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**Empire Company Limited**

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## PRESENTATION

**Operator**

Good afternoon, ladies and gentlemen, and welcome to the Empire Second Quarter 2024 Conference Call. At this time, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session.

If at any time during this call you need assistance, please press *, 0 for the Operator.

This call is being recorded on Thursday, December 14, 2023.

I would now like to turn the conference over to Katie Brine. Please go ahead.

**Katie Brine**

Thank you, Joanne. 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 line for questions.

This call is being recorded and the audio recording will be available on the Company's website at empireco.ca. There is a short summary document outlining the points of our quarter available on our website.

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

Today's discussion includes forward-looking statements. We caution that such statements are based on management's assumptions and beliefs and are subject to uncertainties and other factors that could cause actual results to differ materially.

I refer you to our news release and MD&A for more information on these assumptions and factors.

I will now turn the call over to Michael Medline.

**Michael Medline**

Thanks, Katie. Good afternoon, everyone.

I will start today by saying that on the surface, our Q2 results don't appear as strong as Q1. And it's true, they're not at that level.

But when we unpack everything, as Matt, Pierre, and I have done over the last number of weeks, we don't think they're much worse. Let me tell you why.

First, in late August, we began to see some customers retrench. We believe it's a result of higher interest rates biting and overall economic uncertainty. This retrenchment wasn't major, but it did appear to occur quite suddenly. Second, Q1 fiscal '24 had easier year-over-year comparisons than Q2, resulting in a lower same-store sales this quarter. Third, we did see margins contract a little more than forecasted due to higher promotional penetration of the flyer items. Although, I must emphasize, promotional intensity at our banners did not change, with customers also purchasing more Own Brands products and trading down to less expensive alternatives. Fourth, we saw slightly higher shrink numbers, primarily due to rising theft. And fifth, there were a lot of puts and takes this quarter that we'll break down.

All that said, we don't think we did anything differently or executed less sharply this quarter. And while the macro-environment continues to be challenging, there's a lot of momentum in our business, which you'll see as we unpack these results.

Now, five weeks into Q3, we are seeing increased sales momentum, higher than Q2, but not as high as Q1. We are optimistic this trend will continue as consumers start to regain confidence, and we're in a much better position than we were last year. We're also well positioned as food inflation continues to decelerate and interest rates move past their peak.

I'm going to focus on three topics today: our Q2 results and key market trends; a brief update on our plans to help further stabilize food prices in Canada; and an update on our strategic priorities, including the progress we are making to optimize costs and enhance store and customer experience.

First, our results and market trends. We were pleased to see CPI's food inflation continue its downward trend this quarter, reaching its lowest level in 22 months at 5.4 percent in October. Our internal inflation remained slightly below CPI in Q2, as it has been since this period of high inflation began, and it's maintained its downward trajectory. In this environment, providing value to Canadians and helping further stabilize food prices is a top priority for Empire.

Earlier this month, I appeared before the Agriculture Committee to discuss food inflation. And we have been cooperative with Minister Champagne's office over the last several months, including by submitting detailed plans for how Empire will play a role in helping to further stabilize food prices. I can assure you we were already doing a lot for our day-to-day business, and we have now taken further actions to help Canadians, with the ultimate objective of narrowing the gap between CPI and food inflation.

However, and as I've said before and as I've said to our supplier partners, I've got to emphasize that all key players in the food supply chain have a role to play in stabilizing food prices, not only grocery retailers. While we are seeing inflation decelerate, we're in a unique time where we have inflation on top of prior periods of high inflation, and this requires a different approach. Canadian consumers cannot

afford more inflation. As an industry, we need to look at every single way we can minimize price increases, and this has to be done in close collaboration with our supplier partners.

While the vast majority of cost increases requested by suppliers over the past couple of years have been justifiable and fair, we are now seeing more than a few of our large supplier partners send through cost increase requests for February. And some of them are distressing. They just can't be justified. Inflationary times are not an excuse to pass every single rising cost on to grocers and, more importantly, to Canadians. This was not the way business was conducted before these inflationary times. We have instructed our national sourcing team to be even tougher on this latest round of cost-increase requests. We will not take unfair cost increases and pass them on to Canadians. It's not the right thing to do.

And if that results in a few holes in our shelves, we believe that Canadians will more than understand. Again, this is not an indictment of all our supplier partners. I am referring to several big, multinational CPGs.

And as I've said many times, our federal government has a huge role to play in taking out costs that have accelerated food inflation.  As a company, we will be pursuing new solutions to help mitigate inflation. One way that we can keep costs down is through our Own Brands portfolio, where we have greater visibility and control over prices than with national brands. As we and others have said for several quarters, private label products are in high demand and will give even more space to our Own Brands products if it will help us maintain lower prices on shelves.

Turning to our results. I believe that our business continued to perform well in Q2, as I said. It was a bit of a messy quarter to analyse, given various quarterly puts and takes regarding Crombie REIT and real estate dispositions, the strike at our Vaughan distribution facility, and the sale of our Western Fuel business in Q1. Matt will make sense of all that for you in his remarks in a couple of minutes.

All in all, when I look at Q2, I felt that our execution was just as sharp as Q1, but consumer confidence affected our results a little bit. We continue to attract more customers to our stores with higher transaction counts. Our promotions are constantly improving and are attractive to our customers while still protecting our margins. And we continue to see very strong on-shelf availability consistently above the market.

Moving to our financials. Our sales, excluding fuel, grew by 2.4 percent this quarter, with same-store sales of 2 percent. Both our full-service and discount banners outperformed the market in their respective channels and Voilà grew sales over 15 percent in the quarter. We also maintained stable gross margins, despite increased promotional penetration and supply chain challenges due to the Vaughan RSC strike. We're pleased with how we continue to protect and grow the fundamentals of the business, regardless of the macro-environment, and we are optimistic that we'll pick up momentum as inflation eases. Overall, we delivered an adjusted EPS of $0.71 this quarter.

Onto an update on our strategic priorities. When we announced our long-term goal to grow adjusted earnings per share by 8 percent to 11 percent, one of the key pillars to achieve this ambition was focused on efficiency and cost control. While Empire is out of its transformation era, we still see many areas to be more efficient and we've begun simplifying and taking a back-to-basics approach with all of our core SG&A activities. We are doing this across several initiatives that are tried and true at Empire. We're good at this. We've done it before. While I'm not going to share with you the full extent of these efforts, we felt it would be helpful to give you some insight into where we are focusing.

As we announced last quarter, we have begun making organizational changes to optimize our structure and reduce costs - a refresh of what we did in Sunrise, but on a smaller scale. Almost seven years have passed, and we are a very different company now. We have advanced data and analytics capabilities, new strategic assets in our portfolio, and a much stronger team. Before, the focus was on fixing what was broken. Now the focus is on supporting our go-forward strategy to drive growth in the core. And this isn't just about cutting. The team is being very strategic and is also looking at what we can bring in-house to do better and more efficiently. You will see severances in our financial adjustments this quarter and through to the end of fiscal '24. These costs will be substantially completed by the end of fiscal '24 as we progress this effort.

Another area where we are pursuing cost efficiencies is within goods not for resale, or as I often call it, non-merch procurement. This is an area where we had great success during Project Sunrise and are again seeing opportunity to optimize by leveraging our national buying scale and working with suppliers to simplify our assortment and reduce rates. As one example, during COVID we saw the prices of vinyl gloves, which many of our teammates in-store have to wear, rise significantly. Through this initiative, we have been able to negotiate with suppliers to lower our rates, generating over $0.5 million of savings from this one item. We have done this in many other places, too, such as with paper bags, deli bags, and product containers.

In our supply chain team, we have developed new capabilities to simplify our operations and streamline our engagement with carrier partners. We are laser focused on this simple, yet effective back-to-basics approach to ensure we are getting the best costs from our suppliers so we can offer more value to our customers. There are just a few initiatives of many that we are pursuing, but are areas where we are confident we will generate savings. We have done it well before and know we can do it again.

Now for an update on some of our key customer and sales driving initiatives. Regarding our space productivity program, we have successfully completed all pilots for the first phase of this project, which has allowed us to deploy optimized category planograms by banner and region based on our algorithms. We are very pleased with the actual results from the pilots. They're as good, or in some categories even better than the algorithms' predictions. Seeing the success from the pilots, we have now rapidly begun rolling out new planograms category by category across our stores. And going forward, the majority of new planograms we roll out will be based on this new technology.

There are over 100 distinct grocery planograms being executed in fiscal '24 across our banners, with over 80 percent completed as of today. Now that the first phase is near completion, we are turning our focus to the second phase, which allows us to optimize the total non-fresh space within each store. We have conducted several in-store Phase II space pilots over the last few months, and are on track to start the deployment to stores with the highest returns within this fiscal year. Benefits will begin to ramp up the second half of fiscal '24, with meaningful benefits expected in fiscal '25 and fiscal '26.

Scene+ also continues to progress this quarter, outperforming our Q2 targets with strong new member growth, increasing on-card sales penetration, and significantly higher active loyalty members than we had before. Program awareness and member satisfaction have all increased significantly with Empire customers since launch. Through our partnership with Scotiabank, we have been able to drive new customers into our stores, and we have seen a 400 basis point increase in Empire's share of grocery spend on Scotiabank credit cards since launch. We continue to pursue opportunities to leverage this outstanding loyalty program and work closely with our partners to provide even more value and benefits to our customers.

Lastly, we saw strong momentum from Voilà this quarter. In particular CFC 3, which launched in Calgary in June, has been gaining momentum week over week. Customers who were previously using curb-side pickup are moving to home delivery, as we anticipated. And we see strong basket sizes and net promoter scores across each CFC.

So while there was a lot of noise in this quarter and we continue to experience economic headwinds, the fundamentals of our business remain strong and we delivered solid results. We have a clear strategy to deliver against and our team continues to execute with focus and precision.

And with that, I'll turn it over to Matt.

**Matt Reindel**

Thank you, Michael. Good afternoon, everyone. I will provide additional colour on our Q2 results, our expectations going forward, and then we'll move to your questions.

First, let me take some time to break down our adjusted EPS. Our quarterly results were harder to follow than normal due to the impact of our real estate transactions, both this year and last; the Vaughan distribution centre strike; and the sale of our Western Fuel business.

Our adjusted EPS was $0.71 compared to $0.73 last year. There are three reconciling items that need to be considered, which essentially offset each other.

First, real estate. This year, we benefitted from gains on lease modifications, whereas last year we benefitted from unusually high income related to Crombie REIT's property sales. This year, gains were slightly higher than last year and as such, our adjusted EPS benefitted by approximately $0.02.

Then there were two issues that hurt our results. Firstly, we had the impact of the strike in our Vaughan DC. We've incurred some direct costs in Q2 as a result of the strike, along with a temporary loss of sales and margin in the initial first few weeks of the strike. However, through the contingency plans we

have in place, the Vaughan DC is now essentially operating at normal levels, so we do not expect to have a material financial impact moving forward.

Secondly, we had the sale of our Western Fuel business at the end of Q1. Q2 was the first full quarter that these operations were not contributing to our results. So, the combination of direct strike costs and the loss of the West Fuel business hurt our adjusted EPS by approximately $0.02. It's also important to note that our sales temporarily declined in the first few weeks of the strike, but our operations are now fully back to normal.

I will now dive into the financial performance of the quarter, which can be summarized by one word: resilience. As Michael said earlier, there was some retrenchment from consumers due to interest rates and inflation. We delivered same-store sales, excluding fuel, of 2 percent. Q2 inflation levels were sequentially lower, which also contributed to the sequential decline in same-store sales. It's also worth noting that Q2 of last year was our strongest quarter, with same-store sales of 3.1 percent, so we had some tougher comps to beat.

Our gross margin rate, excluding fuel, grew by 5 basis points versus last year. The slight margin expansion reflected lower distribution costs, primarily driven by efficiency initiatives and supply chain, but partly offset by increased promotional penetration and some margin headwinds related to the Vaughan DC strike. Our gross margin expansion demonstrates the resiliency of our business.

Shifting gears to SG&A. SG&A dollars were $81 million higher compared to the same quarter last year and our rate was 22.6 percent in Q2, which was 74 basis points higher than last year. Consistent with prior quarters, part of the SG&A rate expansion is due to planned investments in business expansion for banners such as Voilà and Farm Boy, as well as investing in new initiatives such as personalization, loyalty, and space productivity.

But we also experienced inflationary cost increases in SG&A, including higher retail labour costs driven by normal wage increases plus minimum wage increases. We also had high depreciation and amortization driven by our focused investments, partially offset by some lower utility costs.

Now one way of mitigating these inflationary increases is by focusing on driving efficiency and cost effectiveness throughout our business. This is a key pillar of our financial framework. We have plans in place to manage our cost base and to deliver savings across several key areas. Michael provided details on a few of the cost initiatives we are pursuing, including non-merch procurement, supply chain, and organizational restructuring. Our non-merch procurement team is focused on driving cost efficiencies across a wide range of business areas, including goods not for resale and store services. Our supply chain initiatives will continue to generate cost savings and efficiency across transportation, processes, technology, and automation. And finally, our restructuring program is in place to optimize our organizational structure, much like we implemented in the early days of Sunrise, but on a smaller scale. Beyond these areas, we continue to pursue opportunities to increase efficiencies and reduce costs, leveraging our scale, size, and our enhanced digital and analytics capabilities.

Our effective tax rate was 22.3 percent in Q2. The Q2 tax rate was lower than the statutory rate, primarily due to capital items taxed at lower rates and the benefits of some investment tax credits.

From a capital allocation perspective, our balance sheet remained solid, as our funded debt to adjusted EBITDA declined to 2.9x from 3.1x last year. In Q2, our CapEx totalled $135 million, mainly spent on investments in store innovations, construction of new stores, investments in advanced analytics, and other technology systems. FreshCo Stores in Western Canada and Voilà CFCs also contributed to the CapEx. We are on track to hit our fiscal ‘24 goal of $775 million.

And with regard to our share buybacks, we're also on track with our fiscal '24 goal of $400 million. And as of this week, we have repurchased approximately 6.7 million shares for a total consideration of $243 million.

Finally, before I hand it back to questions, as in previous quarters, let me take you through the items we excluded from our adjusted results in Q2. Firstly, we excluded cyber insurance recoveries. In Q2, that amounted to $15.2 million after tax, or $0.06 of earnings per share. These are complex claims and we continue to expect additional recoveries throughout fiscal '24. Secondly, we excluded expenses associated with our continuing plans to optimize our organization. In Q2, we incurred costs of $12.4 million after tax, or $0.05 of earnings per share. We have incurred $19.5 million of after-tax costs year to date and anticipate additional costs throughout the remainder of fiscal '24 related to these restructuring plans. These two adjustments reconcile our reported earnings per share of $0.72 to our adjusted EPS of $0.71.

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

**Katie Brine**

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

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## Q&A

**Operator**

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the *, followed by the 1 on your touch-tone phone. You will hear a three-tone prompt acknowledging your request. If you are using a speakerphone, please lift the handset before pressing any keys. First question comes from George Doumet at Scotiabank. Please go ahead.

**George Doumet** — Scotiabank

Yeah. Hi. Good afternoon, Michael, Matt, and Pierre. Just wanted to get started on the same-store sales number. I think you called that an improvement Q3 to date. So just wondering what's driving that?And last quarter, I think you guys were pretty happy with the basket performance. Just wondering how that's performed this quarter? Thanks.

**Michael Medline**

So, actually, Matt, why don't you take it and then send it over to Pierre.

**Matt Reindel**

Yes. On same-store sales, we included that disclosure for a specific reason because when you look at trends, our Q1 was at 4.1 percent, our Q2 is at 2.0 percent. What we didn't want is anyone leaving this quarter thinking our Q3 same-store sales is going to be zero. So our same-store sales is better than Q2, but it's not as good as Q1.

And there's two drivers behind that. One is the cybersecurity event from last year, which will improve our Q3 same-store sales. It's not a massive number. If you remember last year, we said we had some initial loss of sales at the beginning of the cyber event. But it's not a significant number. So it's small, but it will contribute to it. What we've seen so far and what we hope for the balance of the quarter is just improved momentum in the performance of the business.

**George Doumet**

Got it.

**Pierre St-Laurent** —

Plus, we continue to see the same trend on the transaction count, like Michael said in his script. We continue to have traffic in our store. Our promotions continue to be very efficient, relevant to customers and with good balance in managing our margins. Fundamentals remain very strong.

I think it's just the like-to-like comparison that we give more colour to everybody to understand our numbers.

**George Doumet**

Okay. And just my last question on gross margin up 5 basis points, I think 10 excluding fuel, adjusting for the strike. Matt, I think you mentioned previously an expansion of like 10 basis points to 20 basis points. That's kind of a comfortable range that you want to get into. Should we expect that kind of for Q3 and other quarters? And maybe how long do you think we can expand margins, I guess, in the context of our competitors having some margin compression?

**Matt Reindel**

Yeah. I mean, I think I said last quarter that the days of these massive increases in gross margin that we've been reporting are basically gone. And we're now at the point where we have a very stable business and some of those big opportunities have now been captured. So, on an ongoing basis, 10 to 20 basis points would be a very healthy improvement in gross margin. That is what we will target.

I'm not going to commit to anything moving forward. As we know, this is a very challenging environment. But we have enough tailwinds in our projects when you look at supply chain, when you look at space productivity, when you look at the work we're doing on promotions to continue to improve that margin moving forward. And that's certainly our intention.

**George Doumet**

Okay. Thanks. I'll pass the line.

**Operator**

Thank you. The next question comes from Tamy Chen at BMO Capital Markets. Please go ahead.

**Tamy Chen** — BMO Capital Markets

Hi. Good afternoon. Thanks for the question. Wanted to go back to, Michael, your comments on promotional penetration. So I think you said that's still up, but the intensity you said in the quarter was stable. Just some of the other retailers recently said it sounded like they're seeing intensity go up a bit. So I just wanted to ask, at this point now are you still seeing that the general intensity is stable? Because I think we're also seeing anecdotally, like on the flyers, it just seems like that the magnitude and number of deals there has increased lately. So I would be curious to hear a bit more of your thoughts on that area.

**Pierre St-Laurent**

No. We don't see major changes in the intensity. Where we see continuous pressure, is on penetration. Customers are hunting for deals for obvious reasons. They are buying less-expensive products and they're increasing their own private-label purchases. So I think that we can understand that people are struggling with their budget and they're trying to get as much as possible with their money. But in terms of intensity, we did not see major changes.

**Tamy Chen**

Okay. Understood. And on the initiatives with respect to OpEx and the restructuring, are you at a position now to give any insights around what we should expect in terms of improvements on the SG&A once you complete these restructuring initiatives? Thank you.

**Matt Reindel**

Thanks, Tamy. I'll take that one. Yeah. Well, I mean, we're not going to give specific details on an initiative-by-initiative basis. What I would say is, as I said in my prepared notes, you can continue to see severance being recorded through Q3 and Q4. Unlike most cost-reduction initiatives, when you're talking about severance, you get the immediate pickup, the immediate savings with those severances.

So in our cost-reduction initiatives, which are going to be critical to mitigate some of these cost increases that we have, we have a mixture of projects that generate immediate savings and some that are more of a medium-term basis. So we're nicely balanced to take costs out of the organization. But no, we're not going to provide specific numbers on the restructuring.

**Tamy Chen**

Okay. Thank you.

**Matt Reindel**

Thanks, Tamy.

**Operator**

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

**Irene Nattel** — RBC Capital Markets

Thanks. Good afternoon, everyone. Really interested by your comments around the category resets. Can you give us an idea of what you're doing, the basis of some of the changes that you're making, how consumers are going to see this in-store? And sort of what the mix, let's say, of store brands versus private label will look like once you're done?

**Pierre St-Laurent**

Category reset was during Sunrise. Now we're talking more about space productivity. So we're trying to optimize the sales per square foot in the planogram and within the macro-environment of the store. So now we have data and algorithms helping us to maximize sales per square foot. So that's what we are doing right now.

Like Michael said, we did pilots with very encouraging results on the planogram itself. More than 80 percent of our planograms have been completed and they are well integrated with the new tools that the merchandising team is working with, and with our planning with suppliers. So when we're planning activities for the year, we have to engage suppliers into it. This is well implemented right now and now we're on the deployment phase for that.

So we expect same-store sales growth through this initiative over time. And that's the planogram itself. But we're also looking at optimizing and adjusting in the store - the sequencing of categories into the store. So when we do renovations and when we have identified the opportunity in a few stores, you can see the re-lines in stores to optimize sales per square foot. So that's basically the project we're working on.

It's slightly different than what we did through category reset during Sunrise. It's an update. But it's a more powerful project with more algorithms and data that we did not have access to during Sunrise.

**Michael Medline**

I'd say, for the most part, we're not disrupting the store or the customer to the degree we had to in category reset. Unless we're doing a major renovation or building a new store, we're not moving where customers are accustomed to find the category. So if you want crackers and cookies, you know where to go get crackers and cookies.

What you will see are changes in terms of linear feet and in terms of brands sometimes and in terms of own brands, where it makes sense. And we've got the algorithms and they're performing as well or better in real life than the algorithms in terms of boosting sales and maybe some of the other numbers.

And it's probably their biggest project in terms of upside as we roll that out. But we're very confident in it. But you don't want to roll out something in the store which affects customers without some testing and piloting. And that's what we've been doing, and we're extremely happy with such testing and piloting.

**Irene Nattel**

That's super interesting. Thank you. And sorry, I misspoke. I meant planograms.

So if the customer goes into the store, does it look meaningfully different as part of the shift in the planogram? Or is it really just very subtle, but to deliver the increase in square footage?

**Pierre St-Laurent**

It will vary by category. Some categories will have extra space. Some other categories will have maybe less space to give more space to categories that we have more opportunity in terms of sales.

In terms of assortment, we're not expecting overall significant changes. We will just optimize what we already have. We're don't expect less assortment for our customer. But again, it could be variable by category.

But overall, like Michael said, not very disruptive. And no major changes in the SKU counts in our stores. By category, that could vary, but at the total store we're not expecting big changes in terms of choice for customers.

**Irene Nattel**

That's very helpful. Thank you. And just one other question. I was very interested in your commentary around the price increase request from the multinationals. We're hearing it from others. But yet, at the same time, what we're hearing from the multinationals is that they want to focus again on volume. So just trying to kind of reconcile the behaviour from the rhetoric, and I'm wondering what kind of insights you might be able to provide there.

**Michael Medline**

Yeah. So Pierre and I met with all of our big suppliers and medium-sized suppliers and small ones, what was it, a few weeks ago?

**Pierre St-Laurent**

Yeah.

**Michael Medline**

And we spoke. And the rest of our team also did a good job, but we led it off by talking. And I was pretty clear that this is not the vast majority of our supplier partners. We have great relationships. And I believe a lot of them are struggling, first through COVID and then through inflation. This is very, very tough on their businesses.

I saw something last week when a supplier partner put out a press release, multinational supplier put out a press release saying, hey, we keep increasing prices. We keep making more money. We did not like that. We did not like that one iota. That's not the way it should be. It's very, very bad business in the long run for supplier partners to think they have that kind of elasticity in their pricing. And it's bad practice.

What I also said, I'll be perfectly frank with you, I said, before there was high inflation you wouldn't just pass every increase on. So if you paid your people a few bucks more, you didn't pass it on to us, who you know are going to get the blame for it, and then on to the Canadian consumer. That's not right. That's not good business. That's not what happened before. I think in the short term, some of them believe they can pass this on, that it's completely elastic. We'll get blamed as grocers. And Canadians suffer.

And so we were pretty clear. And some of them [price increase requests] are just ridiculous, just ridiculous. Like every cost you have, you either should mitigate or you should eat some of it. And you know what? Every time we have a cost increase, we don't pass it on to the customer. We have to find ways to save money and we got to eat some of it if we have to. And that's the way you do business. And you find efficiencies in your own business.

And I'm not talking about a lot, but I'm talking about some big multinational companies. And we've had discussions with them. And I guess, Pierre, some of them were good discussions. Some, I don't know how this is going to end up. But we'll take fair price cost increases. We will not take unfair cost increases and pass them on to Canadians. So we'll fill it with other goods in our store, including our own brands.

**Irene Nattel**

That's very helpful. Thank you.

**Pierre St-Laurent**

And if I may, on the positive side, that's the exception.

**Michael Medline**

This is a real switch up here. You're going positive on it.

**Pierre St-Laurent**

So in Q1, we said that we had one-third of the cost increases we had the prior year. So in Q2, we can say it's one-fifth of what we had last year at the same time. So the pressure on inflation is going down. The example that Michael gave, it's a few suppliers. They need to understand that the customers' capacity to pay more is at its limit right now. And we need to find different solutions. We've been dealing with inflation for two years. It's not good for our industry and not good for their products to continue to increase prices. And we'll take care of that. But again, the trend is going in the right direction: less cost increases in numbers and in magnitude than prior year to one-fifth of what we had last year in Q2.

**Michael Medline**

Yeah. That's great to say. And also, we also had a discussion. We've got to put more pressure on suppliers where commodities are coming down and costs should be coming down for Canadians.

People always ask us - Inflation is slowing and I think it will dramatically slow. But in cases where it rose because of global tensions or other matters, if those commodity prices are coming down, why are Canadians paying an elevated price still? That's a hard discussion for companies to have and we're having it right now.

**Irene Nattel**

That's great. Thank you.

**Operator**

Thank you. The next question comes from Michael Van Aelst from TD Securities. Please go ahead.

**Evan Frantzeskos** — TD Securities

Hey, guys. It's Evan in for Mike.

My first question is on same-store sales. If I just do the simple math of taking same store sales ex-fuel and less inflation, your same-store tonnage is still negative in around, let's say, 3.5 percent, 4 percent range. And we're in the third year now of negative growth in that number.

So given that comps are easier, do you expect that to stabilize soon? And maybe you can elaborate a bit on the steps you're taking to stabilize that.

**Matt Reindel**

Hi, Evan. Well, maybe Pierre and I will tackle this together. Just first of all, for several years now we don't talk about tonnage, just because historically there's so much noise within the mix within tonnage. So we don't really talk about that.

On a macro-level basis, though, as we've said throughout this whole period, is our tonnage lower? Yeah. Of course. As is the whole industry. So I think that's probably just worth calling out. Pierre is there anything you want to add?

**Pierre St-Laurent**

You're exactly right. Right now, I think that the math we did in the past with tonnage, inflation, and same-store sales isn't relevant anymore considering the magnitude of the inflation that we've had over the last two years. And customer behaviour has changed a lot.

Like we said, tonnage is going down in the entire industry. So this math is very difficult and irrelevant to do, in my opinion. But again, so we're dealing with the same market. And I think we are pleased with our overall performance when we look at every single format individually, like we said earlier.

So in discount itself, we're pleased with our performance. We're growing our share in the discount market. Same thing in full service. So we're pleased with the fundamentals. It's where we remain extremely confident going forward.

We’re making progress, we have strong plans, and we believe that same-store sales will continue to improve.

**Evan Frantzeskos**

Okay. Great. Thanks. And then just on discount. It seems like the trend to discount is still very much there, but your discount exposure hasn’t been increasing very much. Are you still planning to convert your targeted 25 percent of stores in the West? And what’s preventing you from reaccelerating that conversion rate?

**Matt Reindel**

So a couple of things there. But yes, simple answer to your question is absolutely we still have some plans to go in the West to continue that conversion. So we still have some scope to increase. I always do this, but just to clarify. When we talk about this trade down to discount, that’s not necessarily a trade down to a discount shop. Our customers are still in our stores. We still have very strong customer numbers. In fact, they’re increasing.

So what that tells you is that our customers are trading down in our store. So they’re looking for value in our store as opposed to a trade down to discount. I always like to just clarify that.

And then in terms of continued discount expansion, look, that’s something that we will continue to look at strategically. So we know we’ve still got some scope in the West, so we’ll take that. We have some scope in Ontario. But to be honest with you, we’re not going to massively expand discount. That’s not the structure of our business, but we do have some scope to continue to expand.

**Michael Medline**

Yeah. It's Michael. Thanks. That was well said, Matt. Just to clarify, discount same-store sales growth across the country is falling in terms of magnitude. Numbers are coming down, just to clarify.

And two, we stick to what we said. As inflation abates, and it's abating fast now, and as we reach peak and start going down in interest rates, I like full service. I like it a lot. I like where we're positioned. And I like how we've had to change full service and make it even more competitive through COVID and through inflationary times. This is not your grandmother or grandfather's full-service store. And so I like where we are. I like the changes that we talked about here today. I like our strategy. And then when we get a little tailwind, you'll see it.

**Evan Frantzeskos**

Great. Thanks. And if I can sneak one more in, just on the SG&A. If I look at it excluding depreciation, historically Q2 has typically been quite a bit below Q1 in terms of dollars, other than last year and this year.

What has changed in the timing of your expenses to account for that shift?

**Matt Reindel**

That's a good question. When you look at SG&A, as I said in my script, our increase in SG&A is very consistent with what we've had for many quarters now as we continue to invest in our medium-term initiatives, as we continue to invest in store growth. So nothing's changed there.

What has changed is some of the inflationary cost increases. So particularly when you look at store retail labour, that has had a bigger impact on our P&L than in prior quarters. Again, from wage increases, minimum wage increases, negotiated increases, et cetera.

So this is why we've taken the time today through Michael's script and my script to really map out some of the cost-optimization initiatives that we're working on. Because when you have inflationary cost increases like this, you have to take these costs out of your P&L to mitigate. So you have to have significant cost-reduction initiatives in play to have that mitigation effect.

So that's the reason we gave you the additional detail because this is not empty words. These are active cost-reduction initiatives that we're working on as we speak.

**Evan Frantzeskos**

Thank you very much.

**Operator**

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

**Vishal Shreedhar** — National Bank

Hi. Just wanted to get your perspective on shrink, which you indicated was increasing. Is this something that is concerning? Are there initiatives in place that you can implement to reduce that? And how should we think about the impact on a year-over-year basis related to shrink?

**Pierre St-Laurent**

Thank you for your question. Good question. We saw a slightly higher shrink number and some rising theft or shoplifting. But overall, our margins remain strong. At a high level, shrink management is always something that's challenging, but the business is used to dealing with that element. But yes, there is a bit more pressure from theft. But overall, our margin remains strong all in and the team continues to work on mitigating shoplifting and theft with action plans.

So right now, the volatility is creating pressure on shrink. But as I said, the shrink number is included in our gross margin performance. And our gross margin performance is above our peers. So we're pleased with that.

**Vishal Shreedhar**

Okay. And are some of your other initiatives potentially causing or creating opportunity for shrink, such as self-checkout? And if so, how does management think about balancing that?

**Pierre St-Laurent**

That's part of the initiatives we have in place already to mitigate shrink or shoplifting. There are many small things that we can improve to mitigate the shoplifting in stores. And this is one example, but it's not a big one, if I may say.

**Matt Reindel**

Just to tack on to that. It's an interesting question, Vishal. Because I guess the other example we could give you would be CFC 3. So when you launch a Voilà distribution centre, in that initial ramp-up phase, your shrink is a little bit higher. I wouldn't call that acceptable shrink because we don't like any shrink and we're fighting against that all the time.

But that might be an example of where temporarily our shrink would be higher on a launch.

**Vishal Shreedhar**

Okay. Thanks for that colour. And just changing gears here. I was hoping to get some context on Empire's supply chain, in particular its fleet of trucks. And if there's options or if the Company is exploring freight as a service-type initiatives. And if so, is that something meaningful that investors can look forward to in terms of opportunities for efficiency?

**Pierre St-Laurent**

Yeah. Exactly. Like we said earlier, supply chain is one of the pillars to improve our costs. And the team is not only looking at, but we're already seeing the benefit of activities they did with the optimized routing, the utilization of equipment has improved. Our relationship with some of our carriers has changed. And we're expecting to take charge of more loads to reduce cost and bring more products into our RSCs versus using DSD suppliers.

All those initiatives are there to improve our supply chain, minimize our cost and improve our margin. They are already in place, and we expect to see those benefits into this fiscal year and the next fiscal year. But everything is considered right now, including taking charge of our transportation activities more than we do right now.

**Vishal Shreedhar**

Thank you.

**Michael Medline**

Thanks, Vishal.

**Operator**

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

**Mark Petrie** — CIBC

Thanks. Good afternoon. I wanted to just follow up on gross margin first. And is it fair to say that the more modest expansion this quarter is mostly—or ex-fuel is mostly a reflection of normalization in what you're lapping? Or were there greater pressures in COGS anywhere in areas in Q2 versus Q1?

**Matt Reindel**

No. It's more a stabilization. When you look at the different drivers of gross margin, we benefitted, like we said, through supply chain efficiency, so we had a tailwind there. But then you look at things like business unit mix and you look at the core margin of the business, it's relatively stable period on period and year on year.

So in some respects, that's nice because we've got to that point where we're running a stable business. But having said that, we still are confident that we've got enough tailwind and enough fuel in the tank from our initiatives—and freight as a service might be a really good one that we just talked about—to continue to gradually improve that margin over time.

**Pierre St-Laurent**

And yeah, if I may, like Michael said earlier, interest rate increases have changed the pressure on promo penetration. The good news is that it's not the first time we have had to deal with customer behaviour changes over the last two years. And we have been able to correct course very quickly, based on new customer behaviour.

So in Q2, fall, back to school, interest rate increases, we saw additional pressure on promo penetration, but we have been able to correct course very quickly. So that's maybe another element in Q2 to consider.

**Mark Petrie**

Understood. Thank you. And that promotional penetration, Pierre, is that any different? Or that shift, is it any different in discount versus full service?

**Pierre St-Laurent**

Good question. We're seeing the same appetite for deals, for sure. I cannot give you more information other than that. It's a very good question. But every time we see things in the news, we have to re-adjust our promo mix to make sure that we stay in control of our margins.

I can't provide specific differences between discount and full service. The flyer is smaller in discount. They're at a lower regular price. So it's difficult to say, but we're seeing the same customer behaviour change every time there's something happening.

Because people are shopping at multiple stores, not only discount. They're not just going to discount. They're going to full service, and then back to discount. They're shopping four or five stores on average, so it's the same customer who's shopping at different stores. So I expect to see same type of behaviour in both full service and discount.

**Mark Petrie**

Yeah. Okay. And I know you don't typically talk about the regional performances, but just given sort of the shifts in square footage to discount, in Quebec in particular, are you seeing any changes in the competitive intensity in that market? Or maybe just on the topic we were just discussing in terms of promotional penetration?

**Pierre St-Laurent**

Yeah. We saw a slight change in Quebec in terms of when our competitor announced many conversions from full service to discount. So yeah, we saw more activity on the real estate side in discount in Quebec.

And obviously we're not present in discount because of the number of full service stores we have in Quebec. So yes, a bit more discount activity in Quebec in terms of real estate, but many of those

have been through conversions. And conversions in some places could negatively affect our stores, but some could positively affect our stores.

In the past, we saw that full-service store conversions to discount, most of the time were very positive for IGA. So right now, there's appetite for discount. But again, inflation is going down. We have a bright future. We have strong stores, strong networks, strong banners in Quebec, and strong franchisees.

We continue to believe in our strategy.

**Mark Petrie**

Yeah. Okay. Helpful. And sorry, one just last sort of housekeeping. Is it fair to say that space productivity is not yet contributing in the P&L? Or has that contribution started now? Or how material is that contribution now versus the total size of the opportunity?

**Pierre St-Laurent**

I would say that it's not material for now. The pilots are done, planograms are done, but the implementation will follow the category planning with suppliers.

So like Michael said, benefit will continue to come from now to the next six months and into the '25 fiscal year. But I would say we're just seeing the very beginning.

**Mark Petrie**

Okay. Got it. Thanks a lot for all the comments and all the best. Happy holidays.

**Matt Reindel**

Yeah. Same to you. Thanks, Mark.

**Operator**

Thank you. Your last question comes from Chris Li from Desjardins. Please go ahead.

**Chris Li** — Desjardins

Oh, thanks, everyone. I think the answer is yes, but I want to just quickly confirm. So you are still seeing a higher transaction count at the conventional banner. Is that correct?

**Pierre St-Laurent**

This is correct.

**Michael Medline**

Yeah.

**Chris Li**

Perfect. Okay. And that's, again, what gives you the confidence that as conditions start to normalize, hopefully we'll see some of the basket size to trend up again as people buy more from the conventional banners?

**Pierre St-Laurent**

Yes.

**Chris Li**

Okay. And thank you for all the comments on the SG&A expense-reduction initiatives. They're very helpful. I guess my question is, when you look at your SG&A expense dollars, they have been growing at around 4 percent to 5 percent in the last past three or so quarters.

Just from a modelling perspective, do you expect a similar rate of growth for the rest of the fiscal year? Or do you expect that to start to ease as some of these benefits start to be realized?

**Matt Reindel**

So let me take that. I mean, again, I always like to look at this separately in terms of rate and dollars. From a rate of growth perspective, we should start to see that number come down as the impact of our cost reduction initiatives start to bite. So I mean, that's not a commitment, but that's certainly what our expectation is.

From a rate perspective, there's two factors driving that. The rate was a little bit higher because we didn't have as much sales leverage on the top line with a lower sales growth number. We also had the cost increases from retail labour. And the cost-initiative programs have not yet really kicked in.

So as you move forward, we hope that the SG&A rate, will start to decrease as, A, we have higher sales; B, that aggravation on the retail labour line will continue; but C, the impact of our cost-reduction initiatives will start to kick in. Right? We'll start to see that in Q3 with the restructuring and all the work we're doing on supply chain and goods not for resale.

So yeah, I think the expectation is that as a percent of sales that should start to come down.

**Chris Li**

Okay. That's helpful. And my last question, maybe just on Voilà. I'm just curious, specifically in the Greater Toronto Area, can you share with us how are sales trending in this market? Are they growing?

And then maybe secondly, if you look at the industry overall within the GTA, what is the online penetration right now?

**Michael Medline**

Well, we'll answer our own and we'll call you back later and guide you to where you can look to see what the penetration is in the GTA. I don't know if there is a GTA number. We'll take a look. Maybe you can just talk about our own, whether our sales are going up.

**Pierre St-Laurent**

But one thing for sure, online penetration is always higher in the fall and winter than it is in summer. So without looking at numbers, I can guarantee you we have higher sales right now because the season. And it will continue to grow during the winter.

And like Michael said, we have strong NPS. The service continues to be highly appreciated. Voilà is double-digit growth. We're well positioned to capture that growth for sure.

**Chris Li**

Okay. And so if you'd exclude the launch in Calgary this quarter you're saying Voilà sales would still be positive?

**Matt Reindel**

Yes. I mean, don't forget, when we launch a CFC in the initial period, the sales are very small. Right? So they're ramping up, they're ramping up aggressively, but from a very small base.

So yes, even if you excluded CFC 3, healthy growth.

**Chris Li**

Perfect. Well, thanks very much. And yeah, happy holidays to everyone, too. Thank you.

**Michael Medline**

Yeah. Have great holidays, everyone.

**Operator**

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

**Katie Brine**

Thank you, Joanne. We appreciate your continued interest in Empire. If there are any unanswered questions, please contact me by email.

We look forward to having you join us for our third quarter fiscal 2024 conference call on March 14th. Talk soon.

**Operator**

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