FINAL TRANSCRIPT

Empire Company Limited

Fourth Quarter Results Conference Call

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PRESENTATION

Operator

Good morning. My name is Lisa, and I will be your conference Operator today. At this time, I would like to welcome everyone to the Empire Company Limited Fourth Quarter Results 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.

Adam Sheparski, Senior Vice President of Finance, you may begin your conference.

Adam Sheparski — Senior Vice President, Finance, Empire Company Limited

Thank you, Lisa. Hello, and thank you for joining us. Our comments today will focus primarily on the financial results of our fourth quarter ended May 6, 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; Mike Vels, Chief Financial Officer; Clinton Keay, Executive Vice President, Technology and Lead of the Transformation Management Office; Lyne Castonguay, Executive Vice President, Merchandising; Jason Potter, Executive Vice President, Operations; and Pierre St-Laurent, Executive Vice President, Quebec.

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

These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. I refer you to our news release and MD&A for more information on these assumptions and factors.

I will now turn the call over to Michael Medline, who will discuss operations. Mike Vels will then provide a review of Empire's financial results.

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

Thanks, Adam. Good morning, everyone. I've got to say, even though our results are not close to where they will be, I was pleased with the progress we made in the quarter, and what the team is beginning to accomplish.

These are exciting times at Sobeys. We are running the business while transforming it, and we'll spend some time on this call talking about both.

I'll talk generally about our results, including working capital and CapEx, and then I'll get to our four priorities, which will include some more colour on our Sunrise transformation.

First, results. Our efforts in the quarter to stabilize margins have taken root. We were disciplined with our costs, and we saw some real progress on comp store sales.

I hate negative comps, but for the first time in 17 quarters we grew tonnage. Implied deflation was actually higher than our comps. Well, that's progress. And given all this and some great financial leadership by Clinton Keay, we generated free cash flow.

By managing all aspects of our working capital this quarter, we reduced our Sobeys bank debt to zero at year-end, and we still have more work to do to improve our working capital metrics.

Subsequent to the year-end, Sobeys established a new $500 million non-revolving bank facility with terms consistent with the existing bank facility. This facility reinforces our strong and long-standing relationship with our banking syndicate, and proactively addresses the medium-term notes maturing in calendar 2018.

As I said on our last call, we have good underlying assets, including our stores and people, and we saw a glimpse, a glimpse of that in our fourth quarter. But we have a long way to go. We're not out of the woods yet. We are buckling down for tough work, and we have to win back customers who we have gravely let down, particularly in Western Canada.

Our number one priority right now is cost reduction, but we cannot cut ourselves to greatness. We must exceed our customers' expectations, and we must be innovative to win.

Last quarter I said we would put capital spending under a microscope. The result was that we will cut capital spending back to $350 million in fiscal 2018; half of that number is maintenance capital.

The big prize for us right now is to grow sales and improve profit from our existing stores. We have clearly destroyed shareholder value in our capital spend, and that has to stop. Where we do see high-return projects to spend on we will increase CapEx going forward, but not until then.

I should mention that one of the reasons we can cut back on CapEx is the excellent investment we have made over the last few years on our supply chain, notably our distribution centres. As at the end of fiscal 2017, we wrapped up the significant CapEx spend to put in place a best-in-class DC infrastructure across our entire business.

We anticipate the operational cutover of our third automated DC in Rocky View, Alberta, to be completed by the fall of 2017.

Now as promised last quarter, I'm going to organize my thoughts today around our four key priorities. First, we must address our complicated organizational structure, which has created complexity and duplication.

On May 4th, we launched Project Sunrise, and there are three phases to Sunrise: reset our foundation, unlock our scale, and move from defence to offence.

I can tell you that we are right on plan since May 4th. I am excited about the velocity with which the team is working, and it is already a much easier structure to run. We are giving our best talent more responsibility. We will tomorrow be announcing internally the next level of the organization: the vice presidents.

As we move to a less complex, functionally led business, there will be a significantly smaller number of VPs by taking out levels, increasing span of control, and eliminating duplicate positions.

Second, we must take significant costs out of the business. Again on May 4th, we also announced the attainable goal of taking $500 million in costs out of the business. We need these savings to be competitive. We expect the majority of these cost savings to fall to the bottom line.

As we see opportunities to reinvest in the business, to drive sales with a quicker payback in areas like marketing or customer-facing technology, we will do so. Our early work on these cost initiatives are progressing well. We expect to see the very beginnings of these savings to manifest themselves in Q3.

Third, we need to really ameliorate our brands, our understanding of our customers, and our marketing. Interestingly, even before we get at this, Leger in its highly respected survey of Canadian companies recently named Sobeys as the most admired grocer or convenience store brand in Canada.

So as I've been saying, we have a strong base to build on, but we are nowhere near where we need to be on brand, customers, and marketing.

We have now completed our own nationwide study of over 6,000 Canadian consumers, and have analyzed this alongside our own robust internal data. We will incorporate these findings into our strategy to thrill Canadian grocery customers and allow us to compete more effectively. Lyne, our chief merchant, has been leading this crucial work.

As well, we will be able to announce relatively shortly the appointment of our new senior vice president of marketing.

Fourth, we need to fix the West, where we have been sorely letting down our customers. I am pleased with the work Jason and his team have been doing in the West. We saw real progress in store execution and promo mix. That allowed us to improve our comps in the West—still negative—but pretty close to our comps in the rest of the country.

Jason and Lyne are focused on formulating and implementing a strategy, particularly at our Safeway banner, which will be driven from our customer research, and will allow us to exploit white space in the market.

And before you ask, we have not made a call on whether to expand our discount banner to the West, but I continue to be impressed by the performance of our FreshCo banner. Although I see some fertile ground in the West for our discount business, we don't want to be rushed to make a decision. We have a lot of other priorities. And if we do expand, we won't announce it publicly right away, as we don't want to give a heads-up to our competitors.

And now just a few concluding remarks before I turn it over to Mike. As you all know, the Ontario government announced changes to the minimum wages that will come into effect in 2018 and 2019. These changes are coming at us and all retailers rather suddenly, and will obviously impact our labour costs and frankly the Ontario labour force in general. We don't have a number for you at this time, but it is obviously a relatively significant unplanned expense for us, and it will be our job to mitigate these costs.

After five months on the job, I am bullish on our future and the opportunities we have to thrill our customers and shareholders. We have a plan and need to execute with velocity. However, you don't just snap your fingers and improve a company. This type of transformational change doesn't happen in a New York minute. We need some time to work our plan.

On the bright side, I know that the top operating team, my direct reports, are all excellent retailers and excellent leaders. And they are working hard to break down the regional silos which have plagued our business.

While I am excited about the long-term potential of this company, we must realize that Project Sunrise is a significant undertaking for our organization. We are fortunate to have a standard SAP platform already deployed across Sobeys. However, we will need to make numerous process and system changes to support our new structure, and our people will need time to adapt to the new processes.

Look, we cannot eliminate risk, but we will manage and mitigate the key risks. And I can say that our board is taking this initiative seriously. We have established a board committee to oversee our progress, and provide the appropriate governance you would expect from us. I want to be clear, however, very clear, that Project Sunrise will not affect our stores or our distribution centres.

Finally, I can't tell you how pleased we are to have Mike Vels on board as our CFO. He is one of the most accomplished CFOs in the country. He is a strong operational CFO, and is extremely familiar with the food industry from his time at Maple Leaf Foods. And Mike also has extensive transformational skills.

With that, over to Mike.

Mike Vels — Chief Financial Officer, Empire Company Limited

Thank you, Michael. Good morning, everyone. Before I give some colour on the financial results, I'd like to say how pleased I am to be joining Michael and the Empire team. It's an exciting opportunity to join such an iconic brand.

Same-store sales for the quarter, excluding the impact of fuel sales, decreased by 1.6 percent from the same period last year, which included deflation of 1.9 percent.

Our gross margin of 24.5 percent was relatively flat to the same quarter last year, but 80 basis points higher than the third quarter of fiscal 2017 as a result of the focus by our teams to stabilize margins, along with the positive impact of seasonality.

Our focus will remain on keeping margins within acceptable ranges. We need to be disciplined on pricing, and although we will ensure we remain responsive to market pricing, we will also be focused on sustaining and strengthening our margins.

Selling and administrative expenses as a percent of sales was 23.8 percent in the quarter compared to 22.5 percent last year and 23.1 percent in the third quarter of fiscal 2017. The prior year was slightly impacted by an additional week of sales and therefore slightly impacted the SG&A percentage.

I would like to make some comments on our real estate earnings for the quarter. Clearly, as Michael has outlined, the main focus for us is the food business as it's the principal contributor to our results and our future successes.

During the quarter, Crombie REIT contributed normalized quarterly earnings to Empire of $7.7 million compared to 18.1 million in the prior year. The prior year included a large gain on the sale of a group of properties.

The Genstar partnerships contributed $4.9 million to Empire compared to $2.8 million last year, slightly higher than historical run rates. These partnerships have been very successful for Empire, but are now winding down.

Results from real estate can be inconstant from quarter to quarter, and we do anticipate that the contribution from the Genstar operations will continue to decline as those partnerships wind down. And the gains expected or experienced related to Crombie are not necessarily going to be consistent on a quarter-to-quarter basis.

Free cash flow generated for the quarter was $170.8 million, an increase of $90.7 million from last year as a result of increased proceeds from real estate transactions and decreased capital expenditures.

At the end of the quarter, our funded debt to total capital ratio improved to 33.9 percent versus 39.5 percent at May 7, 2016, and cash and cash equivalents equaled $207.3 million.

As Michael mentioned, subsequent to the quarter-end the Company finalized a $500 million delayed-draw non-revolving facility for the purposes of repaying our 2018 medium-term notes. This provides the Company with flexibility and certainty regarding liquidity required to refinance these notes well in advance of their maturities.

Both Empire and Sobeys remain committed to continuing to strengthen the balance sheet and reestablishing our investment-grade credit rating through continued improvement in operations and sustainable management of working capital.

We previously disclosed that Project Sunrise would in addition to delivering $500 million in savings result in the occurrence of approximately $200 million in onetime costs.

At this point, this is our best estimate of these costs and includes severance, relocation, third-party consulting, and minor technology costs, with the majority attributable to severance. Substantially all of these costs are cash costs, and at this point we anticipate the majority of the cost to be charged to earnings in the first half of fiscal 2018 and the impact on cash to occur in the following two to three quarters as the cash is paid out.

The timing and quantum of these costs, however, will be impacted by the rate of progress in the reorganization, and we expect to continue to refine these estimates as the project execution progresses.

In terms of the benefits of the project, we have a clear line of site at this point on the quantum of benefits. The teams continue to fine tune their plans and targets, and at this point we continue to expect to achieve the run rate savings of $500 million by fiscal 2020. We do anticipate benefits to begin in the first quarter as the first elements of the reorganization are executed, with increased benefits following in consecutive quarters.

We expect to achieve these reductions by eliminating the duplication that has arisen in the regional structure; increasing the scope and span of control of our leaders throughout the organization. For example, where previously we might have had several people purchasing goods in the same category, we will reduce to an efficient configuration. Where we previously needed finance support teams in every region, we will now support functional leaders across the organization.

We will now be able to execute transactional work in a standardized manner in our shared services configuration. And in addition, we will enforce standard specifications in compliance to negotiated contracts in our indirect purchasing activities, and expect to gain benefits from more effective negotiations with vendors, who can now work with our leaders who will be able to negotiate with the full ability to execute commitments across the country on a national basis.

The Board of Directors today announced an increase in Empire's quarterly dividend per share from $0.1025 per share to $0.105 per share. This marks the 22nd consecutive year of Empire dividend increases.

On a personal note, my initial assumptions regarding the potential of this opportunity that lead me to join the Sobeys organization have been confirmed in the short time I've been here, as I've had the opportunity to work with the new management team, dive deeply into the details of the transformation plan, and meet the people with whom I will have the privilege to work.

I found the Sobeys people to be excited about the new direction and leadership and committed to doing the right things to improve the business. There's a great deal of talent in the business to help execute our plans.

Of course, we need to ensure that our plans are clear, that we manage them closely, and that we mitigate the risk of the sweeping change that we are introducing to the organization. I am very confident that we can accomplish this and very excited about the possibilities and the upside.

And with that, we'll pass the phone over for questions.

Q&A

Operator

At this time, I would like to remind everyone in order to ask a question, press *, and the number 1 on your telephone key pad. We'll pause for just a moment to compile a Q&A roster.

And our first question comes from the line of Peter Skyler from BMO Capital Markets. Your line is open.

Peter Skyler — BMO Capital Markets

Good morning. As you pointed out, your tonnage turned positive during the quarter after quite a number of quarters of negative tonnage trend. So I'm just trying to get a better understanding of that turn of events. Was there any particular merchandising initiatives or promotions that facilitated that tonnage? Was there any particular kind of discipline that you imposed upon the merchants? Or any other factors that you could refer to that caused this change in trend?

Michael Medline

Yeah. Hi. It's Michael. Thanks for the question, Peter. Yeah. I mean obviously that doesn't have to do with a tonne of things I've done since I've joined because I've only joined five-and-a-half months ago. I do think a few things; that in the West we put three of our best talents out there, and that they have now had the time out there to be able to really improve our stores and the execution we're seeing in the stores. Even since I first went out there last October to scout the Company, I'm seeing far better discipline, better-looking stores, fewer holes, better morale in the stores.

We're also seeing from what used to be called, I guess, our Western region a better feel for how to balance sales and margins, which you got to get right and more disciplined in terms of margins and how to promote and when to promote and how to understand your customers.

In the rest of the country, Ontario and Atlantic, we're seeing especially in our FreshCo discount banner better results and better disciplines, I would say. And we're really emphasizing margin discipline while still exciting our customers.

In Quebec, which is of course historically our strongest part of the country with our great IGA banner and our great franchisees, they just keep on clicking along. It was a bit of a tougher quarter for them as they started to cycle over last year's very aggressive Mosaic price-downs and promotions, and that should continue to cycle until September where we'll get back to more even keel. But they did a great job in terms of being able to manage through that and also control their margins.

So it's the team. It's execution. It's basic blocking and tackling until we can get to the big prizes.

Peter Skyler

Okay. And, Michael, it sounds like from your comments you're undertaking a lot of market research, consumer research it sounds like, particularly in the West perhaps with your other banners, your Eastern banners as well, to try and understand the consumer and gain some insights. I presume once you've gone through that process there will be some repositioning of the banners and of your brands based on what you learn from that marketing research process. Can you just talk about a little bit of the time line as to like when these insights are going to arrive? And when you'd be able to act on them in terms of implementing them through the banners?

Michael Medline

Yeah. Thanks. So it was across the country, you're right. We had a particular emphasis on the West, as you can imagine. And all of us, especially Lyne and I, have been very involved in terms of this work, and we have we've started the analysis. It's very telling. I think it's very—I'm very enthusiastic about the opportunities that are open to us.

It's clear to me that in every area of the country, including Quebec, that we can do a better job responding to what customers are looking at from us, especially in terms of a conventional—more conventional banners.

I would say in terms of timing that we should be able to get to understand our brand promises and how to appeal to customers over the next four months with, I think, the beginnings of that to show up in calendar 2018 at the beginning. I don't want to overpromise. It takes a while to get that kind of work right. I think there are areas we can go at really quickly. The team is highly aligned and highly motivated to do so.

In the meantime, we've got to continue to execute while I'm still not pleased with where our brand positioning is.

Peter Skyler

And would you be prepared to let the cat out of the bag at all with respect to Safeway and any learnings you've had there that are not obvious? I assume—I mean we all know what's happened to the brand and the loss of identity, but any particular surprises with respect to the banner?

Michael Medline

Yeah. No, I'm not going to let a cat out of the bag because Lord knows who is on these calls. But I would say that the—that's my favourite word these days—the latent strength of the Safeway brand and what it means to our Western Canadian customers is still there.

And it's funny. When I get these letters from our customers and e-mails—and they're starting to dry up a little bit actually, which is good—but when I first joined they're the worst kind of letters because they're not angry or anything; they're just disappointed because we let down the customers in areas where we just can't do that. And I think I've reiterated enough, I don't want to talk about the past.

I think that there's a large group of Canadians who love shopping the Safeway banner. When I've recently been out in the stores I've been really impressed. I think they're some of our best stores across our network. The problem is how much we let down our customers. And when you do that kind of brand damage, it has a halo effect on almost every other measurement you look at across your customer base.

And so I guess one conclusion I've reached and the team—well, actually, it's not me; it's the team working together—is that you can't go back. You can't go back and try to reinstitute every single thing you did four years ago. I think we have to move forward from here and that there is not only a great latent brand affinity from our customers, but there are opportunities to thrill them and find the white space that they're looking at in their markets.

So this will not be overnight, but I think this is just heavy lifting and hard work and strong directions, and being aligned going in the same direction. We've done it before, we'll do it again, but it just won't happen overnight.

So I seem some steadying out there, but the big improvement that we'd like to see is still to come.

Peter Skyler

Okay. Thank you.

Operator

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

Michael Van Aelst — TD Securities

Thank you. Can you start by breaking down or giving us a little bit more colour of the same-store sales ex-fuel in West versus the rest of the Company?

Michael Medline

Sure. Thanks, Michael. Good morning. Look it, I'm going—if I may, I'll back up a little bit because we didn't split out the West. And I have to say that when I came into this job, I was not crazy about how we had been segmenting out the West results. And the reason being is not because

I don't like transparency, which I do; I just don't like giving our competitors that level of information. And I am highly aware that they like that kind of information.

Having said that, because we had a huge deviation between the West and the rest of the country, we needed to let you know for a while there how we were doing in the West and how it was driving our negative results. Starting this quarter, there's no longer a real deviation between the geographic regions that's significant. And, therefore, we didn't feel a need to disclose the specific West results, and I don't really feel a need to disclose them going forward in terms of their numerically.

However, in terms of being transparent in terms of any region, I don't mind giving you colour on how the geographies are performing. So, I mean, so I'll give you some colour, which is Atlantic and Ontario performed surprisingly well in terms of comps and tonnage; better than they'd been performing. Quebec was a little weaker, as I said, just in terms of sales and tonnage; better in margin. And the reason just being is that we're cycling that Mosaic last year, and we will be until September.

And the West, a big improvement, especially compared to the rest of the country and came into line with the rest of the country. Its comps were just slightly, slightly worse than the national average, which is a big improvement. Not where we want to be, but improvement.

Michael Van Aelst

Okay. And just a clarification; on the cost savings I think you said we expect to start to seeing them in Q3 fiscal ’18, and then Michael Vels said in Q1. Is that—what’s the difference between the two? Is one calendar; one fiscal?

Mike Vels

No, I think strictly speaking, Michael, we’d expect to see some small beginnings of savings earlier, but really the bulk of the savings—or sorry, more meaningful savings, I guess, you’d start on the timing that Michael mentioned.

Michael Van Aelst

Okay. And then on the CapEx, is that 350 million net of asset sales?

Michael Medline

No.

Mike Vels

No, it’s gross.

Michael Van Aelst

So that—I mean it seems low. I know you spent a lot on your DCs in recent years, and they are state-of-the-art. But when you look at say a match or spending the same amount of money with a much smaller network, do you have any concern that maybe you’re not going to be keeping up the pace of renovations that you need to do?

Michael Medline

Absolutely not. We took—one of the first things I did when I came on board with the team is take a look at capital spending. Maintenance is 175, so you got 175 to go. That leaves you another 175 to do real estate and basically systems. That, given where we are today and the type of improvements we're looking to make, is sufficient capital in fiscal 2018. Just to keep up with the Joneses, we're not going to keep spending capital at a rate and destroying shareholder value.

I can see a day where our returns are better and we see far more compelling opportunities. But the real prize, as I said a few minutes ago, is in our stores, the ones we already have in terms of getting our processes right, getting our disciplines right, running a good retailer. And that doesn't take a lot of capital.

At the same time, we do across our network need to look at areas too as we get into brand and brand promise areas of the store which we're going to emphasize and areas of the store we'll have to renovate. And we have plenty of capital to do that in fiscal '18.

I think generally, retailers and grocers spend a lot of money in capital. I think a lot of it is not high return. And until we get those disciplines and get our own practices in place, we're not going to spend that capital.

Michael Van Aelst

And what kind of square footage growth is built into that?

Michael Medline

We'll get back to you on the exact square footage growth. I don't have it in front of me.

Michael Van Aelst

Okay. And then just final question, I was just wondering how do you square off the, I guess, recognition as the most admired grocer in Canada versus the type of e-mails that you were getting from disappointed customers and the sales trends? What do you think? I don't know if you see any details in the report, but what do you think the differences are between the two?

Michael Medline

Yeah. That's right (phon). Michael, you're exactly right. I mean, I had to square that off myself. I think a few things. One, first of all, every retailer gets disappointed or sometimes angry e-mails and complaints to customer service. And first of all, you've got to get fewer and fewer, and secondly, you've got to deal with them better. And I think the ones we're getting we're dealing with very well now, or I hope we are.

I'd say the thing that squares it off for me is what I talked about last quarter on the conference call, which is even though we have a long way to go there are strengths in this company. So I've talked about strengths in terms of our store locations; I've talked about strengths in our people and our stores themselves. But I do think that we have—and we're seeing that in the customer research we've seen—there's a feeling that Sobeys, Safeway, IGA are connected to community. There's a feeling that they're Canadian. There's a feeling of I like shopping them. There's over the 110 years—it's our 110th anniversary this year—that there's something there that has lasted.

And that's the reason, though, that you can disappoint people is that they expect—they cheer for us; they don't cheer against us. But that means you can also disappoint them. So that, I think, it makes sense when you think about it, but it surprises you at first.

Michael Van Aelst

Thank you.

Operator

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

Jim Durran — Barclays

Good morning. With respect to the cost savings, so if I'm understanding this right from a cash flow standpoint, we're hoping to see about 500 million of cost savings generated. We're going to have 200 million of largely cash-oriented charges, right? So from a cash flow standpoint, over the course of the next three years the cash flow net benefit's about 300 million. That being said, from the market standpoint operationally you are still hoping that most of the 500 million in cost savings would flow through to an improved run rate of EBITDA. Is that correct?

Mike Vels

Well, no, we've—good morning, Jim. So the 200 is onetime, as I mentioned, cash cost. It's a combination of both up-front consulting fees and severances. And the 500 million is an annualized cash saving, some of which may well be reinvested into existing operations.

So we do anticipate a large percentage of the $500 million to flow to our margins, but over time we see significant … we expect to see significant opportunities to reinvest some of that in growing our top line as well. So cost reduction is important for this company.

The more important outcome of Sunrise in addition to that really is shortening our decision lines, creating more simplicity in the Company, operating a large-scale grocer nationally using our scale, and becoming much more nimble in the marketplace. And the combination of reinvesting some of those savings and the operational flexibility that we'll gain will also have positive impacts in our in-store execution and merchandising in the top line. So it is—the total benefits by the time we get to 2020 is not just a onetime cost reduction.

Jim Durran

Thanks, Michael. That's helpful. So would you say that partially with your tonnage improvement this quarter would you say that you feel that by region your pricing relative to the market today is where you want it to be? Or do you still feel that you need to invest on a real-time basis versus where's the market going and what you might have to do in the future?

Michael Medline

It's Michael. I think we're pretty well where we want to be in terms of our price positioning, I think so. Good work has been done over the last year, year and a half in terms of getting us back to where we needed to be. At the same time, we're watching the market, so we're not going to be the patsy. At the same time, I think right now we're in a good position.

Jim Durran

Okay. So I got two other topics I wanted to ask about; first of all, the centralization of procurement. Can you help us understand from your view the subtleties of centralization of the physical buying versus the centralization of merchandising strategy? And how you hope to maintain a sufficient regional component given the differences across the country on that sort of new platform as we move forward?

Mike Vels

So I'll probably answer that in two stages, Jim, and Michael will probably take the merchandising element. So the primary focus on the cost-savings side in the early going is our goods are not for resale. So it's not—it's basically our indirect purchases, which we believe there's a significant area of opportunity.

Because of the regionalization of the business we've had poor negotiating, frankly, fractured supplier base, and inadequate compliance to contracts that are negotiated. So that initial centralization of procurement around indirects is really the focus there is bringing professional procurement processes, systems, and discipline to what is a large volume of indirect goods that we buy across the country. And the savings from that is part of the $500 million.

Separate to that is the reorganization of the merchandising group. And then clearly as we become more efficient, our systems are improved, we'll also be able to deal more efficiently and productively with our suppliers on more of an efficient and partnership basis.

And in terms of how that impacts our merchandising and coordination, I'll have Michael or Lyne provide a few comments on that.

Michael Medline

Lyne, why don't you say a few words?

Lyne Castonguay — Executive Vice President, Merchandising, Empire Company Limited

Good morning. As we're looking in our transformation for the merchandising organization, what we are looking to do clearly is to focus on local versus national and where we are going to have our teams located to ensure that we maintain that balance. Therefore, in our structure we will have a good focus on a national procurement for national categories that we have identified, and then more of a local flair for our fresh for our more local categories.

So it really is looking at perhaps if I could segment into two local and national categories, and then what we've looked at is fresh versus grocery in the majority of the cases. And then we are setting our teams up for success that way where we're basing them in the localities where we feel it's the most critical.

Jim Durran

And, Michael, are you in a position where you're willing to share with everybody what you think the chunks are of the 500 million? Like because not for resale is X percent of the 500 million versus procurement versus headcount or reduction?

Mike Vels

No, we're not at this point. A significant amount of the early savings is clearly related to the reorganization and headcount savings, but we haven't provided a breakdown of the 500 million at this point. We need to fine tune our targets and our plans a little more before we can start talking about that.

Jim Durran

Okay. And my last question is a topic of the day these days is the whole world of digital and e-comm right? So with the hiring of a new senior exec for marketing, what is that person's skill set? Are they going to have a strong digital background? Will they be leading a digital charge? And I'm not ignoring the fact that there's a lot of branding and positioning work to be done, but obviously with the Amazon–Whole Foods announcement the whole element of e-comm and digital has become much more topical in the space.

Michael Medline

Yeah. Three things we're looking for in the marketing person: really strong grasp of a brand and how to build a brand; second, really being able to target customers and understanding data; and three, obviously my predilection is someone who gets digital, gets the new ways of communicating, and is really phenomenal at digital marketing and advertising. And there are some great people out there we're talking to.

Jim Durran

And given all the things you've got going on, like how do you see e-comm progressing for you? Obviously, the market's probably going to have to step it up just to be in a very good position when and if the Amazon–Whole Foods piece becomes a reality in the Canadian market.

Michael Medline

There's no doubt that we have to be a strong participant in e-commerce. That's click-and-collect, but it's also home delivery. We are working out right now in terms of what our strategy is and what our timing will be because we have a few things going on, as you point out.

But you know me, there's no way we're going to miss out on e-commerce, which is going to be so essential not in its short term, maybe not in the medium term, but long term for our customers. And it's all about our customers and what they want. And so we have some work to do there.

But we have a good base in e-commerce. We've been doing home delivery for probably longer than anybody else out of Quebec, and we still continue to do that. We're ahead of everyone else; we were out of Thrifty's in the West, but we didn't put our foot on the pedal. We didn't continue to do that. We didn't expand it. We didn't take it to other areas, and we didn't use it as well as we could even in Quebec.

I don't think it's rocket science. I think there's some work to be done, but we've got to do things in order. We've got to get our structure right, we've got to take the cost out so we can afford everything else, and to make sure our shareholders are being rewarded. But it's clear: I mean you got to be good at e-commerce.

Jim Durran

Great. Thank you, Mike.

Michael Medline

Thank you.

Operator

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

Vishal Shreedhar — National Bank

Hi. Thanks for taking my questions. I guess the first one's for Mike Medline. Just in terms of the minimum wage, you said it's your job to find a way to offset it, but the minimum wage, at least in Ontario, will kick in before the big part of the cost savings from your initiatives start to kick in. So I was hoping to get some granularity on how management intends to address it? And just how do we think about the impact coming to Empire given that you have franchisees and maybe some union contracts which are already above the minimum; maybe some context on that?

Michael Medline

Yeah. Well, we're working through it right now. I mean, these things happen. They sometimes happen suddenly to you, and as retailers we're pretty—we're used to doing that. Let me just back up a little bit.

Because the total impact before mitigation is material for everyone in the retail industry and QSR, we haven't had a lot of time to prepare for it because it's—first of all, Bill 148 was just announced. It hasn't been passed yet. And these things always end up getting mitigated. So we're putting together our plans right now being led by Jason Potter and Simone Gagné our head of HR, and they're working through and we're all meeting—Mike Vels and I are meeting with them. So we're considering all of our mitigation strategies, which is a long list. And as appropriately, we'll report more on our potential impacts going forward.

I think there's a few things going on here. One is we got to mitigate in different ways our response to Bill 148 when it's passed in terms of still being extremely competitive and not affecting our earnings. And at the same time, I think actually the timing of Sunrise is actually going to segue in quite well from the timing of Bill 148.

So having said all that, because it's happening faster there'll be a bit of dislocation and a bit of confusion, I think, throughout the market, but we're putting together our plans. You're just catching us a couple weeks in, so it's a little too early to give you any granularity. And as always, I'm a little worried about telling our competitors exactly what we're thinking.

Vishal Shreedhar

Okay. So in general, just from market responses based on your prior experience, is it fair to say that the industry will adjust with labour optimization and maybe price increases?

Michael Medline

Your words, not mine.

Vishal Shreedhar

Okay.

Michael Medline

But I think it'll be a response in a lot of different ways. And these things happen. The government's brought down a minimum wage. We'll follow the rules and we'll take out the costs as appropriate, and we'll still thrill our customers.

So the world will go on. It makes it a little bit more difficult, but we'll go through it.

Vishal Shreedhar

Okay. Great. Thanks for that colour. And just on inflation, I know it's difficult for everyone to kind of gauge the trends, but there's been some different views from some of your peers on where inflation ends up, call it, in 2017. Do you have any thoughts on where that's headed? And do you expect continued, I guess, continued improvement in the inflation trends?

Michael Medline

If I knew that, I'd be a lot smarter than I am. And I think it's very hard for people to call these trends, especially retailers who only look at their own company and across their own industry.

You know what I'm hoping? I'm hoping that deflation ceases and inflation a little bit, but not too much; it gets better. But we're just putting together a strategy and we're executing for whatever market we find. But I'm not in the game of prognosticating where economics are going to go. It's not my gig.

Vishal Shreedhar

Okay. Fair enough. And another question that's maybe not too fair, but you've implemented substantial price reduction programs pretty much across Canada. And you're starting to see some results not only from that, but also from merchandising improvement. Have you seen your competitors starting to react to your initiatives?

Michael Medline

Not in a major way, no.

Vishal Shreedhar

Okay. Thanks a lot.

Michael Medline

Thank you, and thanks for the questions.

Operator

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

Mark Petrie — CIBC

Hey. Good morning.

Michael Medline

Hey, Mark.

Mark Petrie

I just wanted to come back to the feedback from the customer survey that you guys have started to work through. And when you talk about changes being implemented in sort of early 2018, but obviously refinements going on today and will continue in the stores, are you talking about for next year sort of a more meaningful change to in-store experience or marketing or promotional tactics? Or how should we think about that?

Michael Medline

Yeah. Mark, great question, and one obviously I've experienced a few times before in previous lives. I think that certain areas, once you get focus in terms of what you're trying to do and the customers you're really trying to target and what your brand promise is and it's sharp and it's got a strategy behind it, every single decision you make from then on follows that. Sometimes and often marketing will run ahead of other aspects of it, as you probably already have a story to tell that fits that.

At the same time, you have to look at what products you're emphasizing, what you stand for, what you're doing in the community, the service you're providing in your store. So I would expect that, like I've seen before, that you're focused, you suddenly will see us doing things in a consistent manner, and I'll have no problem sharing at some point in terms of what we're trying to do here. But I find that telling the story and being clear about that runs ahead of some of the other changes just because you can do that more easily.

Mark Petrie

Okay. And I guess maybe a couple other questions sort of related to that. You talked about sort of being satisfied with your price positioning today, but also there's going to be some proceeds from your cost savings that are reinvested back into the business. So is it fair to say that what you plan to be reinvesting back into the Company is more sort of about store experience and marketing as opposed to pricing?

Michael Medline

Yes. That is fair. At the same time, if we feel that we can take advantage of something and there's a return on it, we'll—for pricing, we'll do that as well. But I'd say that you'll see more in terms of marketing, customer-facing technology, and maybe a little bit in the store, but we have not finalized those plans yet. But that's my belief.

Mark Petrie

Okay. And then I guess again just related to that, with the expectation that the majority of the savings are going to fall to the bottom line, do you expect that to be relatively smooth through the period? Or do you feel like there's probably more investment up front and then you're harvesting sort of further out closer to the fiscal 2020 time line? Or what's your perspective on that?

Mike Vels

I think at this stage what we said last time in the press release for the third quarter is consecutive quarter-on-quarter improvements. I don't think we're in a position to call the exact rollout and timing of the plans. Clearly, we have pretty good visibility to our initial rollouts and reorganizational restructuring, but at this point I think we'd just prefer to say consecutive quarterly improvements.

Mark Petrie

Okay. Thanks. And then actually just one other quick follow-up; the 350 million of CapEx—I know you talked about it—do you think that's the right level of spending for this business over the long term? Or is that sort of where you need to be today and then reevaluate what you need to invest in stores over the longer term and in the coming—

Michael Medline

Yeah. It's Michael. Great question. I don't think it's sustainable over a long period of time because we're going to be seeing some great places where we can reinvest in the business, but it's absolutely the place we should be today. And we'll continue to look at that every single year. I would expect next year would be a little higher than the 350. That would be our expectation at this point—maybe not a lot—as we reinvest in areas where we think we can get returns.

But it is, I think, although I do think people spend too much capital and they can get more out of their current assets that it is probably not sustainable over a long period of time.

Mark Petrie

Okay. Helpful. Thank you very much.

Michael Medline

Thank you.

Operator

Our next question comes from the line—sorry. Sorry, one moment.

Michael Medline

Okay.

Operator

Of Irene Nattel from RBC Capital Markets. Your line is open.

Michael Medline

Good morning, Irene.

Operator

Irene, your line is open.

Michael Medline

Okay. Operator, we'll come back to Irene if she calls back in.

Operator

Okay. She just queued out. I'm going to open her line one more time.

Michael Medline

Okay. Thank you.

Operator

Irene, your line is open.

Michael Medline

Hey, Irene. All right, Operator, let's move to the next question.

Operator

Okay. Bear with me one moment. I'm sorry, I'm having a issue here. Sorry.

Sorry, our next question comes from the line of Keith Howlett. Your line is open.

Keith Howlett — Desjardins Securities

Yes. Thank you.

Michael Medline

Hey, Keith.

Keith Howlett

Hi, Michael. I was just wondering on the store network and the footprint of the stores, are you satisfied with the number of stores and the amount of square footage?

Michael Medline

For now we are. I think we have more than enough coverage across the country. We have great locations, like I keep saying, and what we got to do is buckle down and get those stores performing. I would expect if that happens in the future that we'd be looking for more and more opportunities.

Keith Howlett

But there's no rationalization required at this time?

Michael Medline

No, there's not a big rationalization required, no. I mean like any retailer we'll be looking at a store here and there or closing a store here and there, but it'll be probably one-offs.

Keith Howlett

And just on the brand image, particularly in Western Canada where the Safeway and Sobeys stores share the same flier, the same pricing on identical items, as I understand it, the same private label and both have Air Miles, like do you think that you've somewhat blurred both brands?

Michael Medline

Yeah. I think we have. I think that we've brought that customer relationship our brand promise, very, very close together, which—for almost the last year on most of it. So once you have the same flier and once you have the same store operating teams, the same pricing, they become relatively undistinguishable from each other to the customer, and that's what we're seeing.

Keith Howlett

And then just finally on the real estate, I was wondering if there's been any change in the approach to real estate or how you're conducting your relationship with Crombie or anything on the real estate side?

Michael Medline

Yeah. We're really fortunate to have that great—Crombie, the Crombie REIT that we're 40 percent owners of. And I've spent a lot of time, and I know Mike Vels is going to spend a lot of time with Donnie Clow and the team over at Crombie; great team over there. I think there are ways that we can even work better together, and perhaps be able to take costs out of both organizations by cooperating more and sharing resources more and information more.

I think it's a big strategic advantage for us in many ways, but especially that Crombie is so expert at developing properties, and we're expert at running grocery stores. And I think that sometimes we can blur those two things, but that's the real strength we have by having such a strong Crombie REIT.

And this company has a lot of innovation. I mean, we were the first to—were first really to go for the REIT in retail in Canada, which was really innovative at the time. And we're very mature in terms of our understanding how to work with Crombie. So I think this is fantastic, and I look forward to even working more closely so that when we do have new stores—and we do—that we'll be able to have the best locations still, especially because of our partnership.

Keith Howlett

Great. Thank you very much.

Operator

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

Patricia Baker — Scotiabank

Thank you very much. Michael, I've got a couple of questions relating to your opening remarks, and then some further colour that you gave in answer to another question. And that's with the new VP of marketing that you indicated you would be hiring. It sounds like you're pretty active in that search, and definitely given your predilection for where you think some of the weaknesses are and what you want to do at Empire and Sobey, it's a very important position for you. How soon do you think you'll be able to sort of put the pin in that?

Michael Medline

Well, I'm hoping soon, but I don't want to be rushed. I want to get the best person in place, so if you wait a month or two longer, so what in the long term? But I'm a bit impatient.

Patricia Baker

Mm-hmm.

Michael Medline

Plus I've got to warn the person that I'm going to drive them crazy in that role because I'm so interested in it. We're getting some real interest. I mean, we've been able to attract some great people, one of whom is in the room with me. And we're getting a lot of interest from marketers that I think would surprise you guys in terms of people wanting to come and be part of the journey at Sobeys, and they're well aware that we have issues and that we're working to solve them.

But it'll be as soon as we can, as long as we can find the great candidate.

Patricia Baker

Okay. Appreciate that. And these are the kind of surprises we don't mind, Michael. And then secondly, you indicated that very, very soon your key leadership team will be picking the VPs. And I assume that will put sort of—there must be a lot of concern throughout the organization who's going to make it, who's not going to make it. So once that's determined, I think that'll probably be a positive. What can you tell us to reassure us that once those people are chosen that they're going to hit the ground running and there's not going to be a transition period as they learn their new positions?

Michael Medline

Yeah. Well, great question and, yeah, these are tough times. I mean we're having a lot of fun at Sobeys, but I've got to tell you, making these kind of choices and going down in numbers in terms of all levels of the Company it's not the fun part of the job. There's a lot of tough conversations have to be had, and then for some people they're great conversations as we give chances and more responsibility to others. And tomorrow we'll announce to our organization internally what our next level—L3 we call it, which is basically the VPs—will look like. And that will send a signal to the rest of the organization how we're going to be structured because it's easier to tell at that level than it is at the L2 level.

We—I mean obviously one of the biggest concerns we have and our board has and I have is being able to run the Company while we're going through so much transformation.

Patricia Baker

Mm-hmm.

Michael Medline

And I've never seen a plan as detailed as this or thoughtful as this in terms of being able to do that. At the same time, I expect once in a while we're going to have little hiccups here and there because this is a lot of transformation while you're running a big company. I could tell you that my reports are—I've never seen people work so hard, which is good. I've never—people—they're trying to do a lot of things. They're restructuring, they're taking costs out, they're working on exciting the customers all while trying to do the best they can to get quarterly results.

And it's a lot to be asking people, but I don't know any other choice. We're organized. We have even a board committee, which is great, which can oversee all this. But staying like we were was not the solution, so I'll take a little bit of risk in terms of keeping the wheels on while we're transforming than the status quo.

Patricia Baker

Okay. Appreciate that. Thank you, Michael. Good luck.

Michael Medline

Good question. Thanks, Patricia.

Operator

I'd now like to turn the call back to Adam Sheparski for closing remarks.

Adam Sheparski

Thank you, Lisa. Ladies and gentlemen, we appreciate your continued interest in Empire, and look forward to having you join us for our first quarter fiscal 2018 conference call on September 14th.

Goodbye.

Operator

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

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