FINAL TRANSCRIPT

Empire Company Limited

First Quarter 2018 Results Call

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PRESENTATION

Operator

Good morning. My name is Carol, and I will be your conference Operator today. At this time, I would like to welcome everyone to the Empire Company Limited First Quarter 2018 Results 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 for analysts. If you'd like to ask a question at that time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press the # key.

At this time, I would like to turn the call over to Katie Brine, Director of Investor Relations.

Katie Brine — Director of Investor Relations, Empire Company Limited

Thank you, Carol. Good morning, and thank you for joining us. Our comments today will focus primarily on the financial results of our first quarter ended August 5, 2017. Following our comments, we will then be open to your questions.

This call is being recorded, and the audio recording will be available on the Company's website at www.empireco.ca.

Joining me on the call this morning are Michael Medline, President and Chief Executive Officer; Michael Vels, Chief Financial Officer; Lyne Castonguay, Executive Vice President, Merchandising; Jason Potter, Executive Vice President, Operations; and Pierre St-Laurent, Executive Vice President, Quebec.

Today's discussion includes forward-looking statements. We want to caution you that such statements are based on management's assumptions and beliefs. These forward-looking statements are subject to uncertainties and other factors that could cause actual results to differ materially from such statements. I refer you to our news release and MD&A for more information on these assumptions and factors.

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

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

Thanks, Katie, and good morning, everyone. I am obviously pleased with our results in Q1.

We achieved positive same-store sales for the first time in six quarters, had a slight increase in our transaction count with flat tonnage, and we had good increase in basket size in the face of less than conducive summer weather.

We saw moderate inflation, up 0.5 percent, and I was particularly impressed by the sales growth in the western provinces and in our Ontario discount business.

It is difficult to triangulate market share due to differing competitor quarter ends. In Q1, our data shows we stopped market share erosion and started to see small market share gains.

As we shared on prior calls, we've been focused on stabilizing margins to regain control over the business, and I am encouraged that our margins have remained stable as we improved our costs. Our cost discipline has also contributed to improved results. Our apples-to-apples SG&A improvement was very encouraging, and Mike will discuss this in more detail in his remarks.

We are executing better throughout the Company. I'm particularly pleased with our store execution, improved promotions, and pricing position, both actual and perceived.

Now having said all that, you won't be hearing any champagne corks popping over here. We still have significant work to do in all facets of our business, and we are obviously working to build more consistency in our sales and earnings improvements.

I would caution you not to assume that all of our future quarters will be as strong as this one, or that our rate of improvement will be a straight line as we complete the transformation of the Company. We feel good about the incremental progress that we have made since beginning the work on Project Sunrise in early May, but recognize that there are still many areas of the business that require improvement.

I am pleased that our sales and profits appear to have bottomed out, but it's important to point out that we are comping off weak sales results last year. We still need to improve our margins as we lower our cost of goods sold, and our SG&A is too high.

We're getting at this through Project Sunrise and we're making progress, but we still have miles to go. We stabilized margins, put costs under the microscope, but until our Sunrise transformation efforts begin to kick in, our bottom line will be heavily influenced by same-store sales performance.

Comps were stronger this quarter, but we haven't completed all the hard work to ensure the consistency we want to see every quarter, but that'll come. Transformations are difficult, and we need more quarters under our belt to gauge our success. As I like to say, we can't promise that every quarter will be great, but our trajectory is certainly upward.

There's been much discussion recently about the effects of the Ontario and Alberta governments proposed increases to minimum wages. Our assessment of the unmitigated financial impact on Empire in Ontario and Alberta of the increase in the minimum wage rate is approximately $25 million in fiscal 2018 and approximately $70 million in fiscal 2019. These estimates are only the simple wage increases for people in our business earning less than new wage rates, and do not include some of the other effects of Ontario's Bill 148, which we are working our way through.

We have already developed plans to mitigate the immediate impact of minimum wage increases in fiscal 2018 that are above and beyond Sunrise savings. We are working on plans to mitigate the increase in 2019, but there is some risk that we may not be able to fully offset the full amount, considering the short transition time for such a large increase.

We are fortunate that we're already working on efficiency improvement as part of Sunrise, and intend to continue to investigate how we can additionally mitigate 2019 minimum wage costs on top of the $500 million Sunrise target.

This is obviously an industry-wide matter which will shake itself out over time. Like any retailer affected, we will find ways to effectively navigate this additional cost over time, but we will not react in a knee-jerk fashion. Our teammates in our stores are a competitive advantage today, and we're looking to increase that advantage in the future. The Company can't build its brand, thrill its customers, and beat its competitors without engaged, informed, and empowered employees.

I'm not sure anyone believes more than I do in customer-facing and back-end technological innovation, but not at the expense of human interaction. In short, we will not negatively impact our customers experience in our stores in order to mitigate minimum wage increases.

And with that, I'll organize my thoughts again around our four key priorities. First, addressing our complicated organizational structure. We continue to be right on plan. In early October, we will announce the next level of the organization to our employees, and our reorganization is not just a cost-cutting exercise.

We are flattening our entire back office organization, resulting in greater spans of control and increased levels of authority and scope that will reduce bureaucracy and allow us to be more nimble. I continue to be impressed by the morale and engagement of our people in the face of such tough change. I also want to reiterate again that this is a back office initiative, and we are not making changes to our store or distribution centre operations. And all of our changes are designed to improve our store experience for both our customers and our employees' abilities to be more effective.

Second, we are right on plan to take at least $500 million of costs out of the business. We expect the first indications of the savings to show up in Q3. I want to stress, though, that this is a gradual process with progress accelerating as we go through the three-year Sunrise project.

Third, we need to greatly improve our brands, our understanding of our customers, and our marketing. This will take time, but I am pleased with our early brand work, our use of data, and I've been impressed with the recent work of our marketing group.

In terms of our brand promise to customers and filling white space that's available in the market, we have completed our brand and customer research, analyzed the results, and are in the process of putting together a coherent customer strategy that will affect most aspects of our business to achieve greater market share.

Marketing will improve greatly with the addition of our new Senior Vice President of Marketing, Deirdre Horgan. Deirdre is an exceptional marketing leader who completely gets brand, digital data, and e-commerce. She starts on Monday.

Fourth priority, fixing the west. It's clear that we have come off the bottom in our western provinces. The store experience is stronger, as are our promotions. Real improvement.

I have been walking many of our Alberta and BC Safeway and Sobeys stores over the last quarter, and there is a vast improvement in in-store experience. It's night and day from what I saw last year, and even earlier this year when I visited stores. I am very proud of our store employees and managers in this region, but it's a lot easier to turn off customers than it is to win them back.

Many customers lost trust in our brand, and now we have to earn that back. We need to work on providing compelling reasons for our western customers to continue to shop our stores, and give us a higher share of their wallets.

Just a few additional comments. It's become fashionable for every retailer to talk about their e-commerce efforts. Expanding and improving e-commerce is certainly going to be a priority for us at the right time in our transformation.

Empire is actually ahead of the game with our long-standing success in e-commerce in Quebec. In Quebec, 268 of our 290 stores offer our customers e-commerce capabilities. We have been the market leader for years with successful click-and-collect and especially delivery to home for over two decades. Although our Quebec IGA e-commerce business represents a small percentage of our overall business, it is growing at a significant double-digit rate annually and is profitable. Importantly, it casts a halo over our strong IGA bricks-and-mortar business.

Just some perspective, though. E-commerce will represent a small, a small but growing portion of the Canadian grocery business over the next five years. We will thoughtfully build on these capabilities across the country. It is not a question of whether we will participate more in e-commerce, but when and how. We have time to expand our strategies and innovations, as e-commerce will take some time to mature in Canadian grocery.

So overall, after eight months on the job, I am pleased with our progress and especially pleased with the executive team which is making this happen. There is a lot more to accomplish.

With that, over to Mike.

Michael Vels — Chief Financial Officer, Empire Company Limited

Thank you, Michael. Good morning, everyone. As Michael mentioned, same-store sales for the quarter, excluding fuel sales, increased by 0.5 percent from the same period last year.

Our tonnage in total was flat for the quarter compared to last year, as inflation was approximately 0.5 percent.

Our gross margin of 24.4 percent improved by 30 basis points over the same period in the prior year as a result of more disciplined pricing and promotional strategies, as stabilizing margin has been a priority over the past several months. Our focus will continue to maintain stable margins within acceptable ranges. We will continue to be disciplined on pricing, while ensuring we remain responsive to market pricing.

Selling and administrative expenses as a percent of sales was 22.7 percent for the quarter. However, excluding onetime Project Sunrise expenses from SG&A reduces this amount to 22 percent, which compares favourably to 23.8 percent in the fourth quarter of fiscal 2017 and 22.5 percent last year.

The first quarter does not include any significant cost savings associated with Project Sunrise, as we expect these cost reductions related to this initiative to begin in the third quarter. As noted previously, we anticipate approximately $200 million in total costs related to Sunrise, which include severance, relocation, third-party consulting, and minor technology costs.

Substantially all of these costs are cash costs, and at this point we anticipate most of them will be charged to earnings in the first half of fiscal 2018, including the $40 million that were charged to earnings in this quarter.

I'll make a few comments on our real estate operations. During the quarter, Crombie REIT contributed quarterly earnings to Empire of $8.4 million, broadly consistent with $11.2 million in the prior year. The Genstar partnerships contributed $4.1 million compared to $5.7 million last year. As noted previously, these partnerships have been very successful for Empire, but will wind down over the next several years.

The effective tax rate for the quarter of 31.2 percent is higher than our estimate for the full year of 26 to 28 percent. For the quarter, taxation expense was affected by an adjustment to deferred taxes related to the flow-through impacts on the Company as our Crombie REIT completed a tax reorganization. Excluding this adjustment, the effective tax rate for the quarter would have been 26.2 percent and earnings per share would have been $0.02 higher.

In the prior-year quarter the effective income tax rate of 18.7 percent was lower than the Company's statutory rate, as properties were sold to Crombie REIT on a tax-deferred basis.

Free cash flow generated for the quarter was $119.7 million, a decrease of $335.9 million from last year, mainly due to the aforementioned sale and leaseback agreement that we entered into with Crombie REIT in the prior year, combined with some increased levels of working capital during this quarter.

Cash flow was also positively impacted by a decrease in capital expenditures as we work to improve our capital allocation processes.

At the end of the quarter, our funded debt to total capital ratio improved to 33 percent, due to higher earnings and slightly lower debt balances. We continue to focus on our balance sheet and cash flows, as well as our top line and cost base, with an expectation that over time we will re-establish the Company’s investment-grade credit rating.

Project Sunrise, as Michael said, is on track. And we continue to anticipate that the transformation will yield at least $500 million in cost reductions on an annualized basis by the end of 2020.

The organizational change from a regional to a functional structure is on track, and will be completed by the end of the year. Our system parameters, data harmonization, and other items necessary to enable consistent reporting for our functional merchandising operations and replenishment is progressing well. We have already begun synchronizing our purchasing, principally store supplies, and have issued RFPs on a significant amount of our indirect spend on store supplies.

Work is also progressing well on our store operations, labour standards, and replenishment processes.

Several shareholders have asked us over the past five months why Sunrise will take three years to complete, and what activities should be observable over this period. It's probably easy to think about it from the perspective of three buckets.

First, headcount reductions as a result of the reorganization to a functional structure is the first bucket, and will be the first to show results. However, it's also the smallest share of the cost reductions. The national restructure is the key that unlocks many benefits in the second and third buckets as well. It reduces layers, enables employees to impact operations across our entire business, and will drive standardized best practices.

The second bucket relates to operational benefits, including indirect purchasing, replenishment improvements, and operations cost reduction. An example of these activities is our ability on a countrywide basis to standardize specifications and pricing on goods not for resale, GNFR, also known broadly as indirect purchasing. Where we were operating on a regional basis before, we didn't have alignment with these products across the Company.

An example of this is that we have 59 different cake boxes across the country. This is obviously unnecessary.

In July, we had 25 of our operators get together to go through a significant amount of these SKUs, and we ended up with almost 100 percent alignment on the decisions from this meeting. As a result, we are preparing RFPs where vendors will now be able to bid on a smaller number of standardized SKUs on a country-wide portfolio.

The third and final bucket is cost of goods sold. We've benchmarked against our competitors, and we do pay a premium on our cost of goods. It's a function of us not using our scale across the country, and not having the best systems in place to track our all-in vendor cost and performance. This is the largest bucket and the one that will take the longest to recognize.

Our current structure, systems, and processes are not good enough, and cause confusion between us and our vendors. By unlocking our structure and centralizing our merchandising and by extension our procurement, we are simplifying how we collaborate with our vendors while leveraging our national scale. We will consolidate our current pricing structures in our systems and align with our vendor systems, which will give us the basis for negotiation and transparency on our cost of goods sold.

This is a very significant amount of work. We've allowed for two years of significant system changes and discussion with vendors while making the necessary improvements we need to make in our processes. These discussions have begun, and we expect that the majority of the savings will begin to be seen in the third year of Project Sunrise.

As Michael said, a good start to the year, but a great deal of work is still in front of us.

Thank you. And we are now happy to respond to questions.

Q&A

Operator

And as a reminder, if you would like to ask a question, please press *, followed by the number 1 on your telephone key pad.

Our first question today comes from Michael Van Aelst from TD Securities. Please go ahead.

Michael Van Aelst — TD Securities

Thank you. So good progress on improving the top line and the gross margins and on the costs. So congratulations on the quarter so far. But I wanted to ask you a bit about the ... about your pricing strategy during the quarter. The CPI for the quarter looked like it was down about 0.5 a percent, but you guys were up 0.5 a percent. So is this a function of you guys kind of pricing back—bring your pricing and your promotional strategies back to where you want them? And have you made it—are you back where you want now? Or is there still room to go on that?

Michael Medline

Hi. It's Michael. I'll take that. Yeah. First of all, I think there's three parts to this. One is that we did see—and it depends what you're looking at on CPI—we did see, obviously, deflation slow considerably over the last few quarters, and so that obviously helped. But the main thing here is us being far more disciplined in the markets: being priced right for our customers and being competitive. And a lot of the improvement was just more discipline in terms of our promo rate mix; just sort of the great basics of doing retail.

Having said that, we were responsive to competitors in the market. We're not going to, as you can see, we're not going to give up market share, but it was just discipline and a slowing of deflation really helped us this quarter.

Michael Van Aelst

Now is your—you had talked in prior quarters about the price investments that were made in the past, and that I think you were suggesting at times that maybe there—you said the prior management may have gone overboard on some of those. Do you feel like your pricing mix and your promo mix is where it should be now?

Michael Medline

Yeah. I think we made some good moves to lower prices for our customers and be more competitive, especially in certain key categories and key SKUs. We are now there. I like—yeah, I would say within a range you can always find a SKU here, a SKU there that every competitor has a tiny bit cheaper. But within a range we are priced right for our customers.

At the same time, we've upped our game in terms of shopping our competitors and making sure that we remain competitive.

Michael Van Aelst

And are you able to talk a little bit on a broad geography basis as to like how the different geographies are performing?

Michael Medline

Yeah. I can talk broadly about that, and give you a little bit of colour. As I said in my remarks earlier, we obviously to improve results like this we saw some good improvement across the country. But the provinces of British Columbia and Alberta and Saskatchewan really performed much better than we've seen recently, and better than, honestly, that we were counting on.

And the rest of the country was good, and our discount business continues to perform well. So there was—it was good performance across the country; maybe even a little stronger than we would have suspected nine or ten months ago.

Michael Van Aelst

Okay. Thank you. And just final question; I might have missed it. But on your discount banner strategy outside of Ontario, do you have any update you can provide?

Michael Medline

Yeah. I was expecting that question. The short answer is no, I don't have much more to provide. We've not made the decision yet whether to expand FreshCo. It's a complex, strategic decision that will be made in the near future. You can't let these things go forever. You've got to make a decision.

And we need to determine that, a) it fits with our strategy and, b) it doesn't distract from the other great initiatives that we have going on, especially Project Sunrise. Our data, FreshCo performance, and recent analysis we've done have moved me a little closer to expanding discount, being in favour of it, and it being a viable strategic and financial option. But we're not there yet.

If we're to expand discount, it would be in a small, organized fashion under the FreshCo banner. But we'd be converting stores rather than a greenfield approach, that's for sure. And I might say that the capital requirement would not be as large as some analysts have predicted because of the approach we would be taking.

Financially, I'm totally confident this would work. It's more strategically that we have to think this out and look at the opportunity. We've learned a lot operating this banner. So if expanded, the banner would be mutated, let's say, to encapsulate these learnings.

In the end—I want to be really clear—in the end, our current mostly conventional stores will be our driving force for the next five years, even if we do expand. But sometimes when I talk about this people try to read into it. We are still having to make that decision, and we're looking at all sorts of options and risks and analysis.

I hope that's helpful.

Michael Van Aelst

Yeah. Thank you very much.

Michael Medline

Thank you.

Operator

Our next question comes from Vishal Shreedhar from National Bank. Please go ahead.

Vishal Shreedhar — National Bank

Hi. Great quarter. Just in terms of the distribution initiatives that Empire was talking about, Mike, before your time, wondering where you are on those improvement initiatives and how much opportunity is left? And maybe how much benefit we saw this quarter?

Michael Vels

Thanks, Vishal. The distribution initiatives are not all complete. The Ontario distribution centre is completed, obviously. But we're still doing some conversion in our west, western distribution centre at Rocky View. In the west, the transition is actually going very well. We're slightly ahead of schedule, and it's hitting the targets.

In the east I think probably the best way to put it would be to say that our distribution footprint, the systems, and the configurations are in place and operating mostly to spec. There's always improvements you can make. But as we've talked about moving to a functional structure, our replenishment and our merchandising and our operational processes need to be better in our stores. And all of those processes at the end of the day are going to impact our distribution centres.

So a significant amount of the Sunrise work is to improve processes starting in our stores and in our merchandising group, which is still really being reorganized and just beginning to operate on a full geographical basis. So we actually think we're going to see better distribution results as our processes around our replenishments systems improve. And that would obviously increase the efficiency of our distribution centres.

But probably a longer answer than you wanted, but so far we're satisfied. But we do see further upside and the full realization of those returns on capital when we get the processes in our stores fine-tuned and allow our distribution centres to run better.

Michael Medline

Yeah. And maybe I'll just add one more thing, which is previous management before Mike and I were here made some very good decisions in terms of automating DCs. And we couldn't—we wouldn't be looking at the kind of savings that Mike's just talking about if those decisions had not been made. And in fact, we're pretty aware that some of our customers are looking at—some of our competitors, sorry, are looking at putting in very, very similar systems. So it puts us years ahead in terms of automation.

And I think we've a good showing of innovation here at Empire, so we're ahead of that even if they copy us and put in their own automating systems.

Vishal Shreedhar

Okay. Thanks for that colour. Just in terms of that comment you made earlier about as the store systems and processes get in place there should be a greater distribution savings opportunity, is that reflected in Project Sunrise? Or is that outside of it?

Michael Vels

It's reflected in it.

Vishal Shreedhar

Okay. And in terms of the FTE reductions, or the labour reductions associated with the distribution plan that was indicated, call it, a year or so ago, are those labour reductions all made as of today? Or are there still some pending?

Michael Vels

I'd say we're substantially through the plan, Vishal. There's some fine-tuning and some improvements, but we're substantially through it.

Vishal Shreedhar

Okay. And just one clarification on a comment made earlier in the preliminary script. Michael, you had said that e-commerce is growing quickly, but you don't anticipate it to be a significant portion of the business, call it, even five years out. I just wanted to get some colour on why you believe that's so, even with all the competitive change that we may be seeing over the next few years?

Michael Medline

Well, yeah, grocery's difficult to execute for e-commerce, but it represents such a huge prize if done well. So there's no doubt you have to be a strong participant in e-commerce and that—click-and-collect is one part of it, but the big prize is home delivery at the end of the day. This space is important to continue to grow, and it creates—even more than that, it creates a halo around bricks-and-mortar is what I've always found in my prior experiences. So—because customers think you're a dinosaur if you're not capable of e-commerce.

Look, Canada's trailing the US in e-commerce, and grocery is trailing Canadian e-commerce. So grocery was always going to be the last citadel to fall to e-commerce, and so in terms of our own strategy innovation's going to be a huge part of leapfrogging the competition. And with our new SVP, Marketing, we have—who has a lot of digital and online capabilities—we have an additional weapon in our arsenal. And we want to ensure we're providing an offer that excites our customers, so we're working hard on that strategy. And I got to be clear that it's not something that can wait until Sunrise is complete.

I talked earlier about our experiences in Quebec. We also have a very strong e-commerce business at Thrifty's in the west. But I think there's some myths out there. I just read an interesting piece in Moody's that came out at the end of August, and I think it's a really logical grounded analysis of Amazon's present, future in retail and particularly in grocery. And it's worth a read, if you guys get a chance to take a look at it.

Look, Amazon themselves I've faced them before in hard goods and soft goods, and watched them unfold and what they've done to retail for years in the States. And it was just a matter of time, obviously, before they came to Canada. And their strategy is so clear. So I'm a little taken aback at the sudden concern in grocery from Amazon coming in. It was inevitable.

At the same time, bricks-and-mortar for a long period of time is going to rule in terms of market share. And we have all sorts of strength and assets, more than almost anyone in terms of combatting e-commerce, and not only combatting it, but growing our market share and profiting from it.

So although we take every competitor very seriously and we're getting ready for Amazon and their ilk, for the next number of years our biggest competitors start with the letters W, M, and L. So we're—I think all of our strategy is pointing us in the right direction to be able to face all of our competition. But we take it seriously.

Vishal Shreedhar

Thanks for that colour, and continued success as you roll out your plan.

Michael Medline

Thank you.

Operator

Our next question comes from Mark Petrie from CIBC. Please go ahead.

Mark Petrie — CIBC

Hey. Good morning. I just wanted to follow up. When you were talking about better pricing discipline, is that—as being sort of one of the drivers of the gross margin and maybe the inflation, the internal inflation—is that pretty much across the entire business? Or was that maybe more weighted to certain geographies?

Michael Medline

Hi. It's Michael. How are you doing, Mark? No, we're now a national company. Even though we haven't done all of Sunrise, we're acting as one. And so —our strategies now, especially in merchandising, are national in approach. So I wouldn't call out any one region.

Mark Petrie

Okay. Thanks. And then I wonder if you could just comment a little bit about your work and your conclusions to this point with regards to the customer proposition overall? And where you see opportunities in the marketplace to perhaps refine what the Sobeys or Safeway or FreshCo or IGA banners mean to customers?

Michael Medline

That's a great question because obviously we're going to get these Sunrise savings, so how are we going to grow the business, which is the real prize. And I'm increasingly confident in our ability to do that. I talk a lot—and I will in a second—about brand and marketing and all that. The biggest way we can improve our same-store sales is with improving our stores and our promotions.

And that's what you're seeing right now. We haven't made a lot of gains in brand and marketing to date since I've joined. But you're seeing the disciplines in the stores, and I don't think people should discount what it means to have better execution in stores and better flyers and all the other things that go along with it.

And I think sometimes when I talk about brand and customers and marketing I don't talk about that. And that's the big prize at the end of the day. And interestingly, even with some of our travails of a couple of years ago, we didn't lose much in terms of transactions. We didn't lose customer counts. What we lost were basket size predominately. So customers for the most part were still shopping us, but they weren't giving us as big a piece of their wallet or their trust as we need.

And that's good. That's a good sign I'd say because they're still shopping us, and we have ways to get them back and get more share of wallet. So we're doing that right now. We're not waiting for any big brand strategy to do that.

At the same time in the long term I believe it's so important for any retailer to stand for something, to have a clear brand and brand promise, and we're getting there right now and doing that. And then having a story to tell. How are we differentiated from our customers? How can we thrill you? Which customers can we attract or get a bigger share of wallet? And then telling that story. And with the hiring of Deirdre, who has so much great experience, I've always been complimentary of Indigo and what they've done. We have now another member of the team who can help us in that journey.

So while we're doing that there's a lot we can do, though, in just pure execution, though I think I was pretty clear in my remarks that I was very pleased, although we have a long way to go in terms of our progress on that.

Does that help, Mark?

Mark Petrie

Yeah. I guess just to follow up, when you talk about sort of improving in the stores, I mean is that what sort of comes out of maybe part of that second bucket of the Sunrise prize? Or is that kind of maybe the question mark in terms of what's incremental—or what's sort of netted out against the $500 million and maybe doesn't necessarily fall to the bottom line, but does go towards rebuilding the top line?

Michael Medline

I think it's actually a third category, which is I think we have savings in Sunrise. We're going to have some reinvestment to the Company to drive sales, which will automatically go to the bottom line. And then there's the third, which is executing better, we don't count executing better in most cases in our Sunrise savings. Sunrise is optimization, for the most part, benchmarked across the Company across the country.

So I think obviously we've just started on Sunrise, so some of the better execution—now I'm not saying we're all the way there yet—but the better execution in our stores is already happening, and that's apart from Sunrise. That's just I really like this new structure we're putting in place, and although we haven't rolled it all the way down it's already having an impact in terms of being able to harmonize and put our best people on the right projects. And that's what I mean by store execution and better merchandising.

Mark Petrie

And sorry, just to follow up on that. When you're talking about seeing evidence of better store execution, is that, again, largely in the west? Or is that across the region?

Michael Medline

Well, I think west had a little bit further to come than some of the other regions. So they've improved comparatively better than the other regions. But it's not just me walking the stores and I can tell the difference. But we do probably more brand and customer research than any other retailer now, and we're seeing the start—don't want to overemphasize it—the start of better price perception by our customers and the start of a better perception in terms of what's going on in our store.

Like what I don't think we've done a good enough job of is what we want to accentuate even more, especially in our stores, and how to tell that story. And we'll be moving quickly, but that takes a while. It takes a while for people to notice. I think the good thing about grocery is that frequency is so high, so we didn't lose a lot of transactions or customers coming in over the last number of years. And so they can notice changes quicker than what you can see in general merchandise or soft goods.

Mark Petrie

Okay. I appreciate that. Thank you very much.

Michael Medline

Thanks, Mark. Thanks for your questions.

Operator

Our next question comes from Irene Nattel from RBC Capital Markets. Please go ahead.

Irene Nattel — RBC Capital Markets

Thanks, and good morning. Michael, in your prepared remarks you noted that the work that you guys are doing suggests that you're actually gaining back some share. Just wondering if you could share with us on what basis and where and how and categories, that sort of stuff, any colour?

Michael Medline

Sure. Mike, you want to take this one? I'll add any colour.

Michael Vels

Yeah. Sure. Irene, I'm not sure I'd overestimate that. Clearly, it's a combination of better execution, some better pricing, and as Michael said, moderating deflation that has helped our same-store sales. But our statistics are improving, and in areas of the country we are improving on our market share where previously this company had been for many successive quarters losing pretty significant percents of market share.

So I'd say it's a message of stabilizing, and in some key areas, starting to win some back.

Irene Nattel

That's great. Thanks for that. And I was also interested in your commentary around sort of some systems investments and system upgrade that you're going to have to make as part of Project Sunrise to get at the last bucket. Would you be able to again sort of walk us through in a little bit more detail where you think you're lacking and what you need to do? And how we should think of that playing through?

Michael Vels

I can't believe you asked me a systems question, Irene.

Irene Nattel

Always like to keep you on your toes, Mike.

Michael Vels

I'll try not to have the call go downhill here into a technical exposition of our systems, but I think the easiest way to think about it is the Company has operated in four regional areas. As a result, whilst the entire company is on SAP, it's in four different, call it instances, of systems. And so over time the Company's pricing structures and the Company's data and the processes around that have diverged. We can't run, for example, a countrywide vendor negotiation without some alignment between, a) our internal systems; and then secondly, between ourselves and the vendors' calculation of what they think their dead net cost is.

I could go on and on, but I won't, and show you areas of data that have diverged regionally where that can't happen if you're running a functionally led merchandising group, for example. So we're not blowing up and replacing systems; we're taking existing systems and data and processes around them, and we're harmonizing them. And we have to do that work. It is painstaking. It's not rocket science, but it has to get done and it has to get done correctly.

Then at the same time, we are also simplifying how our systems record and calculate cost of goods sold. And that is actually a fairly significant simplification and alignment issue with our vendors, and we need to do that one by one. So it's not very sexy work, it's not hugely risky work in most cases, and we are going to be relying on existing systems just with harmonized data.

I hope that's what you were getting at when you asked the question.

Irene Nattel

Yeah. No, that's really helpful, Mike. Thank you.

Michael Vels

Okay.

Operator

Our next question comes from Jim Durran from Barclays. Please go ahead.

Jim Durran — Barclays Capital

Good morning. So just following up on Irene's question about the systems backbone, can you give us a little bit more colour on how your merchandising organization will evolve in timing, and to utilize that data once it's in place or how it'll operate before that simplification gets put in place?

Michael Vels

That's a good question, Jim. I think maybe the easiest way to answer it—but then if you'd like some deeper dive into that, our Chief Merchandising Officer Lyne's here—but I think the easiest way to think about it is we've changed the merchandising structure, and that's in place and will be in place by the, call it, by the end of the year, say around sort of November-ish.

But then the new team needs to start working, and we have a fairly lengthy interim period where people will be still working on old systems, but transitioning into new. So we do have some pretty hard deadlines in terms of harmonizing data so that people can get a national look at the categories, and a great deal of that systems harmonization work needs to and will be done by the end of the year.

But we still have a fairly lengthy hand-over period where effectively individual merchandiser handing their desks over to people that will manage the entire country, and we're handing over the new data and the new systems and the training through a fairly extensive interim period, which will last into the spring of next year.

Lyne Castonguay — Executive Vice President, Merchandising, Sobeys Inc.

If I can add some colour.

Jim Durran

Sorry, go ahead.

Lyne Castonguay

Good morning. This is Lyne. If I can just perhaps give you two examples to what Mike is saying. I think what we're looking at is really harmonizing the tools that our category managers are using. And the two examples that I can give you is one is on planogramming. Now we're functional—a centralized national company, and we have three different versions of our planogram tools, for example. And so we want to try to get and harmonize our planogram tools to make it simpler for our category managers to manage their business.

Another example I can give you is on our promo planning tools we're utilizing various tools across the country. And so what we have done is really done a study of what are the tools that they're using today, what are the ones that will help with their productivity, and then how do we harmonize it so that we're consistent across the board. And then we're working on training obviously when we have the new team in place to train them effectively to be more productive. So we're looking at simplifying their life and giving them the right tools to do their business.

Michael Medline

And it's Michael. Just the last point, which is there's a lot of work involved here and a lot of effort, but it's not high capital.

Lyne Castonguay

Right.

Michael Medline

We're not talking much capital with what Mike and Lyne are talking about.

Lyne Castonguay

That's right.

Jim Durran

So simplistically we're going from having three or four individuals working with their dedicated regional system to—and I'm oversimplifying—but one person currently working with three or four different systems ultimately moving to one system.

Michael Vels

Yes. That is simplistically absolutely correct, Jim.

Lyne Castonguay

Good summary.

Michael Vels

Sorry, I didn't mean to say that, but yes, that is correct.

Jim Durran

So then—and from an organizational standpoint, I mean one of the key questions I get from investors is that they're just trying to understand the amount of disruption and movement of people, right? When we talk about the centralization time frame, are we talking about a lot of people relocating from where they currently reside to Mississauga? Or how should we think about that in terms of the amount of people movement and disruption prior to getting everything sort of all set up by the end of the year … end of calendar year?

Michael Medline

I could count probably the relocation on my hands and toes; it would probably even be fewer than that. This is not a major relocation.

Jim Durran

You've got 20 toes.

Michael Medline

Well, as far as you know, Jim. We know what happens when you try to do that, and that's not the plan.

Jim Durran

Okay.

Michael Medline

And it's expensive to do, so no.

Jim Durran

Okay. That's helpful. Thank you.

Operator

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

Patricia Baker — Scotiabank

Good morning. I have a couple of questions. First of all, Michael, I want to go back to some of the comments you made in your opening remarks, and I guess this also follows on your answer to Mark Petrie's question. But seemed to me that you've referenced the fact that you've done a lot of brand work and have a lot of data, and that you're ready to … that soon you'll be unveiling a new customer strategy. So first of all, I'd like to say that I'm actually surprised that you got all that brand work done so quickly. And then with respect to the new customer strategy, obviously that's waiting for Deirdre to come in, but do you have a vague time line or any time line you could share when we might actually see that executed?

Michael Medline

Yeah. Well, thank you for your question. The first is that, I think it was the second thing I did when I came into the Company, well, third thing—I met with the team, did a town hall, and then started the brand work actually day one—because I know how long it takes and how important it is, and they can't do anything until they have all that brand and customer work done. And it was done on an expedited basis, but really well-done.

And I don’t really want to put a timetable in terms of when you’ll see it. I mean we’re working right now on brand promise and where the white spaces are. But I would think that these things have a bit of a lead time. It’ll be the new year, probably next spring even before you see real changes.

But right now even as we see this brand work, Lyne, who’s been heading up marketing and doing a great job in the interim period on our team, you’ll already see things digitally and in other spots that already show that. You don’t have to wait for a big bang to know where the opportunities are.

So a little bit now and I’d say much, much more significant next year.

Patricia Baker

Okay. That’s helpful. And then you also in answer to a question said that the Company now is doing more branded customer research than anybody else out there. That I assume is incremental, and that is work that you started when you got there maybe on day one or day two?

Michael Medline

Yeah. I thought—two things. One is I came into a company that was already really quite good at it—better than I would have suspected: very strong team, very good data analytics. And every company I know claims to be so good at it, but this company is good; not great, but good at it. The issue was—and by the way, the Air Miles data we have is phenomenal. And we’re mining it well. I think we could do a little better job on it; we’re mining it well. But the real work in terms of understanding our customers in a different way than that, and identifying where we can beat our competitors and thrill our customers was not fully rounded out. And that's what we had to do.

So it was the new research and the research we already had and putting those together, and that's worked really well.

Patricia Baker

Okay. And where you've indicated that you're gaining market share, albeit small gains in market share, do you and your team have a really good handle on what the specific drivers were in the quarter or over the last little while that permitted you to gain that market share so that you know that you've captured what the solution is for the initial stages of getting stabilizing market share?

Michael Medline

I think at the basics, yeah. I'd say we have a ways to go. I mean remember, I mean when talk about gaining market share we're not where we want to be like thrashing our competitors and taking a lot of their market share and taking a loss in share of wallet. So I don't want to overstate it, but at the same time, yes, especially I'd say in British Columbia and Alberta. They've been doing some good work identifying where we had been letting down our customers—and we have a long way to go, as I said—but some better work there. I know now that Quebec is doing a lot of work as well, and I'm looking forward to that.

But I'm not going to bore you with all the details, but I'd say on the sort of the basics, yeah. In terms of marketing and some of the other areas that we're working on, no we have a ways to go.

Patricia Baker

Okay. Perfect. And if I could ask Mike a question, please. Think in your commentary, Mike, you indicated that you aim to get back to investment grade. Is there a time line you can share when you think you might get there? Or even any particular metrics that will be driving that for you?

Michael Vels

Over time, Patricia, this company is an investment-grade company. It has the market share, the assets, the position, and will have the disciplines and the capital structure that will clearly result in an investment-grade company, but in terms of time lines and targets, we actually don't have one. We've put our financing and our liquidity in place that is going to be pretty consistent in terms of the rates we pay and the cash we have available to us for enough time to complete the transformation.

So it's not a primary goal at this point. Our primary goal is to grow our top line, improve and stabilize our margins, reduce our costs, and we will maintain a responsible capital structure. And so over time with those outcomes this company is and will be an investment-grade company. So I think that's really the only thing I would say about it.

We're not rushing down any roads to try and push it or force it. This is about improving the Company, the operations, and our top line.

Patricia Baker

Okay. Well said, Mike. Thanks.

Operator

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

Peter Sklar — BMO Capital Markets

On this issue of the minimum wage increases in Ontario and Alberta, can you talk about some of the initiatives you're considering to mitigate those costs? Obviously automated checkout I would think would be one, but what other measures could you take?

Michael Vels

Sure. It's probably fair to say that it's a very long list of well thought-out improvements. No one silver bullet, I think as somebody on the call said. But maybe just to give you a bit of colour and give you maybe an example or so, Jason Potter, who is our EVP of Operations, is here and he can give you a bit of colour on that.

Jason Potter — Executive Vice President, Operations, Sobeys Inc.

Good morning, Peter. Thanks for the question. I think Mike already said it's important to note there's many, many tasks that we're reviewing. It's also important to note the leverage we're going to achieve across the entire business with our new structure is going to allow us to make these changes fairly rapidly which are underway standardizing best practices.

And a good example of this is non-customer-facing activities like our cash handling at the till. So we're in the process of changing the tasks related to cash handling which creates a more efficient front-end and less administration; all non-customer-facing activities that help the overall efficiency of the business to run well.

So I won't go through 100 of them, but there are dozens of tasks and activities we are reviewing. And we load those into our quite sophisticated earned labour systems in our stores, and we can measure those modules and make sure that they are in fact in place. So we're feeling good about what we've got in place for this fiscal year as far as the challenges we might face industry-wide related to minimum wage.

Peter Sklar

And, Jason, this long list of things you're considering, was that already underway? Or did the minimum wage announcements kind of stimulate this whole thinking process?

Jason Potter

So this is something that the Company does every year as part of our planning and review process, so many of the things that we review are already in flight. Clearly as time goes on we'll need to be very creative in our approach. You mentioned front-end investments and different activities or areas like self-checkout are things customers actually appreciate.

So we'll be reviewing the list we have, the activities we are undertaking, and with Sunrise there are new opportunities that have been identified that will allow us to be more efficient. But clearly we think it's a strategic advantage for us to have great interactions with our customers, and we're going to continue to invest in those areas.

Michael Vels

Thanks, Jason—I think it's important in the context of these tasks whether something that's new or old is maybe the more important factor is, as we've been saying, Project Sunrise will reduce costs of course in our back office, but it's the key to unlocking the leverage, as Jason said, and the power of these improvements.

So previously these improvements and these tasks would have had to be done in many regions. The fact that we're changing the functional structure enables all of these changes to be spread across the country quickly and urgently, and so the leverage and the dollar improvement is significantly greater than it would have been without Sunrise.

Peter Sklar

Okay. I get that. Thanks. And lastly, Michael Vels, I have one tax question for you. You gave the tax rate after taking out the effect of the Crombie transaction. But what would kind of be your clean tax rate be if you took out the Crombie transactions, as well as the Sunrise charges?

Michael Vels

Well, I'm not sure that I would take the Sunrise charges out of that because that is a taxable item.

Peter Sklar

But do the Sunrise charges attract a normal tax rate? I'm just trying to get at what is the tax rate of your ongoing business for the quarter.

Michael Vels

Yeah. They do. They're just straight cash expenses, and they don't have any unusual tax treatment. In my remarks, actually, I said excluding the Crombie effect our effective clean, if you want to call it, tax rate for the quarter would have been 26.2 percent, and the Crombie adjustment had a $0.02 impact.

Peter Sklar

Right. Okay. Thank you.

Operator

Our next question comes from Tal Woolley from Eight Capital. Please go ahead.

Tal Woolley — Eight Capital

Hi. Good morning. Is it correct to assume that you've given your vendor base a heads-up that COGS reduction is part of the Project Sunrise savings?

Lyne Castonguay

Good morning. This is Lyne. I would say two things. We have been communicating on a regular basis to our suppliers about Project Sunrise and our improvement. We are going to set a conference for our suppliers to give them more specific details on this—it's scheduled for the end of

October—so that we can share with them our expectations. We want to work with them collaboratively, and make sure that they're forecasting for this.

But it is clear that as we look to be a functional, centralized merchandising organization that we are going to go to one cost structure. And as Mike said in his comments, we just need to align on what that cost structure will look like.

Tal Woolley

And I'm assuming you've gotten some preliminary reactions from some of them. I'm just curious what it's been like, given that this is sort of going to be the second big vendor renegotiation project after Simplified Buy & Sell?

Lyne Castonguay

Yeah. I think that it was—quite frankly, I mean we had some great learnings in Simplified Buy & Sell, and there were some complexities as well. So when we talk to vendors, actually it has been so far very well received because they also want to simplify our business. So I've not heard any ill comments at all so far, so.

Michael Medline

Yeah. I mean—it's Michael—I think it's pretty clear to say that our vendor base is pretty happy that we're going to be more normal, let's put it that way, and that they're going to be able to deal with one team rather than five, six, seven teams. And so there's a lot of efficiencies as we work our way through this for our vendors, for our partners, as well as for us.

So yeah, there's going to be some little bumps here and there because we're now transitioning to a more normalized way of doing business. But I have seen nothing but smiles on our vendors' face that we're just going to be so much simpler to deal with, and it's going to be more like what they're set up to deal with.

So I think that although we'll have some interesting discussions in terms of how we do cost and price, this is the right way to go.

Lyne, do you have something else?

Lyne Castonguay

Yeah. I think one of the things that we have done as well is we have created a supplier partnership council where we have chosen some large and small suppliers across the nation so that we can meet with them on a quarterly basis, and also obtain their feedback on how we're doing as a partner with them. And I think this is going to be also—so we're listening to them, and I think it's going to be well received.

Operator

I'd now like to turn the call back over to Ms. Brine for closing remarks.

Katie Brine

Thank you, Carol. Ladies and gentlemen, we appreciate your continued interest in Empire. We are currently out of time. If there are any unanswered questions, please contact me by phone or e-mail.

We look forward to having you join us for our second quarter fiscal 2018 conference call on December 13th.

Goodbye.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.

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