

FINAL TRANSCRIPT

Empire Company Limited

Second Quarter Fiscal 2017 Conference Call

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PRESENTATION

Operator

Good morning. My name is Chris (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 2017 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.

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

Ken Chernin — Director, Investor Relations, Empire Company Limited

Thank you, Chris. Hello, and thank you for joining us. Our comments today will focus primarily on the financial results of the second quarter of fiscal 2017 ended November 5, 2016. Following our comments, we will then be open to your questions.

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

Joining me on the call this morning are François Vimard, Interim President and Chief Executive Officer, and Clinton Keay, Interim Chief Financial Officer.

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

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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 Clinton, who will provide a review of Empire's financial results. François will then discuss the operations.

Clinton Keay — Interim Chief Financial Officer, Empire Company Limited

Thank you, Ken, and thanks to everyone for joining us today. We issued our second quarter results yesterday evening, so I plan to only review the highlights.

Sales for the second quarter of fiscal 2017 decreased by 2.1 percent for the same period last year to \$5.93 billion. Same-store sales for the quarter, excluding the impact of fuel sales, decreased by 2.6 percent. The lower sales relative to the same period last year continued to be the result of a number of factors, including challenges in the West business unit and soft sales trends in most of the store network.

Excluding the impact of fuel sales and the retail West business unit, same-store sales decreased 1.2 percent. Our internal food inflation for the quarter was calculated at negative 0.1 percent.

The factors I just noted adversely impacted gross margin for the quarter, which was \$1.4 billion or 23.6 percent of sales, down 70 basis points from the same period last year.

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EBITDA for the quarter was \$187.8 million, or 3.2 percent of sales, a decrease of \$68.5 million from the same period last year.

Adjusted EBITDA for the quarter was \$181.2 million, or 3.1 percent of sales, a decrease of 190 basis points from the last year. The decrease in adjusted EBITDA and adjusted EBITDA margin is attributed to our continued sales challenges, which highly impact our leverage.

The Company's effective income tax rate for the second quarter of fiscal 2017 was 25.8 percent compared to 29.6 percent in the same period last year. The decrease is attributable to the substantive enactment of legislation to modify the tax treatment of eligible capital expenditures.

Adjusted fully diluted earnings per share for the quarter was \$0.12 compared to \$0.40 last year. Net earnings net of noncontrolling interest was \$33.1 million, a 51.7 percent decrease, and adjusted net earnings net of noncontrolling interest was \$32.9 million, a decrease of 70.3 percent from the same period last year.

Free cash flow generated for the quarter was \$18.9 million, a \$33.8 million increase over last year as a result of increased proceeds from real estate transactions.

At the end of the quarter, funded debt to total capital was 35.0 percent versus 39.5 percent at May 7, 2016. Cash and cash equivalents equalled \$212.6 million.

I will now turn the call over to François.

François Vimard — Interim President and Chief Executive Officer, Empire Company Limited

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Thanks, Clinton, and good morning, everyone. Clearly, a very disappointing second quarter, reflecting the significant and ongoing challenges we have been experiencing in our business.

These challenges have again largely been driven by the negative impact of merchandising and promotional strategies in Western Canada. However, we continued to see softness in other parts of our operation due to price sensitivity by consumers and their continued shift to improve value.

As you know, over the past 18 months we have been focused on improving on overall value equation to the ongoing enhancement of our offer, as well as through important structural change to our pricing model with implementation of our Simplified Buy & Sell initiative designed to provide a better shelf price to our customer.

To date we have launched this initiative in both our Quebec and the Western business unit. While we have seen regular shelf productivity and tonnage trend improve within grocery, overall sales and earnings continue to be below expectation in these two business units.

We continue to work diligently to refine Simplified Buy & Sell, and I've always said that the results we expect will take time as customers become accustomed to the value being created at store level.

We remain committed to making significant improvements to our regular shelf pricing across our business, and believe that adapting our approach based on our early experience and

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learning from both our vendors and our customers will ultimately ensure a more successful and sustainable approach to our business. These adaptations will eventually be implemented across the country, and will allow us to continue our overall value to our customer.

While we have made some important progress in reducing cost throughout the organization over the past few years as a means to invest in our price competitiveness across the country, these efforts have not delivered the size or scale of cost saving that we believe are essential to compete effectively moving forward in what remains a highly competitive marketplace.

Our second quarter results have simply reinforced the need for a renewed focus on our business transformation efforts, as well as a significant extension and acceleration of the work to reduce operating costs within our organization.

As importantly, we must also address and drive a significant reduction in the complexity of our organizational structure that is often characterized by inefficient and complex processes. As a result, we have recently engaged the Boston Consulting Group to assist us with a detailed assessment of our business with a view of making recommendations on advancing both the scope and scale of cost reduction in our organization, while at the same time addressing the organizational complexity that not only add unnecessary costs, but often prevents nimble and responsive decision-making to support the needs of our customers.

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We are in the very early stage of this work with Boston Consulting, but we have clearly identified the complexity of our business model as a significant issue. We expect our comprehensive assessment of all aspects of our business will take a few months to complete.

Last, but not least, we continue to focus on improving our offering and providing greater value for our customers. As we have said last quarter, our capital will more than ever be focused on improving the offering and service in our current network and less focused on the major renovations that affect our service to customers for a long period of time.

Capital plans take time to be realigned. However, we need to ensure we provide to more customers product, service, and solutions they are looking for and expect from us.

Clearly our business results are unacceptable, but as an organization we continue to work aggressively to tackle the challenge we are facing. We also know that it will take time to achieve the cost-saving required to invest in the competitiveness of our business. It will take time to reduce the complexity and drive efficiency in our business, and it will take time for our customers to understand the changes we are making at store level and the overall value it will create for them.

We'll be now happy to respond to your questions.

Q&A

Operator

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At this time, I would like to remind everyone in order to ask a question, press *, then the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. Your first question comes from the line of Mark Petrie of CIBC. Your line is open.

Mark Petrie — CIBC

Hey. Good morning. Wonder if you could just talk about your approach to price investments and promotional strategy and how that's evolved over the last six months and maybe if you could just comment specifically in terms of geographies across your business?

François Vimard

Good morning, Mark. Clearly, as you know, when we talked about that over the past few quarters in terms of the change of our pricing strategy and the way we want to be more, I would, say relevant on the shelf price for our customer. And we have engaged a process of we have called internally Simplified Buy & Sell, which requires a lot of work on the vendor side I would say internally with our category manager and then communicate that to the customer.

As we have said in the past, we have launched that initiative back in—at the end of Q4 last year in Quebec, and have launched that initiative also in the West back in September.

Clearly, all the different regions had a different price position compared to the market, and the investment in margin or the investment in pricing depends on where we want to be and how we're going to compete in those markets. So clearly the launch in the West required more, I would

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say, investment than other regions, and that's what we have done to position ourself where we feel the customer will understand the value we want to provide to them.

What I'm saying is through that process we're learning a lot. We're learning a lot of the elevated change in terms of relationship with our vendors and also the relationship and the elasticity of category and pricing with the customers. And what I'm saying is we're learning through that and adjusting that accordingly to ensure we get the most of it and provide the best value to the customer at the end.

And through those learnings then we'll continue to implement a better price across the country, but taking in account those learnings we had over the past few months.

Mark Petrie

And when you look at those learnings, I mean how much more aggressive do you think you need to be over the next six to 12 months, considering the tonnage trends in the business?

François Vimard

I think it's not more aggressive. It's more there's a lot of learning in terms of, like I said, by category the elasticity of that those pricing investments, and also how do you work with your vendors to ensure we're all aligned with them how the category should work.

And on the other side how can—and that's one of the challenges of that program is being able to communicate that to the customer so they understand the competitiveness of our pricing at shelf level when people are more used to buying only when there's a promotion. And I think you

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have enough experience, Mark, to understand that concept. And even if I don't want to call it an everyday low price, but a concept of a better everyday low price is always more challenging to communicate to customers so they can react and understand the pricing we provide to them.

Mark Petrie

Okay. Thanks. And then I also wanted to ask about the plans for the consultants that you've engaged. And I wonder if you could just sort of specifically talk about the scope of their work. Obviously, operational efficiency and SG&A spending is the focus, but does their work extend to corporate structure, asset utilization, central procurement, pricing strategy, those types of elements of the business?

François Vimard

I think, Mark, at this stage I would say no rock will be not—will be unturned. So the scope is everything that has an impact in terms of cost in our business will be looked at.

Mark Petrie

Okay. That's helpful. Thank you.

Operator

Your next question comes from the line of Irene Nattel of RBC Capital Markets. Your line is open.

Irene Nattel — RBC Capital Markets

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Thanks, and good morning. I'm wondering if you could just give us a little bit of colour on sort of what you're seeing through the quarter and into the current quarter in terms of customer response, traffic trends, basket, and whether you really have a sense of how much more you need to grow the basket and the traffic in order to offset the investment in pricing gross margin?

François Vimard

Irene, as you know, basket clearly is impacted somewhat by the investment you're doing in your pricing. So what we saw during the quarter is a bigger impact in terms of basket and transaction in terms of overall impact.

So I think the customer understands—started to understand the better pricing, but before they put more product in their basket to compensate for the reduction of pricing it takes time. So like I said, the biggest impact we saw over the quarter was more on the basket side that we saw a reduction across some region more than others, but across the board.

And so we're going to continue to be able to market that so the customers feel more comfortable to increase their basket. And then from there, like we always said, it's always easier to increase the basket size of a customer than bring in new customers in your store. So my focus will be more to see the trend on the basket side first and then after that on transaction.

Irene Nattel

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That's very helpful. Thank you. So in the quarter you stepped up your investment in promotional activity to communicate. Should we be expecting another step-up in the back half of the year?

François Vimard

Clearly, as you know, we're really not happy about our top-line sales. So I don't know if I can call it stepping up the promotion, but at least stepping up the communication to the customer so they understand what's going on in our stores. And it takes time for customers to change their behaviour, and it's critical that we continue to communicate to them what we're doing so they feel more and more comfortable to buy in our stores.

Irene Nattel

And what are the key tools that you're using, François, to communicate that message?

François Vimard

There's different tools we're using. As you know, you can do it through digital. We have enough customers that we have potential digital communication to them. Clearly you have your weekly fliers, which is always an element. You have the shelf at store level that you do also. And you have marketing also that depending on the different market we can use either on TV or radio. So there's many tools we're using right now.

Irene Nattel

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Thank you. That's very helpful. And then just coming back to a question of the BCG work, so if BCG is... If you're targeting sometime in Q4 for the report, then presumably you need time to digest it, and then we should be thinking maybe some of the changes will begin to be implemented in sort of the back half of F'18. When is it reasonable to expect you to start acting upon the recommendations?

François Vimard

Irene, it's still pretty early to give you more detail around that. Clearly, and I think you know about that, usually those program you're going to have some short-term, some mid-term, and some more long-term, I would say, initiatives. But we're pretty confident that a significant aspect of those savings are going to help you to provide a better overall solution to our customers.

Irene Nattel

And then finally just one last question, if I may, from the credit perspective. DBRS did issue something of a warning after results yesterday. What's kind of the tone of the discussion that you're having with the rating agencies right now?

François Vimard

Clearly, the tone is what they're looking from us, and I think we told that last quarter. It's less a balance sheet issue. It's more a P&L issue. And they're looking more for a change in the trend.

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And clearly, that's something as you can imagine we're working hard internally. And as long as we can't prove to them that change in the trend they will have to make their own assumption and their own decision.

Irene Nattel

That's great. Thank you very much, François.

Operator

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

Peter Sklar — BMO Capital Markets

François, if you look at your results in Q2 versus Q1 the profitability fell to a significantly lower level, but the issues that you were talking about that are negatively impacting the business, including your price investment in the West; the promotion that you're doing to advertise to promote Simplified Buy & Sell; the implementation of Simplified Buy & Sell, those were around last quarter. So I'm just wondering like what was it that caused the level of profitability of the Company to deteriorate so significantly versus the previous quarter. Was it the rollout of Simplified Buy & Sell? Or was it other factors?

François Vimard

There are many factors. Clearly, as you know, Peter, we have launched Simplified Buy & Sell in the West September 2nd, so that's impacted the second quarter. It didn't impact the first

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quarter. So clearly on margin it has a way larger impact than you could have seen in Q1. And also the fact that to support that launch we did invest a bit on the SG&A side, so those are elements, clearly, that affect our Q2.

Clearly overall you see also the market overall is heating up. I think everybody feels that personally we came out of the quarter in a deficient mode. Part of that created by ourself by the pricing reductions we have made, but I think that overall the market's getting even more competitive. And so everybody's looking for the next dollar of sales, and also the commodity going down in terms of pricing.

So all those elements they affect us. And clearly, we were somewhat impacted also across the country by a situation we had with Air Miles. And I can give you a bit more detail around if you prefer on that one. But so we have different elements affecting us on Q2, but the major one on margin was clearly the margin investment on pricing we have done mainly in the West.

Peter Sklar

So when you say the Air Miles issue, you're finding that the consumer is not valuing the reward like it was before because of all the controversy surrounding the determination of the Air Miles?

François Vimard

Clearly, the negative press that our partner had on the program, considering that we have, as you know, that program coast-to-coast wasn't positive for sure on our customers. Our customers

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weren't happy the way the partner managed that relationship with them. And it did affect us directly.

And we're working with Air Miles to, I would say, recreate, I would say, a positive momentum in that program, which is critical for us. And we hope that LoyaltyOne as a partner will make the necessary steps to ensure that our customers see that as a positive program more than ever.

Peter Sklar

Okay. And then just lastly in the write-up when you were discussing the deterioration in the SG&A margin, one of the things you referred to was the increase in labour costs. Are those contractual labour increases? Or are you adding store labour hours?

François Vimard

There's both, Peter. Some clearly, as you know, as a base of increase we have annual increases that we provide either to our unionized employees or even our non-unionized employees, which are around the same amount. So it's kind of a fixed-cost increase that you have.

And part of it also is additional labour. We have put mainly in the region that we were launching those big Simplified Buy & Sell programs to ensure the offering is top-notch at store level.

Peter Sklar

Okay. Thank you.

Operator

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

Michael Van Aelst — TD Securities

Thank you, and good morning. Just following up on couple of those question; the extra store labour hours that you added to support Simplified Buy & Sell, is that something that will need to stick around? Or is that something that was just needed to get the program launched?

François Vimard

Part of it is launch; part of it also to being sure that our stores are in top shape because I want our customers to really see the best of our offerings when they come in our stores. So I want to invite them with the publicity and promotion we're doing on pricing, but I want them to stick with us when they see our offering and service we're providing to them.

So some of it is part of the launch, which is normal additional SG&A for marketing, things like that, but some of them will be there on a sustainable basis to ensure we have the best offering for our customers.

Michael Van Aelst

Okay. And was there much in the way of consulting costs in Q2?

François Vimard

Not that much.

Michael Van Aelst

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And then on the deflation, how are you managing to keep your deflation less than CPI because CPI for your quarter would have been down about close to 1 percent?

François Vimard

And clearly, Michael, with the change of the trend and the basket side as we have reduced, clearly inflation is a tricky element to calculate, as you can imagine, because people changing their habits. So it depends how you compare it to the previous year. And because of the change on the pricing side, I feel internally that the deflation we had even at the end of quarter was even deeper than we published because that switch of buying pattern from a customer went towards more product that we have reduced price. And when you compare to other product that didn't reduce as much price last year, it does affect a bit the calculation of inflation.

I don't want to go too much in detail of that, but the trend, I would say, feel it's even more negative than we published.

Michael Van Aelst

Okay. And then on the rating agency comments; since you said it's more of a P&L issue than a balance sheet issue, would that suggest that you don't feel a need to shore up the balance sheet through asset sales or something like that to try and stabilize your ratios?

François Vimard

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I think that the rating ratio we have, the rating we have is really linked through our P&L. Like I said, whatever I do on the balance sheet, even if it's on the short term, I don't think will, I would think, change the conclusion that the rating agency can have.

Michael Van Aelst

Okay. And then when I look at the West same-store sales it seems like they continue to get worse, even though you invested in lower meat and produce prices earlier in the year and then you started investing in Simplified Buy & Sell. I mean what are you seeing in the East that gives you confidence that it's going to work in the West?

François Vimard

In the East, clearly there were less margin investments. And we see in the West, I think in the West you have to be careful because clearly—because of the investment of margin you see in dollars a trend that is a bit different that we see in pure tonnage.

But still, there's more work to be done. Like I said, it's more the question of customers regaining confidence in our offering in our pricing position out West, and that's what we're working at.

Michael Van Aelst

Okay. And then a couple of quick ones just on some of the cost-saving initiatives; can you give us an idea of the timing of the two office closures that you had talked about, as well as when you might see some of your first DC closures in the West?

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**François Vimard**

We already closed a DC in the West. The Winnipeg one was closed, I would say, close to 10 months ago. We're in the process of building the automation for our Calgary one. And we already, I would say, partly closed—the costs are still there because it's—the operations are closed, but we still have the, I would say, the asset there in the West.

So over the next, like I said, by summer we should be all rolled out out West in terms of network.

Michael Van Aelst

Okay. And the office closures?

François Vimard

The office closure is done since June.

Michael Van Aelst

Okay. And your tax rate, you had a weird tax rate in the quarter. It was quite a bit lower. I'm not sure I fully understood the explanation, but what do you see that—what should we be using for a tax rate going forward?

Clinton Key

Generally, the 26 percent is a reasonable.

Michael Van Aelst

Okay. Thank you.

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**Operator**

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

Vishal Shreedhar — National Bank

Hi. Thanks for taking my questions. Just on the quarter, I just wanted to get a better understanding of Simplified Buy & Sell and all the, I call them, transient initiatives that you're implementing to turn the trend. So it seems like your gross margins deteriorated predominantly due to the West, but that was planned because of Simplified Buy & Sell. Your SG&A dollars grew, call it, 5 percent-ish in food, and part of that was planned. So obviously when you're doing these things you have an end result in mind and presumably to grow profitability. Just wanted to get some context on if these results you foresaw them, and what these initiatives—what the end goal will be with all these initiatives that you're implementing?

François Vimard

We believe (phon), Vishal, that clearly we were planning for a better tonnage increase than we have seen. Like I said, we're not in the trend that we were looking for. We knew it was going to take time for customers to react, but I would say in the context of the market overall and the challenge, the competitiveness, and the challenge we had with Air Miles and all those stuff, clearly the tonnage wasn't at a level we expecting.

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So our results are weaker than our expectation, so we'll continue to work on this to ensure that we can continue or improve the trend we currently have out West. And in parallel, clearly what's clear for me and like I said to the Board and others that we need to go even more deeper on a cost side to support that pricing investment.

I think that's something in the past we talked about many times saying that we're the most complex retailer to do business with in Canada, but without really addressing it. And that's something that more than ever we need to address to simplify our business and simplify the way we're going at it so we can support that pricing investment.

Vishal Shreedhar

Okay. So if you didn't hit your expectations with the price reductions in the West then why is management so comfortable in saying that you're confident that this is the right strategy, and you want to continue to roll it out presumably nationwide? And how do you know that this investment is going to result in increased profitability, increase to EBITDA dollars?

François Vimard

There's a lot of learning that we have, like I said, Vishal, over the past few months, clearly I think in terms, like I said, category by category, elasticity of product and price, reaction of the customer side. So we're doing those adjustments right now in the two regions, and we have launch to some place, I'll be frank with you. Clearly we have the invested margin that didn't give any results. Customers didn't care about those categories and some of pricing it was more a kind of a

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convenience category and you learning about that; others that you feel elasticity as we are. So there's a lot of learning there that we are adjusting product-by-product, price-by-price, category-by-category right now, and from there to find exactly the right level of investment to get the most of it.

Clearly, pricing was one the issues that we had in our stores, and we need to continue. And in parallel, like I said, we shouldn't forget the fact that our—in the West we didn't work hard enough yet on improving of offering, and that's what we need to do over the next few quarters.

So in parallel, those two elements will make a good offer and a good value for the customers and at the same time supported, but a more lean cost structure will provide us the earnings we're looking for.

Vishal Shreedhar

Are you going to roll out Simplified Buy & Sell—and I'm talking out particularly the lower price component—are you going to roll that out across Canada at the same pace? Or are you going to slow down?

François Vimard

We'll do it differently, Vishal. I would say clearly right now we're learning a lot, and like I said, through those learning, the rollout in the other regions will be done differently.

Vishal Shreedhar

When does Ontario come?

François Vimard

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No plan at this stage.

Vishal Shreedhar

Just a few one here—a few other quick ones; your network as it currently stands, are there noncore assets that you see that Empire could divest? I'm talking about the gas stations; I'm talking about maybe even particular regions where Empire doesn't deem it necessary to operate in.

François Vimard

I would say there is a few assets, clearly, that we can dispose if necessary, but right now we're looking for growth and not for reducing that growth. The gas business, the liquor business, the pharmacy business, we have many different businesses that right now have a good momentum. And we have no intention at this stage to dispose those.

Vishal Shreedhar

Okay. And the SG&A dollar growth, 5 percent, that's tough to leverage even in good times.

François Vimard

Yeah.

Vishal Shreedhar

Could you give us a sense of how much of that was transient, and how much of that is extra energy in the system to turn the trend?

François Vimard

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I would say I can define that. I would say almost like one-third, one-third, one-third. One-third will be structural, normal increase of fixed costs. One-third will be additional labour and SG&A we put in. And don't forget also we had additional—that's the last point there—the additional costs came from the rent because we sold \$400 million of assets to Crombie back in June, so additional real estate costs. If you add up those three you can divide that by three to define the other costs.

Vishal Shreedhar

Okay. Thanks.

Operator

Your next question comes from the line of Tal Woolley of Dundee Capital. Your line is open.

Tal Woolley — Dundee Capital

Hi. Good morning. When you roll out Simplified Buy & Sell in a new market I've noticed you've got a lot of huge messaging in the store to consumers to communicate that shelf price investment. How long are you able to maintain like that promotional messaging in the stores, given that it's a permanent sort of shelf-price investment?

François Vimard

There's different techniques. Clearly, we're using a technique when we launched with different tags that showed directly the reduction of pricing. You can do it for a period of time, and then you have to reinvent yourself to show the customer those pricing. And like I said earlier, that's

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one of the challenge with that, like I said, more everyday low price position is to be sure that a customer still gets excited and understands that.

So you can do it at shelf level by different tack, different, I would say, additional communication you give to the customer, and also through your different signs you have in the stores and also on the flier side. And it takes time for the customers to understand and see that.

Customers look at price and product one-by-one, so you have to be adamant to support that, I would say, up to shelf level so the customer can react at the shelf level. And so we have different programs, like I said, and we adapt that depending on the category of the product.

Tal Woolley

And what's that initial period of time?

François Vimard

That initial period of time depends the way we see the reaction of the customer and what makes sense.

Tal Woolley

Okay. So are we talking weeks or months?

François Vimard

We're talking months.

Tal Woolley

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Okay. And to date I understand there's a lot going on. Is there any evidence that you are rebuilding the customer base at Safeway at all at this point? Or is it just too hard to tell?

François Vimard

Like I said, I would say in terms of tonnage growth, so the customers coming in our store, we saw some, I would say, change in the trends in the West. So some, I would say, better trends than we had earlier in Q1, but still have way, way, way more to do.

Tal Woolley

Okay. And then just finally, 40 million square feet of real estate in the system; how much remains owned by Empire? ECL?

François Vimard

That's a good question. I would say—

Clinton Keay

I'll get back to you, Tal—

François Vimard

Yeah. We'll get back to you, Tal. It will be in a low range with what we have sold to Crombie so far, so yeah.

Tal Woolley

Okay. All right. Thank you.

François Vimard

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Yeah. You're welcome.

Operator

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

Chris Li — Bank of America

Oh, hi. Good morning. Sorry if I missed this in the beginning of your remarks, but did you disclose the same-store sales decline just in the Western business excluding fuel?

François Vimard

Not the West. We said that excluding the West it was 1.2 if I recall.

Chris Li

Okay. So you didn't disclose that; just for the West.

François Vimard

Yeah.

Chris Li

And also in your opening remarks you mentioned that some of the upcoming initiatives could prevent some nimble and responsive decision making to support the needs of your customers. Can you maybe give us an example of what is the potential risk or what you mean by that statement?

François Vimard

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Like I said, what I mean by that statement—and I go back to another—what I have said back in Q1 also—clearly when you see our vendor base telling us that we are the toughest retailer to do to business with because of the complexity of our business just gives you an indication that the way we're going at business is not the simple way.

And in this market you have to be nimble; you have to be simple; you have to work with your partners fast and furious; and be less expensive in the overall supply chain so you can provide a better value to the customer. So that's what I mean by that.

So the risk associated with that at this stage it's unknown because we have to understand exactly what we're going to do. But clearly by experience and by having started discussion, like I said, with third party, it's obvious that there's a major change that could happen or should happen to bring us at the right place.

Chris Li

Okay. No, that's helpful. And then I understand, as you said, it's more of a P&L issue and not so much a balance issue. But in the case... In the event that if your rating is downgraded to below investment-grade, would that have any significant impact both in terms of your capital allocation in terms of your CapEx or dividend?

François Vimard

No, it won't in the short term in terms of material. I think we'll be clear... Clearly, we'll be more, I would say, cautious around capital investment. And not only because of that but also about,

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like I said, I want to be sure that my capital has the best return as quick as possible by showing even more customers what's going on. So we're going to reallocate capital more on that basis, less on the fact that rating can change.

Chris Li

And would that trigger any increase in interest expense on your existing debt?

François Vimard

It will, it could, but not material.

Chris Li

Not material. And then my last question is just any update you can provide us on the new CEO search; are you getting close now to finding... An announcement anytime soon?

François Vimard

I would say the Board working hard and I would say with serious process behind this. Clearly, they understand the criticality to confirm who's going to be the leader for this company, but in the mean time I'm working with the Board to ensure we're doing the right decisions so the business can move forward.

Chris Li

Okay. Great. All the best in the year. Thank you.

François Vimard

Thank you.

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**Operator**

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

Patricia Baker — Scotiabank

Oh, thank you very much, and thank you for taking my questions. François and Clinton, I have three topics I'd like to discuss: a little bit more on the Simplified Buy & Sell, and maybe dig a little deeper, François, into some of the stuff that you talked about with elasticity and perhaps category management, and then thirdly on the consultants.

So first of all, on Simplified Buy & Sell it's pretty—certainly easy to understand that the undertaking in Western Canada was a lot larger than what we saw in Quebec, but I'd be interested to know if some of the gains that you saw, or some of the improved trends that you saw in Quebec in the first quarter with implementation of that program and the fact that you were able to see a lowered proportion of promotional sales in the grocery category, how did that fare in the second quarter? Were there any further improvements? Were there deteriorations? Were there new learnings in Quebec, not just in the West?

François Vimard

I think the transition from promotion to regular price is still existing. We saw the same change in the West also. So clearly we're able to make that change. Clearly, like we've said in the West, that had a large impact on margin.

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What we're learning even with Quebec is, like I said, certain categories that at one point the way the customers react is not the optimal way. So we're doing adjustments in Quebec also to ensure that some of those categories are adjusted.

And we're working not only internally, but with our vendor community to ensure that we have a clear view of how those categories should be attacked. And if promotions of those categories work even better how do you adjust those promotions or those pricings to be more efficient? So there's still a lot of learning there, but clearly there are still challenges to be corrected.

Patricia Baker

Okay. So independent of the Simplified Buy & Sell—and I'm not sure how to phrase this properly, so forgive me—does that mean that inside your system you didn't have the intelligence or the real good sense of how categories worked with your consumer as much as you thought you might have had embedded in the system? Or has there been such a change in the consumer that how the consumer is responding to certain categories has changed dramatically over the course of the last, we'll call it, 12 to 18 months?

François Vimard

It's tough to separate the two, as you can imagine, Patricia, because—

Patricia Baker

Mm-hmm.

François Vimard

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—we changed everything at the same time at the same time that clearly customers are looking for more value. But I will tell you that by having changed all the categories in all our stores at the same time it was maybe a bit too much.

And clearly we had assumptions, and those assumptions some are confirmed, some we can go better at it, and some we have to change—

Patricia Baker

Okay.

François Vimard

—some we have to change totally. And I think it's because internally we didn't even have the additional or the enough, I would say, knowledge to do it. Clearly, we seek information and support from an outside party to do it, and I think we did the best we could with what we had. But now there's a learning curve, and that we're working hard at it.

Patricia Baker

Okay. Fair enough. And then let's talk about the consultants and hiring them. And so essentially, I mean are you seriously looking at this from a return on investment perspective? Because at the end of the day everybody's known for a long time that taking complexity out and taking costs out of the business was an imperative. And now you have to spend some money hiring consultants to ensure that that happens. So you're really looking at this hiring of consultants from

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an ROIC perspective where you expect you will get a good payback on that particular spend, which we know from other grocers who've spent on consultants that bill can mount.

François Vimard

Yeah. No, clearly we're looking at that on an ROIC. And the role of the consultants I see that on two points. First, sometimes it's good to have somebody to show you a mirror of what you are really because you have a hard time looking at yourself. And second piece is to force the discipline to challenge some internal paradigms that we didn't want to attack in the past.

And those are two key reasons why I feel the consultant is necessary. And that's in that phase that we're using them. And that's clearly going to return the capital, clearly.

Patricia Baker

Okay. Fair enough. And then when you talk about the complexity, I mean one of the first things that occurred to me—and I don't know if you're going to be able to answer this—is the fact that you've got such a decentralized regional structure a bit of a complexity in the business?

François Vimard

I would say at this stage, Patricia, it's way too early to answer this. We're looking at everything, as I told you, and we'll come back with more information for the future. And bless you, Patricia.

Patricia Baker

Yeah. Okay. Thank you. I'm going to stop now.

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**Operator**

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

Jim Durran — Barclays

Good morning. As we look out over the next few quarters I just want to get a sense from you for clarity on how you see gross margin investment proceeding from here? And also are there things you can do to restrain the amount of SG&A growth we saw this quarter? So back to gross margin, I mean we saw a 70 basis point investment this quarter. Do you expect that that's going to have to increase to contribute to stabilizing volume? Or can you hold the line?

François Vimard

As you know, Jim, we don't give outlook, but clearly margin investment that we have done so far will continue to be necessary to support our approach. So clearly, and like I said, many adjustments will be done category-by-category to ensure we're getting the most out of it.

On the SG&A side, some clearly will be looked (phon) in terms of they were more on the temporary basis. And clearly we'll try to define as fast as we can elements that either with consultants or we are already have identified that we can act on on short, mid, and long term. So SG&A as a trend in the midterm it should go down, and that's the purpose of the work we're doing.

Jim Durran

And I mean we did a back of envelope estimate on what your comp-store sales were in the rest of Canada based on your disclosure in the press release. It would certainly look like it

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deteriorated fairly significantly. We had an estimate of 1.2 percent decline. Was that mostly deflation? Like is traffic holding up reasonably well in the rest of Canada?

François Vimard

Like I said, I don't give any details, but overall what we saw is it was mainly basket size that went down across the country. And two-thirds of the decrease itself is basket size, one-third is transaction. So you can think about the same philosophy for the rest of the country.

Jim Durran

Okay. And lastly just on the complexity question, like what other elements of complexity do you believe you have in your business that could be eliminated? Obviously a tougher market makes it less tolerable to have these shortcomings, but I mean there was a stretch of time where the Company had extremely good performance and the complexity didn't seem to get in the way.

François Vimard

Yeah. But I think what the market's telling us is that clearly the current complexity creates a lack of nimbleness, like I said. So complexity is at every level. Everything's going to be looked at, like I said.

And it's not only a complexity the way we're working internally, but how we work also with our external partner.

Jim Durran

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And a last question, just are you in a position where you could give us some indication as to how much expense we should expect with respect to the consultants?

François Vimard

Not at this stage, Jim.

Jim Durran

Great. Thank you.

Operator

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

Keith Howlett — Desjardins Securities

Yes. I was wondering when you introduced the lower price points in Western Canada centre of the store focused what your trends were around the perimeter of the store in the fresh department?

François Vimard

You're starting to ask too much detailed question. As you can imagine, my competitor will be happy to know all this. What I can tell you is right now the overall trend is not where it should be, and fresh is something we need to focus and differentiate us even more. So overall trend is not where it should be.

Keith Howlett

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And then just a question on customer data analytics; you had your own royalty program, I guess, in some regions and now it's, I guess, Air Miles across the country. But wondering how much access or ability you have to go through that data to assess some of these price elasticity issues before doing it on a broader-based flier basis?

François Vimard

We have a tonne of detailed data customer-by-customer and basket-by-basket, product-by-product on a daily basis, and we understand pricing and reaction of volume so we can see up to the nitty-gritty detail.

Keith Howlett

Great. Thanks very much.

Operator

Your next question comes from the line of Irene Nattel of RBC Capital Markets. Your line is open.

Irene Nattel

Thanks. Just another question, if I may. I've noticed that here in Quebec you've gone back to the cents off, the gas coupons, and at times there have been stamps that have been offered. So are you kind of modifying the Simplified Buy & Sell a little bit? Or was this always part of the plan?

François Vimard

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No, it's always part of the plan. The Fuel for Food is always a good program even in the context of Simplified Buy & Sell. Clearly, you need activity and customers like those promotions, and so it was always part of the plan, Irene.

Irene Nattel

Thank you.

Operator

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

Peter Sklar

François, on the Simplified Buy & Sell it requires a lot of work on the part of the vendors. How has the cooperation been from the vendors? Is that one of the issues that it's taking some time to bring the vendors on side in terms of their net pricing? Or have they been pretty good in terms of opting into the program?

François Vimard

Peter, you don't make that level of change in an industry without having people that are challenging those changes. So clearly we're working with our vendor community to understand that how as a partner we can overall grow our business. And that's part of the learning we have over the past few months, and we're going to learn from that and move on for the next few quarters on this.

Peter Sklar

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Okay. Thank you.

Operator

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

Michael Van Aelst

Thanks. I'm just trying to understand some of the, I guess, uses of the cost savings that you're working on with the Boston Consulting Group. Do you see the need to invest further in cost reductions—further in price investments, sorry? Or could we see those cost reductions flow through to the bottom line and help restore margins?

François Vimard

I would say that the price investment that we need to do will be to ensure that overall we are the most competitive in the market where we need to. But at this stage—and the cost reduction is a part to fuel it also, but also change the trend we have on the earnings side. So it has two purposes.

The overall margin we're going to have at the end at this stage, like I said, there's still a lot of work to do in terms of understanding where we can get the optimized margin value out of it. So more work has to be done, and at this stage it's difficult for me to give you an outlook on that.

Michael Van Aelst

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Okay. And where would you stand in terms of the consideration of... or the process of considering rolling out the discount banner in the West to help deal with that trend towards value rather than simply doing it in your higher-cost conventional banners?

François Vimard

Clearly then, as you know, we have a lot of experience with Ontario. And there's markets where the demographic and I would say the customer demand it's clear that a different format will make more sense. And so that's something clearly as part of our portfolio that we're looking at.

Michael Van Aelst

Are you able to give us any timing of decisions for that?

François Vimard

Let me be a bit blunt with you. Clearly, even if I was announcing that tomorrow I'm going to launch it I won't say it on this call, so as you can imagine. But clearly it's something that we're taking seriously.

Michael Van Aelst

All right. Thank you very much.

Operator

Again, if you would like to ask a question, press *, then the number 1 on your telephone keypad.

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

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**Chris Li**

Hi. Good morning. Sorry, just one quick follow-up. Just in the absence of permanent CEO, do you think there's a risk that come early next year your consultants propose to you a set of recommendations and then the new CEO comes in and he or she might not fully agree with some of the changes, and then you might be back to sort of looking at your strategy all over again. Do you think that's a real risk? And if so, how do you sort of mitigate that from happening?

François Vimard

That discussion, and clearly it's a discussion I have with the Board on a regular basis, the Board is fully supporting that it's part of the overall process even when we look at a new CEO. So the goal is to be everybody aligned, and whoever comes onboard when they come onboard will be aligned with that too.

Chris Li

Okay. Thank you.

Operator

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

Vishal Shreedhar

Hi. Just wanted to circle a little bit back on the price reduction part of Simplified Buy & Sell; just given the deterioration in EBITDA that you've seen even beyond management's expectation, as I

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think you indicated, I just wanted you to remind us on why it's so important to implement these lower prices? And just to give you some colour on why I'm asking it, so under a traditional higher-price regime called the old way it's not obvious to me that Empire would have hit these low-profit trends using the old approach. So just wanted colour on what's ultimately gained from this approach and why management feels so confident in that?

François Vimard

And overall, Vishal, is the question of providing the right value for the customer, so the balance between offering service and price. And I think we know from trend that the customer is even more asking for more value overall, and that's on that basis that we're making those changes.

Vishal Shreedhar

Okay. Thank you.

Operator

There are no further questions at this time. I return the call to our presenters.

Ken Chernin

Thank you, Chris. Ladies and gentlemen, we appreciate your continued interest in Empire, and look forward to having you join us on our third quarter fiscal 2017 conference call on March 15th.

Good-bye.

Operator

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