FINAL TRANSCRIPT

Empire Company Ltd.

First Quarter 2013 Results

Event Date/Time: September 13, 2012 13:30 p.m. E.T.

Length: 31 minutes

CORPORATE PARTICIPANTS

Paul Beesley
Executive Vice President and Chief Financial Officer, Empire Company Ltd.

Paul Sobey
President and Chief Executive Officer, Empire Company Ltd.

Stewart Mahoney
Vice President, Treasury and Investor Relations, Empire Company Ltd.

Marc Poulin
President and Chief Executive Officer, Sobeys

François Vimard
Executive Vice President, Sobeys

Paul Jewer
Chief Financial Officer, Sobeys

CONFERENCE CALL PARTICIPANTS

Perry Caicco
Analyst, CIBC World Markets

Peter Sklar
Analyst, BMO Capital Markets

Michael Van Aelst
Analyst, TD Securities

Chris Lee
Analyst, Bank of America

Keith Howlett
Analyst, Desjardins Securities

PRESENTATION

Operator

Good afternoon. My name is Michelle and I will be your conference operator today. At this time I would like to welcome everyone to the Empire Company Ltd. Q1 fiscal 2013 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. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press the # key.

I would now like to turn the call over to Mr. Paul Beesley, Executive Vice President and Chief Financial Officer. Please go ahead, sir.

Paul Beesley – Executive Vice President and Chief Financial Officer, Empire Company Ltd.

Thank you very much, Michelle, and good afternoon and welcome to Empire Company Ltd.'s first quarter fiscal 2013 conference call.

Thank you for joining us today. Our comments will focus primarily on the financial results for the first quarter ended August 4th, 2012, after which we'll be pleased 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 Ltd., Paul Sobey, President and Chief Executive Officer; and Stewart Mahoney, Vice President, Treasury and Investor

Relations. And from Sobeys: 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.

This morning we released Empire's financial results for the first quarter ended August 4th, 2011. Empire reported consolidated sales in the first quarter of $4.56 billion compared to $4.15 billion last year, an increase of $403.5 million, or 9.7 per cent.

Excluding sales of $258 million related to the acquisition by Sobeys of 236 retail gas locations related to convenience store operations during the fourth quarter last year, consolidated sales increased by $145.4 million, or 3.5 per cent.

Net earnings, net of minority interest in the first quarter were $108.9 million, $1.60 per share, compared to $89.2 million, or $1.31 per share in the first quarter last year.

Consolidated adjusted net earnings, net of minority interest, were $103.4 million, or $1.52 per share in the quarter compared to $84.8 million, or $1.25 per share in the first quarter last year.

Empire's liquidity remained strong with consolidated cash and cash equivalents of $369 million at the end of the quarter and unutilized bank lines of $695 million. And our debt ratio continues to improve with debt to capital at the end of the first quarter equal to 21.5 per cent versus 25 per cent at the start of the fiscal year.

I'm now pleased to turn the call over to Paul Sobey.

Paul Sobey – President and Chief Executive Officer, Empire Company Ltd.

Thank you, Paul, and I want to welcome everybody to our call today. We are extremely pleased with our first quarter performance and we continue to profitably grow both our core food retail business and our investments in related real estate. And we continue to make progress on our key strategic initiatives.

Sobeys has been and continues to be the main driver of our operating performance and Marc will provide his comments on … specifically on Sobeys in a few minutes.

First, a few remarks on the performance of Empire's investment and other operating segments. Net earnings contribution from investment and other operations in the first quarter was 11.9 million versus 7.6 million last year. Crombie REIT contributed equity earnings of 5.5 million in the first quarter compared to 4.8 from last year and cash distributions received from Crombie were 8.2 million versus 6.8 million last year.

At the end of the first quarter, Crombie's market value exceeded $1.2 billion for the first time and our 42.5-per-cent ownership interest in Crombie was $553 million on a carrying value of 177 million.

For detailed information on Crombie REIT's performance, please see the latest quarterly release dated August 7th.

On the residential side, Genstar contributed (inaudible) earnings to Empire of 4.6 million in the first quarter versus 7.5 million last year, and this performance was consistent with our expectations.

I'll now turn it over to Marc to provide some comments specific on Sobeys' performance.

Marc Poulin – President and Chief Executive Officer, Sobeys

Thank you, Paul. First, a few comment on Sobeys' financial results. During the first quarter, Sobeys sales increased 395 million, or 9.6 per cent to 4.5 billion compared to 4.1 billion last year. Excluding sales of 258 million related to the acquisition of 236 retail gas locations and related convenience store operations, Sobeys sales increased by 137 million, or 3.3 per cent.

Same-store sales grew by 1.8 per cent in the quarter with no retail inflation in aggregate, driven by the continued promotional environment across the country.

Gross profits increased $48 million with gross margins declining 105 basis points to 23.15 from 24.2 last year due primarily to lower margins on the fuel business.

Excluding the impact of lower-margin fuel sales, gross margin was at 24.23 compared to 24.30 last year.

Selling and administrative expenses as a percentage of sales declined 109 basis points to 19.98 from 21.07 last year.

Sobeys Q1 EBITDA was 240.5 million versus 220.4 last year, a 20.1 million increase. EBITDA margin was 5.35 per cent compared to 5.37 per cent last year.

Sobey's Q1 EBIT contributed to Empire increase, a contribution, sorry, to Empire increase to 20.9 million… 20.9 million, sorry, to 156.3 million. Sobey's Q1 adjusted net earnings contribution to Empire increased 21 million to $99.6 million.

Property and equipment purchases totalled 123 million during the quarter with ten new stores opened and two stores re-bannered. At the end of the first quarter, Sobeys' square footage totalled 29.3 million square feet, a 1.7 increase versus last year. Sobeys generated free cash flow of $68.5 million in the first quarter and our debt-to-capital ratio continues to improve, now at 22.3 per cent at the end of the quarter versus 28.5 per cent last year at the end of the quarter.

Now, an update on our key initiatives. We continue to be pleased with FreshCo as we continue to increase top and bottom-line performance. In Q1, we opened an additional two FreshCo stores and they were Price Chopper conversions, bringing the total of FreshCo stores to 70. We also launched a successful price event, the FreshCo Frenzy, along with new fresh meat program.

The SAP implementation in our Quebec IGA operation business unit continued right on track with a fresh go-live completed in the first quarter of this year and a grocery go-live scheduled as planned for this fall.

The Terrebonne, Quebec, automated distribution centre continues to be on plan. We are scheduled to be fully operational by spring of 2013.

During the quarter we opened our new 150,000-square-foot retail support centre at the Victoria Airport Authority. This location serves all Thrifty retail locations and through our wholesale division, more than 40 Independent Grocers province wide.

We completed the first full quarter of operations with the newly-acquired Shell retail gas locations with results that can be qualified as expected. During the quarter we launched a pilot cross-promotion between IGA and its Shell stations; and this promotion, we are pleased to report, was very successful, and we look forward to additional pilots using Air Miles in the coming months.

And we're starting to realize the positive results of our ongoing efforts to enhance our in-store offering and overall execution. Overall, we know that we have the right strategy in place to continue to build for the long term and we are confident that we'll keep on building sustainable value.

Our focus is clear. To continue to improve on our cost structure and productivity while further enriching the shopping experience of our customers. This will include further enhancement of our full-service format offering and we will keep posted on these progresses as they get realized.

Over to you, Paul, please.

Paul Sobey

Thanks very much, Marc. So again, we start the year and we're pleased to say that we're off to a good start, as I noted, and as Marc commented, driven by improved Sobeys operational performance, and we remain committed to stay focused on our strategy, to our food-focused strategy and related real estate, which is our main strategic initiative; and our concentration will be to enhance our food offering to resonate with more and more customers as we move forward.

And we'd be happy to respond to questions that you may have.

Paul Beesley

Michelle, we're pleased to take questions at this point. Thank you.

Q&A

Operator

Okay. If anybody would like to ask a question, please press * 1 on your telephone keypad.

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

Perry Caicco – Analyst, CIBC World Markets

Thanks. I just want to start by delving a bit into the 1.8-per-cent same-store sales number. Marc, you mentioned there was no inflation in aggregate, but I'm just wondering what the trade-offs were between inflation and deflation. You know, were there categories that, you know, that were inflating and others that were deflating and what was going on with promotional weights?

Marc Poulin

Well, the first thing is as you can imagine also, inflation doesn't (inaudible) distribute between categories. It also (inaudible) across the country, but meat, and produce who were deflationary to a certain degree, but… and gross was somewhat inflationary. But at the end of the day, when we mix all of our businesses across the country, we were pretty stable.

Perry Caicco

And was same-store traffic in positive territory?

Marc Poulin

Same-store traffic was in positive territory, and it was in positive territory across all our businesses.

Perry Caicco

And basket size as well?

Marc Poulin

Yes.

Perry Caicco

Okay. Marc, another question. Usually a new CEO means some follow-on personnel changes. I wonder if there's been any changes in your senior management team so far, and should we expect any realignment of our personnel?

Marc Poulin

The change that we have to report is the nomination of the Chief Human Resources Officer in Simon Gagné who … which was announced, if I'm not mistaken, five days ago. Apart from that there, people are reporting directly to the Chief Executive Officer position, no changes apart from that one. And it was a vacant … We had a vacancy at that position.

In terms of operations under Jason Potter has been a change in the Ontario general management position, with Trevor Bartlett who used to be G.M. of the Western operation now taking over. And that's been announced last week or something like that.

Perry Caicco

Okay, and lastly, Marc, a new CEO usually sets an agenda of some kind. I'm kind of wondering what your top three or four priorities are going to be for the business?

Marc Poulin

The CEO basically intended, when he took office, to stay the course that we've been on for a number of years. So basically, the direction is not changing and it's a clear focus on the quality of execution at store level and on initiatives that will enhance the size of the company. We're a $16 billion company and we have a size that will allow us to be a formidable force in the market. So we want to leverage that to the maximum.

And so those are priorities that had been set by Bill, and there's no real change in strategy with this company. We remain food focused, we remain dedicated to offering an exceptional food experience to everybody that shops at one of our stores; and in order to do so, we've got to build efficiencies in the system so that we can drive our costs down, our prices down, and our competitiveness. But overall we want to make sure that the consumers have a great food experience and great service level.

Perry Caicco

Okay, that's good for now. Thank you.

Operator

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

Peter Sklar

Marc, back on the 1.8 per cent same-store sales, given you had no inflation during the quarter, that was, you know, a good volume or tonnage trend above what you've done the last few quarters. I'm just wondering if you can provide some backdrop to that. Do you feel the consumer's stronger or have you got some promotions right? How do you feel about market share? Can you just give us a little more flavour on what on the face of it looks like a very good number?

Marc Poulin

Well, the market, as you can appreciate, is no less fickle than it used to be in the previous quarter, so we have to go with the ebb and flow of a consumer that's very prudent with every dollar she spends and that's no change from the previous environment we've been dealing with for the last few years as a whole. Obviously we are quite pleased with the performance. But it's a business that you've got to win almost on a daily basis. And therefore, it talks a lot that performance about the focus that the team has put at a great in-store execution.

At the end of the day same-store sales are a reflection of the quality of the offering that consumers found when they shop the store; but it's something that we have to fight for on a daily basis because the consumer is still very fickle.

Peter Sklar

Okay. And how are you finding retail inflation coming out of the quarters? I would think we're in for a bit of an inflation period. Are you seeing any retail and getting any traction in terms of retail inflation yet?

Marc Poulin

Not so far. I think we're all anticipating eventual food inflation, but as you know, especially when it's grade base, it doesn't get, as we've been experiencing, it doesn't get into the products right away. So we're more feeling it's going to hit a little bit later on.

That being said, it's not because we have in cost inflation that actually we can reflect to the consumer. You know, the market is extremely competitive right now in Canada, so when that hits it's going to be... we'll see how it can get actually reflected in the consumer's purchase prices. But so it's at that point that we'll have to see in the future.

Peter Sklar

Right. And lastly I just wanted to ask you what your spider senses are saying about Quebec? Are you feeling any impact yet from the Super Centre rollout, or is the competitive environment similar to what it's been over the last few quarters?

Marc Poulin

Well, you know, Quebec, like the rest of the country, had a good performance in Q1. We're not going to comment on any specific competitor but just to say that we're very pleased with the way the Quebec market has been behaving for us. But you know, we're starting from a very strong position with IGA and IGA Extra being the number-one brand in the province and that leadership continued in the... And we're looking ahead in Quebec with very good opportunities to cross-promote with the Shell stations we just acquired. So we're very positive about the prospects for our Quebec business.

Peter Sklar

Okay. Thank you for your comments.

Marc Poulin

A pleasure.

Operator

Your next question comes from Michael Van Aelst from TD Securities. Your lined is open.

Michael Van Aelst – Analyst, TD Securities

Thank you. You provide some colour on the fuel margin excluding, or sorry, the gross margins excluding fuel, and I just want to make sure I'm reading it correctly. Are you backing out just the fuel sales tied to... tied to Shell, or also the convenience store sales?

Unidentified speaker

Just the fuel sales tied to Shell.

Michael Van Aelst

Okay. And I assume it also backs out some fuel sales that you had in a year-ago quarter as well?

Unidentified speaker

No, it doesn't back out the fuel sales that would have existed in our past fuel business before, and that was relatively negligible compared to the Shell business, obviously, and existed quarter over quarter from a comparison perspective. So we backed out the acquired fuel sales so that you can get a better sense of what the margins would look like on a comparable basis.

Michael Van Aelst

Okay. Can you give us some colour on the SG&A growth trend at Sobeys, excluding Shell?

Unidentified speaker

Yes. The percentage would have been 18.7 per cent excluding Shell, SG&A percentage, versus 19.1 last year on a comparable basis; so improvement in SG&A performance as well.

Michael Van Aelst

And that's a line item that tends to move around lot for you guys. It seems to be a lot lumpier than some other retailers. Is there something going on in that quarter that's unusual?

Unidentified speaker

No. Nothing unusual in the quarter. I would say good overall operational performance. And as we say, we continue to see the benefit associated with the initiatives that we've invested in over the last couple of years in terms of productivity at store level and at the distribution level.

Michael Van Aelst

So I would assume that would mean SG&A was actually flat... flattish or down a little bit by the looks of it based on those numbers. No?

Unidentified speaker

SG&A was down, absolutely.

Michael Van Aelst

So you're saying that this is a sustainable trend in the short term?

Unidentified speaker

I didn't say it was necessarily sustainable but … because you're right, we do have some lumpiness in that line. But we believe that the initiatives that we've invested in are going to continue to help us perform at the SG&A level. That's what we need to do in order to continue to fuel our profitability.

Michael Van Aelst

And are there any, I guess, significant... significant programs that are driving this, or is it a combination of a bunch of smaller ones?

Unidentified speaker

It's a combination of a number of ones. You know, we've talked about them in the past, whether it's workforce management or any of the store tools that the distribution centre work that we're doing, including, you know, volume through the automated distribution centre. As you know, we've got the automated distribution centre in Quebec coming online later this year as well.

Michael Van Aelst

All right, thanks. And can you just give us some colour... some guidance on your tax rate going forward?

Unidentified speaker

Yes. It should be consistent with where we were in the current quarter; so right around that 27 per cent.

Operator

Again, if you'd like to ask a question, please press *1 on your telephone keypad. Your next question comes from Chris Lee from Bank of America. Your line is open.

Chris Lee – Analyst, Bank of America

Oh, hi. Good afternoon. Just wondering if you can comment whether the trends that you're seeing in the inflation and also tonnage, has that carried over through fiscal Q2?

Marc Poulin

Well, it's very difficult to talk about fiscal Q2 with so many... so little weeks going on. So let's say though that, you know, especially at this time of the year, the sales trend varies widely from week to week. And so it was the case in Q1 as well. While the aggregate number is very positive for us, it was not ... it changed from week to week and in a very, somewhat unpredictable fashion. The consumer, as I said, is very fickle, very geared toward changing their buying habits depending on what's the situation in a given week. So trending the sales is something that I don't have a crystal ball for.

Chris Lee

Okay. You mentioned also about your second automated DC. Is this still on track to be online, is it spring of 2013?

Marc Poulin

Yes. It's on track for spring 2013. We should be ramping up and starting an opening or the first cases coming in at the November/December timeframe, and we will be ramping up during the spring.

Chris Lee

And just based on your experience on your first auto DC, typically, you know, when can expect to see, you know, some meaningful savings, both at the gross margin and our SG&A expense line from your second DC? Does it usually take a couple of quarters before we can see the material benefits or will we see them kind of almost right away?

Marc Poulin

Well, it does take some time to ramp up, and when we're ramping up, you've got to take into consideration that we're closing other centres. So there's a lot of ins and outs. And then it does take a little time to get used to the new tool, although we are pretty confident that with the experience we've had in Ontario, the Quebec situation will be positive and will go on track. But it does take a few quarters to settle in.

Unidentified speaker

Yes. We don't foresee any savings for this fiscal year. We'll start next year.

Marc Poulin

Yes, obviously, you know, our full ... we'll be in full production towards the end of Q4. So obviously this is almost a question for fiscal 2014.

Chris Lee

And then my question, just on the wholesale contract with Target, can you remind us when that would actually have a financial impact on your ... on your statement? And also, has there been an update in terms of the scope of products that are being covered or any sort of update you can provide us since the announcement?

Marc Poulin

Well, the products that are covered by the agreements are the ones we announced. Obviously, we haven't sold a single Target yet; and as far as how it's going to ramp up, it's depending on Target's plans. Therefore it's almost as if I have to refer your question to Target. It's not for me to tell you what's their opening schedule.

Chris Lee

Thank you.

Operator

Again, if anybody would like to ask a question, please press *1 on your telephone keypad. Your next question comes from Keith Howlett, from Desjardins. Your line is open.

Keith Howlett – Analyst, Desjardins

Yes. I had a question on the SG&A of 18.7 per cent. Was that adjusted for the onetime organizational costs, or is that the gross number?

Unidentified speaker

That's adjusted for the onetime organizational costs as well. Good question, Keith. Thank you.

Keith Howlett

Thank you. And just on the cottage country business which is quite big I guess in Ontario especially, was that particularly good in the quarter given the weather or ... ?

Marc Poulin

It's... as you know, we don't give any indication either by region or by banner. So ... but at the end of the day, you know, overall we're pleased to report that every single one of our operating units had a good performance.

Keith Howlett

And then just on the pharmacy business, I'm not sure if you'd happen to have this with you, but how many Lawton's stores you have now and how many in-store pharmacies you have and how that business performed in the quarter?

Marc Poulin

I don't have the exact number but the Lawton's side is 72 stores and we have around 136 in-store pharmacies across the country. And as you know, that industry also is under a lot of pressure what's going on with the regulation. But overall, they perform as expected.

Keith Howlett

As expected?

Marc Poulin

Yes.

Keith Howlett

Yes. And just a small item on... you have some Rachelle-Béry boutiques in some of your IGA stores in Quebec. Is that something that you would look at bringing to other regions, or is that sort of limited to Quebec?

Marc Poulin

Well currently it's limited to Quebec. We have boutiques in stores. We also have independent stores that are operating on a standalone basis.

What I think is important to note about Rachelle-Béry is that when we did that acquisition a few years ago, we sought that acquisition mainly for the learning associated with dealing with these products. Although the business has been growing at a steady pace since, the key focus behind this acquisition was getting critical mass and some lines for organic products and supplements. And at the same time ... and we've been able to expand if not always in a Rachelle-Béry setup, the offering of these products in not only the IGA business but in some of other parts of the country.

We're also a player in the same field under a different name in the Thrifty business, so there's a lot of sharing that goes on between on between the two divisions on those lines of products.

Keith Howlett

And just on the FreshCo and Price Choppers, I think it was this summer I saw a Price Chopper still in Trenton, I think, Ontario. But I don't know, do you many Price Choppers left in Ontario?

Marc Poulin

Yes. We have 10 at this stage, but the number will continue to dwindle down till the end of this fiscal where there's going to be only a trace left.

Keith Howlett

I see. Great. And is the FreshCo banner something that you would be considering for Atlantic Canada or... ?

Marc Poulin

At this stage the focus on FreshCo is clearly Ontario. It's a brand new brand. There's a lot of work to establish us in the marketplace yet; and we therefore have to work consistently at making the full benefit of the capital we invested into that business. So that's clearly the focus of the team at this stage is we want to get maximal potential for the investment we made in that banner before moving on to other opportunities.

Keith Howlett

Thanks very much.

Marc Poulin

Thank you.

Operator

Next question comes from Chris Lee, from Bank of America. Your line is open.

Chris Lee

Hi. I'm just wondering, what is the gross margin for the in-store business for the Shell Canada stations?

Unidentified speaker

We haven't disclosed what the gross margin is. We have disclosed what the impact is on gross margins if you exclude Shell, but that's all we'll disclose.

Chris Lee

Okay. And just want to confirm to your earlier answer about the 24.23 per cent. That only, you only back out the fuel part of the... of the Shell Canada business, correct?

Unidentified speaker

That's correct.

Chris Lee

Okay. Because I'm trying to get a sense if you also exclude the merchandise part of it above what would be the normalized margin be, just for the food retailing business?

Unidentified speaker

Yes. I don't have that number. We haven't broken it down in that fashion. We've excluded the fuel part so you can have the comparability.

Chris Lee

Okay. Thanks.

Operator

Gentlemen, I have no further questions in queue. I turn the call back over to you for closing remarks.

Paul Beesley

Thank you very much, Michelle. Ladies and gentlemen, we appreciate your continued interest in Empire and look forward to having you join us for our Q2 fiscal 2013 conference call on December 13th. Goodbye.

Operator

Thank you, everyone. This concludes today's conference call. You may now disconnect.

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