FINAL TRANSCRIPT

Empire Company Limited

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PRESENTATION

Operator

Good morning. My name is Jessa (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 Results of Fiscal 2016 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. Thank you.

Mr. Ken Chernin, Director, Investor Relations, you may begin your conference.

Ken Chernin — Director, Investor Relations, Empire Company Limited

Thank you, Jessa. Hello, and thank you for joining us. Our comments today will focus primarily on the financial results of the second quarter of fiscal 2016 ended October 31, 2015. Following our comments, we will then be open to your questions.

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

Joining me on the call this morning are Marc Poulin, President and Chief Executive Officer; François Vimard, Chief Financial and Administrative Officer; and Clinton Keay, Executive Vice President, 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 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 statements. Marc will then discuss Sobeys.

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

Thank you, Ken, and good morning, everyone. Empire's consolidated sales in the second quarter were $6.06 billion, an increase of $64.1 million, or 1.1 percent. The increase in sales was primarily the result of food inflation experienced during the quarter, coupled with incremental sales from the acquisition of Co-op Atlantic and the associated long-term supply and franchise agreements.

These factors were partially offset by integration and operational challenges affecting Safeway operation, which Marc will discuss in more detail.

Sobeys' same-store sales growth for the quarter was 0.1 percent. Excluding the negative impact of oil price on fuel sales, same-store sales would have increased by 0.9 percent.

Sobeys' gross profit for the quarter was $1.47 billion, a decrease of $7.3 million, or 50 basis points compared to the same period last year. Second quarter growth margin decreased 40 basis points to 24.3 percent compared to 24.7 percent for the second quarter last year.

The year-over-year contraction in gross margin continued to be the result of operational challenges in Safeway. Partially offsetting these factors were synergies realized during the quarter related to the Canada Safeway acquisition.

Consolidated EBITDA in the second quarter was $256.3 million compared to $323.8 million in the second quarter last year, a decrease of $67.5 million, or 20.8 percent.

EBITDA margin decreased 120 basis points to 4.2 percent from 5.4 percent last year. The decrease in EBITDA was primarily the result of these factors affecting sales and gross profit, as mentioned, combined with the provision related to the manufacturing purchase price adjustment, higher organizational realignment charges, and distribution rationalization-related costs. These factors were partially offset by the realization of $55.5 million in synergies related to the integration of Canada Safeway and reduced expenses for variable components of compensation, including stock-based awards.

After adjusting for items considered not indicative of underlying business operating performance, consolidated adjusted EBITDA for the second quarter was $303.7 million, a decrease of $27.3 million, or 8.2 percent over the second quarter last year. Adjusted EBITDA margin in the second quarter was 5 percent, down 50 basis points from 5.5 percent in the same period last year.

Finance costs net of finance income in the second quarter were $34.3 million, down $6.2 million, or 15.3 percent compared to same period last year. This decrease is mainly due to the debt repayment in fiscal 2015.

The Company's effective income tax rate for the second quarter was 29.6 percent compared to 25.2 percent in the same period last year. The increase in the effective tax rate—the increase in effective tax rate is primarily attributed to the partially non-deductible of the potential manufacturing purchase price adjustment.

In the second quarter, Empire recorded adjusted net earnings net of non-controlling interest of $110.7 million, or $0.40 per diluted share compared to $126.6 million, or $0.46 per diluted share in the same period last year, a decrease of $15.9 million, or 12.6 percent related to the same period last year.

With respect to our overall consolidated financial condition, at the end of the second quarter Empire's consolidated ratio of funded debt to total capital was 29.1 percent compared to 34.7 percent last year.

Cash and cash equivalents at the end of the second quarter equalled 304 million. Free cash flow for the second quarter decreased $155.9 million from the same period last year. The decrease in free cash flow was attributed to a decline in cash flow from operating activities, a reduction in proceeds from divestiture of noncore assets in our CapEx plan (phon).

During the second quarter, we repurchased approximately 5.4 million non-voting Class A shares under the previously announced normal course issuer bid for an aggregate cost of $148.1 million, or an average cost per share of $0.276. Please note these amounts were restated to reflect the stock split that occurred during the quarter.

As a reminder, the NCIB was put in place for anti-dilutive purposes and is now complete.

Investment and other operations reported operating income of $6.7 million in the second quarter versus $22.1 million in the same period last year, a decrease of $15.4 million.

Equity accounted earnings from Genstar were $2.2 million in the second quarter, a decrease of $9.2 million compared to $11.4 million recorded in the same period last year. The decrease relative to last year was primarily due to fewer lot sales in both Canada and US.

Equity accounted earnings for the Company's investment in Crombie REIT were $6.2 million, a decrease of $2.8 million over the same period last year. We refer you to Crombie Q3 news release of November 9th for detail of its most recent quarterly results.

At the end of the second quarter, the fair value of our 41.5 percent equity accounted ownership interest in Crombie REIT, 40.2 percent fully diluted, was $707.5 million on a carrying value of $357.7 million.

I will now turn the call over to Marc Poulin.

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

Thank you, François, and good morning, everyone. During the second quarter, Sobeys' same-store sales increased 0.1 percent, and excluding the impact of fuel sales, same-store sales increased 0.9 percent.

Our internal food inflation for the quarter was calculated at 2.4 percent.

Sobeys' reported EBITDA for the second quarter was $249.6 million, a decrease of $51.9 million, or 7.2 percent from the $301.5 million in the same period last year.

After adjusting for items which are considered not indicative of underlying business operating performance, Sobeys' second quarter adjusted EBITDA was $297 million, a decrease of $11.7 million, or 3.8 percent compared to the same period last year.

Sobeys' adjusted EBITDA margin contracted by 20 basis points to 4.9 percent from 5.1 percent in the same period last year. The decrease in EBITDA was mainly due to the factors affecting sales and gross profit combined with the provision related to the manufacturing purchase price adjustment.

The decrease in gross profit and gross margin was the result of the continued challenges associated with the integration of the Safeway operation. Continued competitive intensity and a highly promotional environment also played a part.

Partially offsetting these factors were the synergies related to the Canada Safeway acquisition.

As noted in the first quarter's result, the root cause of the weaker gross margin and accompanying same-store sales related to the Safeway operation.

During the second quarter, we made progress in closing the previously identified gap. However, operational issues related to the integration mainly around private label and procurement transition, as well as systems and people transition, have had negative impacts on our customers.

These challenges, combined with a weaker economy in Western Canada, have impacted both same-store sales and gross margins. These challenges are being addressed by a new merchandising team now in place, and we are working on strategies to mitigate and revert to same-store sales trends.

During the second quarter, we have recorded a provision of $39.7 million to reflect the estimated adjustment to the sales price of the manufacturing facility. The sale agreement includes long-term supply agreements with minimum purchase volume requirements. If our actual purchase volumes in calendar 2016 are below the quantities specified in the agreement, the sale price would be adjusted downward.

Based on our operating results in the first half of fiscal 2016, it appears that it is unlikely that purchases in calendar 2016 will meet the minimum volume requirement.

Once the purchase price adjustment is finalized, the minimum volume requirements for the remainder of the long-term supply agreements will be determined. We do not expect future financial exposure associated with long-term supply agreements.

Subsequent to the end of the second quarter, five properties were sold and leased back from Crombie REIT for a total of proceeds of $57.3 million.

During the quarter, we continued the rollout of our new concept stores across the country, including our 11 stores in Ontario, as well as our third new concept store in Atlantic Canada, which was opened subsequent to the end of the quarter.

Despite the recent challenges with the integration of Safeway operations, we remain confident in our ability to deliver or surpass $200 million in annual run rate cost synergies at the end of year three. We continue to identify incremental opportunities for improvement, and we remain committed to reducing costs wherever possible across the organization.

We continue to aggressively tackle the integration challenges and are confident that performance will be brought back in line with our expectations.

Let me close by acknowledging that in what remains a very competitive retail food environment the rest of our business performed generally to our expectations, driven by the ongoing rollout of our Better Food For All strategy, which continues to resonate with more and more customers.

We will now be happy to respond to your questions.

Q&A

Operator

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

Your first question comes from the lines of Perry Caicco from CIBC World Markets. Please go ahead.

Perry Caicco — CIBC World Markets

Yeah. Thank you. On the integration challenges in Western Canada, can we maybe talk a little bit about timing there? So when will the training for your organization be done? And how long after that will it take do you feel for margins and sales to normalize?

Marc Poulin

Okay. So from an employee perspective, beginning of January everybody will be in their new seats, everybody knows what role they're going to play in the new organization, and we're currently training people to their new roles.

In terms of adoption of processes and system, we're pretty confident that by Q4 we will be in the right position on that front, and then we'll be in control of the business of how we operate. And the last part to this equation, though, is we will introduce modifications to our go-to-market strategies associated with the need to attack the same-store sales trend in Western Canada. And obviously, that will depend more on the customer response to this to tell you when it's coming back to what it used to be.

Perry Caicco

And on that same-store sales trend, I'm not sure you can answer the question, but can you give us some indication as to how much of that is self-inflicted versus how much is the market in Alberta?

Marc Poulin

Yeah. Clearly both factors are playing out because we can see differences in customer behaviour in Alberta. And even within Alberta in different parts of the province the market doesn't behave itself. So there's a bit of both.

We don't see the same trends in BC that we see in Alberta, for example. So that's obviously a factor. But quantifying the two it's like trying to split the customer mind. They behave as one, and we've got to address it as one.

Perry Caicco

And just my last question is I understand that the two sort of self-inflicted areas that are customer facing are produce and private label. Do you see one of those being repaired before the other?

Marc Poulin

Well, private label is private label adoption of the new—of Compliments. In some cases, we've switched from Safeway brand to Compliments brand. Some customers are in the process of adopting Compliments. And this is progressing well actually.

We also had initially issues with just as you transition from one product to another around replenishment, about availability of product in store because change of labelling and everything else it's very difficult to perfectly synchronize on every count. So that's going on clearly, so both are in progress.

Produce procurement we're pretty much back on track with service levels that are associated with a normal operations mode, but it left a sour taste on some customers and we have to regain their confidence around our produce offering. So that's a work-in-progress as well.

So that being said, those are customer-facing issues. Obviously, the process and system implications are in all phases of our operation, and the distraction associated with that obviously had other impacts on the overall business that we’re obviously, as we said, towards the end of Q4 we'll feel pretty confident that the business will be operating in normal operating procedures.

Perry Caicco

Okay. Thank you, Marc.

Operator

Your next question comes from the line of Kenric Tyghe from Raymond James. Please go ahead.

Kenric Tyghe — Raymond James

Thank you, and good morning. If I could just follow up on the customer response; you flagged the private label challenges. Were there broader in-store experience challenges? Or perhaps point of sale, speed of service-type challenges? Or was this fairly narrowly related to the issues you've highlighted?

Marc Poulin

No. As I said, those are the two key elements, but overall there's been disruption across the whole way we operate associated with the adoptions of new procedure processes. And it's had an impact on the operation as a whole, which means that obviously service at store levels were also impacted.

People have been distracted from customer-facing activities towards more internal-facing activities as they adopted new processes, and we're not going to say everything went smooth on everything. There's been some impact.

Kenric Tyghe

Thank you. And just one quick follow-up; with respect to the new merchandising team, is that a best-of in terms of the people within your organization team? Or is it a combination of a best-of people and a new mandate for that team or sort of a tweaking of that mandate? How are you thinking about that new merchandising team and the rationale for putting it together as you have?

Marc Poulin

Well, we had to combine the Sobeys operations that are currently based in Edmonton with the Safeway operations, which are currently based in Calgary. We at one point selected the Calgary location for the combined team.

Once we've done that we started a process across the whole business, not only the merchandising, marketing, and customer-facing functions, but also the back-office, where we offered people the opportunity to be part of the new team. We selected people. Some people in

Edmonton were offered to move to Calgary, and we're happy to report that a greater number of people agreed to do so than initially anticipated. So that's good for us as these people are fully embedded into the Sobeys' system infrastructure and processes, and therefore will be of great help to their colleagues once they've moved to Calgary so that we can work as one team.

And the team was, yeah, basically handled with the idea of the best of both teams. That being said, I wouldn't be honest if I didn't tell you that some people were offered to move and decided not to move, and that's part of life, but overall we're very pleased with the team that has been selected.

The team is really energized with the opportunity to build a common business and work together to move our business in the west. So it's a new beginning from that because we've really moved to the next phase of integration with this. And I think we have a very, very strong team now that we believe will bring our business forward.

Kenric Tyghe

Great. Thanks very much. I'll leave it there.

Operator

Your next question comes from the line of Peter Sklar from BMO Capital Markets. Please go ahead.

Peter Sklar — BMO Capital Markets

Marc, the two larger reasons you attributed for the Safeway integration are the private label and the procurement transition. I noticed that you didn't talk about the Safeway merchants coming on to the Sobeys' SAP systems, which I believe was an issue last quarter. So if you could talk a little bit how are the merchants doing—how are the Safeway merchants doing in terms of managing their promotions, their gross margins, et cetera? Has there been improvement since last quarter?

Marc Poulin

Yeah. And I think we also mentioned that fact—and I don't have the exact quote from what I just read—but it's also mentioned there, so I'm not neglecting this as being part of the challenges.

That being said, we're clearly making progress on this front helped by the fact that now especially in category management merchandising we are putting the two teams together and there's a lot of cross training and sharing of information that's currently occurring on that front. And while we're not—and we're doing a lot of training right now with the internal resources around that. So we're clearly making progress on that front, and to be honest, I expect that by Q4 we will be in a normal operating procedure on that front if things keep going the way they're currently going.

As I also said, in the merchandising team we have a lot of people who are very knowledgeable about the system who are actually moving on the integrated team, and that's also going to be of help to us. So it's hard work, but I'm quite optimistic about the team and what they're going to bring to the market.

Peter Sklar

Okay. And could you explain a little more depth what happened in relation to your fresh procurement during the quarter?

Marc Poulin

Well, it started more in the previous quarter, to be honest, is that the produce replenishment was handled by Safeway US in Canada Safeway's world. When we terminated the service agreement with the US that's related to systems also meant that we would have to procure produce for Safeway Canada on our own, which we had been preparing for, to be honest, for quite a bit of months.

We'd been shadowing the US team for six months prior to the launch and everything else, but clearly the move from practice mode to actual was a little bit more difficult than we would have hoped. And as the team went live we didn't perform as well as we would have liked, and we ended up with issues in terms of how much produce we would order and how it would logistically go through the system; the growing pains with the system as it got live from people learning and making mistakes in the process. So that's basically what a lot of those issues were related in Q1 and to a certain degree in Q2, but we're making progress on that front where now service levels are pretty much back to normal.

And it's been, to be honest, a little bit more difficult season now procuring; there's been some events on the quality of supply due to weather and in some growing regions so it's, to be honest, for the team it's been a more challenging season than most due to weather issues and crop—the way the crops behave because of that.

But we've made significant progress on that front, and we believe that the customer experience significantly improved on produce since Q1, but now we have to claw the customer confidence back.

Peter Sklar

Okay. Thank you.

Operator

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

Michael Van Aelst — TD Securities

Yeah. Thank you. In your press release you talk about the merchandise and promotional strategies that are hurting sales. I think you've addressed some of the merchandising ones, but what are the promotional strategies that are hurting sales?

Marc Poulin

It's more—I'm not sure the promotional strategies are hurting sales in more that as we convert we're getting customer reactions to these changes we're making in the stores. Private label is an example. We switched the private label program to Compliments and we've got to get customer adoptions of those new products, and in some cases customers are making the switch to Compliments faster than in other cases. So we've got to address the products that are lagers in that regard and get the customers to appreciate what's in there.

I'll be honest, in some cases it's perception. We have products that are like-to-like in our jargon, which means that we haven't changed the product formulation and we've adopted Safeway's product formulation for Compliments we've done and they're still—but the packaging is not the same and customer have to be convinced that the quality inside the box is as good as it was, and actually in some cases exactly the same, but some customers are—we've got to lead them into this transition.

So that's the kind of situation you find on a day-to-day basis at store level. We've obviously tweaked the assortment a bit in the stores, and also that requires the customer to adapt to this and realize also the benefits of the new assortment we've brought into the stores.

So that's kind of the flux that we're going through right now, and human nature being what it is you see perceived negative change before you actually realize the positive changes that are also going along with it, and that's what we're going through.

Michael Van Aelst

Okay. And can you help me understand how you go about measuring or determining that the drop in customer purchases are strictly a result of customer reaction to your operational challenges versus other factors like competitive challenges or something like that?

Marc Poulin

Well, what we can measure is—and especially to card data, okay, how many customers are shopping our stores versus how many were before and what's being purchased and what's not being purchased and the drop in store traffic or in basket associated with that and we can pinpoint, well, where are the issues. And so that's what we're measuring. To be honest, in lots of cases, we could pinpoint it to our own actions within the Safeway customer base.

We also obviously have a control group that's called Sobeys banner where we haven't changed processes, systems. We've made some changes in the assortment in Sobeys, but obviously less change than you would have had at Safeway. And that also allows us to compare one versus the other, and from there we know that a lot of the issues related to Safeway are self-inflicted.

That being said, I'm not going to tell you that the economy in the west is not playing a role. It is also a factor, and I guess it's difficult to pinpoint which is which in some cases, but the combined impact is obviously having the total impact that we can figure in our numbers. And we obviously know that we'll have to attack this seriously to get the business back to its full potential.

Michael Van Aelst

Okay. And just a final question; in the past we've seen you acquire some gas stations and see stores from Shell. With Imperial Oil selling their Essos, the remainder of their Esso stations, is it something that you'd consider at this point? Or do you need to focus on the job at hand right now?

Marc Poulin

It's not something we would consider at this point, and to be honest, you can imagine that Imperial Oil is more aligned with another grocer than us in terms of cross-promotion and things like that.

So the Shell acquisition made a lot of sense for us because of the fact that we share loyalty programs, that we had a common customer base, and so we're in the gas business in order to—no pun intended—but fuel our food sales.

Michael Van Aelst

All right. Thank you.

Operator

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

David Hartley — Credit Suisse

Thanks. And, Marc, just I noticed there's some buybacks in the quarter. Could you talk a little bit about your view towards buybacks as we move forward? And how active you plan to be there?

Marc Poulin

We're done. The idea of buybacks was mainly to address the dilution impact of our long-term incentive plans, period.

David Hartley

Okay. Just want to be clear on that. And just so I'm clear, you talked about having processes and training, et cetera in place, and also return to normalized selling environment, I guess. So the processes in place, should that be in place by the beginning of Q4? And then if that's the case, would you expect the return to normalized selling practices, et cetera, or a normalized sales environment to be in place by that time or at the end of Q4?

Marc Poulin

So timing-wise I would say it's more end of Q4, to be honest, because if you put it in perspective, the new team takes it on in January as officially start date, if you want to put—not that it hasn't started, but if you're on the blocks and you need the gun to start the race, the official start date is in January.

But it's been ongoing for the last few months, and there's been training activities and things like that going on and it will keep on going. So it's difficult to give you a perfect date where it's not—maybe there is a date where we should give a final exam to everybody and see—like we were in school—but it's not exactly the way it happens. So give people time, and there are some people who are joining—are going to be part that have already that knowledge because they were part of the Sobeys operation.

That being said, it's a different environment for every one of them with a Sobeys' model that's now more franchised than corporate, the corporate model in Safeway, so everybody has a bit to learn. Everybody has a bit to learn about the Safeway stores themselves. They're not the same footprint as the Sobeys stores, so it's while we believe that technical knowledge will be there and better handle the process, practice is what's the proof in the pudding.

That being said, you're saying a normalized environment. Well, we're combining two teams into one, but we're also asking people to do merchandising and promotional activities on what used to be Safeway and what used to be Sobeys in terms of—and that will require the people to get that proper knowledge.

And we're obviously going to make changes to our go-to-market strategies, and then that will require customer—we believe it's going to be to the benefit of customers, but we need customers to see how customers react to that. So it's—and that obviously is just not the—it's not something we can put a final date on.

David Hartley

Okay. And just last question. You've kind of touched on this, but the Sobeys legacy business, can you give us some idea how that is looking? When you consider same-store sales growth and inflation are they more in line and are you holding on to market share there? Can you give us some colour on that? And how the margins as well are doing on that legacy business?

Marc Poulin

Well, I think we did say in the script that overall the—our business performed generally according to our expectations, and the Better Food For All positioning is resonating well with customers.

I think we are seeing exciting things happening at store level and customers are reacting well to it, so it's clearly we're—as always in business there's always challenges, but overall I'm generally—on an overall basis, generally speaking, we're happy with how the Sobeys business performed.

David Hartley

Okay. Thank you very much.

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. Just with respect to improving the same-store sales trend at Safeway—I think you alluded to that earlier—how do you expect to do that? Is that investing in price?

Marc Poulin

We're obviously right now working on our go-to-market position. The new team is building plans as we speak on this, and it's a little bit too early to tell the way it's going to shape up, but I can guarantee you that the focus will be on providing a superior customer experience.

Vishal Shreedhar

Okay. So okay, that's fair enough. Thanks for that. In terms of how the Sobeys legacy business is performing—I think one of my colleagues might have asked—but last quarter you gave us indications on gross margins. And is there any colour or extra colour that you can give us just to help us better understand when you say in line with your expectations what it might mean for an investor?

Marc Poulin

Well, as you know, we don't separate numbers on a region or even per banner basis, and we will not do so.

Vishal Shreedhar

Okay. In terms of the gross margin deterioration in food retailing, it seems like there was an improvement, or call it, less negative quarter over quarter. I think this quarter down around 40-ish; last quarter down around 60-ish. What was the reason for that delta?

Marc Poulin

Clearly even though things are far from being perfect, we're on an improving trend in terms of getting control of our operation. As you know, gross margin is a factor of merchandising and promotional strategies, and as a grocer you've got to have good controls over that one so that you don't over or under invest and get good controls, and that with the adoption of new processes and system it's been challenging, but we're improving.

The other aspect, though, also is obviously supply chain and third is controls at store level around measures like shrink, to name one, that has a significant impact on gross margins. And on that front too we are making some progress, but we are not what I would consider in a normal mode of operation yet.

But practice makes it better, and we're optimistic that we'll be in greater control as time passes by and we will reach a point where this will be behind us in the not-so-distant future.

Vishal Shreedhar

Okay. And just lastly, with respect to the SG&A trend, I think you may have flagged this last quarter, but the improvement on the rate wasn't as strong as the prior quarter. Just wondering, was that due to training? Or were there transient factors in there? Or is that a new trend that we should expect?

Marc Poulin

Well, I don't think we can speak about—from a quarter to quarter there's fluctuation, SG&A, investment behind promotions, investment behind some pushes on labour. Yes, we did put more effort on training, but even in the Sobeys business we've made some investment behind some new programs.

So I think the SG&A trend is a number that fluctuates from quarter to quarter naturally. And I don't think you should see too much into this quarter versus the other one, except for the fact that it is true that we will not—we will invest what's necessary in SG&A to get the west business in the right spot in terms of training and resources and communications internally and all those activities that may have a short-term cost on the SG&A line, but will by the long-term benefit for the health of business.

So we're not going to be skimping on the necessary steps that are necessary to put us in the right spot.

Vishal Shreedhar

Thanks for your colour.

Operator

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

Patricia Baker — Scotiabank

Thank you very much. I think I have four or five questions. The first one is just a clarification on the timing of the transition from Edmonton to Calgary. You indicated that the new merchandising team would be up and ready to run on the 1st of January. So is that when we see operations close in Edmonton?

Marc Poulin

Not close because we still have people running the business as is, but between now and June we are having people adopt their new roles, and some people unfortunately will be leaving the organization as we rationalize the team. So that's kind of the time frame.

Patricia Baker

Okay.

Marc Poulin

And in the meantime we have people who are focused on the new world in their new roles, being trained for it, and some people are keeping the boat afloat on the business as we go along. And we're thankful for those people—for everybody's effort through this transition because I think I cannot really—there's a team in Edmonton and in Calgary. They're really, really, really putting their heart into it, and on behalf of our customers we have to say thank you to them.

Patricia Baker

Okay. I appreciate that. Now just somewhat related to that, Marc, if we can go back to the private label issue, and it sounds like given the colour you've provided with on the formulations, et cetera, it's communication—the problem that can be solved by communication and maybe marketing and sampling and things like that. Do you need to have the merchandising team in place to do the final address of getting the consumer to understand what you've done with the private label?

Marc Poulin

We've already done—started a lot of work on that front. And it's, for example, sampling you mentioned, we're sampling Compliments products currently in the stores, and we're communicating with customers. And so it's—this is not something that it's not like a sprint; it starts when the gun blows. And all of this is in progress.

Patricia Baker

Mm-hmm.

Marc Poulin

So there’s a date, yes, in January where officially we can say it started, but I can tell you on lots of things the people know they're going to work together are not saying, well, until January I'm not talking to my future neighbour.

Patricia Baker

No, I understand.

Marc Poulin

So a lot of this is currently occurring and lots of programs are, as we speak, being developed and some of them actually implemented. Private label is one of them.

We're—our sales trend in private label is night and day versus what it was in the heavy phase of transition. So we're—and I have to admit that I am happy to see that how this is being executed and we're making significant progress on that front, so the work is not finished. We’ll keep working on it, but it's—we're doing a lot better.

Patricia Baker

Okay. It sounds like you're moving in the right direction. If we go back a few quarters and talk about Alberta and maybe a couple of quarters ago where you were seeing the weakness—you indicated it was just in the oil-related markets—is the weakness in Alberta now being felt more broadly than that? The economic, yeah.

Marc Poulin

Yeah. Obviously the Fort McMurray markets and markets such as are feeling the brunt of it. Yes. I think it plays also on an overall mood of the customer.

Patricia Baker

Sure.

Marc Poulin

I mean I think anybody who travels to Alberta will tell you that people are a little bit more worried than they were a year ago, and so that also plays a role. So it's more a factor and yes, I mean it wouldn't be honest to say that Alberta as a whole has a different vibe than it used to have.

Patricia Baker

And then you referenced interestingly enough that in a way you're getting a handle on what the self-inflicted wounds are, et cetera, is that your legacy Sobeys business is a good control group. So likewise I would assume that your Safeway business in British Columbia, where you're not having that weakness, is also a control group to let you parse out what's the economy and what's the issues around the transition?

Marc Poulin

Yeah. Clearly we can relate one versus the other and we can compare between provinces, and not all provinces are reacting exactly in the same manner even in the Safeway business. That being said, every market has its differences and its own challenges, and we've got to put that into the equation as well.

Patricia Baker

Okay. And just a technical question for François; where are we on the de-leveraging at the moment?

François Vimard

As we mentioned, during the quarter, Patricia, we didn't de-lever at all and we…

Patricia Baker

Mm-hmm.

François Vimard

NCIB and that disposal, so we are I think at a good place at this stage not focusing on de-leveraging way more. It will all depends how much cash flow we're going to generate during the year.

Patricia Baker

Okay. Thank you.

Operator

Your next question comes from the line of Jim Durran from Barclays. Please go ahead.

Jim Durran — Barclays

Good morning. Sorry to focus on the same thing, but I'm just trying to make sure I've got the right understanding as to what's going on. In the quarter you were saying that your comps didn't come in at the level you were hoping for. Would you attribute most of that shortfall to greater weakness in Alberta than you were expecting? Or more drain from the disruption that you experienced at Safeway?

Marc Poulin

Yeah. There's clearly a disruption factor that's across all of Safeway business because it's not only an Alberta situation. There's clearly an Alberta situation that's being played out, and Alberta's situation can be analyzed twofold.

There's the direct oil-related market that we have a pretty good grasp of what it means, and there's an overall Alberta market vibe, or negative vibe, if I can call it that way, that's in there that's also having a factor. It also spills to Saskatchewan to a certain degree.

So it's difficult to point out. The combination of the two is obviously not a good recipe, and we've been experiencing that.

Jim Durran

Okay. Banner change on the horizon for Western Canada; would I be wrong in assuming that these difficulties have pushed off any timing where you might change or rationalize the Sobeys and Safeway banners?

Marc Poulin

It's—the—our go-to market strategies are currently being reassessed by the combined team, and we're obviously looking at what's going to provide the best value and experience for our customers.

Jim Durran

And so is the weakness in Alberta, because obviously as you pointed out it's become a bit broader based because of the psyche of the consumer in Alberta, do you feel that you need to change your price proposition both at Sobeys and at Safeway in order to retain customers as opposed to seeing them trade down to more price-conscious levels?

Marc Poulin

We clearly are relooking at the way we go market, and that's the work that's currently going on.

Jim Durran

Okay. That’s great. Thanks, Marc.

Operator

Your next question comes from the line of Keith Howlett from Desjardins Securities. Please go ahead.

Keith Howlett — Desjardins Securities

Yes. Good morning. I had a question on the private label transition. If I recall, at some stages you had both private labels in the store. I was just wondering when it began to become apparent—or why the early results didn't carry through. Is it—like…

Marc Poulin

Yeah. As we were transitioning private label from Safeway program to Compliments, what makes the early readings about customer adoption a little bit difficult is that you don't have—you have supply changes disruption switching from one to the other; you had to clean up the old inventory, bring in the new one, and everything else; and not very easy to find out if a drop in sales in private labels were related to those disruptions.

As you transition you also promote less product label, which is normal because you don't want to advertise a product that you're not sure whether you'll be able to get it in time to the store. So on top of just being in stock position you also have less promotion going on, so is that the cause of lower sales or not? And we couldn't get a good read on it.

We enigmatically felt that it was mainly less promotion and less transition logistic issues that were—and customers were not—customer reaction was okay. But once we've gone through the pure transition we could actually isolate the customer reaction to the switch, and honestly we have to say that we were a little bit caught off guard by the fact that we needed to work a little bit harder with the customer to get the proper adoption of the private label program than we anticipated. So in hindsight we underestimated what needed to be done to get the customer.

Now that's that been addressed in earnest there's a lot going on on that front currently in the stores, and we're already seeing the progress on that front that I'm very pleased with. So we're not out of the woods yet on this front. I mean customers will have to try new products and be convinced that the offering is as good as the one they used to have, but it's progressing well, so it's—we've probably been under investing behind the customer in the transition phase and we're—we have to correct that.

Keith Howlett

And just wondering on the Air Miles program, does the Safeway customer appear to the have the same interest? Like is your penetration of Air Miles similar regardless of store banner?

Marc Poulin

Yeah. We—penetration of the Air Miles program is as good as it used to be with Safeway. I think actually the customers realize the benefit of being able to accumulate Air Miles in both Sobeys and Safeway currently, so that played in our favour.

I have to admit that that the introduction of the Air Miles program in our liquor business has been good for that business, so overall—and in pharmacy, in Sobeys' in-store pharmacies, the introduction of the Air Miles propositions has been good for us.

So no, we're pleased about customer reaction to linking both the banners under the same loyalty program.

Keith Howlett

And just one last question on pharmacy; broadly on a national basis do you do your own pharmacy distribution or use a third party wholesaler?

Marc Poulin

So in Atlantic Canada we do our own, and in the rest of the country we work with a third party.

Keith Howlett

Thank you.

Marc Poulin

Thank you.

Operator

If there are any additional questions at this time, please press *, followed by the number 1 on your telephone keypad.

Your next question comes from the line of Chris Li from Bank of America. Please go ahead.

Chris Li — Bank of America

Hi. Good morning. Maybe just a question for François; François, can you just remind us how we should interpret the synergy number of 55 million? I understand obviously it's not the incremental number. Is it more or less sort of a run rate number? Or how—can you just remind me how I should look at that number in relation to your 300 million target?

François Vimard

Yeah. You should look at it as what we have realized during Q2. So at this stage I can say it's almost a run rate number because the next phase of synergy will come more with the rationalization of distribution, as we have announced. And that's going to come more in F ’17, so at this stage you can see that as now going forward a run rate up to F ’17.

So that's why we're confident that we'll realize at least the 200 million we talked about.

Chris Li

Okay. So if I just roughly analyze that, you had sort of 222 million, so you have 300 million you're targeting. So delta is kind of what is yet still to be realized?

François Vimard

No, that's not exactly what I said. What I said…

Chris Li

Okay.

François Vimard

Is that 55 million we had this quarter you can consider that as a run rate going forward. Actually, as I said in the last quarter, there is some variability from one quarter to the other quarter, so multiplied by 4 is not exactly a right number, but it will give you a sense that we should at least achieve that 200 million.

Chris Li

Okay.

François Vimard

And into next year, as we said, in F ’17 we’re going to have additional synergies coming from distribution sites. So I'm not talking about 200 million, but I'm talking over 200 for sure.

Chris Li

Sorry. Okay. I understand. Okay. Gotcha. And I guess maybe a question for Marc. If I take everything you've said so far on the call with respect to the Safeway integration, is it fair to say that you're kind of more or less on the fourth or fifth inning in terms of completing the Safeway integration? Like about halfway done?

Marc Poulin

Well, clearly from a—we always said it was a three-year plan to get us from a technical and synergy point of view, and after that obviously there would be some work to be done around the offer and the customer proposition and things like that because that doesn't—you need to do the first set of activities before you can actually address the second.

So I don’t know if I'm in the fourth, fifth, or seventh inning on this front, but if you want that baseball analogy, now the starting pitchers are being replaced by the relief pitchers because we're putting the two teams together and everything else. So I don't know when that occurs in a baseball game, but that's the phase we're at.

We're combining the operations. We always said that this year would be the most challenging one because we're—the technical phase, that's what we did first, and that was mainly systems. Now we're in the human phase of things, putting it—combining the operations; adoption of new processes and tools; getting people to work together in new roles with learning about a part of the business that they may never have handled before. That's what we're in right now.

There's going to be another phase where we're going to do distribution system integration, which obviously is a lot of hard work as well, and then we've got to start taking the best of both worlds for the benefit of our customers in actually what shows up at store. And that's also starting to take jive (phon), but some of it is also dependent on having people in place to do so and building that common understanding of the proposition we want to bring forward to our Safeway and Sobeys customers.

So that's the word that's currently occurring and we're hitting some challenges in this process, but at the end of the day we also see that we're making progress towards that agenda that are not insignificant. And yes, I think if you finish on your baseball analogy, we will win the game.

Chris Li

Great. Thanks so much for the colours. Thanks.

Operator

There are no additional questions at this time. I turn the call back over to the presenters.

Ken Chernin

Thank you very much, Jessa. Ladies and gentlemen, we appreciate your continued interest in Empire, and look forward to having you join us for our third quarter fiscal 2016 conference call on March the 10th.

Good-bye.

Operator

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

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