FINAL TRANSCRIPT

Empire Company Limited

Second Quarter 2019 Results Conference Call

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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Empire Company's Second Quarter 2019 Results Conference Call. At this time, all lines are in a listen-only mode.

Following the presentation, we will conduct a question-and-answer session.

If at any time during this call you require immediate assistance, please press *, 0 for the Operator.

This call is being recorded on Thursday, December 13, 2018.

And I would now like to turn the conference over to Katie Brine, Director, Investor Relations. Please go ahead.

Katie Brine — Director, Investor Relations, Empire Company Limited

Thank you, Joanna. Good afternoon, and thank you all for joining us for our second quarter conference call. We will provide some short summary comments on our results and leave as much time as we can for questions.

This call is being recorded and the audio recording will be available on the Company's website at empireco.ca. As well, there is a short summary document outlining the points of our quarter available on our website.

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

Today's discussion includes forward-looking statements. We caution that such statements are based on management's assumptions and beliefs, and are subject to uncertainties and other factors that could cause actual results to differ materially. 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.

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

Thanks, Katie. Good afternoon, everyone. We are gaining traction. We are pleased with our results this quarter. We had strong same-store sales, two consecutive quarters of positive tonnage, stabilized margins, and Sunrise cost savings continue to manifest themselves on the bottom line.

Sales momentum continued in Q2. Same-store sales were 2.5 percent, the highest in 15 quarters, and food same-store sales, excluding pharmacy and fuel, were 3.0 percent. Internal inflation was 1.3 percent. Food tonnage was 1.7 percent. Sales were solid across the country, but most notably in Quebec, FreshCo, Safeway, and Sobeys Ontario. Customer count and basket size were both up. We saw inflation on food prices accelerate due to tariffs, transportation, and produce costs during the quarter. As we have stated previously, we will resist cost increases to the degree possible, but are starting to see the inevitable price inflation.

We have successfully stabilized our margins. The variance in gross margin rate over prior year is largely attributable to an increase in lower margin fuel sales and banner sales mix. Our food gross margin held steady.

EPS was $0.40, up 48 percent over last year. Our EBITDA margin increased 50 basis points over prior year, due to lower SG&A. We realized these SG&A improvements even after the impacts of store closure costs and headwinds facing the industry. And Mike will take you through this good news cost story in more detail in a few minutes.

We are often asked if there is any reason why our EBITDA margin cannot reach a comparable rate to our major competitors. The answer is, there is no reason. There will be slight differences due to structure, related to real estate assets and the relative size of pharmacy, but we're confident we can achieve comparable margins over the long haul.

We're excited about the steady and ongoing advancement we are seeing in our business. But as we ameliorate our execution and results and see tangible short-term gains, we are particularly proud of the moves we have made over the last year to set us up strategically for medium and long-term success. We are very pleased with the progress we are making across all of our key strategic initiatives—Project Sunrise, FreshCo 2.0, Farm Boy, and Ocado. We are halfway through Project Sunrise, and this initiative continues to progress exactly as we anticipated, on plan, on time. Again this quarter, we are more confident than ever in our ability to reach our Sunrise target of at least $500 million, and expect to see the vast majority of these cost and margin improvements fall to the bottom line.

Category resets drive a large portion of our Sunrise savings, and coupled with improved execution, will position us to win in our stores by ensuring our shelves are stocked with the items the customers want most. As we realign our stores wave by wave over the next year, we will see some slight changes to the brands we carry, but no material changes to the layout of the store. These changes may mean some minor disruption in the store, as with any realign. We are looking forward to seeing the very beginnings of category reset changes in our stores at the end of the third quarter.

The strong progress on our category resets program can be attributed to close collaboration with our supplier partners and the hard work of our team, especially our merchants. We are exceedingly proud of our merchants. We have imposed upon them a significant amount of change, and they have risen to the challenge. They are getting better each day at the blocking and tackling involved in executing as a national food retailer, while bringing home the savings on category resets.

I should also point out that we are seeing improvements in our stores in terms of in-stock, customer experience, and shrink levels. We still have plans to improve our stores, but we are increasingly proud of the efforts of our operators and teammates in our stores.

Another of our key strategic priorities is the expansion of our FreshCo banner to the west. We remain on track to open our first two FreshCo stores in Winnipeg in spring 2019. Our expansion of FreshCo to the west will allow us to convert some of our underperforming Sobeys and Safeway stores in markets which are better suited to discount, and to participate to a greater degree in this high-growth segment.

As I've mentioned before, our FreshCo stores will have evolved branding that more strongly signals discount and value. We piloted this refreshed branding in four of our London, Ontario FreshCo stores in June, and we continue to see extremely positive results in customer feedback.

Winning in key urban and suburban markets like the fast-growing GTA, where our market share is frankly too low, is another one of our key priorities for growth. I'm confident in the three-pronged approach we are taking to win in these markets.

First, our acquisition of Farm Boy gives us a winning format that will allow us to accelerate our growth in urban and suburban markets. We believe we will be able to build on Farm Boy's industry-leading growth, operational and customer metrics, and expect to double the size of the business in the next five years. We welcome Jean-Louis and Jeff and their exceptional team to the Sobeys family. We look forward to freeing them up to do what they do best.

Second, our smarter and higher-return capital investments in our discount and conventional stores will revitalize our existing store network in urban and suburban markets.

And third, our Ocado-powered e-commerce solution, which remains on track to launch in the spring of 2020, will position us well to expand our presence in the GTA and beyond.

The progress we have made over the last couple of years is thanks to the hard work of my teammates, especially our executive team. I find myself surrounded by a team that is committed to accountability, execution, velocity, and innovation. We are making strides in all of these areas.

We have great talent at Sobeys, which we are now starting to unleash, and we are very fortunate to be able to continue to attract strong talent. Sandra Sanderson joined us as our new Senior Vice President of Marketing a few weeks ago. Sandra is an exceptional marketing leader with a deep understanding of brand, customers, loyalty, and digital. Yan Branco also joined us two months ago as our Vice President of Produce Merchandising, obviously a key area for us. Yan brings with him over 25 years of experience in produce.

Given where we are in our transformation, we are extremely pleased with our results this quarter and our overall trajectory. I've always said, retail is a simple business: sales, margin, cost, and capital allocation. The trick is executing on these quarter after quarter, year after year, and we still have room to improve on our execution. We are putting the foundation in place and gaining traction, but we still have a ways to go to extract this Company's full earnings potential. So for any of my 120,000 teammates listening to this call, let's not get ahead of ourselves; we still have a long way to go.

And with that, over to Mike.

Michael Vels — Chief Financial Officer, Empire Company Limited

Thanks, Michael, and good afternoon, everyone. Firstly, some additional colour on our margins, Project Sunrise, and SG&A.

Gross margin dollars for the quarter increased primarily as a result of increased sales, and would have been higher except for three items. First, the closing of the 10 underperforming stores in Western Canada and the associated reduction in gross margin. Secondly, pharmacy gross margin was lower due to health care reform and the Alberta Air Miles inducement ban that was effective September 28th of last year. And third, increased transportation and other costs continued to have an impact, although some of these inflationary increases began to be reflected in the shelf price during the quarter.

The gross margin rate was lower than last year, impacted by a higher proportion of fuel sales which carry a lower margin, with the fuel price increasing materially but with a lower margin than last year. The sales mix between banners also had some impact on the gross margin rate, as margins vary between discount and conventional formats, and franchise versus corporate stores. Overall, our free margins were very consistent with last year and improved from the first quarter.

We are halfway through Project Sunrise, and as Michael said, it's on track. As we have mentioned previously, we estimate up to a further 30 percent of our $500 million target can be achieved during fiscal 2019, with the majority of this in the second half of our fiscal year. As we begin to generate benefits related to our category resets, we expect these to be reflected in improved gross margin, as well as sales.

Adjusted selling and administration expenses as a percent of sales was 21.3 percent this quarter, 130 basis point improvement. We are very pleased with this progress, and a large portion of this improvement reflects the achievement of our Sunrise targets for the first half of the fiscal year.

There were also several other positive impacts on SG&A during the quarter. First, we had lower incentive compensation costs this quarter compared to higher accruals in the prior year, and secondly, several more stores returned to consistent profitability in the second quarter. As a result, we were required to reverse additional impairments that the Company had previously recorded related to underperforming stores, primarily in Western Canada. This is a good-news story. For the remainder of fiscal 2019, at this time, we expect impairment reversals to be immaterial.

Minimum wage increases had an effect on the quarter, although we were able to partly mitigate this impact. Due to recent legislation in Ontario, passed into law on November 21st, we have reduced our fiscal 2019 estimate of the unmitigated impact of Bill 148 on our fiscal 2019. We initially estimated an unmitigated impact of up to $90 million, and we have decreased this estimated impact to be up to $70 million, a net $20 million improvement. Wages included in SG&A were also increased in addition to minimum wage, as a result of higher sales increases.

Although capital expenditures were lower than last year, we continue to expect total capital expenditures of approximately $425 million for the year, based on significant planned activity in the second half of the year. This includes construction of FreshCo stores in Western Canada, rollout of the new FreshCo designs in Ontario, and multiple store innovations and improvements in the rest of the country.

This capital estimate for the year does not include Farm Boy capital estimates. We will update our estimates to include Farm Boy in the third quarter.

The Farm Boy acquisition closed on December 10th, and has been set up to operate as a separate company within Empire's structure, under the leadership of Jean-Louis Bellemare and Jeff York, who, together with members of their management team, will continue to own 12 percent of the Company. The acquisition was financed through a combination of cash on hand and a new $400 million senior unsecured nonrevolving two-year credit facility. Farm Boy has significant and continuous growth in same-store sales and EBITDA, which we expect to continue as we seek to double the size of the Company in the next five years.

Cash flow generation continues to be strong. The sustained strength in our sales, along with the continuous cost reductions due largely to Project Sunrise, maintain our confidence that the Company will return to its investment-grade rating in the near future.

Lastly, on November 20th, we pulled romaine lettuce off our shelves in response to a notice received from the Public Health Agency of Canada, linking several confirmed cases of E. coli. We have now sourced romaine lettuce from a different, unaffected region, and it is back on our shelves. While this did not impact results for the second quarter, we do expect some impact on gross margins in our third quarter.

As we look forward to the second half of the year, we remain confident that our work related to the category resets will be reflected in expanded margins. Our merchants have been in their new roles for a while now and are gaining traction. The risk we identified related to our merchandising is much lower as time has passed.

In terms of timing between the next two quarters, we are still in the process of finalizing arrangements with all of our suppliers. But based on our store execution plans and our latest view of supply arrangements, we expect significantly more benefits to be reflected in the fourth quarter of the year, with some of these benefits beginning towards the end of our third quarter. I will also note that historically our third quarter has not been as strong as our second quarter.

Our most significant risk and focus for the next few quarters is ensuring that we execute on the category reset plans in our stores, with minimum customer disruption and cost. This is a great deal of work and we are relying on our teams in the stores to execute with excellence. We're not yet in the clear, but we are very satisfied with our momentum to date.

And with that, I'll hand over to Katie for questions.

Katie Brine

Thank you, Mike. Joanna, you may open the line for questions at this time.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the *, followed by the 1 on your touch-tone phone. Should you wish to decline from the polling process, please press *, followed by 2. If you are using a speakerphone, please lift the headset before pressing any keys. One moment, please, for your first question.

And your first question is from Patricia Baker from Scotiabank. Patricia, please go ahead.

Patricia Baker — Scotiabank

Thank you very much. Good afternoon, everyone. I have two questions. We talk about the business on a year-over-year basis when we look at the quarters. But given what you're trying to do, I'd be very curious if you could share with us, if we compare Q2 to Q1, so on a sequential basis, what kind of improvements did you see? Where was the progress if we look at Q2 versus Q1 as we proceed through into the back half of the overall transformation plan?

Michael Vels

Hello, Patricia. I think I'd really point out two things. First of all, the momentum that we had in the first quarter related to same-store sales and tonnage improved over the first quarter, and we feel we have some momentum on those lines.

Secondly, I think we were fairly clear that, while we felt our margins were stable in the first half, we would have preferred that we'd passed on some of the cost increases into our pricing, and felt that we had some compression in our margins in the first half due to that. That has significantly improved in the second half as we started to pass along costs, and that's been reflected in our internal inflation. I'd point to those two items as being probably the two things that we're most happy about.

And of course, while we keep saying we're on track with Project Sunrise, that's no small feat. People are working very, very hard to remain on track and to generate the improvements quarter over quarter on a consecutive basis. So those would be the three things that I would point out.

Patricia Baker

Okay. That's an interesting point that you make that the Project Sunrise, very, very big three-year transformation plan, very ambitious to get out at least 500 million in costs. And to date, to be fair, you guys have delivered exactly to everything that you've promised and, as you say, are very much on track and on plan. Is there any one thing that you would attribute to the fact that you've been able to do this without, so far, knocking on wood, any hiccups in the execution?

Michael Medline

Yeah. Hi. Thanks, Patricia. It's Michael. I think it's that the Company is becoming more and more disciplined and much more process-driven. And that when you do these type of projects, and basically everything we're trying to achieve here, that we do them in a far more thoughtful and planned manner, and that we hold ourselves and our teammates accountable for every single deadline and every single number. And if there is any slippage, we get it back on track very, very quickly. And so I think that's a credit to the people on this call with me, but also to our teammates across the country. But that's what it is, it's just every single day being able to execute. And that's very difficult for companies to be able to do, and we're getting much better at it.

Patricia Baker

Okay. Sounds like there's a lot of vigilance.

Michael Medline

Oh, yeah.

Patricia Baker

Okay. Thanks a lot, Michael.

Operator

Thank you. Your next question is from Mark Petrie from CIBC. Mark, please go ahead.

Mark Petrie — CIBC

Good afternoon. On the SG&A, as you called out a couple of sort of onetime items or nonrecurring items there, what's your sense or estimation in terms of the organic SG&A growth in the business today? And what's your expectation for the next sort of 12 to 18 months?

Michael Vels

So we did point out elements of our SG&A, Mark, that we expect to be nonrecurring, and which you shouldn't annualize, so you picked up on those. Moving forward, we feel we've mitigated to the extent possible most of the minimum wage increases that we can, so I think the wage costs that we're seeing in our quarter are probably pretty consistent with where we'd expect them to be going forward. And beyond that, we continue to see annualized impacts or positives related to some of our indirect sourcing initiatives that do show up in SG&A. And we are continuing to fine-tune our organizational design, and probably expect to see some minimal improvements on that going forward.

So I hope that gives you the colour you were looking for. We're not projecting a particular target on SG&A as percentage of sales or anything like, but I think we're stable on our wage line, I think we still see significant improvement in call it non-labour costs in SG&A that we're still getting at with indirect sourcing, and probably some fine-tuning on our labour as well, on our backstage salaries as well.

Mark Petrie

Okay. I guess that second point was sort of what I was trying to get at, which is kind of the benefits still to flow through from earlier achievements or earlier progress related to Sunrise. I mean, how much of that is sort of embedded in the business today versus incremental from here?

Michael Vels

I think a significant amount is imbedded in the business, is the short answer to that. But the elements that we haven't really started to address as a national company are those natural optimization opportunities that you can generate with a well-functioning purchasing team, improved systems that help you with your processes, and just help make you more efficient. If you sort of step back and just think about what we've been doing over the last two years, we revised our organizational structure, and now we're heavily into category resets, and those are hard things to achieve but they've got big returns associated with them. As those are behind us, we're going to put our minds very much to optimizing the remaining structure. And as I said, there's all kinds of purchasing savings that we think we can access, but those are in the future, and we expect to see some of those reflected in SG&A for sure. So after we finish achieving at least our 500 million, we're going to turn our minds to what else we can do.

Mark Petrie

Okay. Thanks. And then I just wanted to ask about FreshCo and the pace of rollout that we should think about for 2019, after the two initial stores in Winnipeg, and also in terms of pace of the renovations or refreshes in Ontario. And then I guess also just any update with regards to your labour negotiations in BC.

Michael Vels

Okay. That's a lot of questions. So for 2019, as we've outlined, we're heavily engaged in getting our Winnipeg stores on the ground, and we're on track to get those done in the spring of 2019.

On labour negotiations in BC, those are progressing. We're almost complete, and we believe that resolution on that will be achieved in the short term, and we will obviously progress immediately with our plans in BC. Too early at this time to give you a definitive answer on when those stores would land in BC, but we actually feel pretty good that we'll be in action there fairly soon.

And on our rollouts in Ontario, our real estate group is in process today, and targeting the first stores that will be rolling out over the next sort of second half of the year. But we'll update those plans probably in more specific detail as we report our third quarter results.

Mark Petrie

Okay. Appreciate it. Thank you.

Operator

Thank you. Your next question is from Peter Sklar from BMO Capital Markets. Peter, please go ahead.

Peter Sklar — BMO Capital Markets

On the retail food inflation you experienced in the stores, as I recall, I think you disclosed that at 1.3 percent, and you've talked about that like it was more of a Q2 effect, that you're able to pass through costs. How is that unfolding as you exit the quarter and as you are in the early part of Q3? Does that ability continue, as you continue to pass through costs? Is inflation accelerating? Decelerating? Any flavour would be welcome. Thanks.

Michael Vels

Hi, Peter. Yeah. We continue to monitor and push back on price increases, but at the same time some of them are merited by our supplier partners and that we're passing on those costs, as we said we would.

Peter Sklar

Okay. And is your expectation, the level, is it about the Q2 level? Or it's increasing or decreasing? Or it's difficult to comment?

Michael Vels

It's about the same.

Peter Sklar

And then lastly, on your tonnage, I think you disclosed that tonnage growth was 1.7 percent, which is quite a robust tonnage number. Obviously, you'll be taking market share with that kind of tonnage growth. I'm just wondering if you can talk about why you're having that kind of success on your tonnage. Is it your promotional program? Are there other things you can point to? And I know you can't talk about who you're taking share from, but is it coming from regions or certain competitors? Or is it a little bit here, there, and everywhere, that you're taking share?

Michael Medline

It's here, there, and everywhere. It's easier when you're not doing well to explain it, I think sometimes, than when you're doing well. I'd say that in almost every area of our business, we're just performing a little bit better, so the stores look better, there are fewer holes. The teams across the country are in their jobs a little longer and they're getting sharper. But I would say that our fliers are smarter and they're better presented, and the team there is doing a good job. But it's overall just, retail as you know, a million little details, and we're just getting a little better at everything. And there's not usually a silver bullet, and there's not here. Just doing our job better.

Peter Sklar

Okay. Thank you.

Michael Medline

And the other thing I would add, I guess, is that all the regions are starting to pull their weight as well, and we're proud of the performance across the country. You can't be gaining tonnage, you can't be seeing the kind of comps that we saw with too many outliers. So it's just good, consistent performance across the country.

Peter Sklar

And, Michael, how does the West feel to you, given what's going on in energy? Does it feel a little bit light?

Michael Medline

First of all, yeah. I mean for the people in the West, I wish the economy was doing better out there, and that things were easier for them. But honestly, I said that we'd seen good sales in Safeway; we're seeing much better performance out West than we have been for some time, which is admirable in the face of what some of the economic challenges that Canadians out there are facing.

Peter Sklar

Okay. Thanks for your comments.

Operator

Your next question is from Vishal Shreedhar from National Bank. Vishal, please go ahead.

Vishal Shreedhar — National Bank

Hi. Thanks for taking my questions. Maybe we'll just start, given that it's such a major focus for Empire right now, if you can just explain at a high level what these category resets entail, why they're so significant to the Company in terms of margins and sales potential, and what are the key risks associated with them.

Michael Vels

Sure. In terms of just providing some of the granular detail or maybe some examples; Pierre could give some colour. But the overarching goal here is, having completed our organizational redesign and put people in their jobs, and in places that now allow them to have a full vision and full control over the entire country, and with one person or a team of people now controlling each category on a national basis, we are now using our scale and our improved analytics to reset every single one of our categories, based on the strategic plan that each of the merchandisers has put in place for that category.

That is yielding several benefits. First of all, improved, simplified, and in some cases more innovative or better assortments for our customers. And secondly, a rationalization and improvement of our supplier base, which has led to efficiencies both in our assortments and cost reductions, as we've been able to negotiate new pricing and new costs with significantly larger volumes at play, instead of what the Company was doing in the past, which was working their categories and their negotiations on a regional basis.

In terms of the risks and progress, Pierre, do you want to give a little bit colour on that?

Pierre St-Laurent — Executive Vice President, Merchandising and Quebec, Empire Company Limited

Yes. I think the bigger risk is the status quo, because we're complex across the country, and we simplified our business, like Mike said. The risk is more behind us. I mean, because the risk was more associated to the fact that we are renegotiating everything, we reviewed every category, and at the same time, we have to drive the business. So with the results we've got in Q2, we're really happy to see that we're able to manage that program really well, and at the same time deliver results.

So we’re in the middle of reviewing every category. The next step is to land in store after Christmas, after a very key period for us. And honestly, in term of merchandising, the worst is behind us, and we see a big opportunity in the discussion we have with suppliers. And so far, we’re very happy with the progress we’re making with the plan, with designing, with suppliers, and then the next step is to land in store. But also, redo the plan-o-gram in store, it’s normal course of business; it’s just the magnitude will be a bit greater. We’re working really closely with operations to land in our stores appropriately by waves, without disrupting the stores. So that’s where we are now. But I think in term of merchandising, the worst is behind us, and the next step is to land in store.

Vishal Shreedhar

Okay. Thank you for that colour. I guess given that there have been so many changes at store in such a short period of time, I mean you guys are doing a lot of things at once, and I guess you’re continuing to do them. Have you noticed—and Michael, you may have alluded to this off the top—but have you noticed improving customer perception of your stores? Do you see the net promotor scores or whatever metrics you track?

Michael Vels

So we’re not in position to provide statistics on that, but I’d say the short answer is, yes. But Lyne is here and she’s running the operations, and made material improvements in the stores, maybe she can give you some more colour to that.

Lyne Castonguay — Executive Vice President, Store Experience, Empire Company Limited

Thanks, Vishal. We are seeing our scores move in the right direction, and we're very pleased with that. We are monitoring our stores, and it's something now that we are actually keeping top of mind and in front of our operators, to talk about our customer experience, and making sure that we are taking care of our customers and that we're looking at their comments, and that we're talking to our customers and staying close to the feedback. But we are indeed seeing improved scores, and we're pleased with the progress we're making. As Michael says, we still have some progress to be made, but we're moving in the right direction.

Vishal Shreedhar

Okay. Thanks for that colour. And just a quick one here, just for our own modelling, so we can model a bit cleaner here. I know in H2, the Sunrise benefits will be weighted towards Q4. But in H1 of fiscal '19, were there Sunrise benefits of any magnitude, so that when we think about H2, we should take that out?

Michael Vels

Yes. We did have Sunrise benefits in the first half, because we annualized the benefits that we generated the year previous.

Vishal Shreedhar

So incremental benefits?

Michael Vels

Yes, that's right. So we have incremental benefits in the first and second quarters, and that would be part of the net 30 percent that we talked about for this year. But the majority of that benefit really is in category resets, and it'll be mostly in the fourth quarter, starting late in the third.

Vishal Shreedhar

Okay. So I should think of the majority of that 150, not all of it, split towards Q4? That's a fair way to characterize that?

Michael Vels

That's right.

Vishal Shreedhar

Okay. Thanks for your help. And congrats on the quarter, guys.

Michael Vels

Thank you.

Michael Medline

Thanks, Vishal.

Operator

Thank you. Your next question is from Jim Durran from Barclays. Jim, please go ahead.

Jim Durran — Barclays Capital

Great. Thank you. Good afternoon. Just interested, you were mentioning that there was that one region that was not performing as well as the rest of the chain, and I assume that that might focus to Alberta specifically. Can you talk about what improvements you've made at the Safeway business and the Sobeys business in that market? And whether there's additional stuff you can do in that market to try and regain stronger momentum and catch up to the rest of the business? Or is the economy just too tough in Alberta to expect the business to be able to ramp up that way?

Michael Medline

Yeah. First of all, there wasn’t a region that we were displeased with, and certainly not Alberta. We’re seeing a lot of progress across the country, but in that region too, thanks to a lot of things that are going on. But our flyers are sharper, our stores are much better. If you walk our stores, compare them to how they were, they’re much sharper. And our marketing’s better, and I think with Sandra joining the team, that’ll even get sharper.

You saw that we reversed for the second quarter a row some impairments in the West. Frankly, I’ve never seen reversals in impairments; usually, you impair something, its impaired. But I think that’s tangible evidence of the improvement we’re seeing in our stores, where even stores that we didn’t think could recover and see better results are seeing better results, from, first of all, the stabilization of margin, and also from exciting our customers more, and better practices in the store. There’s still some work to do to get back the share that we had lost. But we’re working hard to accelerate the pace of that.

And so I think the West, and there’s a multipronged strategy, including conversion of some of the stores to discount, is one of our actually most significant opportunities for success and improvement. So as a whole, I’m not going to say I’m pleased, because I’d like to see more, but I’m somewhat pleased in terms of the progress we’re making. A lot of it reflects the progress we’re making across the whole country.

Jim Durran

Going back to your comment up front about margin achievement versus peers. Historically, one of the explanations that was provided was that perhaps Empire Company's sales per square foot across the country is not as robust as some of your competitors, and so that becomes an impairment in terms of SG&A leverage, et cetera. Would you say that your productivity on average is lower than your peer group? And that part of the opportunity, which isn't part of Project Sunrise specifically in the cost savings bucket, is to try and significantly increase your productivity over the course of the next three-plus years?

Michael Medline

Absolutely. I mean, when you look across country, in most regions, we have the best locations, we have great assets. And I think as we look forward and we see category resets—which are going to make the store stronger at the end of the day—and better execution, that we have real upside to gain in sales per square feet, and that'll really make a difference. So I couldn't agree with you more.

And by the way, it is all regional. In certain regions, we have more to gain. But you see a region like Quebec, where historically, being strong, it's even getting stronger. So there's ones that are below par that we'd like to get up there, and there's some that are incredibly strong that we still think there's room to gain.

Jim Durran

And I know we're probably getting too far ahead of ourselves, but to what degree does consumer brand message and any materially different merchandising strategies play, when you get into sort of the latter part of next year, in terms of trying to capture some of that upside?

Michael Medline

Yeah. I think, as I said, that our brand messaging, our marketing has improved appreciably, but it's nowhere near where it's going to be a year from now. And we have a lot of good plans, and we have some great leadership. Not only Sandra, but Trinh, and the leadership that Lyne brought in while she was double-dutying in merchandising and marketing, and then operations and marketing. Lyne's got a bit more time now. But I think we're on a good path there, and I think there are some—I'm not going to say what it is—but I think there's some marketing opportunities that we haven't fully taken advantage of that will connect us even closer to our consumers. I'm getting more and more pleased and excited about how we're using data, and how we're going to use data in the future to be able to serve our customers better.

Jim Durran

Great. Thanks, Mike.

Michael Medline

Thank you.

Operator

Thank you. Your next question is from Michael Van Aelst from TD. Michael, please go ahead.

Michael Van Aelst — TD Securities

Yes. Thank you. Just back to Project Sunrise. So I appreciate the colour about being stronger as you get to the end of Q3. Can you give us a little bit more colour, though, as to the percentage of vendors that you are negotiating with presently? Are you basically negotiating with them all at the same time, for the most part? And will we see the benefits of these negotiations all start quickly into the new calendar year? Or is it going to ramp up considerably throughout next year as well?

Michael Vels

The short answer, Michael, is it's going to ramp up. So we are negotiating in, I guess, internally, we call them waves. Each of them is material. There's three big ones and one slightly smaller one, so a total of four. And one of the reasons for that is, we can, theoretically, I suppose, have negotiated with all suppliers at the same time, but we need to manage the operational impact and how we get to the stores. So we have scheduled them over F2019 and F2020, and that's why the Sunrise benefits are only annualizing the full 500 by the end of F20. So yes, we start seeing some benefits now, and that is slightly earlier than we had anticipated probably when we started a year-and-a-half ago. But they do phase in, and they are spread over time.

Michael Van Aelst

And, I mean, this is the last big bucket of savings, correct?

Michael Vels

Yes.

Michael Van Aelst

You did the headcount reductions, and you've gotten a lot of the goods not for resale? All right. Okay.

Michael Vels

Yes. That's right.

Michael Medline

As part of Sunrise.

Michael Van Aelst

Right. Exactly.

Michael Medline

Yeah. We’re not going to stop.

Michael Van Aelst

No, I hope not. And then on Ocado, I know we’re still over a year away from the first one opening, but how far along are you in terms of determining where your next-year locations, and when they’ll be opening?

Michael Medline

Yeah. We were just talking about that today, and we haven’t made a final decision yet. But I think in the next four or five months or so, we’ll know when the timing is and what the next CFC will be.

Michael Van Aelst

All right. Thank you.

Michael Medline

Thanks.

Operator

Thank you. Your next question is from Chris Li from Macquarie. Chris, please go ahead.

Chris Li — Macquarie

Good afternoon. Just first question is, where are you guys in terms of implementing initiatives to reduce in-store labour costs with things like self-checkout or electronic shelf tags? And also, is improving your in-store labour cost part of the Sunrise savings? Or are they incremental?

Michael Vels

We had, in the first wave, I guess, of Sunrise savings, we had some immediate benefits that we counted in the early going, related to becoming more consistent with our standards for labour in store, becoming more consistent on processes, and improving just some of the efficiencies within our stores. I think we were satisfied at the time that we gained a lot of low-hanging fruit, just through becoming more consistent.

As we go forward, innovation in our stores through, whether it's self-checkout or anything else, is not really designed to reduce labour. It's designed to delight customers. And maybe all this talk of cost reduction gives people the wrong impression. But the really significant benefit here is improving our sales, as I think one of you mentioned, becoming better from a productivity perspective, and that's going to require innovation and better merchandising. And if self-checkouts are one of the innovations we think about, it's going to be something that makes the customer feel better about being in our store. We're not going to be a reduce-our-labour-at-all-costs company. That's really not the way; we can't shrink ourselves to greatness. We're comfortable with what we achieved in the first part of Sunrise. We're on to bigger and better things, which is customer experience and getting our resets correct.

Chris Li

Okay. Great. That's helpful. And just maybe on private label, where are your thoughts on that right now? I know next year, you are planning to do something with the program there. If you can give us on update on what you're thinking on that, it would be helpful.

Michael Medline

Yeah. We're going to make some major changes next year in our presentation of private label, which we think is going to be great for the customer, and it's going to make it far more relevant. And I don't want to tell people who may be listening what those changes will be, so I'm sorry, I can't.

Chris Li

No problem. That's understandable. And maybe just a longer-term question. In my view, I mean I think there is a pretty clear line of sight to your earnings growth over the next year-and-a-half, because a lot of the growth obviously will be driven by Sunrise. But it becomes perhaps less clear as we head into fiscal '21, because there will be other things at Ocado, and you expand out West, and I can appreciate that we're still a couple years away and so it's not easy to really quantify the impact. But longer term, Michael, what do you see as your sustainable earnings power over the longer term? I know some of your peers in the past have talked about 8 to 10 percent EPS growth. Do you think you can do better than that, given the things that you are doing?

Michael Medline

Yeah. It's a bit of a mug's game. I mean if I said 8 to 10 percent, you'd kill me, because this Company has the potential to do better than that, but we have not publicly said what we're going to do on that. I think you've got to judge the progress we've made to date, and what your confidence is that we're going to continue to put up initiatives, especially on the top line, and continue to take out costs, and invest better than we ever have before. I think we don't talk about capital allocation a lot on these calls, but that is one of the places where, especially Mike and myself and the senior team, put a lot of our time in terms of where are we going to invest in the stores, in technology, in innovation going forward. And so I think that this company is, I mean if you think about what our strategy really is, it's—

just to put it down in really simple terms—execution and innovation. And on both of those, we have a long way to go before we're worried about improvements in the Company.

Chris Li

Okay. That's great. And my last quick question, just modelling, I guess for Mike is, how much of the unmitigated minimum wage impact of the 70 million this year, how much of that has already been incurred in the first half of the year, roughly speaking? Is it half, or?

Michael Vels

Probably a little less than half, I would imagine, but close.

Chris Li

Great. Okay. Thanks, and happy holidays, guys.

Michael Medline

Yeah.

Michael Vels

Thank you.

Michael Medline

Merry Christmas, happy holidays.

Chris Li

Thank you.

Operator

Thank you. Your next question is from Keith Howlett from Desjardins. Keith, please go ahead.

Keith Howlett — Desjardins Securities

Yes. I had a question on the four waves of reset. Would you have completed negotiations on wave one, and are just waiting to land them in the stores in January, post-Christmas? Or are you still in the midst of the first wave?

Michael Medline

The former. We're basically finished wave one negotiations, and are just going to put them in after our quiet period after the holidays, and they'll be going in at the beginning of the year. So wave one is generally complete. And then we're going to start working through wave two now.

Michael Vels

Yeah. I just wanted to clear that, as Michael said, we're going to be going in after the holidays, but they're not all going in at the same time.

Michael Medline

No.

Michael Vels

So we are spreading all of the categories over a period of time, the first one due to go in beginning of February.

Michael Medline

Yeah. And when I said we had a lot more process, we have waves, we have tranches, I don't want to bore you with all the details, but there's a lot of precision and planning going into this to make sure that we do this right.

Keith Howlett

And when you characterize how it's going when you report Q3, I'm just wondering, will you sort of say we've negotiated with 30 percent of our dollar value of purchases, and we have realized X amount of savings? Or how will you characterize the Sunrise benefits?

Michael Vels

I think we'll deal with that when we get there, but I think we'll give you a good feel for how it's going, how it impacted our third quarter. I think we'd be comfortable with explaining that. But as I said, because of the timing, a lot of the benefits will be in the fourth, but we will be able to give you maybe a more precise update at that time.

Michael Medline

Yeah. And maybe a bit more colour. Wave one and two are the larger waves, and they're pretty close in size to each other.

Keith Howlett

And the benefit of Project Sunrise in the first half of this year, excluding the annualization of the cost savings of last year, do those relate in any way to reset? Or they're sort of another group of savings?

Michael Vels

No. They're another group of savings. So not all of the Sunrise benefit is reset for 2019. We have the annualized effect of what we did last year, plus some new initiatives on indirect sourcing, for example. So the number that we provided is inclusive of all of those positive effects as well, many of which are being reflected in the first and second quarters.

Keith Howlett

And then just a question on the management incentive compensation. Was the peak quarter in fiscal ‘18 the second quarter? Or is there—I guess it depends on the share price performance—but is there likely to be any further year-over-year benefit this year on that front?

Michael Vels

Yeah. I think the short answer is yes, because we were accruing last year to higher payouts, and that continued all the way through the year. So yes, you should expect to see a positive variance in our third quarter, and I think probably also in our fourth, unless we over-deliver on our results and accrue for a higher incentive payment in the fourth. But yes, all things being equal, you should see some continued positive variances for the second half.

Keith Howlett

Sorry, and just one last question on Western Canada; will have the two FreshCos this year in the spring. Would you anticipate the pace would sort of really step up to a dozen in the next year? Or is it going be sort of an ongoing ramp of those inversions?

Michael Medline

I think we’ll give you a little bit more colour next quarter, because I think you’re owed that. But it will certainly be accelerating pace.

Keith Howlett

Great. Great. Thanks very much.

Michael Medline

Thank you, Keith. Have a good Christmas.

Operator

Thank you. There are no further questions. I will now turn it back over for closing comments.

Katie Brine

Thank you, Joanna. Ladies and gentlemen, we appreciate your continued interest in Empire. If there are any unanswered questions, please contact me by phone or e-mail. We look forward to having you join us for our third quarter fiscal 2019 conference call on March 14th. Goodbye.

Operator

Ladies and gentlemen, that concludes today’s conference call. We thank you for participating and we ask that you please disconnect your lines.