FINAL TRANSCRIPT

Empire Company Ltd.

First Quarter Results Conference Call

Event Date/Time: September 12, 2013 — 1:30 p.m. E.T.

Length: 53 minutes

CORPORATE PARTICIPANTS

Paul Beesley
Empire Company Limited — Executive Vice President and Chief Financial Officer

Paul Sobey
Empire Company Limited — President and Chief Executive Officer

Marc Poulin
Sobeys — President and Chief Executive Officer

Paul Jewer
Sobeys — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Perry Caicco
CIBC World Markets — Analyst

Peter Sklar
BMO Capital Markets — Analyst

Michael Van Aelst
TD Securities — Analyst

Jim Durran
Barclays — Analyst

Patricia Baker
Scotiabank — Analyst

Keith Howlett
Desjardins Capital — Analyst

Chris Li
Bank of America Merrill Lynch — Analyst

PRESENTATION

Operator

Good afternoon. My name is Laurel (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Empire Company Limited First Quarter Results Conference Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. At that time in order to ask a question simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. Thank you.

I'll now turn the call over to Paul Beesley, Executive Vice President and CFO. Please go ahead, sir.

Paul Beesley — Executive Vice President and Chief Financial Officer, Empire Company Limited

Thank you very much, Laurel, and good afternoon and welcome to Empire Company Limited's first quarter fiscal 2014 conference call. Thanks for joining us today.

Our comments will focus primarily on the financial results for the first quarter ended August 3, 2013. We'll then be open to answer your questions.

This call is being recorded in live audio on our website at www.empireco.ca.

Joining me on the call this afternoon are, from Empire Company Limited, Paul Sobey, President and Chief Executive Officer, and Stewart Mahoney, Vice President Investor Relations and

Treasury. From Sobeys we have Marc Poulin, President and Chief Executive Officer; François Vimard, Executive Vice President; and Paul Jewer, Chief Financial Officer.

Today's discussion includes forward-looking statements. We want to caution you that such statements are based on management's assumptions and beliefs.

These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. I refer you to our news release and MD&A for more information on these assumptions and factors.

This morning we released Empire's fiscal results for the first quarter ended August 3, 2013. We advise in our quarterly reporting that Empire Theatres has been classified as a discontinued operation, which requires segmentation of its financial results. Accordingly, remarks on the consolidated results of the Company reflect the performance of continuing operations.

Empire reported consolidated sales in the first quarter of $4.61 billion, a $100 million or 2.2 percent increase over last year. Consolidated adjusted net earnings from continuing operations net of non-controlling interest in the first quarter were $89.7 million or $1.32 per diluted share compared to $102.6 million or $1.51 per diluted share in the first quarter last year.

Items which are not considered indicative of underlying business operating performance, which impacted after tax net earnings in the quarter, consisted of transaction costs of $7.1 million associated with the proposed acquisition of Canada Safeway.

Consolidated cash and cash equivalents was $467 million at the end of the quarter versus $369 million a year earlier. The Company also had restricted cash of approximately $1.8 billion at August 3, 2013, in connection with the closing on July 31, 2013, of the Company's previously announced offering on subscription receipts to partially fund Sobeys' acquisition of substantially all the assets and select liabilities of Canada Safeway.

The Company believes that the financing elements are in place to sufficiently fund the acquisition of Canada Safeway, including transaction costs. In the event that certain of the financing transactions are not completed by the time of closing, the Company does have in place fully committed credit facilities for the full purchase price, plus transaction expenses required to close the Canada Safeway transaction.

I will now turn the call over to Paul Sobey.

Paul Sobey — President and Chief Executive Officer, Empire Company Limited

Thank you very much, Paul, and good afternoon, everyone. Our first quarter net earnings performance was below expectations, reflecting a highly competitive and promotional food retailing operating environment, the discontinued operations of Empire Theatres, and initial expenses associated with the acquisition of Canada Safeway.

During the first quarter, Sobeys' sales increased 99 million or 2.2 percent to 4.6 billion, and Sobeys' first quarter adjusted operating income contribution to Empire was 138 million versus 159.8 million last year. Empire's investments and other operations recorded adjusted operating income contribution to Empire of 6.1 million in the first quarter versus 7.7 million in the same period last year.

Crombie REIT contributed equity earnings of 6.7 million in the first quarter compared to 5.6 million last year, with cash distributions received from Crombie REIT in the quarter of 8.8 million. At the end of the first quarter, the fair value of our 42.7 percent ownership interest in Crombie REIT, 40.8 percent fully diluted, was $527 million on a carrying value of 194 million. For detailed information on Crombie REIT's performance, please see their quarterly release dated August 8th.

On the residential property side, Genstar contributed equity earnings to Empire of 3.1 million in the first quarter compared to 4.6 million last year.

Marc will now comment on Sobeys Inc.

Marc Poulin — President and Chief Executive Officer, Sobeys

Thank you, Paul. First, a few comments on the market environment in the first quarter.

The market was highly promotional, particularly when compared to Q1 last year, which as you know was a record quarterly performance for the Company. In the quarter we made prices that were meant to drive loyalty and traffic, and even though this was costly, our market share was stable to slightly positive, depending on which part of the country you're talking of.

As the quarter progressed we adjusted our promotional mix in our shelves, and EBIT showed improvement. This positive trend carried forward as we exited the quarter.

So with this background on the market environment, I'll now provide some financial highlights. Sobeys' same-store sales growth in the first quarter was negative 0.1 with little to no food inflation. Real same-store sales growth improved slightly from the negative 0.4 experienced last quarter. Gross profit decreased 3 million to 1.04 billion in the first quarter, with gross margin declining 56 basis points to 22.59.

Excluding the transaction costs related to the Canada Safeway acquisition and the loss on disposal of assets, Sobeys first quarter adjusted EBITDA contribution to Empire was 226 million, down 18.5 million. Along with the impact of the higher promotional environment, EBITDA was also impacted by a number of other factors, including expenses associated with our plan to enhance positioning of the Sobeys brand, and our own additional store opening activities, and weaker-than-expected store performance in cottage country.

During the quarter, we continued to take advantage of opportunities to grow the business. Our investment in property, equipment, and investment property purchased totalled 104 million. We opened, acquired, or relocated 17 stores versus 10 last year. Net retail stores square footage increased by 200,000 square feet in the quarter, with total square footage of 29.7 million square feet at the end of the quarter, a 2.4 percent increase from the first quarter last year.

Free cash flow generation was 50 million in the quarter and 291 million over the last four quarters.

While much of our attention over the past number of months has been on the Canada Safeway acquisition, we have also been busy working on the evolution of the Sobeys banner to better serve the changing needs of Canadian food shoppers.

As you know, our food-focused, fresh-driven offering has a natural appeal for Canada's increasingly health conscious consumers, and we are committed to making it more compelling every day. Our research suggests the sizable consumer segment that is concerned that better food is too expensive, too time consuming to prepare, or too difficult to find to include in their everyday life. In fact, 73 percent of Canadians think they would like to eat better than they currently do.

We believe there is a clear strategic opportunity to provide what Canadians are looking for. Over the past month, we have been making changes in our offering in Sobeys banner stores across the country. It is the beginning of the evolution of the Sobeys brand that will encourage Canadians to eat better, feel better, and do better.

We will show Canadians that better food tastes great, is easily available, convenient to prepare, and leads to a healthier lifestyle. Starting this week, consumers will not only see the changes we have made to our food offering, but as importantly in the support we provide in our store, as well as through our flyer, our online presence, and through digital tools, all of which will empower, enable, and motivate Canadians to eat better every day. Sobeys' new brand platform will be accompanied by an exciting new store content that will be rolled out later this fall.

And to help educate, inspire, and empower Canadians to eat better, we have partnered with world renowned chef and campaigner, Jamie Oliver. As Sobeys' spokesperson, Jamie will partner with the Sobeys team as we begin our journey to help Canadians eat better, feel better, and do better. He will focus on bringing awareness to sustainability, cooking skills, product development, and community social responsibility.

So the next 12 months and beyond promises to be very exciting for Sobeys, with much opportunity to satisfy the consumer and for value creation. This longer-term perspective is important for the sustainable health of our business. We do not manage the business with a view to optimize any one quarter's result. We are all about generating sustainable growth over the long term, and on a trailing four-quarter basis Sobeys continue to grow its sales, EBITDA, and adjusted net earnings.

We know that any period of heightened promotional activity will generate quarter-by-quarter volatility. This is simply the ebb and flow of the business. We have experienced this many times before, and we are a long-term player committed over time to long-term growth. We are confident that we will continue to profitably grow the business. Our long-term growth prospects remain firmly intact.

Over to you, Paul.

Paul Sobey

Thank you, Marc. Despite a challenging market environment, we are confident of the future growth of the Company, and remain well positioned to grow earnings and build shareholder value, including the opportunity for profitable growth as a result of the acquisition of Canada Safeway.

We will continue to execute our strategic priorities and growth initiatives to drive sales and strengthen the business, and we remain committed to reducing costs and increasing efficiencies across the business, and look forward to the successful closing of the Canada Safeway acquisition later this fall.

This acquisition represents a highly strategic opportunity for Sobeys to leverage its existing asset base and effectively create a new platform for growth. We will ensure that we have the necessary resources and action plans in place to successfully integrate this exciting and transformational acquisition.

We also expect a successful closing of the sale of Empire Theatres in our second quarter, and anticipate to generate net proceeds after associated expenses and costs of $216 million. These transactions align with the strategic direction of the Company to focus our resources on the food retailing business, to our 100 percent interest in Sobeys, and on our related real estate business through our equity interest in Crombie REIT.

We are now happy to respond to your questions.

Q&A

Operator

At this time, I would like to remind everyone in order to ask a question press *, then the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Perry Caicco of CIBC World Markets. Your line is open.

Perry Caicco — CIBC World Markets

Thank you. I want to talk about the promotional firefight that's going on in the Ontario market. You're obviously a big part of that with FreshCo, so my first question would be is FreshCo with this pricing strategy on track to achieve the types of volumes that you're obviously targeting?

Marc Poulin

We are quite happy with the results we're seeing in the consumer acceptance of the FreshCo concept. The banner is clearly in our mind gaining ground with the consumer, and we believe that it's a banner that will be successful in the future, growing both its consumer loyalty levels and its market share.

Perry Caicco

And how far away are you, though, from achieving the kinds of volumes it's going to take to make FreshCo a real contributor?

Marc Poulin

I think we're really on the trend that's alongside what we've been expecting, and we're very much on time with that on the volume. No problem.

Perry Caicco

And, Marc, has the discount firefight involving FreshCo and the others caused the Sobeys conventional banner in Ontario to kind of get caught in the crossfire?

Marc Poulin

I think the overall market is highly promotional, and it's on the background of a consumer that remains difficult to convince to spend dollars at store level right now. So you really are playing, as I said in previous calls, you're playing the game on a week-to-week basis. There's heightened importance being placed on how you play the promotional game, and obviously this time around we've been chasing volumes that didn't materialize for all kinds of reasons.

And we clearly have to relook at some of the market and commercializing and promotional plans that have been put together because they clearly didn't pan out to expectations.

Perry Caicco

And that leads to a question about your ambitious new marketing campaign; I guess it's around Jamie Oliver, and I guess a change you've made in a number of your practices. I mean is this an intention to justify your pricing position in your conventional banners? And if so, isn't it sort of inevitable that the market, the way it is that you're going to have to get more serious about pricing in conventional anyway?

Marc Poulin

It is an intention to deliver great value to consumers. At the end of the day, I think what's important for the consumer is to add value, and there's more than one way to deliver value. Obviously if you are a discount the price is the key focus of that value equation. If you're in full service the value equation comes from numerous factors.

And clearly we believe that we can deliver better value on the fresh side and full service side of our portfolio in repositioning a little bit the offer at store level that we would present it to consumer, that we would merchandise it, and that's the journey we've embarked upon. But we also believe that consumers are kind of waiting for a grocer to take this kind of a position, and will respond very favourably to the enhancement that we will make to our offering.

Perry Caicco

And my last question is just wondering if you've made any decisions involving your organization in Western Canada, the role of the Safeway executives, and the role of the Safeway banner?

Marc Poulin

We are very much looking forward to bring on the team, the very good team at Canada Safeway. That's clearly in this acquisition not only are we acquiring good real estate, but more important in my mind we are—there's a great group of people that's going to be joining our team.

How we will work that out by putting the two teams together remains a work in progress, but I can clearly say that the talent that's present at Canada Safeway is very welcome in the Sobeys team.

Perry Caicco

Okay. Thanks, Marc.

Operator

Your next question comes from the line of Peter Sklar of BMO Capital Markets. Your line is open.

Peter Sklar — BMO Capital Markets

Marc, for two quarters now you've had this negative trend of declining gross margin and declining tonnage. You've attributed that to the competitive environment, highly promotional. Can you talk a little more specifically about what has changed over the last couple of quarters? Like is it in a particular region? Is it a particular competitor? Is it in discount versus conventional? Or is it across the board nationally?

Marc Poulin

Well, I think it's—obviously the intensity may vary from region to region at a certain period of time, but overall I think it's important to note that this is on the backdrop of very tepid consumer demand right now. The market growth is very weak. Inflation is nonexistent. So obviously—and you get, whether we like it or not, there's a lot of people who put a lot of square footage in the marketplace, ourselves included. So it obviously doesn't make for, I think, market conditions that are favourable in the short term. So you've got to play the game promotionally; you got to defend turf.

I think it's very important, as you know, that as a company we've never been market share leader and our DNA, if you want to put it that way, has always been to protect market share. And honestly, based on the numbers we have to a certain degree we've been able to achieve that across the country in this very difficult environment. I have to admit that the cost of it in this quarter was a little bit over what we would have liked, but on the long term we believe that that's important to build a healthy business is to continuously invest in the business the way we should to maintain competitiveness over the long term.

So we—but I would be lying to you if I didn't say that we feel there is some adjustment to be made because the way we've done it this time around is clearly not the best way of going at it.

Peter Sklar

Okay. And, Marc, earlier in your prepared comments you said something I didn't quite hear. You were talking about some change Sobeys have undertaken, and you talked about the change in trend exiting the quarter. Could you go back to those remarks? I didn't quite understand what you were....

Marc Poulin

Okay. So the—if you're—there are changes to the Sobeys banner that we're currently applying, so we'll start with that. During the quarter, honestly the team has been preparing the launch of the new positioning. So we've gone to over—close to 200 stores where we did relines this quarter. So obviously that took a lot of the people's attention as we introduced broader assortment in various categories that more align with the positioning that we're taking.

We're starting introducing new commercial programs or train people around those new commercial programs. So there's been a lot of activity in this quarter along the lines of the launch we're making this week, and obviously this is a journey. I'm not going to tell you it's finished. It's going to—it is a journey, but we're clearly working hard at repositioning the Sobeys brand in order to provide better value to Canadians along the lines of better food for all.

The other comment is more like we saw, as the quarter evolved, better trends in terms of sales, and there may be new risk factors that explained it. I like to use the weather as one of them, but clearly the early spring, if we compare this year to last year, were not exactly of the same nature. And we did heavy promotional activities that didn't pan out the way we thought they would pan out. Early in the quarter the sales were—but the sales have been improving from period to period.

Peter Sklar

Okay. And just lastly, one question on Safeway. On the synergies, the 200 million of synergies, you talked—you've kind of broken it down into two buckets. I think there's 100 million of synergies in year one. Can you be a little more specific? Is that the run rate you expect as you exit year one post-acquisition? Or...

Marc Poulin

Yes. It's exactly that. It's exactly that. The 50 percent of the 200 million overall synergies that we've projected, that's 50 percent is the run rate at the end of year one. And...

Peter Sklar

And how does that build through the first year? Is it linear? Or is it all come at the end? Or do you get a big chunk right from day one?

Marc Poulin

No. It won't be—it's clearly not linear. There's going to be—the first six months there's going to be a get-to-know-one-another period, although there's some of that going on right now, as you can expect. There are limits to how much sharing of information we can do in this context as the transaction is still under review by the Competition Bureau.

So the first six months will—roughly. Don't hold me to months, day-by-day account of activity, but you can expect that you're going to see less early on that you'll see towards the end of that first year, which is normal because it's going to take time to if only to share the orientation and get organized. I mean this is not a—this is a big team that we've got to—two big teams that we have to put together to achieve those kinds of synergies, and if we want to do it right we've got to do it in such a way that people understand how, why, and we're doing it and get going at it.

So I would—it would be fair to expect that in the first year especially it's going to be a little bit more backhanded than in the following years.

Peter Sklar

Okay. Thanks very much.

Operator

Your next question comes from the line of Michael Van Aelst of TD Securities. Your line is open.

Michael Van Aelst — TD Securities

Yes. Hi. Good afternoon. I guess the first question has to do with the same-store sales trends during the quarter. You mentioned that they started off weaker and finished off stronger. And I'm wondering if your pricing had anything to do with that because, if I recall correctly, you said your inflation in fiscal Q4 was just under 1 percent and the other two major grocers had flat inflation. And then now you're—all three of you are back down close to zero. So I'm wondering if maybe your pricing was a little out of line heading into the quarter and that you corrected that during the quarter? Could you comment on that?

Marc Poulin

The trend is mainly driven by promotional activities a bit more than inflation. I think inflation was pretty tame all around the quarter. Now we're digging into what is a not an exact science what you're talking. Even though our promotional investments in the quarter were—didn't give the results we were expecting, I would hope that some of it has had an impact the same-stores sales trends, and that we did retain loyalty of the customers.

There's still work to be done analyzing this and doing postmortem on it that we obviously will do because, as I said, clearly the plans didn't work as expected, and there's going to be some analysis to be done to correct course.

So what we're pleased is that overall, albeit it didn't pan out the way we would have liked, we don't—we've been able to maintain our market share, and therefore it's for us to work on that base to bring the business to the level we want to bring it.

Michael Van Aelst

Okay. And when you take a look at the margin contraction in the quarter, I was also wondering if there was any—if that improved as the quarter went on as well? And whether the change in offering towards the better food, the change in your, I guess, it was your produce I think you were talking about as well, did that lead to any initial extra shrink that will take a little bit of time to go away?

Marc Poulin

There's a little bit—there's numerous factors that explain the contraction margin, and it's been you could argue erratic over the weeks. It's very much dependent on promotional activity and the success or unsuccess we've had with them as we rolled them out in the various parts of the country.

It's also fair to say that a lot of the new programs we're rolling out now, so it's not—clearly you cannot infer a lot of that, though we did invest. When you do relines and things like that it does cost on shrinkage, things like that and there may be a little bit of that too in the numbers.

So overall it's very much—it's already difficult enough to give you numbers every three months. I'm not sure I would like to give you numbers every week, but it's very much a week-to-week game right now.

Michael Van Aelst

Okay. And just a final question on the competitive dynamic. I was wondering if it's changed much as far as whether it's coming—whether this step up in competitive pressures or competitive activity if it's coming more from traditional or nontraditional than what we've seen in the past year or so?

Marc Poulin

No, it's not. I'll be honest on this one. We feel the competitiveness of the market, it's a market that we've been fighting in this environment for a while now, and I don't—I would not argue that Q1 of this year was more of a step-up. It's probably the way we played it on our side that was not up to par.

And we'll have to admit on this one and bite the bullet because honestly it was more our own doing than it was a step up in the competitive activity. That being said, if you compare it to maybe last year or a couple of years ago, there's clearly a step-up.

Michael Van Aelst

Thank you.

Operator

Your next question comes from the line of Jim Durran from Barclays. Your line is open.

Jim Durran — Barclays

Yeah. Marc, I was just wondering if you could explain to us what the sort of driver is in your thinking to the new store concept for Sobeys?

Marc Poulin

Well, Jim, we believe that currently the full-service side of our offering could do an even better job at providing value to Canadians. We see that the way Canadians—what the Canadians are expecting from a full-service grocery store is changing, and we have to respond to that change. And I think we as a grocer we can do a much better job at providing healthy meals to our consumer, products that are fun, that provide variety in people's plate.

So those are all elements that we feel that we can do a better job, and I think we're very well positioned as the preeminent fresh grocer in this country, and with the acquisition of Safeway we'll clearly be a very strong player in full-service fresh offering to deliver on that promise.

And we basically challenge ourselves to be more in tune with the customer. And we want to help Canadians get better food on their plates, have a better relationship with food overall, and we feel that we have a lot to deliver on that point. And so that's what we're after.

Jim Durran

And do you—how critical do you see the new store format being to the success of that versus some of the reline work, signage changes, et cetera you're going to do in the other stores?

Marc Poulin

It's a combination of both. Obviously, we hope that the new programs that we will introduce in existing stores will perform well, but we also know that the new store format will allow us to make it shine even more. So it's kind of we've got to work on both fronts.

We cannot only execute in a renovated store because—but we cannot—we will have to renovate stores to deliver even more on that promise. So—and as I said, it's not a one thing; it's not an advertising campaign. It's more than that.

It's a commitment on the long term, and it's a journey we're starting today and it's not only a one-month thing or a one-advertising campaign thing. It is a long-term commitment on delivering a better fresh experience to Canadians.

Jim Durran

And just last question just on sort of the margin side of the equation. Are there any extraordinary cost savings initiatives that you could deploy to help protect your EBITDA margin while still having to invest gross margin? Or are we sort of in a steady state now still doing very good cost containment obviously, given SG&A was not up a significant amount?

Marc Poulin

Well, you've got to realize that these numbers were done as we were investing behind some initiatives, and we did some investment in advertising in FreshCo in that quarter especially, so we keep believing in investing. Obviously, we are looking at elements of cost to help fund our activities, so we've got to look at reducing our cost base.

And the automated warehouse in Terrebonne, for example, now is fully operational. That's not an insignificant element in the cost structure. So we keep on working the plan on the cost side, but the story of this quarter is margin investment that didn't pan out the way maybe it should have or the way we expected that to pan out.

Jim Durran

Great. Thank you, Marc.

Operator

Your next question comes from the line of Patricia Baker with Scotiabank. Your line is open.

Patricia Baker — Scotiabank

Yeah. Thank you very much. Most of my questions have been answered, but I just want to address two topics again. Number one, the consumer. I'm just wondering, Marc, in your discussions are you implying that this quarter the consumer was weaker? Or is it rather that this quarter yet again the consumer remained in the doldrums, and you're maybe a little bit surprised that they're not starting to come out of the doldrums?

Marc Poulin

Yes. The consumer was weaker; yes, Inflation wasn't there. So basically whether we like it or not, the way we—from all of our indications, the market demand overall across the country has been pretty flat. There are pockets where it's more difficult than others, but if you take as an aggregate and you ask for what was the market growth in the market and then you—I don't want to harp, but you have some factors that didn't help: construction strike in Quebec for two weeks. Stats Can showed that number; it wasn't pretty.

So there have been a lot of little factors like that that maybe were circumstantial in this quarter that made it maybe worse that what it could have been, but overall I think, yes, we're still facing, unfortunately, an environment where the consumer needs to be primed up. And you're going to win your battle on a weekly basis for sure, given the—given their, how to put it? They're very careful with their dollars.

Patricia Baker

Yeah. No, I think that's—yeah. I appreciate that, and you made it very clear that you are referring to at least a slightly weaker consumer. And then I just want to clarify one thing. In your opening remarks, and it may well be that I didn't quite hear you correctly or fully and then in the answer to one of the questions, and you talked about the cadence or the progression through the quarter, did you actually say that towards the end of the quarter things got better? Or as you moved out of the quarter things got better?

Marc Poulin

Well, as the quarter progressed our sales trend clearly improved.

Patricia Baker

Yeah.

Marc Poulin

And that's—so overall it's been the key driver of our performance for the quarter.

Patricia Baker

And do you think, I mean you just also in a commentary answer to the last question you indicated that you're looking very carefully because the investment that you made didn't deliver what you though it would deliver. But if in fact the sales have started to improve do you think you might be getting some of that what you had expected from the investment starting to come through?

Marc Poulin

I'll be honest. I mean clearly we didn't play the game as well as we should have played it. So yes, as much I'd like to say that we've got some benefit from this, it was clearly not the right way of going at it.

Patricia Baker

Okay. That's fair. I really appreciate that. Thank you.

Operator

Your next question comes from the line of Keith Howlett of Desjardins Capital. Your line is open.

Keith Howlett — Desjardins Capital

Yes. I had a question on the promotional environment in the conventional channel. In terms of promotion, how much would you be able to affect through your loyalty program and direct communication with those consumers and how much still relates to flyer activity?

Marc Poulin

Well, the activity in this quarter was mainly driven by flyer activity.

Keith Howlett

And as you go forward with your new paradigm, if we want to call it that, will the loyalty communications be a larger part of that? Or is that really a separate issue?

Marc Poulin

No, I think you're right. It's not a separate issue and they are—we will have to relook at the way we went at it because it clearly is not the winning way. What we did, we're going to play differently is clear, and I'll be more than clear about it.

Keith Howlett

And in terms of the new tilt in stores, are there assets within the system that are—more closely reflect that? Like do the Thrifty stores or the Quebec stores or—we haven't really seen exactly what you're going towards yet.

Marc Poulin

Well, I think what you mentioned is there are parts of our business that are closer to the new strategy than others, and I think that you are a very clever analyst of the market.

Keith Howlett

Thanks. And then just finally on the FreshCo stores, would you look at changing any Foodland stores in smaller markets to FreshCo?

Marc Poulin

Honestly in this quarter we've closed a couple of stores in the Ontario market for conversion to FreshCo, so we've had some expenses associated with that, and so those are the opportunity we currently are seeing with FreshCo.

As we said on FreshCo, the current plan is not to we said, like for example, go across the country with the concept and things like that. The focus for next couple of years on FreshCo is very much on trying to refine what we have, get the formula to a level of preciseness in how it’s being executed where we will be satisfied with the results and the execution to yield where the profitability direction we want to do.

And that's always been the plan. The first three years were spent very heavily on converting the Price Chopper to FreshCo. That's pretty much done. There are only five Price Choppers left, and it's really a negligible factor now in the overall business. But now it's time to finetune every aspect of the business to make sure it's delivered the maximum what should be delivering, and that's what the team's going to focus on.

So apart from a couple of conversion of Sobeys to FreshCo that we've embarked upon this quarter, the focus is much more on fine-tuning the formula.

Keith Howlett

And then just one question on the Safeway relationship, assuming the deal progresses as planned. Is...

Marc Poulin

By the way, it does progress as planned.

Keith Howlett

Sorry?

Marc Poulin

By the way, it does progress as planned.

Keith Howlett

It does progress. Safeway in the US has been doing, as I understand it, quite a bit of work on a health and wellness initiative relating to nutrition and a broader based, I think, connection between drugs and food, et cetera. Will your relationship with them have any cooperation on that front? Or is your initiative really entirely your own?

Marc Poulin

Well, the initiative under Sobeys' banner is obviously something that predated the acquisition of Safeway. That being said, we made the acquisition of Safeway knowing very well where we felt our future lies in the full service—with the full-service format, and we felt that this acquisition was obviously very much in line with the future we see for our stores under that format.

So that's why this acquisition makes so much strategic sense. It's not only great assets and great locations, I'll repeat a very good team, but it's also a very good alignment in terms of the culture of both companies, and that's why we believe this acquisition was strategically so compelling.

Keith Howlett

Thanks very much.

Operator

Once again, in order to ask a question, please press *, then the number 1 on your telephone keypad.

And your next question comes from the line of Chris Li of Bank of America. Your line is open.

Chris Li — Bank of America Merrill Lynch

Hi. Good afternoon. Just have two questions here. Other than the Empire Theatres, can you maybe update us on where you're at in terms of the sale of other noncore assets? I remember in the prospectus it was mentioned that there are potentially up to about 800 million of noncore assets that are available. Can you update us on where you're at in terms of your thinking?

Marc Poulin

Well, we also said that a lot of those—the first noncore assets that would go under stores that the Competition Bureau will ask us to divest of, we are in current discussion with the Competition Bureau to finalize that list. And so that's the first step, and after that we will—as you know, there are other assets that we've identified and we are currently doing the work alongside that. But clearly the first focus is the stores that we will have to divest in order to satisfy the Bureau.

Chris Li

Okay. Do you expect you have to sell the full 800 million? Or is that not a final...

Marc Poulin

No. Those are assets that we have identified that are available for sale, and obviously we will take the right—800 was available; 500 we identified as selling through the financial—in order to finance the transaction. So we had more than we would—we have more identified that we will need to sell, and all dispositions will be taken with the long-term value of the shareholder in mind. And we will therefore take the appropriate decision.

This is not a fire sale in any way, shape, or form.

Chris Li

Right.

Marc Poulin

Just—so we will take the time necessary to make the disposition that makes strategic sense for the business; that enhanced value for the shareholders on a long-term basis.

Chris Li

Okay. And my second question is of the 56 basis point decline in the gross margin, how much did say the fuel business roughly forms? And the target wholesale business? You could think of those three factors combined, did they on a combined basis have any material impact on the margin decline?

Marc Poulin

Well, the debt reform had an impact. I mean we're not going to put it into various numbers, but it's clear we had that. And there were a number of little—the fuel business in Quebec in Q1 saw a spat of promotional activity that was clearly unusual. So anybody who's still in Quebec during that period will understand what I'm talking about, and that's—but that's behind us.

So there's been all kinds of little factors on top of the promotional activity on the food business that didn't go our way this quarter and that—but that's part of business. And honestly I'm not going to say—I'm not going to hide behind those to—the real cause is the way we play the promotional game, and I'm not going to lie to you. This is the real cause, and this is the one we corrected.

Every quarter you have plus and minuses, and we're going to attack the real cause and not take little add ups as excuses.

Chris Li

Okay. That's great. And just on terms of the operating expenses, and maybe a follow-up to an earlier question. It seems like if you adjust for the Canada Safeway transaction costs, it seems like it was fairly well controlled, up just over 1 percent. Is this a reasonable run rate to expect for the remainder of the year as you think about the business?

Paul Jewer — Chief Financial Officer, Sobeys

Yeah. We wouldn't give any specific guidance on that, Chris. Obviously as Marc said, our goal is to continue to reduce our expenses. We've got plans in place that are starting to do that and putting the automated DCs already talked about. We can't give any specific guidance, but obviously we intend to continue to work on lowering expenses so we confront our promotional activity.

Marc Poulin

Yeah. And promotional and also repositioning. I mean let's not kid ourselves. We're doing TV advertising this quarter on the—and Jamie Oliver as much as he is willing to work with us doesn't come for free. So there—but we've been working on reducing costs elsewhere in the business so that we can fund those investments into our brand. And we believe that this is the time where we should invest behind the brand because we believe that we have a consumer proposition that will resonate with customers. But if nobody knows about it then we're in no better shape.

Chris Li

Okay. And maybe just two quick last questions. Your tax rate, pro forma at Safeway, what's your expectation on that?

Paul Jewer

In the prospectus we used 26 percent, I believe, was the pro forma rate. So this quarter was a little lower than that, obviously, but that's a bit of a one-time benefit.

Chris Li

And are there any tax benefits that you're inheriting from the acquisition that you can use to offset?

Paul Jewer

Yeah. There are, absolutely. Again in the prospectus material we identified the fact that we're buying assets, and as a result of that we'll get a step up in cost base. That will have a cash tax benefit going forward; less of an impact on the income tax rate from an accounting perspective.

Chris Li

And on…

Paul Beesley

In addition the CEC is worth mentioning?

Paul Jewer

Yeah. The goodwill pool, so the fact that we're creating significant goodwill on this transaction goes into the CEC pool, and that gives us an additional tax deduction. Again, not an impact on rate, but certainly a very positive impact on cash taxes.

Paul Beesley

CFE (phon) cash reduction.

Unidentified Speaker

41 million a year.

Chris Li

And then on the pension side, I think in the prospectus it's also mentioned that it's about 49 million to the Safeway Canada plan. Is that a reasonable run rate to model for us…

Paul Jewer

Yeah. That's the cash contribution number, I believe, you're using…

Chris Li

Yes.

Paul Jewer

The expense number is a little less than half of that. So that's a reasonable number for—based on the analysis that we've done thus far.

Chris Li

Okay. Thank you, guys.

Operator

Your next question comes from the line of Michael Van Aelst of TD Securities.

Michael Van Aelst

My question's been answered. Thank you.

Operator

Your next question comes from Jim Durran of Barclays. Your line is open.

Jim Durran

I was going to ask the tax question, but I'll ask a different one. Marc, any change in the pricing environment in Quebec specifically? I mean most of your competitors have been referring to Ontario as sort of the focal point.

Marc Poulin

Well, we don't really give regional numbers, and I don't think we will give regional details about the—about our business, so I will refrain to go into this argument.

Jim Durran

Okay. Thanks, Marc.

Operator

There are no further questions in queue.

Paul Sobey

Thank you very much, Laurel, and thank you very much, ladies and gentlemen. We appreciate your continued interest in Empire, and look forward to having you join us for our second quarter fiscal 2014 conference call scheduled for December 12th.

Good-bye.

Operator

This concludes today's conference call. You may now disconnect.

*****