FINAL TRANSCRIPT

Empire Company Limited

Second Quarter Results 2015 Conference Call

Event Date/Time: December 12, 2014 — 2:30 p.m. E.T.

Length: 50 minutes

CORPORATE PARTICIPANTS

Stewart Mahoney
Empire Company Limited — Senior Vice President, Treasury and Investor Relations

François Vimard
Empire Company Limited — Chief Financial and Administrative Officer

Marc Poulin
Empire Company Limited — President and Chief Executive Officer, Sobeys

CONFERENCE CALL PARTICIPANTS

Peter Sklar
BMO Capital Markets — Analyst

Perry Caicco
CIBC World Markets — Analyst

Jim Durran
Barclays — Analyst

David Hartley
Credit Suisse — Analyst

Vishal Shreedhar
National Bank — Analyst

Patricia Baker
Scotiabank — Analyst

Michael Van Aelst
TD Securities — Analyst

Keith Howlett
Desjardins — Analyst

Chris Li
Bank of America — Analyst

PRESENTATION

Operator

Good afternoon. My name is Sharon (phon), and I will be your conference Operator today.

At this time, I would like to welcome everyone to the Empire Company Limited Second Quarter Fiscal 2015 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, press the # key. Thank you.

Mr. Stewart Mahoney, Senior Vice President, Treasury and Investor Relations, Empire Company, you may begin your conference.

Stewart Mahoney — Senior Vice President, Treasury and Investor Relations, Empire Company Limited

Thank you, Sharon, and good afternoon everyone, and thank you for joining us today.

Our comments today will focus primarily on the financial results for the second quarter ended November 1st. Following our comments, we will then be open to your questions.

This call is being recorded in live audio on our website, that's www.empireco.ca.

Joining me on the call this afternoon are Marc Poulin, President and Chief Executive Officer; François Vimard, Chief Financial and Administrative Officer; and Clinton Keay, Executive Vice President of Finance.

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 also the MD&A for more information on these assumptions and factors.

I will now turn the call over to François, who will provide a review of Empire's financial results, and Marc will then discuss Sobeys.

François Vimard — Chief Financial and Administrative Officer, Empire Company Limited

Thank you, Stewart, and good afternoon, everyone.

Consolidated sales in the second quarter were 5.99 billion, an increase of 1.58 billion or 35.8 percent. The growth in sales is primarily due to sales from the Safeway operations and food inflation, slightly offset by increased competitive square footage in the market, previously announced store closure and divestiture, and ongoing competitive intensity.

During the second quarter, Sobeys same-store sales increased 1.7 percent.

Sobeys gross profit for the quarter was 1.48 billion, an increase of 488 million or 49.1 percent compared to the same period last year. Second quarter gross margin increased 221 basis points to 24.7 percent compared to 22.49 percent in the second quarter last year.

Overall gross profit and gross margin in the second quarter were impacted by the Canada Safeway acquisition and related synergy, inflation, and highly promotional environment.

In the second quarter, we realized synergy of 31.5 million related to the acquisition of Safeway.

Consolidated EBITDA in the second quarter was 324.3 million compared to 196.8 million in the second quarter last year, an increase of 127.5 million or 64.8 percent. EBITDA margin increased to 5.41 percent from 4.46 percent last year, a 95 basis point improvement.

After adjusting for items which are considered not indicative of underlining business operating performance, consolidated adjusted EBITDA for the quarter was 332.2 million, an increase of 110.2 million or 49.6 percent over the second quarter last year.

Adjusted EBITDA margin in second quarter was 5.54 percent, up 51 basis points from 5.03 percent in the same period last year.

Finance costs, net of finance income in the second quarter were 41 million, up 19.9 million over last year due to an increased debt level as the results of financing for the Canada Safeway acquisition.

Finance costs were 2.8 million lower than in the first quarter and 6.6 million lower than the fourth quarter last year largely reflecting a reduction over 1.1 billion in funded debt since the acquisition.

Income tax—effective income tax rate on continuing operations for the 13 weeks ended November 1, 2014, was 25.2 percent compared to 26.3 percent in the same quarter last year. The decrease is primarily due to the timing of realization of tax benefits compared to the same period last year.

In the second quarter, Empire recorded adjusted net earnings from continuing operations, net of non-controlling interest of 128.2 million, $1.39 per share compared to 83.4 million, $1.22 per diluted share last year, a 13.9 percent increase on a per share basis.

With respect to our overall consolidated financial condition, at the end of the second quarter, Empire consolidated ratio of funded debt to total capital was 34.7 percent compared to 35.5 percent last quarter.

Cash and cash equivalents equalled 376.5 million. Free cash flow for the quarter was 140 million versus 169.6 million last year. And fiscal year-to-date, free cash flow was 532 million versus 237.8 million last year.

Investments and other operations reported operating income of 22.6 million in the second quarter versus 6.6 million in the same period last year, an increase of 16 million.

Equity accounted earnings from the Company investment in Crombie REIT of 9 million was up 3.6 million over the same period last year. At the end of the second quarter, the fair value of our 41.5 percent equity accounted and ownership interest in Crombie REIT, 39.3 percent fully diluted, was 708 million on a carrying value of 369.

Genstar contributed 11.4 million in operating income in the second quarter, an increase of 3.4 million compared to 8 million recorded in the same period last year, which was primarily driven by stronger lot and housing sales.

Now I will turn to Marc.

Marc Poulin — President and Chief Executive Officer, Sobeys, Empire Company Limited

Thank you, François, and good afternoon, everyone.

Our 35.8 percent growth in consolidated sales and 49.6 percent growth in adjusted EBITDA from the second quarter last year largely reflects the contribution of Safeway operations, synergies realized from the acquisition, as well as Sobeys sales and merchandising initiatives including new and innovative commercial programs as part of the Company’s purpose to help Canadians eat better, feel better, and do better.

During the quarter, the market remained highly competitive. Our same-store sales for the quarter of 1.7 percent benefitted from higher levels of food inflation, coupled with ongoing sales and merchandising initiatives.

During the quarter, we estimate internal aggregate food inflation to have been 2.4 percent.

Decrease in Sobeys adjusted EBITDA of 111.4 million and in adjusted EBITDA margin of 48 basis points or 5.16 percent largely reflects the impact of the Canada Safeway acquisition, our ability to realize synergies, and improvement in our base business.

I'll now provide some highlights on our progress with our integration of the Safeway business and also on recent initiatives. So as far as the Safeway integration is concerned, it's worth noting it's been now more—a little over a year since the closing of the Canada Safeway acquisition.

And I am pleased to report that we have surpassed our first year targeted annual run rate synergies of 100 million. At the end of the quarter, we have successfully converted close to 80 percent of the Safeway stores over to our technical systems.

During the second quarter, we continued to complete—sorry, during the second quarter, we completed systems conversions at three more retail support centres, and 9 out of 10 Safeway retail support centres have now transitioned to our EXE warehouse management system.

Overall, we remain confident in our ability to deliver $200 million in annual run rate cost synergies at the end of year three.

So the technology integration continues to progress very well, and our synergy work in each functional area is proceeding as planned with all businesses function—all business functions, sorry, having developed their integration milestone.

Overall, we continue to identify incremental opportunities for improvement and we remain committed to reducing costs wherever possible across the whole organization.

During the quarter, we closed an additional seven of the approximately 50 underperforming stores announced last June. This brings the total number of stores closed to 30.

Subsequent to close of the second quarter, Sobeys entered into an agreement with Canada Bread to sell two bread manufacturing facilities. The sales are expected to occur during the Company's fourth quarter of fiscal 2015. The sale of these facilities will have no material impact on the Company.

With respect to the sale of the four dairy manufacturing facilities in Western Canada, we expect to close the sale to Agropur Cooperative by the end of this fiscal year for $356 million. As you may know, Agropur has obtained approval from the Competition Bureau for purchase of our dairy manufacturing facilities.

In conjunction with the sale of the dairy facilities, we secured long-term supply agreements with Agropur which will enable us to expand the Lucerne brand throughout the stores in our Western Canada business.

As we continue to successfully roll out new programs, which are clearly resonating with customers, we have seen strong same-store sales growth in stores where we launched these programs, as well as in stores which deliver in our Better Food For All and Mieux Manger, the joining of the eating better strategy.

We continued to roll out our new concept stores which are resonating with our customers. In the quarter, we opened our renovated store at Laird & Wicksteed in Toronto. And subsequent to the end of the second quarter, we opened a Sobeys Extra store in Saskatoon, as well as in Milton in Ontario. We now have a total of 12 new concept stores across the country, with additional stores planned in the new year.

Going forward, we will continue to roll out the new Sobeys Extra stores and innovative programs into our stores in order to improve and further differentiate our offer.

Our employees and franchisees are clearly excited about the value-add of these programs and the stores provide to our customers. We remain confident that we will continue to profitably grow the business. Our long-term growth prospects remain firmly intact.

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 Peter Sklar from BMO Capital Market. Your line is open.

Peter Sklar — BMO Capital Markets

Thank you. You indicated that your retail pricing was 2.4 percent on a same-store sales of 1.7 percent. So, Marc, I'm just wondering if you could comment a little bit, either you had a mix change or you had some negative tonnage growth, which suggests you lost some share. So I'm just wondering if you can give some characterization of these numbers.

Marc Poulin

Yeah. So 2.4 inflation, 1.7 comp share growth, tonnage, though overall our sales increased, now remember (phon) there are some new stores into the mix; you've got to take that into account. But overall, I think we can characterize this quarter on our part as a quarter where we basically we're very conservative with our promotional program, as we were really focused on Safeway integration and other activities related to managing the business on other fronts. So we'll admit that we were fairly conservative in our promotional plans.

Peter Sklar

Okay. And my next question is I'm just wondering if you could give further comment on the tone of the overall grocery market in Canada. Are you finding it's somewhat more stable now that you've lapped the worst of the square footage additions, i.e. Target and Wal-Mart Supercentre? And you've also lapped really the worst of the cost of grocery pressures which would have been protein prices and foreign exchange. So are you seeing the market somewhat more stable or rational?

Marc Poulin

Stable, clearly, we can't say. So as to say that there's still some square footage growth in some parts of the country, especially if you look east so that's a factor in the business. That being said, on the sort of factors you mentioned I would say that I'm cautiously optimistic about a market that will stabilize around basis that are more rational than what we have seen in some quarters in the past. And at the same time, we are seeing that customers are reacting very well to the differentiated programs we're putting in the marketplace, and that obviously creates optimism on our part as it shows that our strategy is resonating with the customer.

Peter Sklar

Right. And just lastly, I believe you were able to reintroduce Air Miles into the BC pharmacies, so that would have been up and running in Q2. Did you notice any discernible effect in the pharmacy business of Safeway as a result of the reintroduction of the program?

Marc Poulin

It's improving. But unfortunately, in this business, it's quickly lost and long to recover. So and you can imagine also that scripts needs to be renewed on a three-month basis, for example, so some of that business coming back will be a little bit slower. But clearly though the trends are better and that was a positive factor in our business and will continue to be so in the next quarter.

Peter Sklar

Okay. Thank you.

Operator

Your next question comes from Peter (sic) [Perry] Caicco from CIBC World Markets. Your line is open.

Perry Caicco — CIBC World Markets

Good afternoon. It's Perry. Marc, when you look at inflation in the business, how much inflation will you be able to engineer into the business over the next couple of quarters? And is there enough inflation at this point to cover the cost increases?

Marc Poulin

So engineer in a sense that we would be able to generate inflation over and above the commodities...

Perry Caicco

Right.

Marc Poulin

The commodity price inflation?

Perry Caicco

Right.

Marc Poulin

In this quarter, not really. Cleary, the story about this quarter is passing the commodity cost inflation that we saw without creating too much downgrading in terms of customer purchases, and we've seen some of customers moving to cheaper cuts of meat, for example, because of the inflation that we had to pass through. So and obviously, that—it's a bit of—the story about this quarter is our willingness to protect the margins on one side and pass along those cost increases and our ability, how do you play the promotional game as you go through this. And as I've said before, we had a fairly conservative promotional plan on that front.

So I'm not sure we're in a position yet with the customer where we can move them in a better place yet. There's still a little bit of sticker shock to the new price points that are driven by the cost of commodities, so I'm not sure we can say so. I'll say though, as you know, without talking about the future, obviously the recent events on the price of gas are usually good for us as we compete with gas for this weekly purchase expenditures, so that’s something that’s—something that I look positively upon, and but let's see if customers will be willing to spend those extra dollars at the grocery stores.

Perry Caicco

So if this quarter was a relatively conservative promotional quarter, and...

Marc Poulin

Yes.

Perry Caicco

If you had a bit of a struggle to cover all the costs and inflation, what were the sort of other puts and takes on gross margin in the quarter? And how should we think about gross margin for Q3 and Q4?

Marc Poulin

Well, obviously it's difficult to predict Q2 into Q4, and the—it's—but we've—to be honest, this quarter was one—a quarter where we didn't want to blow our brains out, if we can use that expression. We played it conservatively. We protected our gross margin fairly well, and we spent our energy on Safeway integration and other aspects of the business. We have a lot on our plate, and we cannot tackle everything at the same time, so we choose our battles. And this quarter, we decided not to be too promotional.

Perry Caicco

And last question. As I understand it, the systems are, I guess, scheduled to be completely integrated by March. Is that fair to say?

François Vimard

Yeah. Spring, we're talking spring, calendar 2015. Yeah.

Perry Caicco

Right. So once those systems are integrated with Safeway, do we see the programs of the two divisions becoming more compatible? And would that result in any changes to either gross margin or SG&A rates for the following time period?

Marc Poulin

So obviously, yes. The system integration is the prerequisite to make the programs more similar. As you know, there's the Air Miles launch in the Sobeys businesses. Western Canada was kind of the first step towards that. That's one that was not too SAP system dependent, if I can put it that way, so that we are—and we're quite pleased with the results of this launch. And yes, we will start working on the programs. We're starting to integrate the private label, and a number of Compliments products are already making their way to Safeway stores. So but again, it's not—we can say it's going to be March that—or spring, whatever, that we will have the systems in place. Integrating the two commercial programs of the two—of Safeway and Sobeys will not happen in a flash. It will take time, and but we're already starting to work with that in mind.

Perry Caicco

And sorry, should that generally have a positive margin impact on the business?

Marc Poulin

Net margin, we expect yes, because it will start delivering better synergies and also will allow migration of best practices between the two businesses. And as much as we—we're integrating the SAP system, but there are already improvements in our operating procedures that we will be implementing in the SAP system that we've learned from Safeway and we'll be able to spread across the whole business so it's—as much as I would like to say that we'll close the IT shop when SAP is fully integrated in the business, I don't think that's going to happen. We are lining up numbers of initiatives that will allow the business to be more productive in the future based on what we're learning from the way Safeway used to operate, and that will benefit the business as a whole.

Perry Caicco

Okay. Thank you.

Operator

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

Jim Durran — Barclays

I assume it's too early to tell us what your pricing strategy you made for Safeway, but I think as Perry was just asking, like as these businesses get more aligned from an operation and internal standpoint, and then secondly, you're offering to the consumer, is there anything you can tell us about the pricing strategy at Safeway versus Sobeys in the west?

Marc Poulin

Yeah. I guess you've just got to try, because it's too early to tell at this stage, as we are putting the system in place to better track all those elements and analyze it and make decisions, so you're a few quarters early on this one.

Jim Durran

And with respect to your synergies, I mean you—you're ahead of the plan at this point, presumably on procurement only, and yet you're reiterating your longer-term objective. Are you less optimistic about the amount of synergy you can drive out of the other two phases? Or...

Marc Poulin

We're totally...

Jim Durran

Is this...

Marc Poulin

We're totally committed to the $200 million of synergies. And as we always said on this game, that's what we've committed to. And on that front, we're—we have no reason to believe that we will not hit that target. But we also said that that at one point we would stop counting. And so as far as the other parts of the plan, we are as optimistic as we were when we made the acquisition. On the synergy front, honestly, everything is really working according to plans, and we are discovering every day opportunities. So we're—we like what we see.

Jim Durran

Okay. And the last question, just on the store closures, can you just update us on the expected timing of the rest of the closures?

Marc Poulin

So we closed...

François Vimard

We have 30 closed so far, so we closed some others that are going to be in Q3, Q4. And there are going to be some that we're going to have in fiscal ‘16 also because there are some deals we have to put in place before closing them so.

Jim Durran

So roughly how many delayed till then?

François Vimard

Sorry. Sorry, Jim?

Jim Durran

How many now delayed then into your new fiscal?

François Vimard

I would say not a lot. I would say most of this will be done this fiscal. We'll have some that is going to go in fiscal '16. It would be less than—maybe around five.

Jim Durran

Great.

Marc Poulin

We did close a number of them, December 4th and 6th.

François Vimard

Yeah, also. Yep.

Jim Durran

Okay. Great. Thank you.

Operator

Your next question comes from David Hartley from Credit Suisse. Your line is open.

David Hartley — Credit Suisse

Yeah. Thanks. Just to follow up on the previous fellow's questions, just with regard to the quarter, was—given that you're trying to integrate two different banners and strategies with them, was any work done in the quarter that would have affected sales or margins at all?

Marc Poulin

Not really. The businesses kept operating as separate business units on their own systems, and doing—according to the merchandising plans and programs that they had set for themselves. And so far, anything—most of the customer-facing activities, so such as merchandising, haven't really been touched by the—for the customer. That being said, it is also clear that the Safeway team is heavily involved in planning for the system switches and everything else. And when that occurs, we're not—the attention—it takes—a lot of attention is being focused on internal processes. And so it's—the team has been very—worked very hard to, at the same time, do all that extra work associated with conversion and system planning, and at the same time, maintaining a customer proposition that was resonating with the customer. So they're—they have a lot on their plate. And we thank them for that because they're working very hard and they're delivering on that.

François Vimard

And like I said, Marc, I think the key point is that the only thing that really changed is announcement of Air Miles west.

Marc Poulin

Yes.

François Vimard

And so far we see good reception of the customers.

David Hartley

Okay. So maybe a way to characterize that would be kind of prepping for the alignment, if you will? Would that be fair to say?

Marc Poulin

Really it's the—sometimes people seem to forget that we only took over Safeway one year ago, and it's a three-year plan. So we're not—it's not sprint, it's a marathon. And we're not even halfway through. So it's a long, long work for everybody. It's a long journey. But the good thing about it is that we are hitting every target we've set for ourselves, and we're very confident about the integration plan. And I think the results show that everything's—why this acquisition made sense. And we're very optimistic about what the combined Sobeys/Safeway will deliver for our customers in Western Canada and for our business in general.

David Hartley

And just in the quarter itself, so the interplay between volume and margin here, obviously planned out this way for the quarter. Is that something we could see going forward? Or is this just going to be opportunistic as the market dictates? And really at the end of the day for the quarter, would it be fair to say it came close to ending up to where you would have been in gross margin dollars even if you had of promoted? Or do you feel like there was still that little bit of pressure from the market? Could you kind of give us some colour into your thinking around the tactics for the quarter?

Marc Poulin

Well obviously, in a market like this one, that's still—as much as we like to say that the market's a little bit more stable than it was a little while ago, on a historical basis it remains a fairly promotional market overall. And therefore, in a market that's highly promotional like the one we're currently living in, your results are impacted by how you play the weekly flyers and how customers are reacting to this. So in that regard, sometimes you just—you decide to—you want to push on the pedal, gas, and sometimes you decide that you want to play it safe and make sure that you get home safely. And in this quarter, we took the decision that we wanted to play it safe because people had a lot on their plates on other factors. And as in any business, if you play it more risky and things don't pan out properly, it creates disruption in the business that we didn't feel was necessary at this stage.

David Hartley

Okay. And just last question, there's been some vendors that have come out and said that they are going to start charging higher prices as they pass through commodities at their businesses onto retailers and customers. I mean has any of that started to take formation in this current quarter? And if I recall a year ago, it was a highly promotional quarter, so we're kind of a reversal of what happened a year ago. Does any of that ring true at all?

Marc Poulin

Well, obviously on the perishable side of the business, we've been—some cost increases have been passed through from the suppliers, and we are slowly—we're passing it to customers and with some success in that matter. But as you know there's always a lag. It's going to be interesting to see what's going to happen on a packaged good centre of store pricing; there's a lot of things going on lately with Canadian dollars, and it's difficult to predict at this stage how packaged good manufacturers, which tend to be US owned, will react to the new reality of the Canadian marketplace. But I think everybody will have to adjust their plans to a fairly new reality.

David Hartley

That's helpful. Thank you.

Operator

Your next question comes from Vishal Shreedhar from National Bank. Your line is open.

Vishal Shreedhar — National Bank

Hi. Thanks, for taking my questions. In terms of the internal inflation number that you provided, is that the entire network? O non-Sobeys—or non-Safeway?

François Vimard

It's the entire network.

Vishal Shreedhar

Okay. In terms of the same-store sales growth, when you were sort of providing that next quarter, will that include Canada Safeway?

François Vimard

Yeah. Starting next quarter, there's going to be—as you know we're going to lap the acquisition of Safeway, so starting next quarter is going to be a full integration. Yeah.

Vishal Shreedhar

Right. Can you give us some indication of what that might do to the comps given that we don't have a baseline? Is that going to be supportive of comps all else equal? Or not supportive?

Marc Poulin

Well, can you help me with the crystal ball about how the market will behave in the next few months and I'll adjust my promotional plans and then everything accordingly. No. Honestly, it's difficult to know. We look on a quarter-by-quarter basis, this game is—it's still highly promotional so it's played on a weekly basis. And some weeks you win, some weeks you lose. What we like though is that on a long-term basis, the Western Canadian market is a growing market and that's the part of good sales performance in the long term. But if you asked me to predict it on a short-term basis, I will not be able to help you on that.

Vishal Shreedhar

Okay. In terms of gas sales, did that impact your comp in the quarter? And if so, by how much?

Marc Poulin

Not really. Nothing of that nature. No.

Vishal Shreedhar

Okay. In terms of the competitive—enhancing the competitive position that you talked about in the quarter for next quarter, will that be additive all else equal to gross profit dollars? Or is it an investment in gross profit dollars to support sales? Like how should we think about that?

Marc Poulin

I'm not sure I understand your question.

Vishal Shreedhar

Will the investment in pricing—will the investment in pricing being—will it be wholly offset by the increase in sales?

Marc Poulin

Well, we haven't said we were going to make an investment in pricing in the next quarter, so that's why—I'm not trying...

Vishal Shreedhar

Okay.

Marc Poulin

There's been a miscommunication here. We'll obviously see how the market behaves. This is an important season for grocers at Christmas. And everybody—we'll see how the battle lines of our competition and ours line up and in what part of the business. What we're seeing though is I can say we're seeing some ability to pass through some of that commodity price inflation to the customers in our categories so that work keeps—it's in progress and it's—we're not seeing that being stopped right now. But then, after that, it's really highly dependent on how the promotional game will be played.

Vishal Shreedhar

Okay. Understood. Thanks, for the clarification. So when you said earlier that in this quarter you were conservative with promotional program that did not imply future investment in pricing?

Marc Poulin

No. That was a strategy in the last quarter. And I will refrain from expressing publicly my strategy for the following quarters as I'm sure there are more than analysts on the call and maybe a few competitors.

Vishal Shreedhar

Okay. Understood. Thanks for your time.

Operator

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

Patricia Baker — Scotiabank

Hi, there. Most of my questions have been asked, but maybe I missed it but I find it surprising that we got this far in the lineup and no one asked about traffic and basket.

Marc Poulin

So traffic was a little bit down and basket was up.

Patricia Baker

Okay. So that's a very similar trend to what we saw in the first quarter then.

Marc Poulin

Yeah. With a little bit less investment of gross margin into promotional activity.

Patricia Baker

Exactly. And then, François, did I hear you—I just didn't quite hear exactly what you said but you referred to something that's going well or having good reception. Were you talking about the Air Mile program in the Sobeys stores?

François Vimard

Yeah. That's what I was…

Patricia Baker

Okay.

François Vimard

Talking about.

Patricia Baker

Okay. Super. Thanks, a lot.

Operator

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

Michael Van Aelst — TD Securities

Hi. You've covered most of it, but I do have a few little pieces here left over. On the other income and the real estate sales, particularly the residential real estate sales, do you expect them to remain at these elevated levels? Or is there just more product being put on the market by you? Or is it pricing that's going up and you think it can be sustained at these levels?

François Vimard

As you know, Michael, it's a partnership, so it's not only you. It's a partnership that we're part of. Clearly, there's—it's timing in the market. So when the economic is good, they sell depending on the opportunities. So there's some variation quarter by quarter. And as you saw over the past few years, they were pretty successful when they were put on the market and that's what we saw last quarter as well.

Marc Poulin

I think it's fair to say that it was driven by customer demand more than the offer though. Real estate is still healthy in this country.

Michael Van Aelst

Okay. It’s just that it’s been—I guess there’s been relatively stable numbers for the past few years, and this year it's jumped the last few quarters. So I’m just wondering if we should be assuming that that pace of real estate sales is going to continue.

François Vimard

And there is right now in the market some good pace in terms of sales, but it all depends on how the market kind of reacts really.

Michael Van Aelst

Okay. Great. And one other little one. Last year you were adjusting for gains on assets sales and dilution gains. This year you didn't adjust for the gain on asset sales. Is this the policy going forward that we should be building into adjusted earnings?

François Vimard

Yeah. The policy going forward is that everything that are not of recurrent—which is not recurrent in the business and not related to our day-to-day operation, we’ll adjust for. So like you saw, we did adjust for the manufacturing sale. But gain and loss on the real estate, we won’t adjust going forward, and that's why we didn’t last quarter also on the loss on sales.

Michael Van Aelst

Thank you.

Operator

Once again, if you'd like to ask a question please press *, then the number 1 on your telephone keypad.

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

Keith Howlett — Desjardins

Yes. I was just wondering on the difference between a Sobeys Extra and say the Sobeys that you expanded and renovated in Toronto on Laird & Wicksteed that you referenced.

Marc Poulin

Yes.

Keith Howlett

What would be the fundamental difference between those two concepts?

Marc Poulin

Well, in the Sobeys Extra, such as the one we opened in Stonebridge or in Milton, we have the space to add, for example, pharmacy which is part of what we believe is part of what's necessary to call a store Sobeys Extra. So there are a number of services along the way that are necessary to call the store an Extra. And that being said, it is true that the Laird store does have a lot of the features you would find in a Sobeys Extra. The only difference is that we do not have the square footage so that we could put everything in that store. We were limited by the square footage that was made available to us. But at 38,000 square feet, that store is a very nice little store and we like very much the customer reaction to it. It's been overwhelmingly positive.

Keith Howlett

And then just on—I'm not sure if this is correct but there might be three Price Choppers left. Are they part of these—or maybe you don't want to answer that, part of the stores to close? Or are they going to become FreschCo?

Marc Poulin

They're all at various stages of redevelopment. And as you know, we've always took the position that we would keep them as Price Choppers until they'd actually been redeveloped. So that's why they're still Price Choppers. But to be honest, it's a very insignificant part of the overall FreshCo story.

Keith Howlett

And just on the private labels in Western Canada, I was—happened to be out there recently and I noticed you've got the Safeway private labels in the store and you've got the Sobeys private labels in the store. Have you made final decisions on like would there, say, be Safeway organics after you finish? Or is it all going to be in the Sobeys private label?

Marc Poulin

No. We've—the decision is made. It's all going to be Compliments amongst the various tiers of Compliments and the various sub-brands. And but we are currently combining the two portfolios. So if there's a Safeway product that's been developed by Safeway that's popular or—we will re-label it under Compliments. So we're taking the best of both programs right now, be it on the

SKU level base, also on the supplier base. There are some products at Safeway that do very well that they didn't have the same supplier that we used to have and sometimes we're switching to the Safeway supplier for the Compliments from now on, and vice versa. There are some Compliments products that were performing a lot better than Safeway was performing in the same category, and it's the Safeway product that will get converted to the same supplier we used to have under Sobeys. So it's, in this case, it's really taking the best of both worlds.

Keith Howlett

And then just finally on the Calgary market, or I guess more broadly in Western Canada. I guess one of the privately owned competitors changed some banners and I guess also entered Calgary over the last year. Do you notice any specific impact? Or is it just similar to any other openings?

Marc Poulin

Well, it's clearly having—it's having an impact in the micro markets in which they open. I mean I'm not going to say that if a competitor's store opened across the street from us we will not suffer. So yes, it's added square footage in the Calgary market and it's one more competitor, and Western Canada is a competitive market. And we have to compete every day and every week to show that we have the mojos for our customers.

Keith Howlett

Great. Thank you.

Marc Poulin

Thank you.

Operator

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

Chris Li — Bank of America

Oh. Hi. Good afternoon. I have a question on just on your capital expenditure. I think shortly after the Safeway acquisition, I think you had provided some longer-term guidance with respect to CapEx of I think between the 650 million to 700 million per year for the next three years. And I'm just wondering, given all the asset divestitures you've made since then, is that still a target that you're holding on to?

François Vimard

Yeah. That's still a target for the next three years. So Chris, clearly for this year, we'll be in the low range of that 600 million to 700 million but that's still our target.

Chris Li

And what would be the embedded square footage growth within that target? Is it like 1 percent? Is that reasonable?

François Vimard

Well, like we said in the past, our growth on additional square footage is between 1 and 2, but most of that investment also would be towards renovating current network also. So part of that capital is not for additional square footage but clearly to just improve our network overall.

Chris Li

Okay. And any updated thoughts on expanding FreshCo also out of Ontario?

Marc Poulin

No. FreshCo, at this stage, as we've said, is we're in the fourth year of a five-year plan. The first three years were dedicated to convert the assets to the FreshCo formula. This year and next year, to be honest, will be very much dedicated to make sure the formula itself is optimized too. And after we've done that, we'll look at what we do with the banner in terms of geography and capital investment. But at this time, we don't want to distract the team on the task ahead of them of optimizing the formula. And we're very pleased. We keep on being very pleased with what we're seeing out of FreshCo. It's a team that is doing what has been asked from them very well.

Chris Li

Okay. And my final question is, and I apologize if you addressed this already, but just given the decline in oil prices, the potential impacts in Western Canada, particularly in Alberta, do you expect that to be a headwind for you in the next few quarters? Or do you expect any response that you need to sort of accelerate any investments that you need to do to remain competitive out in Western Canada?

Marc Poulin

Well, I think specifically how it relates to the overall economy of Western Canada and what impact it will have on employment and actual population migration and things like that, I think it's really too early to tell. And as much as we like to say that we have a growth business with our Western Canadian assets, I don't think you can relate this company as it being totally Western Canada driven. So in that respect, generally speaking, lower gas prices are good for grocers. So there's going to be all kinds of impact going on. But overall, across Canada, customers—our customers should have more money in their pockets because they'll spend more—they'll spend less at the pumps. And it's going to be our task to convince them that some of that money should be reinvested in their place.

Chris Li

Okay. Great. Thank you.

Operator

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

Jim Durran

A bit of a follow-on just on your transportation cost as the price of oil has been dropping. I mean, we've been hearing that diesel's been sticky, right, and I don't know what the nature is of your transportation contracts. So can you just give us some idea as to how variable that could be? And is there a lag because of contracts that might take place?

Marc Poulin

We're typically not hedged on the price of fuel so whatever movement we get, up or down, they do hit the bottom line.

Jim Durran

And I assume that diesel’s the primary driver, not regular gas prices.

François Vimard

Yeah. It’s primarily the price of diesel. You’re right Jim. And clearly, diesel didn't see the same movement as regular gas, but they'll still see some trends downwards.

Jim Durran

Okay. Last question. Just turn to Quebec with the Wal-Mart Supercentre build-out now quite into its development. Any change in terms of its impact when it opened stores? Any change in their pricing strategy that you've noticed that has caused the impact to be worse rather than less?

Marc Poulin

No. We obviously there's just more and more stores being opened in Quebec and in Atlantic Canada for that matter. And but we compete with Wal-Mart through our differentiation strategy and as we do in the marketplace. It's the overall value offer we propose to customers that made the IGA banner in Quebec the number one banner in the province. And honestly, we’re happy with how our Quebec business is evolving through the additional square footage being placed in the marketplace.

Jim Durran

In the trading areas that they're in, would you classify the pricing still in Quebec being higher than in Ontario?

Marc Poulin

Well, it's higher in Ontario, it depends on what the customers are purchasing and everything else. And that's a very complex question. And honestly, it's not one where we have great value in spending time on, to be honest, because we manage on a market-by-market basis. I think what you can say is that the Quebec marketplace is a market that's very well differentiated from the customer perspective and the customer experience which allow us to compete on more than one lever than price alone. And that's obviously something that's been positive for our business for a number of years.

Jim Durran

Great. Thank you, Marc.

Marc Poulin

Pleasure.

Operator

Once again, if you'd like to ask a question press *, then the number 1 on your telephone keypad.

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

Michael Van Aelst

My questions have been answered. Thank you.

Operator

Okay. Once again, if you'd like to ask a question, please press *, then the number 1 on your telephone keypad.

We have no further questions at this time. I turn the call over to the presenters.

Stewart Mahoney

Thank you, Sharon. And, ladies and gentlemen, we appreciate your continued interest in Empire, and we forward to you joining us for our third quarter call on March 12th. Thanks very much.

Operator

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

*****