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PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Empire Fourth Quarter, 2021 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 star zero for the operator. Also note that the call is being recorded on Wednesday, June 23, 2021.

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

Katie Brine — Director Finance, Investor Relations, Empire Company Limited

Thank you, Sylvie. Good afternoon and thank you all for joining us for our fourth quarter conference call. Today we will provide summary comments on our results and then open the call for questions. This call is being recorded and the audio recording will be available on the Company's website at www.empireco.ca. 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; and

Pierre St-Laurent, Chief Operating Officer, Full Service.

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 & Chief Executive Officer, Empire Company Limited

Thanks, Katie. Good afternoon, everyone.

Last year's Q4 results were unprecedented. We were at the peak of COVID panic buying. We saw off-the-chart sales and margin growth. So we knew last year's results were going to be challenging to repeat, but we did match them.

There are three things you should take away from our results today. One, we're making consistent progress on executing Project Horizon. It's how we matched last year's outstanding results. Two, we're driving real sales growth. Three, we're maintaining good cost control even while investing more in our business. Our strong cash flows allow us to make these investments while returning more money to you, our owners.

Like all of you, I hope things get back to normal soon. Most importantly, for the safety of our frontline teammates and customers and our country, but also because when we return to normal you will see clearly what a fundamentally stronger company we are.

I want to cover four topics today: our capital allocation strategy, our Q4 results, our future grocery market expectations, and our progress on Project Horizon.

First, capital allocation. Mike and I have discussed this with you a lot over the last four-plus years. We are strong believers in the power of a well-executed capital allocation strategy. The strength that we have built in our operations and merchandising, plus our strategic investments in renovating our stores, Farm Boy business, FreshCo expansion, Voilà, and now Longo's, have put us in an enviable position.

When Mike and I joined Empire, we lacked rigor here in our approach to capital projects. Today our team has the capability to effectively manage capital in our organization. We have shown we can identify great projects with very good returns, and we deliver on them consistently. Over this time, we have also made two excellent acquisitions, reduced our net debt, and achieved an investment-grade rating from our credit agencies.

Returning capital to shareholders is an important part of our strategy. It's why we have continued to increase the dividend and have been buying back shares. To that end, today we announced a 15.3% increase in Empire's quarterly dividend per share, commensurate with our strong cash flows and continued and growing confidence in our business. We also believe that share buybacks are a useful tool to utilize excess cash. Today we announced that we have renewed our NCIB to repurchase up to 8.5 million shares or 5% of our outstanding shares. Combined with the prior NCIB, this enables us to buy back the shares issued for the Longo's acquisition and more beyond that.

And we are doing this while still investing in future growth. For fiscal 2022 we will increase our capital spend to $765 million, which includes Longo's capital projects. Capital will be deployed to renovate and refresh current stores, continue to build out our Farm Boy network in Ontario and our discount network in Western Canada, advance our e-commerce expansion, and invest in advanced technology, all high-return, dependable investments and Mike will walk through all this in more detail with you in a second.

Now on to our Q4 results. As a reminder, we were the first Canadian grocer to publicly anniversary the extreme stock-up phase of COVID last year. More than two-thirds of our Q4 last year was impacted by the most extreme levels of stock-up buying behaviour we've ever seen. Same store sales last year were high and volatile, ranging from a week that declined in sales to a week with growth of 52%, resulting in unprecedented 18% year-over-year growth that quarter.

With that in mind, we are very pleased with our performance this quarter and throughout fiscal 2021. Our two-year sales stat for Q4 same-store sales was 10.4%. Because of extreme COVID impact on results last year, we believe a comparison to two years ago is a more meaningful indicator of real growth. This quarter our sales declined 1.3% and our same-store sales was negative 6.1%. Well, you know I don't like negative numbers, but don't think anyone expected to see a repeat of last year.

In e-commerce, Q4 last year saw our established IGA.net and Thrifty Foods businesses grow sevenfold. As expected, we saw these e-commerce businesses slow from these highs in Q4 this year, as all established e-commerce players will experience when comparing to the start of the pandemic last year; however, even with last year's extreme growth, in Q4 we still grew overall e-commerce sales by 15%.

This remarkable net positive increase was driven by the exponential growth of our new Voilà business in the GTA and I'll speak more on our progress on Voilà in a moment.

COVID also had a large impact on gross margin last year, driven by sales mix and customer behaviours. Last year, inventory shortages reduced our supplier partners' ability to provide promotional items and customers shifted toward full service for a one-stop shop. In Q4 this year we held our gross margin rate flat to last year without the same extreme COVID tailwind. The recovery of our service departments and Horizon initiatives, particularly our promotional optimization, offset the sales mix impact from the prior year to achieve this. And this year, combined with our Sunrise and early Horizon benefits, we delivered a record high rate of 25.5%, our highest gross margin as far back as we can look. Now this is impressive performance and I'm so proud of the margin discipline we've built in this company over the last four years.

EBITDA margin rate was 7.4% this quarter. The real story here is how we're closing the margin gap to our peers. In fiscal 2017 the average gap to our peers was 4.4%. In only four years we have reduced that gap to about 1.9%. That translates to an increase in adjusted EBITDA margin dollars of approximately 170%, a colossal achievement for our team. We've shown that we can drive meaningful, sustainable margin improvement and we will continue to reduce this gap through Project Horizon and we will not stop there but will work to pass our competitors.

Now to our expectations looking ahead. As more Canadians receive their COVID vaccinations, we expect to see three things. First, we expect many Canadians to gradually shift some spend back to restaurant and hospitality industries as lockdowns ease or places reopen and social gatherings resume.

Second, many customers will start to shop more often and shift their basket mix. We expect basket size will decline somewhat and transaction counts will increase somewhat as some customers become more comfortable shopping multiple banners. Customers will also return to buying more prepared food and visiting our service counters as they reopen. We are already starting to see these trends in our stores.

Third, we expect the split between full-service and discount banners will stabilize but not return to pre-pandemic norms. We have revamped many of our full-service stores and believe customers, more than ever, see the value in our full-service offering. In Q4 we saw some impact to our market share as some customers returned to shopping multiple banners as they began to feel a little safer, but we expect to hold on to substantial market share gains as COVID subsides. We have also noticeably grown our discount presence, adding over one million square feet to the discount network in Western Canada to meet the evolving needs of the customers. In Ontario we now have 95 stores and in Western Canada we have 40 locations confirmed and we are on track to have about 48 stores opened by the end of fiscal 2023.

As COVID subsides and Canada is able to safely reopen, we believe we are very well positioned to meet these changing customer needs with our diverse network and well-aligned offering. While we expect the grocery industry will shift towards some pre-pandemic ways, we do not believe it will fully return to the way it was. And we've been pretty accurate in our projections over the last while since the pandemic started. We've been pretty open with you.

Finally, an update on Project Horizon. As of this quarter, we were one year into our three-year strategy. I am pleased that we are on track to deliver our goal of $500 million of incremental EBITDA and 100 basis points of EBITDA margin improvement over the three years. Despite some early delays due to

COVID, our team has done an impressive job catching up on key initiatives. For example, our promotion optimization initiative continues to drive early results. Other initiatives, like strategic sourcing, are well established from Project Sunrise but continue to build efficiencies and improve our bottom line. And I'll share a few updates right now on key strategic initiatives.

First, we closed on our purchase of 51% of Longo's, including Grocery Gateway, on May 10th. We are thrilled to welcome the Longo's team to the Empire family. This acquisition is important to our strategy to grow our presence in the key Greater Toronto Area where we have historically been under-penetrated. As well, the addition of Grocery Gateway complements our goal to win grocery e-commerce in Canada.

Second, Farm Boy. May 17th marked the halfway point in achieving our commitment to double Farm Boy's store base within five years. We opened seven new stores in fiscal 2021. One store opened one week into fiscal 2022. In fiscal 2022 we expect to open seven net new stores. We continue to be extremely pleased with our acquisition of Farm Boy, which has grown its industry-leading same store sales growth since we acquired them.

Finally, Voilà. My view on Voilà does not change quarter to quarter. We have the best solution and are more confident than ever in it. Yesterday marks the one-year anniversary of the first delivery to a customer, and that customer was me. And one year in, our average customer shops twice a month and their basket size is 3.8 times greater than the average bricks-and-mortar basket. As I said, Voilà is growing quickly. Over the last year we've worked hard to build our workforce of talented delivery teammates fast enough to keep up with growing demand. Even still, our core performance metrics have remained above target. We remain on track to open our second customer fulfillment center in Montréal in early 2022.

This is expected to be even smoother than our GTA CFC. We already have customers helping us to scale faster and we're very pleased with our store pick solution. We've launched in 30 stores in fiscal 2021 and, as we continue to build our CFC network across Canada, the store pick solution allows us to quickly offer e-commerce in regions where CFCs will not deliver or are not yet built. We need to be able to serve customers where, when, and how they want to shop, and by the end of fiscal 2022 we expect to have up to 120 stores, which means we'll have e-commerce options in every province. We are well-positioned to win grocery e-commerce in Canada.

You know, sometimes I hear concerns we're doing too much, and maybe for some companies that would be a problem, but we've assembled the best team in Canadian retail. There is talent and structure in our organization that we never had before. We have bandwidth and see more opportunities to grow sales, improve margins, and reduce costs. With that said, although we continue to find new opportunities to improve our business, our focus right now remains on Horizon. Besides, we need to leave some upside for our next three-year strategy.

And as a final note, I want to take this moment to wish the best to Canada's athletes heading to the Olympic Games in Tokyo this summer. Sobeys is the official and exclusive grocer of Team Canada and I'm so proud of the work we're doing to support our athletes.

With that, I'll hand it over to Mike.

Michael Vels — Chief Financial Officer, Empire Company Limited

Thanks, Michael. Good afternoon, everyone.

I’ll provide some additional colour on our results, our expectations for capital expenditures in fiscal 2022, and some comments on expectations for next year.

As Michael noted, we do believe the two-year stack is the best way to interpret our results as we start comparing to timeframes that are particularly distorted due to COVID shopping behaviours. During COVID, we grew our sales and market share to a level we didn’t expect to see for several years, reflected in the 10.4% increase in same-store sales from the fourth quarter two years ago.

Our gross margin rate was very strong and, as Michael said, the fact that we were able to match last year’s strong COVID stock-up driven rate shows the positive impact of our Horizon initiatives and the focus on sustaining the margin focus in our teams. We continue to sustainably improve our gross margin performance, as demonstrated by the increase of 150 basis points in our annual gross margin rate since Sunrise began in fiscal 2018.

We’re now over two years into the expansion of discount in the West. We’ve opened 28 FreshCo discount stores in Western Canada, 26 of them conversions of old full-service stores. All stores opened in our first year continue to improve their results and, in aggregate, are performing better than the full-service stores they replaced. After we opened the first stores in the first year, we focused on operational improvements and margin management. As a result of that experience gained, stores that opened in our second year are performing better than those opened in the first. While the absolute net earnings of the discount business in Western Canada has been relatively immaterial to total earnings so far, we are seeing strong improvement in EBITDA and sales compared to the full-service stores that they replaced.

This quarter there were some significant items in SG&A, which resulted in our SG&A as a percentage of sales being 20 basis points higher than last year. Not all of these items, however, will occur in the future to the same degree. We had higher incentive payments to our teammates in stores, distribution centers, and backstage. We do not expect to see these expenses at the same levels in fiscal 2022. The new Voilà business now has its full back office SG&A and supply chain costs reflected in the company's total SG&A at significantly higher rates from when we initially launched to customers a year ago yesterday and these expenses will continue and will grow with the business. We also didn't see the same amount of sales leverage that arose due to higher sales in the stock-up period last year and through the last year we also hired new store personnel all the way through fiscal 2021 to manage store safety and sanitization, which has increased our store labour SG&A. And finally, right-of-use asset depreciation under IFRS 16 is higher than last year, reflecting an increase in occupancy costs. While not as material, we also had Longo's closing costs this quarter, which will not be repeated.

These SG&A increases were partially offset by lower COVID costs and benefits from our strategic sourcing initiatives. The temporary lockdown bonus of $9 million paid to teammates in regions that had government-mandated lockdowns this quarter was less than the "hero pay" paid to all teammates last year. We expect SG&A expenses in the first quarter related to the increased costs of maintaining sanitization and safety measures and other COVID expenditures to be between $15 million and $20 million, less than the first quarter amount last year of $67 million.

This quarter's effective income tax rate was 19.7%. As outlined in our news release, our income tax rate for the quarter was impacted by some revaluation to tax balances, not all of which will recur in the future. Excluding these adjustments, we expect our tax rate for the quarter would have been between 24% and 25%. The effective income tax rate for the full year was 25.8%. And excluding the effect of any unusual transactions or differential tax rates on property sales, we're estimating that the effective income tax rate for fiscal 2022 will be between 26% and 28%.

Earnings per share includes $0.04 per share of Voilà dilution for the quarter and $0.18 for the year, less than our initial estimate of $0.20. In fiscal 2022 we expect to see improvement in the profitability of CFC 1 in Toronto as volumes continue to increase and costs reduce due to improved operational efficiencies; however, Voilà total costs will increase as CFC 2 in Montréal begins operations and store pick e-commerce is implemented in up to 90 additional stores across the country. In total, we believe that the impact of Voilà's continued growth will dilute fiscal 2022 net earnings by approximately $0.25 to $0.30 per share compared to $0.18 this year. Based on our current forecast of sales growth, we expect that fiscal 2022 will reflect the highest net earnings dilution of the Voilà program as CFC 1 is expected to begin to reflect positive EBITDA results towards the end of the third year of operations, partially offsetting the impacts of opening new CFCs.

Equity earnings increased year over year mostly due to higher earnings from Crombie REIT, which continues to perform well despite ongoing disruption caused by COVID-19. Crombie has built a solid foundation and are well positioned to continue to deliver with a high-quality portfolio, over half of which is anchored by Empire grocery banners. 2020 was a big year for Crombie as they saw four major developments reach substantial completion, including our own CFC 2 in Montréal.

Cash flow generation continues to be strong with free cash flow of $745 million for the year. Our focus on returning cash to our shareholders continues. Today we announced an increase in Empire's quarterly dividend per share from $0.13 per share to $0.15, a 15.3% increase. Our dividend per share has grown by a compound annual growth rate of 10.9% over the past three years. We also renewed our share buyback program following buybacks of $153 million in fiscal 2021. We intend to more than offset the shares issued as part of the Longo's transaction and have, since the year end, already purchased the equivalent of one-third of the shares issued in that acquisition.

Capital expenditures, of course, are a key element of our capital allocation strategy. Our capital investment estimate for fiscal 2021 was between $650 million to $675 million and we ended the year at $679 million. For fiscal 2022 we expect to invest approximately $765 million back into the business. About a half of this investment will be allocated to renovations and new and converted stores with 10 to 15 FreshCo stores opening in Western Canada and seven net new Farm Boy stores in Ontario. We continue to invest in our advanced analytics technology and other technology systems, which will be approximately 15% of the total investment. We will invest approximately $80 million in Voilà, which includes our share of the Montréal and Calgary CFC build costs, up to 90 new store pickup locations, additional spokes, and associated investments in technology. This estimate also includes capital for Longo's projects.

As we begin fiscal 2022, we know the year will continue to be affected by the pandemic, but it's really difficult to predict the net impact of lower results due to COVID and the positive effect of Project Horizon initiatives. We expect that, during fiscal 2022, same store sales will reduce somewhat as industry volumes decrease compared to the unusually high industry sales in fiscal 2021. Fuel volumes are also expected to increase as we see travel restrictions reduce and economic activity increase.

We believe our margin rate will continue to benefit from Horizon initiatives, along with the addition of Longo's, which has a higher margin rate than the Empire average. Margin will be partially offset by the effects of sales mix changes between banners due to the expected easing of COVID restrictions. Both comparisons in fiscal 2022 for same store sales and earnings per share in particular will be affected as we lap a full year of COVID results embedded in fiscal 2021.

Finally, fiscal 2021 is a year we'll certainly never forget. We launched Voilà, our home delivery service in the GTA, our store pickup service in four provinces, and our new three-year strategy, Project Horizon. And we made great strides with our FreshCo and Farm Boy expansion plans and welcomed Longo's to the family. Going into fiscal 2022 we are up against the tough comp of COVID, but we saw how Horizon initiatives improved the comparison in Q4. Fiscal 2021 was a solid year and we are looking forward to what we will do in fiscal 2022.

And with that, Katie, I'll hand the call back to you for questions.

Katie Brine — Director Finance, Investor Relations, Empire Company Limited

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

Q & A

Operator

Thank you. Ladies and gentlemen, if you do have a question, please press star followed by one on your touchtone phone. You will then hear a three-tone prompt acknowledging your request. And if you would like to withdraw your question, simply press star followed by two. If you are using a speakerphone, we do ask that you please lift the handset before pressing any keys. Please go ahead and press star one now if you have any questions.

And your first question will be from Karen Short at Barclays. Please go ahead.

Karen Short — Analyst, Barclays Capital

I just wanted to talk a little bit about the overall environment, so wanted to start with the promotional environment in 4Q and expectations for 1Q and beyond, and then I'm wondering if you could weave into what your thoughts are on inflation, both at cost and at retail in fiscal 2022, what your perspective is. And then I had one other question.

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

Hey, Karen. I'll take the first question and then I'm going to throw it over to Pierre and Mike if they want to say anything on inflation. And thanks for your question. I appreciate it. We predictably see customers purchasing more promotion right now this year for a few reasons that should be pretty obvious. One, because customers are not stocking up as they were last year; two, planned shopping is increasing;

and three, suppliers are more in control of their production and inventory than last year, not completely back to normal, but more than last year, so there is more availability on the shelf.

In terms of the competitive environment, it's always been a competitive environment and we don't expect this to change. We're not seeing anything strange out there and I don't think it'll be any different from pre-pandemic times as things get back to normal. So it's competitive, it's normal, and that's what we're seeing.

Karen Short — Analyst, Barclays Capital

Okay. And then on inflation, cost and retail?

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

So, you have to remember we're coming up through a complex quarter compared to last year. It's definitely not a good benchmark for us. There are costs that have been added to various supply chains across the world. Some of those were temporary, some were not. So, suppliers always ask for cost increase and we have seen our share of those. We are not accepting all price increases, as usual, and we think the business in general is returning more to normal, which should result in a more normal inflation rate over time.

Karen Short — Analyst, Barclays Capital

Okay. And then I wanted to just ask a question about FreshCo. So wondering if you could just elaborate a little bit on what, if anything, changed from an execution perspective for the fiscal 2021 class of stores to improve the profitability or is that really just more a function of the pandemic helping with an improved profitability profile?

Michael Vels — Chief Financial Officer, Empire Company Limited

So, it's not the pandemic. Our discount stores probably would have done better without the pandemic impacts. It was very hard to open them, hard to staff them, and starting a new business in the new geography was very difficult for the management team. And they did an amazing job opening the stores they did under the conditions that they had to deal with. So, certainly they would have preferred to have done all of that in a more normalized environment.

The reason that our second-year stores are doing better is about operational excellence. When you start in a market, you've got a new management team, you've got a new franchisee, the competition response is not entirely predictable, and you're learning. You're just learning lessons and realigning your supply chain, receiving product out of new distribution centers. So, as we roll into the second year and improve the efficiencies, moved our labour rates to where our targets were, got a bit smarter with our promotions, all of that was experience that our new franchisees and our new management team in Western Canada were able to apply to the second year of stores.

So it really is just more miles in the saddle, a management team that found its rhythm, and franchisees who are able now to learn from each other, from other franchisees in the same region, and they're all excited, they're doing an amazing job, and we're actually very happy with the progressive improvement that we're seeing in all of those stores in Western Canada.

Karen Short — Analyst, Barclays Capital

Okay. And then just last one for me. In terms of the gross margin, obviously you talked about promotions resuming, but that was offset by Project Horizon benefit. Wondering if there is any way you could quantify the Project Horizon impact in basis points. And then, on that note, obviously you had dilution from Voilà in this year, but when I look at the two-year gross margin change versus 2019, it was down pretty meaningfully, and I don't think that that is explained by dilution.

Michael Vels — Chief Financial Officer, Empire Company Limited

A lot of the Voilà impact is in SG&A and, in fact, the Voilà gross margin is quite healthy. The impact or the amount of Horizon benefits are very hard to separate out and put a number to. We're going to be in the position that we'll certainly give you a perspective on how we feel about the success of those initiatives, but we're going to need to be judged by our sales increases and our margin rate. And the offset that we referred to was last year the margin rates, we felt, were artificially high because of the everyday pricing that a higher percentage of the basket was sold at and we made up, you know, more so than this quarter, and we made up that headwind with improvements in efficiencies and our promotions work that was mostly the analytics and the work we've done on our Horizon initiatives.

Karen Short — Analyst, Barclays Capital

Okay, great. Thanks very much.

Operator

Thank you. Next question will be from Patricia Baker at Scotiabank. Please go ahead.

Patricia Baker — Analyst, Scotiabank

Thank you very much for taking my questions. Good afternoon, everyone. Michael, I just want to follow up a little bit on a comment you made in your opening remarks. One of the underlying tenets of Project Horizon is that the initiatives that are embedded in Project Horizon are designed to drive market share increases and you stated that you expect that you'll be able to sustain the majority of the market share increases that you saw in the last year and I'm just curious about what would be the drivers of that. And then, more importantly, are you doing anything special to try and keep the new customers and is there anything there that you can share with us?

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

I'll take that. Great question. And I'm going to answer the first part and I'll see if Pierre wants to answer and give away anything to you on the second part.

I’m going to separate it into two pieces. I’m going to separate out COVID and I’m going to separate out Horizon, because I think they’re two different moving pieces. Customers turned to us during the pandemic more than others because we had the products and they felt we were a safe place to shop and that our operations were incredibly efficient and productive, more than any other time in our history. So we gained market share through that. We brought in new customers who saw the value in what we were doing in terms of pricing, in terms of offering. And we believe that we’ll retain a good portion of those customers afterward. And we’ve done everything we can, some of which Pierre will not tell you, to retain those customers. So, good. So, even if nothing else is happening, good, we’ve got more market share than we had two years ago.

Now turn to where we are compared to pre-pandemic and even compared to last year in terms of our operations, our merchandising, but especially our Horizon initiatives that are going to go, and most of what you’re seeing right now from Horizon, almost all of it is margin improvement, because we said that margin improvement would be in the first year and a half and then in the last half of Horizon, especially the last year, you’d start to see even more market share. So right now it’s the operations, the merchandising, plus that we had more customers try us out and like us, that has driven the market share. And then we’ll build on that and grow market share through our Horizon initiatives and Pierre is always improving, and so is Mike Venton and everybody else in the company. And now we’ve got Longo’s. Farm Boy is always great. So that’s what I want to separate out, because these are two different moving pieces. So gained market share, we’re going to keep a good portion of it, and then we’re going to go after more.

Pierre, what do you want to say to Patricia? Anything you want to illustrate on?

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

Very well said. We saw a change in customer behaviour during the pandemic and we strongly believe that we'll keep some of those gains post-pandemic. We saw some interesting growth in some categories and it's where we're seeing good stickiness. I think customers discovered the better offering we have been able to build over the last two, three years, so I think we'll benefit from that going forward. And yes, Michael is right; now we're focusing on Horizon, margin expansion through different initiatives in pricing, promo, Own Brands, and now we are working to continue to improve our productivity per square foot. So we're in much better shape than we were pre-pandemic and we'll keep as much as we can from those increases.

Patricia Baker — Analyst, Scotiabank

Okay. Thank you very much, both of you, for that. I just have a follow-up question. Just on Voilà and your plans to roll out another 90 of your store pickups in fiscal 2022, I'm just curious whether that would have been in your original plans or were you guided by the experience that you had with the first 30 to roll that out faster?

Michael Vels — Chief Financial Officer, Empire Company Limited

If I understand you correctly, Patricia, I just want to make sure I understood the question, are you saying that the rate of improvement was in our original plans or are we going faster than what we'd originally anticipated?

Patricia Baker — Analyst, Scotiabank

Are you going faster than you anticipated because you might have seen good experience with the first ones that you opened?

Michael Vels — Chief Financial Officer, Empire Company Limited

Yeah. It's closer to what our original plans were. I'd say, if you had to say are we going slightly faster or slightly slower, we're actually probably slightly slower, just because it's just limited by the pace at which we can put the new process into each store. But we like the outcome, we've seen good volumes, and our customers really like it, and so that's what's driving us to put it into more stores.

Patricia Baker — Analyst, Scotiabank

Okay. Excellent.

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

Thanks, Patricia.

Operator

Thank you. Next question will be from Kenric Tyghe at ATB Capital Markets. Please go ahead.

Kenric Tyghe — Analyst, ATB Capital Markets

Thank you and good afternoon. Michael, you called out in your comments the IGA.com, your Québec business online, doing seven to ten times, you know, last year would have done the year prior and obviously cooled off this year. Could you provide any insight on, while obviously you saw a decrease in that business, how that settled out with respect to your relative share in that market, understanding, obviously, you didn’t put up the same sort of growth numbers as you did? And then a follow up to that would be how do you think about moving that business forward as you launch your Voilà offering into that market later this year and sort of throughout the forecast window?

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

I mean I think that we’ve outperformed in the markets that we’ve competed in in e-commerce. You’ve got to remember in Québec we had the number one market share. We still have the number one market share and it’s just moving depending on how safe people feel leaving their homes. And if you think back, when you’re talking seven, nine, ten times the volume that you would normally do, I mean that’s, first of all, unsustainable and it’s strange, right? And so that was always, I mean we knew that was going to come off that kind of high. But what we’re seeing is that the volumes in all the markets in e-commerce are remaining at a higher level than they were, much higher level than they were pre-pandemic, but off the heat of what that was.

You asked about Québec CFC and our confidence in that. It's a different situation. In that market we're going to be able to transfer over customers to an even better solution and take more customers from our competitors. And what we also see is that, I'll look at Katie and see if I'm allowed to say this, but we see that customers that start shopping with us in e-commerce spend more than 1.5 times more weekly with us overall and they've become our most loyal and our best customers. Very few customers shop only one way, especially in Québec, with us. They shop bricks-and-mortar and they shop e-commerce. So Québec is, I wouldn't say easy, because it's never easy, but we have already the biggest market share that will transfer over to Voilà and that is efficient, makes more money, better service to our customers, and then that translates to our brand and to our bricks-and-mortar, so that's a win-win-win. I'm really happy about that.

Kenric Tyghe — Analyst, ATB Capital Markets

Great. Thank you, Michael. And if I could, just one more question, just on the inflation discussion and to the expected normalization of sort of consumer behaviour, increased restaurant visitation, et cetera. How do we think about the evolution here or how are you thinking about the potential evolution of food inflation given that one of the overhangs over the last period has been sort of the supply chain and the redirection of a lot of fresh and related into grocery and out of restaurants? And clearly there will be increased tension or tightening of the market potentially as more restaurants get back to something approaching normal, hopefully sooner than later from a social point of view, but perhaps not from any other reason.

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

Pierre and I are looking at each other. We don't think it will be a major impact on us.

Kenric Tyghe — Analyst, ATB Capital Markets

Thanks very much. I'll leave it there.

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

Thanks, Kenric. Take it easy.

Kenric Tyghe — Analyst, ATB Capital Markets

You too.

Operator

Thank you. Next question will be from Irene Nattel at RBC Capital Markets. Please go ahead.

Irene Nattel — Analyst, RBC Capital Markets

Thanks and good afternoon, everyone. As you were walking through sort of the improvements that you've made that are driving some of those market share gains. You mentioned private label and wondering where you are right now with Compliments, how you feel about that Compliments re-launch and whether it achieved your objectives.

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

Very good question, thank you. So we now refer to private label as Own Brands at Empire, so Own Brands remains strong in the basket, very happy with our progress. Rebranding is going extremely well. The business is generating improved results and penny profits are improving in Own Brands. It's a huge opportunity and we know that it is needed across the country and we're still working on it. And, as I've mentioned in the past, penetration is not our main focus in Own Brands. It's about playing the right role in the category and the profitability by product. That's our main purpose and it's how we behave and it's how we drive the business with that group.

Irene Nattel — Analyst, RBC Capital Markets

That's really helpful. Thank you. And can I take from your comments that you are in fact able to achieve the margin advantage with your Own Brands that you had been targeting?

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

Absolutely. Own Brands program is one of the initiatives of Horizon, so Own Brands will contribute to the margin expansion.

Irene Nattel — Analyst, RBC Capital Markets

That's great. Thank you. And then just switching over to FreshCo, you noted both in the release and in the remarks that although the stores in Western Canada are not delivering a material EBITDA contribution, they are certainly outperforming the conventional stores they're replacing. So how should we think about, I guess, the maturation cycle of those stores and the path to delivering a more meaningful EBITDA contribution?

Michael Vels — Chief Financial Officer, Empire Company Limited

I think the easiest way to put that, Irene, is, as we gain more critical mass in the markets, we expect the efficiencies to improve in all of the stores. We do have a point of view as well that, as restrictions continue to ease, particularly in the West, that we'll be in better shape to increase our sales and increase the number of customers in the stores. So it really is just consistent increase and consistent improvement. So, as I mentioned, the stores are on a good cadence and a good rate of improvement and really it's just continuing that.

Irene Nattel — Analyst, RBC Capital Markets

That's great. Thanks, Mike. And then just one final one. I know it's been, what, about I guess six weeks that Longo's has officially come into the family. Just wondering about sort of anything you might be able to share with us in terms of thoughts around the integration, around sharing of best practices, around just anything you can share with us. Sorry, not the integration, because I know that it's a standalone, but you know what I mean.

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

Yeah, I know what you mean. And it's early days, but we have great plans, Anthony and his team and our team in terms of how to work together. We identified synergies. We're working on getting those synergies. We're working together and discussing ways to run supply chains and comparing notes on e-commerce. And I've got to tell you that both Farm Boy and Longo's, it's like a treat to partner with them and, as always, our goal as we're a big company and we're hungry is just not to drive them too crazy. And once again, we're simple folk, Irene. We're simple folk. If something works, we just keep doing it.

And Farm Boy went so well and what did we do? We went to JL and Jeff and we gave them a menu and what do you want to pick from the menu? And they chose it. And Longo's is looking at a menu too and they've got to figure out how much they want to eat at one time, but there is so much when you bring these companies together. And to have leaders like JL and Jeff and Anthony Longo, I mean these are pros. They know what they're doing. And, in fact, I think Pierre and JL had dinner last night together and they were talking private label and produce and you know, forget what we can bring to them, what they can bring to us has been awesome. And when Pierre talked about Own Brands, a lot of it are learnings from Jeff York and JL along with our great team. It just keeps getting better. So, it's just not something that keeps me up at night.

Irene Nattel — Analyst, RBC Capital Markets

Didn't think so. Thanks so much.

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

Thank you.

Operator

Thank you. Next question will be from Michael Van Aelst at TD Securities. Please go ahead.

Michael Van Aelst — Analyst, TD Securities

Hi. Good afternoon.

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

Hi, Michael.

Michael Van Aelst — Analyst, TD Securities

I wanted to go back to what you're seeing in the quarter and what you're seeing for fiscal 2022 so far. I In the gross margin discussion you talked about some pressure on the margin from mix between banners, so I'm assuming you're talking about a shift towards discount has already started. Is that accurate?

Michael Vels — Chief Financial Officer, Empire Company Limited

In terms of the mix comment, that would be correct, but relatively minor in the quarter.

Michael Van Aelst — Analyst, TD Securities

Okay. So has that picked up recently as we've seen cases come down and mobility increase? And what are you doing to try to keep that customer? Because you did mention that you plan on keeping a lot of that market share. Are you fighting to keep that market share within the conventional banner or to capture it in discount as these customers change channels?

Michael Vels — Chief Financial Officer, Empire Company Limited

I think it's a lot of what Michael just said previously, is the customers are in our stores. The number one prize is to use our improved execution, like the new banners that we have and Farm Boy and Longo's and of course the new stores we have in FreshCo, to maintain them within the Empire ecosystem. And clearly, over time, as consumers shop more banners, we're going to have to be sharper and we're going to have to execute well, but we set ourselves a target of maintaining and sustaining as much of that sales benefit as we can and it is really about execution and making sure that all of our Horizon work, particularly work we're doing on analytics, personalization, and other initiatives like that, keep the customers within the Empire family.

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

I think that's a good answer that Mike gave. I just don't want to overstate it. Sometimes, you know, these things are very small and incremental and they start, but when you read them in, not a slam at the media, but when you read them in the media, they seem like huge titanic shifts, which just don't happen like that. So, Michael, we can't comment on quarters before the one we're talking about, but things change very, very slowly in this business and customers are very sticky.

But I also want to say like we were growing market share pre-pandemic, we grew market share through the pandemic, and we also intend to grow market share post-pandemic. The issue is how much of that, and we don't have every answer, we try to have a crystal ball, and we've been pretty darn good, as I said, since the beginning of the pandemic, it's just trying to get how much returns to a little bit of normal and how much doesn't. And you guys have your own guesses, we have ours. We're bullish, but we do, you know, we're realists too. We know what we can keep and what we're not going to keep and then we go after some more. So I just don't want to overstate it. It's just not as titanic as people make it out to be.

Michael Van Aelst — Analyst, TD Securities

Okay. On the e-commerce side, so you've got your first spoke location up and running. Can you discuss the economics of those spoke locations? What are the key benefits in delivery time or costs? Are these also initially dilutive and then they improve profitability with volumes as well, I'm assuming?

Michael Vels — Chief Financial Officer, Empire Company Limited

The primary reason for spokes, Michael, is to, first of all, improve your range, which they do. The second, but really more important reason for having one, is to reduce the congestion at the CFC. As the volumes increase, it just becomes logistically impossible to have all of the small cube vans waiting and lining up to take each of the orders away every day. So the economics of it for us is, as you get to a point where your congestion at the CFC, mostly vans loading, becomes significant, that's when the spoke makes sense and you reduce the congestion. The spokes are not massively expensive. They're relatively small pieces of real estate. They are principally cross-dock facilities and they don't, in terms of the total results of the Voilà business, they're not that material in terms of changing the trajectory of the earnings. So the Voilà business doesn't see a dip in the earnings when they open a spoke that shows up on the radar. I'm not downplaying the impact, because it is part of the business model, but they're just not at the same level of cost and complexity as, obviously, the big CFCs.

Michael Van Aelst — Analyst, TD Securities

Does it improve your delivery times?

Michael Vels — Chief Financial Officer, Empire Company Limited

At the margin. We still need to take the product from the CFC to the spoke and you've still got that transit, which you don't save. The spokes are not significant inventory locations. That's still the CFC. And so, yeah, at the margin it'll improve your time. It really improves the efficiency more than it improves the time to deliver.

Michael Van Aelst — Analyst, TD Securities

Okay. And how many do you expect to have of these when you get to the scale that you expect over the next few years?

Michael Vels — Chief Financial Officer, Empire Company Limited

I think, and I reserve the right to be wrong here, but I think the plan was roughly four in the GTA, but plus or minus one on the other side of that. And then we would also have a spoke to service Ottawa as well.

Michael Van Aelst — Analyst, TD Securities

Okay. And actually last question. I guess going forward now, will Longo's revenues be included in your same store sales over the next four quarters or are you going to wait until they've been there for 13 months or for 12 months?

Michael Vels — Chief Financial Officer, Empire Company Limited

No, we'll include them.

Michael Van Aelst — Analyst, TD Securities

Okay. Excellent. Thank you.

Operator

Thank you. Next question will be from Mark Petrie at CIBC Capital Markets. Please go ahead.

Mark Petrie — Analyst, CIBC World Markets

Thanks and good afternoon. I just wanted to follow up here just with regards to the comments on private label. Is it fair to say that you're still relatively early days in terms of the overall contribution from that initiative to the Horizon targets? Or is the progress material at this point?

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

It's early. We followed roughly the same process we did for category reset. So we are doing things by waves, by categories. We completed wave one, so that will hit stores in the near future, and then we are working already on wave two and wave three. So, wave two will be in September. So, during the year we should see incremental margin expansion through these initiatives. So, early days so far in our margin.

Mark Petrie — Analyst, CIBC World Markets

Okay. Thanks. And then with regards to the efforts on promo effectiveness and efficiency, I guess supported by data analytics and new initiatives there, would you say that the gains so far have been pretty low-hanging fruit and improvements from here get a little tougher? Or how are you looking at that?

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

No, we are very encouraged by the adoption of the tools by the team. Some surprise, obviously, because the engine is very powerful to crunch a lot of data. No, I don't think there is low-hanging fruit and more difficult things. I think that will be a constant progress and it's all about every single promotion. And we have different seasonality so, over time, we will continue to improve our ROI and promotion and investment on both sides, on our side and on the supplier side. So, very pleased also with the support from our supplier partners. They are highly interested by the results we have so far and we will improve both, ROI on both sides, the ROI for them and for us, so more meaningful promotion and more efficient.

Mark Petrie — Analyst, CIBC World Markets

Okay. Thanks. And then I've got a couple of questions just on Voilà. I'm just wondering, you know, what have you seen with regards to customer retention and what are the patterns that you've seen in terms of people trialing Voilà and then evolving and shopping as your execution has also evolved?

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

We're seeing incredibly high rates of retention. So the key is to get someone to try Voilà and once they try it the level of retention is extremely high. And then, as they progress, they buy more and more product from us and a higher percentage of their total shop, in many cases a very high percentage of the total shop. As you may have seen, because you follow these things pretty closely, Mark, that our product choice, especially on fresh, is really good now and we're seeing that really pop. And so, no, all the metrics are good. Just get someone to try and most of them get hooked.

Mark Petrie — Analyst, CIBC World Markets

And relative to your expectations or plans, how aggressive have you been in ramping up the marketing and promotion side of it, I guess both around retention but also around attracting new customers?

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

I think I'd say medium. I'd say that, you know, because scale to us is really important, we want to attract the customers, but we don't want to do it stupidly where we're just getting customers because we are offering some ridiculous deal. We're offering value. We have delivery passes. We have all sorts of offers that are really innovative in terms of marketing to customers. We just had our first anniversary offer to our long-time customers as well. So I'd say medium. I think if we really want to turn up the number of customers we could be more aggressive, but I think we're doing it in a really smart way.

Mark Petrie — Analyst, CIBC World Markets

Okay, thanks. And then just last one maybe, with regards to the sort of flattish outlook for EPS growth this year and then the longer-term or three-year target for 15% growth CAGR, can you just help us understand sort of what the key levers would accelerate next year? I guess you sort of, Michael, talked about same store sales growth or market share gains accelerating, but I would guess that would be supported by gross margins continuing to expand. And is better SG&A leverage a key part of the plan or is it mostly top line and gross margin?

Michael Vels — Chief Financial Officer, Empire Company Limited

Hey, Mark, I think we've said consistently from the outset that we're going to be very focused on the SG&A line and reducing the costs, but the majority of the improvement in Horizon over the next few years, well, at least over the Horizon period, is going to be in our top line and our margin rate.

Mark Petrie — Analyst, CIBC World Markets

Okay. Fair enough. Thanks a lot. Appreciate it.

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

Thank you.

Operator

Thank you. Next question will be from Vishal Shreedhar at National Bank. Please go ahead.

Vishal Shreedhar — Analyst, National Bank Financial

Hi. Thanks for taking my questions. With respect to your promo effectiveness initiatives and your data analytics, is Empire's reliance on a partner system for loyalty data, is that a hindrance at all? Or are you able to get all the data you need in the manner you need it?

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

I think we've made great inroads with our partner and, look, it can always be better and we're always looking for better ways to do it, but I think that the relationship we have has been much, much better in that we get a lot of data that we need. And to be perfectly honest with you, Vishal, we have all the data in the world we need. It's a matter of what we do with that data. And that we do internally now and it's fuelling all of our Horizon initiatives with that data. So, yeah, could it be a little better? Sure. But that's not the sticking point. The sticking point is to take what we have and make it efficient.

Vishal Shreedhar — Analyst, National Bank Financial

Okay. And Michael, maybe thoughts on just strategic orientation. Empire's acquisitions mainly focused in the conventional arena, have focused on GTA, let's say, but the fastest-growing demo is immigrants, minorities, and they tend to shop at discount more, and wondering if this is something that Empire reflects on and if they feel their mix of discount in conventional is appropriate in the GTA.

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

You know, I'll answer it a few ways. One is we're just digesting our partnership with Longo's. Second, we feel that our offering to all Canadians, at Chalo but also initiatives that we don't talk a lot about it because, in terms of our full service it's really great and we have great plans to be able to capture that. We're always looking for opportunities, I suppose, but I think that we have the assets, especially in the GTA, to win the GTA. We set out in 2017, as I said in our strategic plan, knowing that we didn't have those assets and that we needed to grow e-commerce, and we've done everything we have to do now, we've just got to execute the hell out of it.

Vishal Shreedhar — Analyst, National Bank Financial

Okay, thanks. I'll leave it at that.

Operator

Thank you. Your next question will be from Peter Sklar at BMO Capital Markets. Please go ahead.

Peter Sklar — Analyst, BMO Capital Markets

Okay, thanks. I just have a few quick questions on Voilà. Michael Vels, you said that it lost $0.18 for the full year, and I believe you gave the loss for the fourth quarter but I missed it.

Michael Vels — Chief Financial Officer, Empire Company Limited

$0.04, Peter.

Peter Sklar — Analyst, BMO Capital Markets

Okay. And then can you talk a little bit about the accounting for the launch of the Montréal CFC? It's launching in the next calendar year, when is the launch date? And how do you deal with costs up until that time? Is everything capitalized or are there expenses that are falling to the bottom line?

Michael Vels — Chief Financial Officer, Empire Company Limited

So, we don't have an exact date. We're saying early in 2022. And we'll be more specific about that as the construction schedules progress more and we get testing done with the installation of the Ocado technology systems.

Because, and I know this wasn't your question, we have a number of customers, many customers that we're converting over, and those customers need to see as good or better experience with the launch of the CFC, and we're going to make sure that we're 100% ready. So we're staying a bit flexible on the exact date of the first order, because we want to make sure our customers have a great experience.

In terms of the accounting, it’s, as you might imagine, anything that is, say, for example, a design cost or a construction cost, is capitalized. Any of the back-office SG&A that we’re adding, and we are going to be adding that as we go through F22, would be expensed. And then any expenditures that Crombie does on our behalf ultimately is realized in the form of a lease when we take possession.

Peter Sklar — Analyst, BMO Capital Markets

Okay. And then, Michael Medline, I believe I heard you say that you’re going to try and convert people from IGA.net over to Voilà, the Voilà CFC in Montréal. Is that correct?

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

Yeah, in the territory where the Voilà par IGA covers.

Peter Sklar — Analyst, BMO Capital Markets

So how does that work? Because I believe IGA is a franchise system in Québec, so how do you deal with the franchisees on that issue?

Pierre St-Laurent — Chief Operating Officer, Full Service, Empire Company Limited

We had discussions with franchisees on that topic for many years, so we’re all aligned on the purpose of adding an automated CFC. So the franchisees are well engaged in our strategy. We’re not seeing any issue by doing it.

By the way, we have a huge presence in the Québec market, and not only in our business but in general, the unemployment rate is very low. There's a lot of shortage in retail in general. So a dealer will use their resources to serve customers coming in the store and will serve e-commerce customers in a more efficient way through a CFC. It's a win-win. Through the CFC we'll add more window deliveries open, so we'll have more chance to meet the demand. And like Michael said, when we look at the profile of these customers, they're more loyal to the entire ecosystem by 1.5 times. So, there is a win-win for us, for them, at lower cost, and in the most, in a better efficient way. So these things have been shared with dealers over the last two years, so we have very good discussions, we have very strong relationships with them, and they're really well engaged in that strategy.

Peter Sklar — Analyst, BMO Capital Markets

Okay. And then just lastly, the CFCs require a lot of labour, particularly drivers. Given the labour environment, is that holding up the unfolding of these businesses at all?

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

Labour is tight all over the place, but we're doing a great job being able to find drivers and great people to work in our CFC and for our organization. But there is no doubt that labour is tightening.

Peter Sklar — Analyst, BMO Capital Markets

Yeah. Okay. That's all I have. Thank you.

Operator

Thank you. And your next question will be from Chris Li at Desjardins. Please go ahead.

Chris Li — Analyst, Desjardins Capital Markets

Just one quick question on Voilà. I know food waste is a big expense and I know Ocado has best-in-class food waste ratio of 0.4%. I'm just curious where are you now in that journey for CFC 1 and is improvement in shrink one of the key drivers to allowing you to achieve EBITDA positive towards the end of year three? Thank you.

Michael Vels — Chief Financial Officer, Empire Company Limited

We're happy with our experience to date. We started off, as you can imagine, Chris, a new business, and the only customer was Michael Medline. And he didn't buy everything that was available, so shrink numbers in the early days were high. As we've gained volumes and, of course, got more comfortable with our customer, with our suppliers, our shrink numbers have reduced. And I think it'd be fair to say that we're not at our targets, but we're getting much closer. So, part of the improvement through F21 has certainly been shrink, but it's not the most significant driver of our numbers for F22 because the CFC is actually doing much better than when we started. And while they certainly can be better, it's tight today. It's just going to get tighter.

Chris Li — Analyst, Desjardins Capital Markets

Great. Thanks very much and best of luck.

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

Thanks, Chris. Appreciate it.

Operator

Thank you. And at this time, Ms. Brine, we have no further questions. Please proceed.

Katie Brine — Director Finance, Investor Relations, Empire Company Limited

Great, thank you, Sylvie. Ladies and gentlemen, we appreciate your continued interest in Empire. If there are any unanswered questions, please contact me by phone or email. We look forward to having you join us for our first quarter fiscal 2022 conference call on September 9th. Talk soon.

Operator

Thank you. Ladies and gentlemen, this does indeed conclude your conference call for today. Once again, thank you for attending, and at this time we do ask that you please disconnect your lines.