel like a broken record, but our business has great momentum and we've never felt better about what's ahead of us. As we said, we remain confident that we will deliver our Horizon targets next year, but the benefits don't just stop when Horizon ends in Fiscal '23. Actually, material and additional Horizon value will continue to be earned in Fiscal '24 and beyond.

We're building tools to dramatically improve the store and customer experience. We're renovating, converting and building the best-looking grocery stores in Canada that continue to drive our best returns, and we're finding more personalized ways to connect with our customers. These initiatives start generating benefits during Horizon but will really hit their stride in Fiscal '24 and beyond. Thanks to these and the other investments we're making today, we will reap incremental rewards from Project Horizon for years to come.

As we begin to think beyond Horizon, we are no longer a transformation story, and we are proud of that. We are now consistent operators. We now execute with precision and we have a well-earned reputation as tremendous business partners. We deliver value to our customers. We offer solid returns to our shareholders. After Fiscal '23, we will not release another three-year plan. Our focus will be on execution, and we intend to grow our results at a greater rate than our competitors.

Now, before I hand it over to Matt, I want to take a moment to congratulate our Canadian Olympians and Paralympians on a fantastic winter games, and wish the best of luck to the Paralympians competing in the final few days. Sobeys is the official and exclusive grocer of Team Canada, and I'm so proud of all that we're doing to support our athletes.

Now over to you, Matt.

Matt Reindel

Thanks, Michael. Good afternoon, everyone. I'm going to provide some colour on our third quarter results, an update on Voilà, and then we'll move to your questions.

Our gross margin was 25.7 percent, which was 41 basis points higher than last year when you exclude fuel. This is largely due to both the addition of the higher-margin Longo's business and incremental benefits from our Horizon initiatives, including the expansion of Farm Boy in Ontario, FreshCo in Western Canada, and our promotional optimization tools.

We are very pleased with our margin performance despite a very choppy trading period where we navigated through increased inflation and supply chain challenges while still ensuring that we were price competitive.

Our SG&A rate was 21.9 percent, which was 40 basis points higher than last year. As per our last quarter, there were a few puts and takes here. Firstly, Longo's has a higher SG&A rate than our average, and we will continue to see this mix impact until we comp their results in the first quarter of Fiscal '23. Secondly, we had higher depreciation due to an increase in right-of-use of asset depreciation under IFRS 16. These increases were partly offset by lower COVID costs.

Our EBITDA margin increased 50 basis points to 8.1 percent, reflecting our strong gross margin performance and our share of significant gains on the sale of properties by our Crombie REIT.

Our effective income tax rate was 26 percent, which was lower than our statutory rate, primarily due to consolidated structured entities and capital gains, both of which are taxed at lower rates. We do expect that the tax rate for Q4 will be consistent with Q3.

Our free cash flow generation continues to be very strong. As of this week, we have repurchased \$249 million worth of shares under our NCIB, and have substantially reached our target for Fiscal '22. Of course, we intend to continue buying back shares in Fiscal '23.

For capital investments, we've spent approximately \$500 million year to date and remain on track to spend our estimate of \$765 million. Our focus remains primarily on our stores and we continue to be very satisfied with the returns generated from our real estate projects. This quarter, we renovated 34 stores, opened one new Farm Boy, relocated one Farm Boy, and opened seven new FreshCo stores in the West.

Now during Sunrise, we were focused on fixing problem stores, addressing underinvestment and defending our top stores. Now that our problem areas have been addressed, we are moving from defence to offense, investing in renovations that will enable us to sustainably capture market share and increase our sales and profits.

Now before we move to your questions, I want to dig a little bit deeper into Voilà. We remain very confident in Voilà as the optimal business model to sustainably deliver a profitable e-commerce grocery business at scale. So let me give you a few updates from the last quarter.

First, we announced our fourth customer fulfilment centre, or CFC, as we call it, which will be in the Greater Vancouver area of British Columbia. With our four CFCs, we will be able to serve approximately 75 percent of Canadian households, representing 90 percent of Canadian e-commerce spend.

Second, the beauty of our exclusive deal with Ocado is that we have a partner who is investing in research and development, and will continue to bring efficiency to our network. Our fourth CFC will have new generation robots, more efficiencies, and a lighter environmental and carbon footprint. If you want to see more, I would encourage you to go to our earnings presentation on our website. There is a link to an Ocado video showcasing their new innovations.

Third, our second CFC in Montreal recently completed employee testing and began transitioning customers in some areas of Quebec to Voilà from IGA.net. The feedback from the employee testing and our initial customers is fantastic. They're off to a really strong start. This will be a phased rollout, as we expect that by summer, approximately 85 percent of the Quebec population will have access to Voilà.

Fourth, in Q4 of this year, our CFC in Ontario will extend its geography to Ottawa and surrounding areas through an additional spoke.

Fifth, construction for CFC3 continues on track, and we have added another 22 locations for curbside pickup using Ocado's in-store fulfilment technology.

We're really pleased with our e-commerce programs. Voilà's impact on Empire's earnings is on track to be somewhere in the middle of the previously disclosed range of \$0.25 to \$0.30 for Fiscal '22. We believe that Fiscal '22 will be the most dilutive year for Voilà for a couple of main reasons. Firstly, we have a faster customer ramp-up in CFC2 than we had for CFC1. As a reminder, IGA.net in Quebec is an established business that we are transferring over to Voilà, so we already have a significant amount of volume to flow through the CFC.

Secondly, we'll have minimal additional backstage resources for the new CFCs, as this was all set up for CFC1, so we are getting a better leverage of that fixed cost. It's worth noting that the addition of Ottawa will immediately add volume to CFC1.

In conclusion, Q3 was a very strong quarter, and we have strong momentum. Project Horizon is on track. It was designed to deliver \$500 million of EBITDA, including the effect of the Voilà strategy, and that is what it is doing. We are pleased to report that we expect our Fiscal '22 net earnings to be even higher than our COVID inflated net earnings in Fiscal '21. That's really a testament to our consistent and sustainable execution.

And with that, Katie, I'll hand it back for questions.

Katie Brine

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

Q&A

Operator

Your first question will be from Kenric Tyghe at ATB Capital Markets.

Kenric Tyghe — ATB Capital Markets

Thank you and good afternoon. Michael, your opening remarks called out the choppiness in markets. Could you speak to the biggest challenges and provide some insight into the biggest challenges you managed through in quarter with respect to inflation's impact on consumer behaviour and the dislocation of the amplified supply chain pressures that you called out?

Michael Medline

Yes. I mean, I think the number one challenge in all of retail right now is the supply chain, and that it just hasn't gotten back in shape for many reasons, including high demand and the disruptions that you know about, Kenric.

Our team is all the time trying to find products where we're short, where our great supplier partners just can't keep up and supply us. That's causing us to go out and buy more in the market, and at times really scramble to make sure that we fulfil our customers' needs. I think we're doing as good or better job than anyone out there from what I can tell in store. As I noted, we're above market in terms of the third-party reports and in terms of on-shelf availability, so I'm happy about that, and that's really a testament to our merchants and our operators.

In terms of inflation, I'm not sure it's too much new to say and it's a reality, again, that all businesses across the globe are facing. We are retailers. Part of our daily jobs is to deal with the rising cost of doing business, and we have the right people in the right seats now to do that. We have to manage it very, very closely, and we've never seen anything in our careers to match it.

Periods of high inflation are extremely challenging, and I'm going to ask Pierre in a second to talk to you about how we're navigating through it.

It's fair to say that our team has never faced so many at one time, that we're negotiating hard with our supplier partners. So, in many cases we have very justifiable cost increases, to be honest with you.

At the same time, there's often a lag, between cost increases and price increases as we provide value to our customers. All of this is challenging to our team. I don't think anyone out there is doing a better job, and I'm very proud of that.

Pierre, do you want to say a few words?

Pierre St-Laurent

I'll just add that based on how we are structured, I think we need to be very agile right now because of all those reasons previously discussed such as supply chain and inflation. The way we are structured now with the Sourcing team who are working on cost increases and sourcing in general, while our Merchandising team can continue to focus on building good promotions, relevant promotions for customers and managing the margin.

I think it's why we are in a good spot; but once again, we need to work very closely with both sourcing and merchandising, and it's what we're doing right now. We're really pleased with the Sourcing team, focusing on managing the volatility element of our supply chain and costing, and having a dedicated Merchandising team that continues to be smart and meet customer demands and concerns. We're in a good spot.

Kenric Tyghe

Great. Thank you for that. And just one quick further question for me. I appreciate all the additional colour, Matt, on Voilà and its performance, and I understand you're not going to be providing your dollar sales or otherwise for your four other online platforms. But could you just provide some colour even directionally on how Voilà is tracking to your internal expectations? I understand the planned growth and the additional CFCs coming on, but I'm just trying to get a read on, net net, where you are versus where you expected to be with Voilà. I'm understanding it's growing, but just trying to get after some sort of additional colour on where you are.

Matt Reindel

Sure. I mean, it's a little bit of a different story by CFC, because obviously CFC2 has literally just started up in operations. I think in my comments, I've told you where we're up to on that. That's going to be a phased implementation launch. Over the next 12 weeks, we will ramp that up in the Quebec area. By the summertime, we should have 85 percent of the population available to Voilà. That's very much in the ramp-up phase.

For CFC1, overall, we're happy with where the business is. I think as we said, the net dilution is going to be in that range of 25 cents to 30 cents, probably somewhere in the middle of that range. So overall, I think we're happy with how that CFC1 is progressing.

Kenric Tyghe

Thank you. I'll get back in queue.

Michael Medline

Thanks, Kenric.

Operator

Next question will be from Irene Nattel at RBC Capital Markets. Please go ahead.

Irene Nattel — RBC Capital Markets

Thanks, and good afternoon, everyone. I guess I have two questions. My first is a follow-up on the Voilà discussion, and it's really from a practical perspective. You mentioned that you're going to be building on the base of IGA.net. Will it be a case where it will look the same as IGA.net? Practically speaking, how does that actually work?

Michael Medline

Yes. Like Matt said, the reason it's 85 percent, there are a few markets where it's too far from the CFC to be able to service it; but in hopefully 12 weeks, we'll have 85 percent of the province served. It's very simple to move over from IGA.net to Voilà. If you talk to our Quebec business, they're very, very pleased with how this is being set up. The website is even nicer. The choice of products is greater.

And everyone who's tested it is extremely pleased, especially Pierre and Luc, who are key constituents here, so very, very simple.

The exciting part is that our Voilà basket size in Ontario is—I don't know whether Katie will get mad at me or not, but over 3.5 times larger than our bricks-and-mortar basket size, which is a lot bigger difference than at IGA.net to what we expect to Voilà. We're going to expect even from our own customer, that they're going to have a better experience, our basket size will be larger, they'll shop more at IGA and bring their basket more to IGA than to any competitors. At the same time, we're going to be growing our market share.

Not only is it more profitable for us, because it's a way better system, way better for customers, way bigger basket size, we'll convert people over, and we have the number one market share in the province, and we expect to take much more market share, because now we have by far the best tool. This one, we are watching it like hawks; but because of what happened in the GTA and our success there, and now because we're converting already great customers to an even better platform, we're not losing any sleep honestly. We're watching it very closely and making sure that the transition goes well.

Irene Nattel

Thank you, that's great. Just shifting gears, if you don't mind. Obviously, we're seeing a surge in inflation, and certainly our last couple of weeks' surge in oil prices that is hitting consumer wallets. Can you talk about what you're seeing in terms of consumer purchasing behaviour, promotional activity, trade-down to private label, the usual stuff?

Pierre St-Laurent

Yes. We know that customers are more sensitive for value in today's environment. We feel good with all the innovation and redevelopment we've done for Own Brands and private label; new packaging and new assortments. Obviously, our Own Brands is on fire right now, and we're pleased with that.

We're growing much faster than the national brand, and it's good for customers, and it's good for us. We also introduced good offers to customers, and we're seeing very good traction on value packs and things like that.

The large assortment we have in our store provides many options to customers to mitigate inflation right now, and we feel good about that. So yes, we are seeing customer behaviour change. They're looking for more value in everything they're buying, from national brands to our Own Brands, we are seeing customers switch their choice of protein, and we're adjusting our merchandising plan accordingly, making sure that we're relevant for customers, and that we offer them what they're looking for. Yes, we have to be very agile like we said at the beginning, and the team is doing a very good job to stay relevant for customers without compromising our performance.

Irene Nattel

You're seeing an increase in penetration of promotion within the basket?

Pierre St-Laurent

Yes, partially you're looking for deals; but once again, we are able, with the large assortment we have in our stores, to stay relevant for them. So yes, they're looking for a good deal; but at the same time, we have much more than deals to offer to them. As you know, there is inflation everywhere, fuel prices, restaurant prices; people are seeing inflation everywhere.

We have very strong prepared food offers, which is cheaper than going to restaurants. And year-over-year, we're seeing good growth there, and it's a good margin product. It's good for customers, and it's good for us. It's what we have in mind all the time, to stay relevant for customers and make sure that we're leveraging all of our assets to go through that period.

Irene Nattel

That's, great. Thank you.

Operator

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

Michael Van Aelst — TD Securities

Thank you. The gross margin was quite strong; but OpEx, as would be expected, I guess, was also up quite a bit. If I back out the COVID cost and the depreciation, it looks like it was up about 7 percent.

I was hoping you could help me understand how much of this might be tied to Longo's being added in. When you look at the organic side of it, what are the largest puts and takes on the pressures and then how you're managing it?

Matt Reindel

Sure. I could take a pass at that.

When we look at our SG&A for the quarter, there's nothing particularly of a one-time nature in there. As I said last quarter, we're beginning to get to a kind of run rate of SG&A. When you look at SG&A year-over-year, you're right, one of the major drivers is that mix impact of Longo's, and we'll continue to get that until we comp Longo's next year. We also have the mix impact of the higher SG&A businesses, such as Farm Boy and Voilà. Then there's higher occupancy costs, so right-of-use depreciation under IFRS 16. It's a combination of those few things. Like I said, there's some puts and takes in there, but there's nothing that is particularly one-time in nature.

Michael Van Aelst

There is no Olympic cost, I guess, anymore?

Matt Reindel

Not in Q3. That was earlier in the year.

Michael Van Aelst

Okay. And then you mentioned on the NCIB that you're substantially completed, but I thought your plan was for 8.4 million shares, and you've done 6.4 million or so. Am I misunderstanding?

Matt Reindel

The current NCIB we have runs from July 2021 to July 2022. It doesn't match perfectly with our fiscal year. We will continue to buy shares under that existing NCIB, and then we intend to renew the NCIB in July. It's a little bit confusing when those two programs don't exactly match period to period; but for our fiscal year and what we had targeted to buy back this year, we are substantially complete.

Michael Van Aelst

For the fiscal year, okay. Got it. All right, thank you very much.

Matt Reindel

Sure. Thanks.

Operator

Next question will be from Patricia Baker at Scotiabank.

Patricia Baker — Scotiabank

Thank you very much, and good afternoon, everyone. I have two questions.

My first question is on Voilà. And Michael, you're mentioning the access to the R&D and that you'll be able to use the new generation bots with the Vancouver facility. Kroger this week also was talking about using those new generation bots, and that that's going to lead to a lower cost to build for them on some of their later CFCs. I'm wondering if that is the same case for you.

If you just think back to when you first did the partnership with Ocado on the Smart platform, have you taken advantage of any other R&D opportunities from Ocado since then to now?

Michael Medline

I'm going to let Mike answer the question, because he's worked closely with Ocado, and then if there's anything I can add, I will.

Patricia Baker

Okay. Thank you.

Michael Vels

Thanks. For us, the most significant impact for the new bots would be there is potentially some differences in how you build the grid, but a lot of other things go into that quick build, including seismic impacts and that sort of thing, but they're much more energy efficient. The significant impact for us would probably be reductions in energy usage as opposed to necessary construction cost.

We're already up in one CFC and fully operating in terms of builds, and so there's been limited opportunity to materially change the grids and the actual infrastructure and construction build. Where we have benefited is that Ocado has a very strong pipeline of incremental adds and improvements to their algorithms and their end-to-end software. I'd say from an R&D perspective, we benefited the most from upgrades and improvements they made on that end since we started CFC1.

Michael Medline

Yes, the only thing I'd add is in terms of if you go on the Ocado link on our website, you'll see a lot on the picking innovation.

Patricia Baker

Yes, I've seen it.

Michael Medline

And in terms of getting closer to the customer and shortening delivery windows, I think that is the reason we love their technology, and this was also because of the entrepreneurial innovative spirit of Ocado, and they haven't let us down. This is a company that is going to continue to innovate and stay ahead of everyone else, and we'll continue to put in some or many of the innovations that occur as we go along.

The key, though, is to get the big CFCs up in the four markets. Everything else can fall away from there. I think our opportunity, because we haven't broken ground yet, is in Vancouver to take some of this as well.

Patricia Baker

Thank you for that, Mike and Michael. My next question really is kind of directed at the gross margin. It was nice to see that you were able to build on last year's margin performance there. When we look at promotional optimization, how should we be thinking about that? Where are you in executing against that? Should we be thinking about something that as the gift that keeps on giving, that it will be constantly having reiterations of optimizing your promotions?

Pierre St-Laurent

The promo-optimization is related to two things. Last year, we launched the tool that our merchants are working with, with great adoption. It's why we increased our gross margin a lot last year. This year, it's a combination of both. We continue to work well with the tool, plus in my opinion, the team is stronger and they have good judgment. They are more agile. They're playing more with the tool. It's a combination of strong execution and usage of the tool.

It's continuous improvement. It was a new tool last year. This year, we have a better comprehension of the tool, and as I said at the beginning, the fact that the Merchandising team is focusing on promotion without dealing with cost increases and supply chain issues, it's very helpful, and that's why we kept good control of our margin.

Patricia Baker

Thank you, Pierre.

Matt Reindel

And maybe, Patricia, just to add one thing to what Pierre said. When we launched the promotional optimization tool last year, we had that significant uptick in margin; this year, we've matched it, and that was really important for us because we are making sure that we're delivering a sustainable profit improvement. The fact that we were able to match that margin rate from last year demonstrates the sustainability of the tools that we're putting in place. That was a real litmus test for us, which we passed, so we're very happy with that.

Patricia Baker

Okay, thank you.

Operator

Thank you. Next question will be from Peter Sklar at BMO Capital Markets.

Peter Sklar — BMO Capital Markets

Good afternoon.

Just on these new technologies that Ocado is offering up on the grid and the robots. I'm just wondering why you're not incorporating that in Calgary? Is it just that Calgary is too far down the road in terms of engineering and design at this point?

Michael Vels

We've completed the design and the engineering, and there are some things for sure that I think we will end up either retrofitting or putting into all the CFCs, things like the automated frame loads, for example, which are relatively retrofit. Outside of that, it's really Vancouver that could probably be the first one to have major changes resulting from that R&D.

Peter Sklar

And when I was reading the Ocado stuff, they had a little bit of trouble, like a labour issue. They just couldn't get enough drivers. I may have asked the same question on the last conference call, but in the new market here, are you able to recruit enough drivers for all the vans that are running around the city?

Michael Medline

We're always transparent. During the height of Omicron, we couldn't fulfil every single order that we were getting online; and knowing you, you were going online to check on us. We were out three days in terms of the ordering, which we do not like. We'd rather be able to fulfill our customer orders in a tighter period of time.

The team at Voilà led by Sarah went into overdrive and were able to make all sorts of adjustments so that we were able to lower that to two days, then one day, even during very, very big periods of demand during the height of Omicron. Although labour is tight everywhere and we're always looking for great people to join us, especially in Voilà, right now, it's not an issue that's constraining us, but it was a bit of a bottleneck there for a while.

Peter Sklar

When it is a bottleneck, Michael, what is the constraint? Is it drivers or the CFC, or the pickers what is it?

Michael Medline

Well, it's not just people driving. These are really skilled people who are great with customer service and understand our standards. So we just can't take anyone off and put them in a truck and expect them to do the job. It's not really the driving aspect of it. Most people can do that. It's understanding our processes and the standards we uphold every single day. That was a constraint for a little while. We put in all sorts of ways now that we're more flexible.

Peter Sklar

Just switching topics here. I think you still have that strike, that work stoppage at the DC in Quebec. I think it's in Terrebonne. Can you just explain a little bit more in detail how you're working around that? I assume you're using other DCs and direct drop; but would that have had a noticeable impact on results as we go through Q4?

Michael Medline

Great question, and obviously we're not pleased to have any sort of disruption; but yes, because we don't talk about it, you can tell that it's not top of mind, because we really have a great team that's working around it. Maybe I'll just start at the beginning, which is we settle around 60 collective agreements a year and haven't had a strike in 10 years. This is rather unusual, and I want to be really clear that right now the impact on our shopping experience for our customers is absolutely minimal in Quebec, absolutely minimal.

If you're in Quebec, many of you go in our stores and you'll know that it's had almost no impact on how we're serving customers. When we get a deal that's reasonable for both sides, this thing will be settled. Of course, there are incremental costs to our business, and there will be in this quarter, but they're not unreasonably costly.

You got to understand that the cost impact is not going to be very material to our results. They're mostly incremental freight costs, because we have a very resilient supply chain. Thankfully, we are national in scope now, not regional like we used to be. Thankfully, the redundancies and systems we put in place at the beginning of the COVID pandemic to serve our customers are now putting us in a really good position going forward. Our contingencies have been great.

We're a national company. We have 25 DCs. Also, most of our assortment is organized nationally, with regional assortments that we can handle even in this case. So far, so good. We're leveraging our facility in Vaughan, and we have other DCs that we can use in Quebec City, even the Maritimes, to take care of this. Yes, there will be incremental costs. That's going to be a tiny bit more costly, but we believe that it's worth it in this case to get to a fair agreement with our teammates.

We have a great relationship with our supplier partners, so we will have the products in our stores. And we also have a great relationship with our teammates across the country, and I can't wait to welcome back our Terrebonne facility when we can settle this up, because they are our teammates, and we don't like going through this, but we're handling as best we can.

Peter Sklar

Okay. That's it for me. Thank you for your comments.

Michael Medline

Thanks. Great questions. Thank you.

Operator

Next question will be from Chris Li at Desjardins Capital Markets.

Chris Li — Desjardins Capital Markets

Hi, good afternoon. Michael, your Horizon financial target implies sort of low-teens EPS growth for Fiscal '23. I mean, this is pretty impressive considering that it's net of still fairly heavy dilution from Voilà next year as you continue to expand. This implies even stronger growth from the core business. I know a lot of your confidence is predicated on just accelerating benefits from Horizon, as you always have said that year three is the greatest.

I guess my questions are, is the strong growth assumption next year also influenced by market factors like inflation and competition? Secondly, what are the risks that would cause you not to achieve that growth target for next year? Thanks.

Michael Medline

Obviously, we had to do Horizon. We set our Horizon targets before we knew there was going to be a global pandemic. We set them before we knew there was going to be this sort of supply chain and this sort of inflation. Actually, I think it's even a harder goal, because our teams have been working so hard on some other things while they're still putting in the Horizon initiatives.

What's really gratifying is, as we said, we expect to hit those Horizon initiatives through all that; but because of some of the things that have been going on, some of our work and benefits are actually postponed, and you'll see the majority of them occur post Fiscal '23 close.

What I'm really excited about is we set these three-year targets, which we're not setting again, I said, but we don't suddenly stop because we're at the end of the fiscal year. For some of our projects, many of our projects, the peaks will hit in '24 and '25 now while at the same time we were able to accomplish Horizon. I'd say we're optimistic people. You know us. We look at risks all the time, and Matt and Mike are leading us through what kind of risk there could be in our business, and we look at those, and can mitigate and plan for them. Right now, we're feeling good, but we've seen such huge what Matt calls choppiness in our business.

The supply chain has every retailer concerned about being able to get products on time and at a good cost. That's going to be a risk we look to at least for the next year as this probably continues. It looks like this is going to be a highly inflationary market for times to come. We're not economists, but we speak to economists, and that's what they're predicting and what we're hearing. Those are the two big things.

My confidence in our level of execution and us being Empire are very high. They're really global or almost industry concerns and risks that worry me more, not about our own business or our own set of execution, because we have plans to improve our business.

I think other than some of these great projects, like space productivity, which are going to be giving us great benefits, especially in Fiscal '24 and Fiscal '25, what I'm most excited about now that we have this great infrastructure in place are some of the other projects we have, and if you go across our country, you'll see really great renovations in our stores. You're going to see better execution.

I give real credit to Pierre and his team, but especially to Pierre, that while we were going through Sunrise and we were doing Horizon, we left some of the store execution and some of the supply chain issues alone so we wouldn't disrupt our business while we were turning around the Company. We have a lot of opportunity now that Pierre is exploring and is going to be executing on in terms of serving our customers better but also being far more efficient. Some might say, hey, you're five and a bit years into turning this Company around, but now I think a lot of the times I'm thinking that the good things are still to come now that we have this infrastructure in place that we can build on.

We're very excited about that, and I should also mention what we're doing on our investments in data analytics and personalization. I don't even know if we're in the first inning of the baseball game on those. We're just starting that. There is lots of upside, but we've got a lot of work to do, and these are tough markets.

Chris Li

Great. That's very helpful, and all the best.

Michael Medline

Thanks, Chris.

Operator

Next question will be from Vishal Shreedhar at National Bank.

Vishal Shreedhar — National Bank

Hi, thanks for taking my question.

I was wondering on the difference between delivery and in-store grocery and how they inflate differently, given last mile is such a large component of delivery cost and fuel has gone significantly higher. I know about the view to keep Voilà pricing similar to in-store pricing. I was hoping to get some context. Is there a big difference there on how they're inflating? If so, how is that managed?

Matt Reindel

Thanks for the question. I would say there is no big difference.

Vishal Shreedhar

Okay. And then on the same topic, I was hoping you could update me on the spoke model. For Vaughan, how many spokes do you have and what is the cost for installing them, and how specifically do they improve efficiency?

Michael Vels

We're still in the process of building out the total network. At this stage, most of the deliveries will still come from the Vaughan CFC. Over time, we're probably going to have maybe four or five in Toronto. They're relatively low cost to build out, as they're not very sophisticated facilities. They basically receive straight trucks from the CFC, which are coming in large frames pre-picked, and then they're being transferred through the facility, sort of cross-dock nature, to the delivery vehicle. That's designed to do two things, really.

It eliminates congestion up in the CFC, it enables us to place the product closer to the final destination, cuts down the total number of miles driven delivery trucks, and it's more efficient for our drivers, because they don't have to go up to the CFC to start their routes; they start the process at the customer. All of that adds up to a nice efficiency improvement and the cost of delivery, and it also reduces congestion and complexity up at the CFC by moving large amounts of products out of the CFC overnight.

Vishal Shreedhar

Eventually these spokes will be installed in every market where you have CFCs. Is that a correct way to view it?

Michael Medline

Yes, and then we'll have some markets like, as Matt said, Ottawa where we'll actually service the entire city from spoke and not from the CFC. Yes, we expect spokes across the country in every location that we have CFC.

Vishal Shreedhar

Okay, got it. Thanks for the answers.

Michael Medline

Thanks, Vishal.

Operator

Thank you. And at this time, we have no further questions. I would like to turn the call back over to Katie Brine.

Katie Brine

Thank you, Sylvie. We appreciate your continued interest in Empire. If there are any unanswered questions, please contact me by phone or e-mail. We look forward to having you join us for our Fourth Quarter Fiscal 2022 Conference Call on June 22. Talk soon.

Operator

Thank you. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending.