

FINAL TRANSCRIPT

Empire Company Limited

Third Quarter Fiscal 2017 Results Conference Call

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PRESENTATION

Operator

Good morning. My name is Kelly (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the Empire Company Limited Third Quarter Fiscal 2017 Results Conference Call. All participants are in a listen-only mode.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask 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.

I will now turn the call over to Ken Chernin, Director of Investor Relations. Mr. Chernin, you may begin your conference.

Ken Chernin — Director, Investor Relations, Empire Company Limited

Thank you, Kelly. Hello, and thank you for joining us. Our comments today will focus primarily on the financial results of the third quarter of fiscal 2017 ended February 4, 2017. 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 Michael Medline, President and Chief Executive Officer; Francois Vimard, Executive Vice President; 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 Michael, who will discuss operations. Clinton will then provide a review of Empire's financial results.

Michael Medline — President and Chief Executive Officer, Empire Company Limited

Thanks, Ken, and good morning, everyone. This is the first time that I get to talk to you, our shareholders, as a group.

I'm extremely pleased to be part of the Sobey's Empire team. I've been busy the last two months travelling the country, walking stores with our regional teams, and assessing our assets, strategy, and opportunities.

I'm not going to spend my remarks reporting numbers that you can read in our news release. I want to give you colour on what we're seeing. And let me start with some positives.

We have a proud history with 110 years of serving our customers, a latent legacy of success, a loyal and committed workforce. We have broad and deep retail talent throughout the organization.

We have a store network that can improve, but is in good shape; a strong consumer franchise in Quebec and the Atlantic region; a well-run and increasingly successful discount banner

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in Ontario; a massive national scale that hasn't been fully realized; and we have a board and controlling shareholder who are truly committed to long-term shareholder value.

Having said that, our results over the last six quarters have been extremely disappointing; this quarter was no exception.

Our top-line results were negative. Our bottom line is nowhere close to acceptable. However, it is apparent to me that we have the assets to put numbers up on the board. There is plenty of opportunity here. It is up to management to seize these opportunities.

We have been facing a number of retail issues, all of them fixable. We just need to focus and proceed in a methodical manner to tackle them.

We will take aggressive and bold actions to address the issues in our business, and we are prepared to make the tough decisions and decisive actions necessary to see Empire return to sustainable, profitable growth. We need to put in place a clear focused game plan, and then execute with velocity.

Based on early observations, I have identified four areas that we must focus on, both in the short term and over the longer term, to fundamentally improve Empire's performance. For a while on these calls I will organize my thoughts around these four priorities.

First, we must address our Byzantine organizational structure, which has created complexity and duplication, and create clearly defined accountabilities. This will result in cost

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savings, allow us to take advantage of our \$24 billion scale, and let us move fast and with consistency.

We will improve our cost structure and streamline our decision-making process, which will enable us to better serve our customers, and respond and capitalize on changes in the marketplace. We will do so without giving away the local flavour so key to grocery. We are making good progress on this work to simplify our structure.

Second, we must take significant costs out of the business. We will be smart and aggressive in how we approach this.

We will be executing on quick productivity wins; low-hanging fruit. There's a significant cost-reduction prize in materially improving some pretty basic retail processes.

Francois spoke, on our December call about undertaking significant work to tackle both organizational, structural complexity, and our costs across all of our company. I am pleased with the progress we are making.

We have made good headway in recognizing which costs to attack first, and work has now commenced. I am obviously personally engaged in this work. When we're ready, we will update you.

This will be a multiyear journey of progress and results, but there are expected financial improvements throughout that journey.

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Third, we need to really work on our brands, our understanding of our customers, and our marketing. Those of you who know me will understand how crucial I view this area. I am not going to mince my words with you.

I am disappointed in how we have approached our customers. Our ability to understand our customers and effectively communicate with them has been sorely missing. And interestingly, it's not that we don't have data, or don't possess an ability to crunch this data. In fact, we're good at that. We just haven't emphasized brand customer marketing. And this has been a significant factor in leading us to the top-line issues we are now seeing.

Look, a food retailer must be priced right, but that's table stakes. It is critical that we offer a broader and more compelling value proposition which goes beyond price, as that alone won't be enough to welcome our customers back into our stores.

Customers are compelled by a value proposition of which price is just one component. Therefore, we will communicate our value proposition in a far more effective exciting way. We have gotten away from that. Work has already begun on this portion of the journey.

Fourth, we must and will fix the West. It is clear that we have damaged our relationship with our customers. We have made some questionable decisions when it comes to our Safeway integration.

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We have market share to make up. We are devising a strategy to welcome our customers back, and address our top- and bottom-line performance. For competitive reasons, as you understand, I do not wish to elucidate on our particular Western strategy today.

Just a few concluding remarks. I've gone deep in terms of understanding our FreshCo business in Ontario. It is resonating with customers and continues to improve.

Of course, as you would expect, we are looking at the feasibility of expanding our discount banner outside of Ontario. This would take significant planning, work, and analysis. We are not ready to make a call on that yet.

Deflation is certainly a hurdle for us, as it is for the food retail industry in general, but most of our issues are self-inflicted. Fixing these issues will necessitate a great deal of change at our company.

Our first priority must be cost reduction. Taking costs out will enable us to do three things: first, let us move fast and efficiently; second, reinvest savings into marketing; and third, improve our bottom line, which we owe to you.

We are also putting our capital expenditure plans under the microscope. Frankly, given the returns we have seen on capital deployed over the past few years, we have not earned the right to spend at these levels.

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We are implementing a disciplined CapEx program, which will scrutinize every dollar we spend of your capital. The real prize is going to be getting far better returns out of our current assets.

We see plenty of opportunities in the square footage we have today to generate superior returns. We are not going to spend our way out of the issues that face us. I should be able to update you on our fiscal 2018 CapEx plan on our next quarterly call in June.

In closing, I can tell you I am very excited to be a part of this iconic Canadian company. There are a myriad of opportunities to improve our company and our results. It just takes some time, hard work, and plain old-fashioned resolve.

Getting these things right will improve our results, and give us the inner underpinnings to innovate, to thrill our customers, and to beat the competition.

I will now turn the call over to Clinton.

Clinton Keay — Interim Chief Financial Officer, Empire Company Limited

Thank you, Michael. Same-store sales for the quarter, excluding the impact of fuel sales, decreased by 3.7 percent from the same period last year.

Consistent with past quarters, ongoing sales challenges in the West and soft sales trends across most of the network contributed to these poor results. Excluding the impact of fuel sales and the West retail business unit, same-store sales decreased 2.6 percent.

Our internal food inflation for the quarter was calculated at negative 2.2 percent.

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Gross margin percentage for the quarter was 23.7 percent, relatively flat to the same quarter last year and the second quarter of fiscal 2017. Gross margin continues to be impacted by investments by the business to drive customer traffic.

Selling and administrative expenses as a percent of sales was 23.1 percent in the quarter compared to 22.4 percent last year and 23.1 percent in the second quarter of fiscal 2017. Obviously our sales challenges impact our leverage, and management continues to focus on cost savings in the current environment and will give further details of these initiatives in the coming quarters.

In regards to investment and other operations, Crombie REIT recognized strong financial results this quarter compared to the same period last year. Crombie experienced an increase in lease termination and lease settlements in the quarter. I will refer you to their disclosures for further information.

The Genstar Partnerships were significantly down from prior year to gains of \$19.8 million in the same quarter last year. It should be noted that earnings results of the real estate investments can fluctuate from quarter to quarter.

Free cash flow generated for the quarter was \$28.2 million, a decrease of \$111.8 million from last year as a result of our reduction in operating activities and decreased proceeds from real estate transactions, offset by decreased capital expenditures.

At the end of the quarter, our funded debt to total capital ratio was 34.7 percent versus 39.5 percent at May 7, 2016. Cash and cash equivalents equalled \$203.3 million.

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We are now happy to respond to your questions.

Q&A

Operator

And at this time, if you would like to ask a question, please press *, then the number 1 from your telephone keypad.

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

Michael Van Aelst — TD Securities

Hi. Good morning. A few questions for you; first of all you talked—Michael, thanks for the update, by the way, and your views—you did talk about going after low-hanging fruit and about focusing on taking costs out first, reinvesting in marketing, and then growing the bottom line. I guess how would you balance out the last two components, the reinvesting in marketing and growing the bottom line? Do you have to see the top line stabilize and your market share stabilize before you start to allow some of those savings to go to the bottom line?

Michael Medline

Yeah. It's a great question in terms of balancing, and we're going through our budgeting process right now in terms of next year. As we go through that budgeting process—and I don't want you all to get ahead of where we're at; we've got plenty of work to do—but there is an opportunity

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here to take some of these quick wins. And most of them, I think, it'll be later in the year when we see the run rate start to pick up, and we've got to be able to pick up that top line.

And so once we get that top line going, as you guys know, in this business that's what's really going to get us going. But it's got to go in order. We have to be able to get the structure in place. Secondly, we've got to take the costs out. Third, we've got to do a better job, not only marketing but understanding our customers, and get that top line going.

But I think all of this we're ordering as we go through and looking at it. I don't think that there's a choice of one or the other, like I said. I think we've got to invest more in marketing, and we've got to as we move forward put more in the bottom line. Our returns to our shareholders, they're just not acceptable.

Michael Van Aelst

Right. Thank you for that. And then—

Michael Medline

Thanks, Michael.

Michael Van Aelst

—when you look at the Simplified Buy & Sell initiative, what signs are you seeing that lead you to believe that it's having the desired effect, given that it's been in place I think for almost a year now in Eastern Canada, and the trends don't seem to be improving that much?

Michael Medline

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Well, I think it's ... Coming from the outside, I've got to say that these things take a little bit of time. It's not the moment that you're priced correctly or you make these big changes the customers don't just flood straight in.

I've got to tell you that I'm seeing some good signs, early signs of this being priced right working because we've made some great strides in being priced correctly and sharply across the country. We've talked mostly about our efforts in Quebec and in the West, but we've really cut prices in the Atlantic and Ontario regions as well. So while we still have some minimal price balancing to do, overall we're in good shape now.

And look, here's the thing, though. I think where we got away from it is you've got to be priced right, and that's pretty basic, but I think we've strayed away from talking about our overall value proposition. So Canadians should shop us for a variety of reasons, and we've gotten away from that laser-like focus on thrilling the customers and we got fixated only on talking about price.

And so everything that happened to me now looking back was predictable. We needed to be priced right for our customers. We're now generally priced right for our customers.

What we haven't done is given them other compelling reasons to come into our stores and shop us. And so we've got to see increased signage, we've got to see more units in the basket, but I'm pleased with some of the work that's gone on.

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We did it very quickly in a big-bang kind of fashion; perhaps it could have been a little bit more gradual. But we are where we are today, and I think going forward now we can really work with the customers because it's not going to be just a price conversation because we're there now.

Michael Van Aelst

Good. That's good to hear. And then just final question for now is on the SG&A side. In the first half of the year you saw that growth of around 5 to 6 percent at the OpEx line. In the third quarter it fell down to 1.7. Can you discuss some of the factors behind that change? I know that the first half of the year you talked about it equally being split between inflation, rent, and like I'm trying to remember the other one now. But if you could just describe what you see as being the main changes between I guess the run rate in the first half of that year and then what you're seeing now?

Clinton Keay

Yeah. Michael, I would say it's consistent with last-quarter comments that we've seen increases in inflation, as you said, and then the rental side as well that we had increased lease expenses.

Michael Van Aelst

So what allowed it to go down to 1.7 from the 5 to 6 percent growth rate in the first half of the year? Are you spending less on the Simplified Buy & Sell initiative?

Clinton Keay

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From last year—Mike, I'll tell you what, we'll just ... I'll follow up on that with you.

Michael Van Aelst

Okay. Thank you.

Operator

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

Peter Sklar — BMO Capital Markets

Good morning. On your gross margin percentage you held your gross margin; actually improved 10 basis points. And that is despite the investment in price you're making in the West, and I assume the tail end of the pricing you were doing for the Simplified Buy & Sell. So can you explain the dynamics of why your gross margin percentage stabilized? It sounded, Michael, earlier in your commentary on the call that the pricing with respect to Simplified Buy & Sell has largely been done, so maybe the stability reflected that. Could you just let us know what's going on there?

Michael Medline

Okay. First of all, this is the last time you're ever going to hear me use the phrase Simplified Buy & Sell. I don't like the phrase. It's pricing; it's for our customers. So we're not going to talk like that anymore, and that initiative is mostly behind us. So I'm going to let Clinton go into a little bit more detail on the gross margin, but I'd just like to say with our pricing initiatives mostly

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behind us, we do believe that our margins will stabilize over the next couple of quarters; however, we'll have to see how competitive the market is.

We're not going to—we'll be competitive out there, and we'll be seeing what's going on.

Clinton Keay

And in terms of the margin, the 10 basis points, mainly due to the margin I just call it the balancing in terms of the mix that we've had. Certainly what we've seen, we had our launches last year with the Simplified Buy & Sell and throughout that period we've been course-correcting, and I would suggest that's the stabilization of the margin that we've seen.

Peter Sklar

Okay. And, Michael, have you spoken—have you actually—when you did your traveling across the network have you actually spoken to Safeway customers? And what's your perception of the issues that's taken the Safeway customer out of the store and they've gone to competitors' banners?

Michael Medline

We only have an hour here, Peter. I've got to—I'll keep my comments short. Yes. I have. I think—trying to think of what a whirlwind it's been, especially in the first couple weeks. But I immediately went out West, which I knew I would, and spent time both with the team, spoke to our employees in the West, and spent a lot of time in stores, and continue to do so. In fact, I'm on the

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West Coast right now. We were in Victoria yesterday—sorry, two days ago visiting Thrifty stores, and we were in Safeway stores yesterday.

I've also been with—a group of us have been attending focus groups that we've been doing in the West to understand better how we can win our customers back, especially the Safeway customers.

Look, I don't know if there's any use in me going back and rehashing some of the decisions that I explained on my conference call script that were questionable. I wasn't here. I didn't know what pressures we were under. It was not a smooth integration.

And I go back to my point that I believe that the understanding of the customer has been sorely missed. And that some of the decisions made would not have been made with a better understanding of what differentiated Safeway customers from Sobeys customers from our competitors' customers, and what they held dear.

And in my experience, my long experience with different banners, when you take away what's dear to customers there's a grave effect, and it's a lot easier to lose customers than it is to win them back. The focus groups and some of the other work that I'll talk off-line if anyone's interested in terms of how we're looking at customers and understanding customers in a way we've never done before but that I'm more used to, indicates to me that we really did let them down. But there's a latent loyalty to Safeway in the West that we have to be able to recapture.

Does that help?

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Peter Sklar

Okay. Yeah. That does. And then just my last question; in your fiscal Q4 I assume you're seeing increasing deflationary trends. I'm just wondering, is that impacting competitive intensity within the industry as you look across your regions?

Michael Medline

We haven't seen—well, let me phrase this perfectly. Yeah. We're continuing to see deflation; however, this is a very competitive sector, and it's always competitive. We do not see increased competitive intensity that we haven't seen over the last 6 or 12 months.

Peter Sklar

Okay. Thank you.

Operator

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

Jim Durran — Barclays

Good morning. Can you give us some idea as to whether your tonnage or traffic in the West has stabilized yet? I mean given that the gross margin was actually up, I would assume that there was some positive indications on trend whether it was less negative or potentially turn positive?

Michael Medline

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Yeah. I don't think I can do that right now because I'm in the middle of a next quarter; however, I think we're starting to see some signs that it's—how would you say it—less negative. I wouldn't be popping champagne corks yet, though.

Jim Durran

So I guess we can't say that we're yet at stability at least, right? There's still work to be done.

Michael Medline

Oh, yeah, there's lots of work to be done on these things. But the top-heavy lifting in pricing, a lot of the work the team's doing I've seen some good things going on in-store, but we haven't communicated with our customers. And we're not quite sure how to do that at this point. So I think when we can do that and be able to tell our story and be able to fulfil that promise in the store to our customers, that's when you really turn.

So it's degrees of happiness at this point, right?

Jim Durran

Yeah. In terms of you, the management team, and BCG sort of working together to finalize details of a plan, should investors be expecting communication of sort of the broad strokes of the plan when you report Q4? Or how do you see this unfolding?

Michael Medline

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I've been reading all the analyst reports. There's a lot of pressure on Q4 for me. Let me say it this way. We're going to work ... We're going to move with a tremendous amount of velocity, but we will not be rushed. And so I believe in Q4 that you'll see progress and we'll be able to tell you more progress, but I don't think Q4 will be the grand unveiling of our strategy going forward.

At the same time, we are doing all sorts of things. It's pretty clear I think from my comments some areas where you can see where we're moving toward. So I'd like to—I don't think there will be and I'm not quite clear a lot of companies have this great unveiling of a strategy, but Q4 we will be in more detail on some of the elements that I talked about, especially the first two elements which were structural—or organizational structure and taking costs out.

In some areas—and you know I like to be transparent, but for competitive reasons I don't want to also broadcast a lot of the things that we have planned, some of which we've made decisions on and some of which we still have to make decisions on.

Jim Durran

And so my takeaway would be that you are already implementing perhaps some cost-reduction initiatives, and will have done more by the time we get to the end of June for the Q4 reporting period. So you're not waiting—

Michael Medline

That's right.

Jim Durran

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—for that moment.

Michael Medline

Jim, that's exactly right, but I don't want you all running too far ahead here because ... and jacking what you think we're going to be able to do in the next quarter or two. These things—we're in flight now, but it does take time to get the run rates up.

Jim Durran

And what do you have to learn on the discount side to drive a decision on whether FreshCo will appear in Western Canada or not?

Michael Medline

It's a very complex decision and one that we wouldn't ever take without a lot more work and study. I think as I said—and I'm not sure we bragged enough about how FreshCo is developing in Ontario. I've done some deep dive into that aspect of the business, and I'm pleased with our growth there, and where we're heading, and the leadership in that discount group. We'd have to be far more assured that there's a place for us in those markets that we can compete.

And these things aren't overnight successes; you've got to win customers over. And so where would we play? Is there room? And you heard me say that I'm not keen on spending a lot of capital in the next little while, so we've got to be very cautious how we spend capital until—and really sweat our own current assets out a little bit harder. So we're not there yet.

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I'm happy with the Ontario business, but it's a big decision in order to be able to expand out. And it's a very complex decision that we're looking at.

Jim Durran

Do you have any leaning with respect to the conventional segment whether you should be a two-banner—sorry, three-banner player or less banners?

Michael Medline

No. I'd rather not speak about that today if that's okay with you, Jim.

Jim Durran

No. That's fair. Thank you. Appreciate it.

Michael Medline

No problem.

Operator

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

Irene Nattel — RBC Capital Markets

Thanks and good morning, everyone. Michael, again, I echo the comments; really appreciate you sharing your thoughts and your candour. I think clearly one of the issues that everyone is trying to struggle with is how long does it take to reconstitute what is acceptable levels of profitability? And like what does that look like? Is it a slow, steady uphill climb? Is it a hockey

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stick? Is it two quarters? Is it six quarters? And again, not trying to pin you down, but anything you can share with us around your thoughts at this point regarding what recovery looks like.

Michael Medline

Yeah. Thanks. It's a great question, and one I think about all the time and I talk to the team about. And this isn't obviously my first rodeo in retail in terms of trying to bring great change and you, Irene, know some of the background on that.

I think what these things do is they're—it's like I said, it begins with heavy slogging; taking the dumb out; best practices; taking the costs out; changing the culture. So I always want to see improvement. And then it becomes usually a hockey stick, but that's only when you understand your customers and you're really resonating.

So I'm not going to give how many quarters, and in fact I don't know exactly how many quarters it will take. I believe that the assets, including the people, we have the talent to be able to do this. And that was really what I was trying to assess especially in my first couple of months.

That doesn't mean we don't have to augment change. We have a lot to do, but we have some real food retail talent and retail talent throughout the organization, but I'm trying to state this which is we have not delivered to our shareholders what they deserve.

And the fastest way to do that is to get at those costs. And as I said, there will be—to get a run rate will take a little time. I think you can see now, and I can't speak for what's going to go on in the industry, et cetera, but I think we're in a good shape on margins. And then it's a question of

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getting the customers back, and that is not an overnight success, but I think—well, I know we'll get there, but we've got some more work to do.

Irene Nattel

That's very helpful. And I really don't want to put words in your mouth, but it sounds to me to like what you're delivering, Michael, is the message that, hey, kind of we have an idea of what we need to do, but it's going to take time and don't get ahead of us in terms of your expectations. Is that fair?

Michael Medline

Yeah. Because I think you can hear me that I'm not pleased with the results. I see, as I said in my script, a myriad of opportunities, and all these opportunities are fixable. There's a number of them, but they're fixable, but sometimes when I can see it's not tomorrow. The team can't go at it and fix everything tomorrow.

So we're chunking this out and taking it and putting process in to make sure that we can consistently improve as we go forward, but I just—I've only been here two months. I don't want to overstate what we could do in two months, although I'm happy with where we are.

Irene Nattel

That's great. And just one final question, if I might, and this goes to the whole idea of rolling out discounts in Western Canada. Presumably you need to stabilize the existing business

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before you can start rolling out new formats that likely are going to deliver lower returns at least initially.

Michael Medline

Yeah. That sounds right to me.

Irene Nattel

Okay. Thank you, Michael.

Michael Medline

Those were good words to put in my mouth.

Irene Nattel

I try.

Operator

And your next question comes from the line of Mark Petrie from CIBC. Your line is open.

Mark Petrie — CIBC

Hey. Good morning. I just wanted to follow up on a few topics that have come up already. And I guess organizational complexity is one we've heard a lot about from Empire for many years actually, and I guess I just want to hear from you. What are the biggest hurdles or barriers for the Company as you go to execute on that? And it seems like you have support from the organization, but where are the risks on execution?

Michael Medline

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Okay. Well, let me start off pretty generally and then I'll try to go a little bit more deeper, but we're going to have to make some crucial and tough decisions. And management before I was here correctly brought in outside experts to help us tackle these organizational and cost structure issues, and any company worth its salt would have made that decision, that same decision.

And as I said, I'm pretty—well, I am very engaged in this work. I can tell you straight out that our highly regionalized structure is hindering our ability to make decisions; use our scale; have consistent practices; and take costs out. There are significant opportunities here, but we need to get on with it.

And I believe that there is a strong appetite within the organization at every level for change. And so I have not encountered a lot of roadblocks in terms of the team being able to make the changes we're going to make. They're going to be complex changes, they're going to be very different from what the Company is used to, and there's a strong culture here. And so we're going to have to change the culture and the structure in terms of how we do business.

We have not come out exactly in terms of all the changes on it. We're getting there. Otherwise, I would tell you today what it was. But mostly it's just taking the time.

I mean I'm relatively new in the organization; don't want to do harm and slow down any progress we're making in other areas. But I can tell you, every single day that goes by I realize that the current regional structure we have is very, very difficult to get things done, yeah.

Mark Petrie

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Okay. Thanks. And then just coming back on the Safeway business, you mentioned that communicating better with customers is probably your top priority, but also there's an element of delivery that value proposition in-store. But at the same time, it sounds like you're satisfied with the price position broadly. So aside from the marketing and communicating with customers, what do you believe you need to improve in the Western Canadian operations?

Michael Medline

Some—I think it's—and you can't just talk; it's not all marketing. You've got to stand behind it. I'd say that it's not clear enough yet in our Safeway stores, and many them—and I've walked many of them—I'm very proud of what we stand for and how we're differentiating ourself in-store from our competitors, and what we're going to be able to brag about.

And I think that there's some work there in terms of our offerings, what we call internally commercial programs, in terms of how we can thrill our customers when they're in the store and really what we stand for.

I was walking the Thrifty Food stores in Victoria earlier this week, and it's so clear what those stores stand for. And you can feel the emotional connection between the customer and the employees and the customers in the stores. And Safeway, we can do that. And we're not that far from being able to do that. And the team is highly engaged, and we've put even more talent out West to be able to do that.

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So it's not just the case of you can't just market. You've got to market according to your strengths, and you've got to market and connect with the customers when you have a good story to tell. We've got some work to do there, but it's not miles away.

Mark Petrie

Okay. That's helpful. Thank you.

Operator

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

Michael Medline

Hey, Tal.

Operator, you want to move on?

Operator

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

Vishal Shreedhar — National Bank

Hi, Mike.

Michael Medline

Hey, Vishal.

Vishal Shreedhar

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Just a quick one on your outline of approach here, and I recognize it's early, but you mentioned cost optimization, org structure, looking at discount, et cetera. These comments were made by prior management as well, and I know the details are probably more important than the high-level points. But as a result of implementing your approach, what would you say are the biggest changes that the Empire org might see in the next ... in the coming quarters?

Michael Medline

You're right, though, but we've talked a lot about things in the past, and I hate talking about things. I like to actually talk about what we've done and actions. I'm not sure because we haven't come to final decisions on org structure and haven't spoken to the organization as much as I would like that I want to share any more on that today, if that's okay with you.

And we'll talk more about that as we go forward.

Vishal Shreedhar

Okay. Fair enough. Just on one of the other comments that you made in your preamble, you indicated that Empire has to earn the right to spend, which sounds sensible. Just wondering if that logic applies in other businesses like drugstore? Could Empire investigate maybe divesting of certain assets which they potentially deem noncore?

Michael Medline

I mean we'll look at anything that makes sense for our shareholders, for sure. However, at this point let me be quite clear that the current intention is not to part with an asset like pharmacy.

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And one of the reasons is because I am very used to be able to use some of these related businesses to really drive sales and customer loyalty to our core business; in this case, grocery. And I think that there is a lot of opportunity that's been taken and some still to come in order to really tie these businesses together in terms of a great customer value proposition.

Vishal Shreedhar

Okay. And this question may have been asked earlier in the call in a different way, but obviously you have a dashboard of probably 100 metrics that you look at on a regular basis in order to determine if the business is moving in the right way. For an investor if you had to point out a few high-level metrics that you'd say this shows that we're moving in the right direction, what would those be? Would it be ROIC? Would it be same-store sales growth? Would it be EBITDA margin, kind of the standard retail margins? Or is there something you'd point ahead of the others?

Michael Medline

Yeah. That's a great question. And there are a lot of numbers I look at. But I'm a simple person, and so I come down to same-store sales and the bottom line because I don't think you can cheat those two numbers. And that's how I've always looked at retail.

And in terms of us in terms of looking at whether we're—how we're stabilizing, I would think that you should look at margin very closely in this period of time because we've gone through so much margin deterioration due to a number of factors, but including our own rebalancing our pricing in order to get it right for our customer.

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You should continue to watch the same-store sales. That to me is the number one number that I watch, and so that's how I'm looking at it pretty simply right now.

Vishal Shreedhar

Thanks a lot for your colour. Good luck.

Michael Medline

Thank you so much.

Operator

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

Patricia Baker — Scotiabank

Oh, thank you very much. I have a series of questions this morning. Good morning, Michael.

Michael Medline

Good morning, Patricia.

Patricia Baker

So first of all, when you mentioned—and you may have answered this before, but I got distracted—when Peter asked the question about the gross margin he referred to it as having stabilized this quarter. And I think Clinton also rephrased using the stabilization descriptor. Would you say we are at a point where the margin has stabilized?

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Michael Medline

Yeah. We believe that it's stabilized, but we have to—the only reason I even pause is because it's a competitive marketplace—

Patricia Baker

Yeah.

Michael Medline

—and we continue to compete. And so we will compete. And so we're not going to give away market share. And so ... But I think you can see here that we believe that the great preponderance of our pricing initiatives are thankfully behind us, and that we are in good shape to compete on a whole value proposition.

Patricia Baker

No, because it's nice to see because we had six quarters of consecutive margin decline, so it was quite welcome to see that in this quarter. Did you actually give us what basket deflation you experienced in Q3?

Clinton Key

We did not—

Patricia Baker

Will you?

Clinton Key

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—from a basket size. From a standpoint of that, I mean the deflationary part of it, I think, drives it. There's certainly a relationship between the deflation we recorded this quarter and the basket size.

Patricia Baker

Okay. Another thing, I guess a broader question for you, Michael. Everybody's trying to get at your time line, and when is it going to turn? When is it going to turn? And I understand why people what the time line. And I think it's been said before by primarily Francois has been giving us the message for a long time that we have to be very careful and assume that when you're trying to get a customer back that does take a long time. Empire will not be the first retailer that's really—that has in history reset course. And if I look back at other companies that have done that, it typically takes a minimum of 18 to 24 months to get that done, and that's probably the time line we should be looking at.

And I'm not trying to put words in your mouth there at all, but in your opening remarks you did indicate that as you got at the things that you're going to get at we will see not a magic turn. What we will see, improvements, slow and steady improvements as we move through time before you get to the final goalpost or runway of getting those customers back we will see improvements operationally. Is that fair to rephrase what you said?

Michael Medline

That is 100 percent what we're aiming to do, 100 percent.

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**Patricia Baker**

Okay. Okay. Thank you. Next point, first of all I want to congratulate you on using the word Byzantine in an earnings conference call; don't think I've heard that before. And then given that you made that with reference to the change in the organization structure, I applaud the fact that that's the first thing on your agenda because I think there could be amazing big wins there. And you've gone far in discussing the fact that it will help you not only on the cost side, but in better decision making. But as everybody's waiting for, or has been waiting for the reveal of a big overarching strategy, as I read the MD&A and the fact that you've identified four key areas that you say you're going to focus on driving fundamental improvements in the business, both in the short and the long term, is it fair to say that really what you've laid out for here is your strategic framework more or less because these are the important things that you believe need to be tackled to reset the course for Empire?

Michael Medline

Yeah. I think these are some pretty good headings to—I mean when I've come in here and been investigating and looking at the data and travelling the country and looking at everything, I kept going back to these four points in terms of these are the things if we can—when we get them right will turn this into a highly successful company. And everyone's going to want to know—have a lot more meat on the bones of this, but it's a nice structure. And that's why I'm going to keep coming back to it.

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Patricia Baker

Okay. Good. So I'll think about it as your strategic framework. You referenced earlier that the management before you got there had outside consultants to help them determine looking at processes costs, et cetera, et cetera. Are the outside consultants still there?

Michael Medline

They are.

Patricia Baker

Okay.

Michael Medline

Thankfully.

Patricia Baker

Okay.

Michael Medline

But first off, let me be really clear: this is our work. This is management's work. This is Sobey Empire's work, not a consultant's work. We have to make the crucial and tough decisions, not a consultant.

And so Francois and the team and the board rightly brought in help, as I believe every single retailer does out there, to benchmark and push us and make us better.

Patricia Baker

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Mm-hmm.

Michael Medline

But at the end of the day they don't have to make the decisions; they don't have to run the Company. And so I am so glad that the consultants are here, but it's up to us to turn the fortunes of this company.

Patricia Baker

Since the most important thing I think you indicated that these things are put in this order for a reason, and that getting the organizational structure changed is a precursor to actually being able to get at the other important things that you need to get at, can we have some sort of a sense, or is it too early for you to tell us, how quickly we're going to see that shift?

Michael Medline

It's got to be fast.

Patricia Baker

Yeah. I know.

Michael Medline

There's no use fooling around.

Patricia Baker

Okay.

Michael Medline

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And it's not fair to the organization to tease this out too long. There's a lot of people who want to know how we're going to structure ourselves and how they can help make us a success. And I'm a—as much as I'm trying to temper things, and I realize things take a long time, I'm an impatient person.

And so we've got to do it the right way. We've got to think it through and be respectful. I do not intend to do further harm to this company through organizational structures, so I've got to work with the team to make sure we're not taking undue risk while we're doing that, but the faster the better. Let's get on with it.

Patricia Baker

So fair to say it's in process?

Michael Medline

Yes.

Patricia Baker

Thank you very much, Michael.

Michael Medline

Thanks, Patricia.

Operator

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

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Keith Howlett — Desjardins Securities

Yes. I had a question as to how you view the Sobeys banner and what it stands for? In some regions there's the Better Food For All and Jamie Oliver program. I'm just wondering what your thoughts are on the positioning of the Sobeys banner?

Michael Medline

Yeah. Keith, it's Michael. I'm going to be quite frank: I don't think our positioning with our customers in the Sobeys banner is where it needs to be, and work will be done and changes will be made.

So Better Food For All was fine for its time, and we've got to figure out a more compelling value proposition for our customers that will excite them and thrill them and get them in the store.

Keith Howlett

And then this isn't—unfortunately, I guess Sobeys was a bystander in the loyalty program. I don't know if debacle might be the word that the loyalty program provider didn't understand their customers. But how do you view the way ahead on loyalty?

Michael Medline

Yeah. I mean we're committed to the Air Miles Program. We weren't pleased, as Francois was clear on our last call. We're proud of our brand, we're going to build our brand, so we want everyone associated with us to do their best on that.

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I have looked at the data in lots of detail. I have met with our partners at Air Miles. I'm not going to say that the damage done in Q4—or in Q2 and Q3 was due to Air Miles. It certainly wasn't helpful, but the issues we have are our own issues. And I am convinced through the work we've done in the last six weeks especially that Air Miles is on track.

Our customers are very loyal to Air Miles, and that's why they sometimes get disappointed if they're not there. And I'm pleased with the progress and where Air Miles is going, and it will be an important component of our loyalty program.

Keith Howlett

And then in your four headings one of them related to the West business unit. But I was wondering what your overall view is on the Ontario business unit? Clearly FreshCo it sounds like you're satisfied with the progress and management there. How do you view the balance of the Ontario business?

Michael Medline

Well, I guess there's in my head I'd say FreshCo, Foodland, which I'm very pleased with, and Sobeys, which I think we're making good progress on. But I think some of the Sobeys issues are across the country and are not just with Ontario.

That's part of the frustration I have with some of the regional structure that there's differences even with Sobeys across the regions. But I'm pleased with how Ontario's being run in all facets.

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**Keith Howlett**

And then just finally on the wholesale business. I think this is a very large business for I'm not sure, but to Sobeys. Can you speak to what your thoughts are on the ... how the wholesale business fits with the balance of the retail business?

Michael Medline

I mean it's a good business on its own; it's extremely well-run. We've got some great leadership over in our wholesale business, and on its own it's a good business. And it gives us—it defrays a lot of our costs because it's a big ... It makes us bigger. So I'm very keen on our wholesale business. I mean it's a slow-growth good business, and I'm very pleased with it. I think it fits well.

Keith Howlett

Thank you.

Operator

And again, if you would like to ask a question, please press *, then the number 1 from your telephone keypad.

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

Tal Woolley — Eight Capital

Hi. We're going to try this again. Can you hear me?

Michael Medline

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Oh, hi, Tal. We can hear you now.

Tal Woolley

Great. Perfect. Sorry about that. Michael, my question just really had to do with the fact that while Empire was looking—the board had been pretty clear about the strategic direction that they were sort of heading in. And I certainly hear elements of that in your commentary today. I was just wondering in the time that you've been there what maybe are the new things that you've maybe brought to the board's attention that they weren't aware about previously?

Michael Medline

Tal, I want to keep my job.

Tal Woolley

Appreciate it.

Michael Medline

So I like this job. So I think it's—I mean this is a very savvy board, let me be quite clear.

Tal Woolley

Yeah.

Michael Medline

And the Sobey family are extremely savvy and knowledgeable in this area. And I think it's—they're behind ... The board and the family want this to be successful for all our stakeholders,

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especially our shareholders. And so they are 100 percent behind making the changes that we'll need to make to make this a fantastic enterprise.

I'd say that probably—it's a good question—I'd say it's on the brand customer marketing that I bring that—maybe not a surprise; these are smart people—but that I've been highlighting that type of work maybe more than I have the other. And I think we're all aligned in terms of the velocity that we have to move on.

Francois, is there anything else you think that—

Francois Vimard — Executive Vice President, Empire Company Limited

No.

Michael Medline

You've been watching me here, so.

Francois Vimard

You're doing a great job.

Michael Medline

Oh, yeah, right. So anything else, Tal?

Tal Woolley

I'm sorry, my implication was—yeah. No, my implication wasn't to suggest that there was a lack of foresight on the board's part, it was just to get an idea of what you're bringing to the table. But that's it for me. Thank you.

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**Michael Medline**

And there are a few other things, but I don't want to mention them today. I'll bring them up as they're more mature.

Tal Woolley

Okay. That's great. Thank you, Michael.

Operator

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

Michael Van Aelst

Yes. Thanks. Just one follow-up; you mentioned that you're not interested in spending a lot of capital right now. Can you update us on where you stand vis-à-vis your covenants? And how much this may restrict you in investing in strategic alternatives in the short term?

Michael Medline

Well, let me talk broadly about liquidity. And I mean first of all we weren't surprised with the ratings downgrade; I wasn't at least. And that our goal is, of course, to one day get it back to investment-grade, but it's pretty immaterial on our cost of borrowing on existing debt, and we have significant liquidity.

So I don't think—and I'm looking over at Clinton here—that the idea of being far more draconian with capital spend is a business decision and not a funding decision.

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How about that? Is that, Clinton ...

Clinton Key

That's fair, yes.

Michael Medline

Okay.

Michael Van Aelst

Okay. Thanks, guys. Can you clarify what the covenants are?

Clinton Key

That's not something we disclose.

Michael Van Aelst

Thank you.

Michael Medline

Thanks, Michael.

Operator

Your next question comes from the line of Kenric Tyghe from Raymond James. Your line is open.

Kenric Tyghe — Raymond James

Thank you. Good morning, Michael.

Michael Medline

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Hey.

Kenric Tyghe

Michael, you touched on your customer data and the fact that you not only have lots of it, but that you're good at running it. And that the opportunity you've—that Empire has missed in the past was perhaps in monetizing that data. How material to your mind is the opportunity around data? And does that opportunity to your mind fit into that low-hanging fruit bucket?

Michael Medline

It is material and it does not fit into the low-hanging fruit.

Kenric Tyghe

What needs to happen between here and there for you to be able to start better monetizing what is the opportunity around data within the organization?

Michael Medline

Just be—I think we have it, and we're really good at running it. It's a question of I think some of it comes down to organizational structure, and the kind of questions we want to ask. It's up to management, it's up to the operators to be able to figure out a strategy and then be able to use that data to really, really excite customers.

And that's the piece, that last piece of how to utilize the data—and you hear this so often from other retailers—that's where we have to pick it up. And in fact, I think we need—that's an area

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where we're good at, and I think we can be great. And we need maybe a little bit of help of people who are really good at that.

Kenric Tyghe

Great. Thanks very much.

Michael Medline

Thank you so much.

Operator

And this concludes the Q&A portion of today's call. I now pass it back to Mr. Chernin for closing remarks.

Ken Chernin

Thank you, Kelly. Ladies and gentlemen, we appreciate your continued interest in Empire, and look forward to having you join us for our fourth quarter fiscal 2017 conference call on June 28th.

Good-bye.

Operator

And this concludes today's conference call. You may now disconnect.

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