FINAL TRANSCRIPT

Empire Company Limited

First Quarter 2021 Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Empire First 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 assistance, please press *, 0 for the Operator.

This call is being recorded on Thursday, September 10, 2020.

I would now 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, Joanna. Good afternoon, and thank you all for joining us for our first quarter conference call. Today, we'll provide summary comments on our results, what we are seeing in the industry today, 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 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 and Chief Executive Officer, Empire Company Limited

Thanks, Katie, and good afternoon, everyone. You know, so much has happened at our company since we last spoke in June. We announced our new three-year growth strategy, Project Horizon. We launched Voilà, our game-changing e-commerce solution. We continued to grow our number of Farm Boy and FreshCo locations. We ratified our crucial Alberta labour agreement. And we were upgraded by S&P to an investment-grade rating.

Today, I want to focus on a few key topics: the early progress we're making on Project Horizon, our performance this quarter, and an update on the trends we are seeing as a result of COVID.

We announced Project Horizon, our new three-year growth strategy in July. And while our announcement was slightly delayed as a result of COVID, the team was already in flight on many of the initiatives. Through Project Horizon, we plan to deliver an incremental $500 million in annualized EBITDA by the end of fiscal 2023.

When we launched Project Sunrise over two years ago, we had a few doubters. Many thought we couldn't do it. They discounted our goals, said the savings wouldn't drop to the bottom line. But our team came through, and we proved them wrong. We delivered on time, above target, and above expectations, and we plan to do so again.

Project Horizon is just as bold and equally as ambitious. And we know we have a lot of work in front of us to get to the $500 million, but we are much more optimistic now than we were three years ago. We are a completely different company today than we were when we started Sunrise. We have reset our foundation, transforming Empire from a regional to a national company. We have sharpened our talent at every level and, in my opinion, now have one of the best executive teams in Canada.

We have sustainable earnings growth, we have standardized our operational processes, and we've improved our cost structure.

Although we only announced Horizon in July, it was not a standing start, not at all. Our initiatives are either underway, or they are initiatives that I have seen successfully completed at other companies. Horizon is not rocket science. The only rocket science are the algorithms we're using in Voilà and the artificial intelligence we're using throughout the Company.

Many of these initiatives, we identified at the start of Sunrise, but we simply needed to do things in the right order, at the right time. We needed a solid foundation to be able to achieve our earnings potential.

Our earnings growth over the next three years will come from, one, growing market share and, two, building on the cost and margin discipline we developed during Sunrise. I will speak to you about the initiatives we have ongoing to grow market share, and Mike Vels will take you through our cost and margin initiatives.

A number of initiatives are underway to support market share growth, including investing in our store network, scaling up grocery e-commerce, growing our private label portfolio, continuing our Western FreshCo expansion, and increasing the Farm Boy footprint in Ontario.

Firstly, investing in our store network. Toward the end of Project Sunrise, reinvesting in our stores became a key priority. We have seen extremely strong returns on these projects. Indeed, they are our best return projects. We have an ambitious store renovation program that ensures we deploy capital to revitalize most of our stores over the next seven years. Our renovations will range from a refresh to a full reset of the store, but at a minimum you will see enhancements to the core and modifications to our key departments to better support our strategy. So far, in the first quarter, we have touched 21 stores.

Over the three years of Horizon, we plan to touch and improve approximately 30 percent of our store network.

Next is expanding Farm Boy in Ontario. Farm Boy continues to be a weapon for winning share in urban markets in Ontario, where we were under-penetrated. At the outset of the pandemic, Farm Boy saw a slight decline in their same-store sales, as a large portion of their offering is focused on prepared foods. However, their same-store sales have been restored to even higher-than-historic levels, as the exceptional leadership team at Farm Boy continues to successfully innovate to adapt their stores and offerings.

The Farm Boy store count will grow in a mix of urban and suburban communities, with diverse store sizes and formats to fit the needs of local customers. We've announced plans to open another three Farm Boy stores in calendar 2020 and seven in calendar 2021. This brings Farm Boy's total announced store count to 42 stores, and this, of course, is just the beginning.

The FreshCo team is doing a great job too, and I want to talk about FreshCo's Western expansion. FreshCo continues to outperform other discounters nationally, while making progress expanding the discount banner to the West. Our brand equity scores are very high. Since the start of this fiscal year, we opened seven FreshCo stores, bringing our total store count in the West to 22 stores open. And we have eight in different stages of development, including two that we announced today in Regina and Grande Prairie. We are very pleased with our early results in the West.

We also reached a mutually beneficial labour agreement that will allow us to expand FreshCo into Alberta, the final Western province impacting our expansion. This is a huge milestone for the FreshCo West team and for the Company. Our first two FreshCo stores in Alberta are expected to open in Spring 2021.

I want to talk about improving store space productivity. Driving better space productivity in the current store network is a crucial engine for long-term market share growth. The foundation of productivity is the customer offering and assortment in each department, as well as the mix in the store as a whole.

During Sunrise, the Company revamped its offering through the category resets program, but with a significant constraint: maintaining the current space allocation within stores. During Project Horizon, the Company will drive a step-function improvement in space productivity, using advanced analytics to optimize every customer-facing element of the offering: store footprints, department space allocation and strategies, layouts and adjacencies, category assortment, and localization decisions.

We're also going to win Canadian e-commerce. In response to the increased penetration we have seen in grocery e-commerce throughout the pandemic, we accelerated the customer launch of Voilà, our game-changing online grocery home delivery service, to meet the increasing demand from customers for delivery. We began with a relatively small number of SKUs to test the system and have been ramping up big time.

Voilà launched in the GTA in June, and we are very pleased with the early results. Customer feedback has been overwhelmingly positive, and our customer net promoter score is the highest I have seen in my career. Customers are seeing the benefit of a central fulfillment model. And one of my favourite customer quotes to date is, "I received all that I ordered, and this is no less than a miracle nowadays. I immediately saw the benefits of picking from a dedicated warehouse versus store. Produce was really fresh and well packed. On-time delivery was exactly within the slot I requested. I felt the price of items was good and so were the range of promotions." And we did not pay that person to write that.

Positive customer experiences are translating into strong repeat behaviour, much stronger than we forecast, and positive word-of-mouth referrals. This, coupled with a strong marketing campaign blanketing the GTA, has meant steady and strong week-over-week order volume growth. We're delivering best-in-class customer service with near-perfect, on-time and fulfillment rates.

Our second Voilà customer fulfillment centre will launch in Montreal to service the Montreal and Ottawa area in early 2022. We have accelerated our plans for the remaining two Voilà e-commerce customer fulfillment centres and have even more confidence than ever in that plan. That's going to give us a total of four customer fulfillment centres across Canada, covering about 75 percent of the population and 90 percent of the spend.

In the few areas of the country where our customer fulfillment centres will not deliver, or are not yet built, we will be introducing Ocado's proven store pick solution. In August, we started testing store pick in Nova Scotia, with plans to expand to customers by the end of summer, and then move West. It is clear now, more than ever, that we must be able to serve customers where, when, and how they want to shop. We are well positioned to win grocery e-commerce in Canada.

We're growing our Empire private label portfolio. We've been working hard to improve our private label business through increased product innovation and the reset of key categories. Already, as a result of these improvements, our private label sales have grown faster than the industry. In August, we launched a campaign to highlight the rebranding of our entire Compliments portfolio; very happy with that. We will remain focused on improving our private label portfolio, as we know it will become increasingly important in uncertain economic times.

And we're going to provide best-in-class customer personalization. We're moving forward aggressively with investments in analytics and technology to deliver on our vision for unique customer experiences. Building a personalization capability enables Empire to better identify customer preferences, and support direct, individualized experience and personalized communication, evolving from mass communication to personalized connections with its customers. We're going to rely on both of those.

The goal is to deploy world-class and practical personalized communications and offers to inspire customers and improve the experience and relevance of promotions. Personalization is a key enabler in delivering unique customer experiences, driving incremental behaviours, and engaging new customers.

Now onto our first quarter results. Results were strong. You saw that. Grocery sales are still significantly higher than historical levels, and we continue to gain market share nationally. Same-store sales, excluding fuel, were up 11 percent this quarter, slightly below the average of 13 percent for the first six weeks of the quarter that we gave you on our last call.

Basket size is way up, and transaction count is down over prior year, but we see trips slowly increasing, week over week, as some customers are beginning to initially feel it's safe enough to shop a little more frequently—a little more. Pharmacy has stabilized. And as Canadians have gradually been travelling more across Canada, we see fuel sales increasing.

Q1 sales were impacted in the first six weeks by remnants of the lockdown. As restrictions started to ease up and over the last two periods of the quarter, we've seen sales rates slightly reduce, but still significantly elevated over prior year. We're now halfway through our second quarter. And when we look at the last two periods of Q1, plus the first five weeks of Q2, same-store sales have been averaging approximately 8 to 10 percent. And it's sticking around there. It's clear that many Canadians' food habits remain changed and, we predict they will stay changed due to the severity and length of COVID concerns.

Full service continues to outperform discount, but the gap between the two is slightly lessening. Of course, sales are stronger in regions which are currently most concerned about COVID. Looking ahead, we believe same-store sales may slow down a bit further, but we see the stickiness in a good portion of the consumption that shifted from restaurants and hospitality businesses to grocery sales.

Our gross margin dollars were positively impacted by our increased sales. Gross margin rate was 25.1 percent, up 50 basis points over the prior year. The margin rate improvement over last year is largely due to customers' continued preference for one-stop shops at our full-service banners, a slightly less promotional environment, and the annualizing of Sunrise savings. These positive improvements were partly offset by our service counters being closed for much of the quarter. We have now opened our service counters in almost every store across this country.

EBITDA margin rate was 110 basis points higher than last year. And when we look, again, over the last 12 months, our EBITDA margin continues to grow faster than our major competitors.

Our EPS of $0.71 this quarter is the highest in our company's history.

And lastly and briefly, I'd like to talk to you a little bit about the trends we continue to see as a result of COVID.

This pandemic has fundamentally impacted how most Canadians shop for food and continues to do so. And many of the trends that we discussed last quarter have continued over the last few months. We still see many, many Canadians gravitating toward one-stop-shop grocery stores that meet all of their household needs. Full service continued to grow faster than discount this quarter, albeit not to the same extent as during our fourth quarter, in the heat of that pandemic. And we believe it will continue to do so for the short to medium term, as most customers continue to seek out one-stop shops.

Online grocery sales in Canada continue to remain at elevated levels, although pulling back from their highs, per our internal data, as consumers have embraced e-commerce in all forms throughout this pandemic. Empire's e-commerce businesses in Quebec, through IGA.net, and B.C. through Thrifty Foods, had sales growth of approximately 370 percent this quarter. We continue to believe that customers will shop in stores that invest in safety and sanitation for as long as we are without a vaccine and probably even when we do find one.

So provincial restrictions have eased. At Empire, we have not let our guard down. We continued to maintain the increased safety protocols in our stores, with occupancy limits, one-way aisles, and masks.

When I arrived at Sobeys, we were non-investment-grade rated by our credit rating agencies. The senior team and our board made it a priority to return Empire to the investment-grade quality we knew it could be. We focused on operating a more efficient company, growing the cash flow through Sunrise, and bringing more discipline to the capital allocation process to strengthen the Company's balance sheet.

Last July, DBRS upgraded us to investment grade, and a few weeks ago, S&P upgraded us as well. We now have an investment-grade credit rating by all of our agencies. And being investment grade provides access to even more cost-effective capital.

The momentum at Empire continues thanks to the hard work of our incredible team of 127,000 teammates and franchisee partners from coast to coast. I've always said retail is a simple business—sales margin, cost, and capital allocation—but the trick is in executing consistently, and we are doing just that. Quarter over quarter, year over year, we are making strides toward extracting this company's full sales and earnings potential and, most importantly, thrilling our customers.

And with that, over to Mike.

Michael Vels — Chief Financial Officer, Empire Company Limited

Thank you, Michael. Good afternoon, everyone. We're almost halfway through our second quarter of fiscal 2021 and, as Michael said, over the past 14 weeks we've seen same-store sales averaging about 8 to 10 percent. Basket sizes are decreasing, slightly, but we're also seeing customer visits increasing. Looking ahead, we believe same-store sales may reduce a little further but still expect the stickiness of the consumption that shifted from restaurants and hospitality to grocery to persist.

We expect we will continue to incur $15 to $20 million in SG&A expenses per quarter, related to the increased costs of maintaining sanitization and safety measures and other COVID measures.

The gross margin rate improved 50 basis points from last year. Through the lockdown, which was during our fourth quarter and a part of our first quarter, we held the line on prices in store to the benefit of our customers. At the same time, the mix of sales in our stores changed materially from the prior year, with many more sales at regular store pricing. And we also benefitted from continued Sunrise benefits.

Our service counters, that were closed for COVID, and which are typically higher margin sales, slowly opened throughout the first quarter.

SG&A as a percent of sales was 20.6 percent, an improvement of 55 basis points over last year. If you remove the hero pay component of the COVID costs, it improved approximately 120 basis points, including the one-time, retroactive lump-sum payment of $15.6 million made to our Safeway Alberta teammates for hours worked over the past three years.

EBITDA margin rate was 110 basis points higher than last year. This was partly offset by COVID expenses, as the first half of this quarter included hero pay and the one-time bonus we paid to our front-line and distribution centre teammates when the temporary hero pay program concluded.

Equity earnings decreased year over year, principally as a result of decreased equity earnings from Crombie REIT. This was primarily driven by some bad-debt expense resulting from the impact of COVID-19 on the collection of outstanding receivable balances. Empire makes up over half of Crombie's rent, and Crombie has a strong, flexible balance sheet and remains in good financial health.

The effective tax rate for the quarter was 29.4 percent, higher than the statutory rate, primarily due to a revaluation of deferred tax assets. Excluding the impact of any unusual transactions or different tax rates on property sales, we estimate that the effective income tax rate for fiscal 2021 will be between 26 and 28 percent.

Earnings per share this quarter was net of a $0.05 per share of Voilà dilution. Voilà, as you all know, is a new business. So it is reasonable and expected that we will have a few years of dilution as we build the team and the processes required to get our volumes up to scale.

We continue to expect dilution of approximately $0.20 for fiscal 2021, and that the GTA CFC will be dilutive for at least the first two years. As we get to critical mass, the curve declines quickly. It's too early to share specific data—we only launched June 22nd —but we are really pleased with our retention rates, and customer reactions and repeat rates.

Our cash flow generation continues to be strong, and in August we returned to investment-grade ratings with both of our credit rating agencies. This provides options to access the debt capital market with improved spreads, in addition to renewing our existing credit facilities.

Sobeys has non-revolving credit facilities maturing in our third quarter, and we are considering refinancing using public debt, or a combination of public and bank debt.

We have a disciplined capital allocation process, and we invest in projects that have a solid return for shareholders. We announced as part of Project Horizon, that we expect to invest approximately $650 to $675 million in capital this year. Approximately half of this investment will be allocated to renovations and new stores, of 10 to 15 FreshCo stores opening in the West, and 8 Farm Boy stores in Ontario.

Approximately 15 percent of the total investment will be in advanced analytics technology and other technology systems. We will invest approximately $65 million in Voilà, which includes our share of the Montreal CFC build cost.

We renewed our normal course issuer bid in the first quarter to repurchase up to 5 million shares, and it is the Company's intention to execute on the NCIB this year.

Project Horizon officially kicked off this quarter. Michael discussed the first element of the project, growth in market share, and I'll cover building on cost and margin discipline. This element is a continuation of Sunrise plus some additional initiatives.

There's still so much opportunity to remove non-value added costs and ensure that we contain our costs and optimize our margins as the top line grows. A number of initiatives are underway to support building on our cost and margin discipline.

First of all, driving non-merchandising sourcing efficiencies. The strategic sourcing team we created as part of Sunrise is still in place, of course, and will continue to build further efficiencies and cost reductions in all indirect spend. We're a $26 billion company, and with this scale and scope I have a lot of confidence that the team will continue to find benefits for many years.

Secondly, we'll continue to build merchandising sourcing efficiencies. We continue to make investments in advanced data and our category planning process, working with our supplier partners to ensure we bring the best value and offer to our customers. Now that we've completed category resets, and we have our private label team fully in place, we believe there are categories where the sourcing costs could be better.

Thirdly, we're investing in best-in-class analytics to enable effective promotions. Advanced analytic tools will be leveraged by our category merchants nationally, across formats which will expand our margins by improving our net cost of promotions, while continuing to improve value for our customers.

Fourth, optimizing our supply chain productivity. This quarter, we opened our newest distribution centre in BC, which consolidated three previous DCs into one facility, securing a centralized location that increases our capacity and efficiency in that network. We will also be looking to optimize our logistics networks and consolidate certain procurement processes across the entire country.

And lastly, improving system and process. We will continue to leverage technology to improve our systems and processes. These will yield efficiencies and cost reductions in our back office and our support functions.

Our systems we have were built regionally, which makes them less efficient in our national structure. They don't hold us back materially, but our teammates look forward to the efficiency they will have pulling data from one system and improving processes across the country.

Fiscal 2021 started off with several exciting milestones for Empire. The launch of Voilà, testing curbside pickup in Nova Scotia, are just a couple of them. Additional stores announced for FreshCo in the West and Farm Boy in Ontario. We ratified a new CBA for many of our Alberta Safeway stores. We were upgraded to investment grade by our credit agencies.

And this is just the beginning. We have a packed agenda for the next three years of Horizon, and we're off to a strong start.

And with that, Katie, I'll hand the call back to you 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. You will hear a three-tone prompt acknowledging your request.

If you are on a speakerphone, please lift the handset before pressing any keys.

Your first question comes from Karen Short from Barclays. Please go ahead.

Karen Short — Barclays

Hi. Thanks very much. I just wanted to ask a couple questions on e-commerce. In terms of the Ocado update, that $0.20 per share for fiscal '21, the first question I have is, does that include curbside?

And then, I guess, do you have any colour, or could you provide any colour on what that assumes in terms of total sales in e-comm?

And then on curbside, I'm just curious what the driver of that decision was? And maybe a little colour, like who's doing the picking? How is the Ocado platform integrated into that? Do you pay a fee for it? Things like that. And then I had one other question.

Michael Vels

Thanks, Karen. If we forget to answer any of those questions, let me know. I'll answer the financial questions first, and then I'll pass on to Michael for the logistics of curbside pickup.

So the dilution number for this year does include any costs related to curbside pickup. We have said before that we don't anticipate that initiative to be consequential to earnings in the year. So yes, it would include it.

At this point, we're not going to be disclosing sales numbers. I will say that our sales numbers are right on our business plan, very happy with it. But beyond that, we're not going to provide the dollar number related to the sales for Voilà.

In terms of the logistics of curbside pickup, I'll pass that over to Michael.

Michael Medline

Thank you. It's a pretty simple system. We're using the great front end that we have at Voilà, and the customers are liking that in the testing we're doing on curbside. And it's our own teams in the stores that are doing the picking and interacting, using the right protocols in terms of safety and hospitality that we are proud of already in the GTA. So that's how we're doing that.

It's a great question. Mike and I have always been big believers in centralized fulfillment in terms of e-commerce, and we still believe that. But at the end of the day, we're a customer-focused company.

Our customers are telling us they want e-commerce, and Ocado's store pick solution has been tested in more markets and more stores now. And we wanted to use an Ocado solution when we did store pick. So we're going to take advantage of that and put it in earlier than we'd initially planned for.

But we're targeting two types of areas to put it into: areas we'll never have a CFC, where we do not intend to lose market share and expect a halo effect on our bricks-and-mortar; and two, areas where we will probably place a CFC in the future, and we want to get that business in and then convert customers over when the CFC is built.

Truthfully, the lion's share of sales, of profitability are in the CFCs in a central pick solution, but we're in the business of serving customers. And so you'll see most of the sales and most of our business will be through the CFCs but in those two instances, we thought it was a good idea to do store pick.

Karen Short

So can you maybe just elaborate a little bit in terms of curbside? When you were looking at what your offering is versus your competitors, what do you think your competitive advantage would be on the curbside?

Michael Medline

Yeah. I mean, our competitive advantage is not as stark as it is—we have a huge competitive advantage, obviously, with the CFCs—mammoth. And curbside is not as big a competitive advantage, other than we have great stores and unbelievably great teammates, as we've seen especially through COVID. So that's the, kind of, thrill for the customer. We're both process-oriented and customer-oriented now, and that combination is really paying off. And even in the tests we're doing in Nova Scotia, that's the feedback we're getting from our own employees, and we'll soon get them from the customers.

But that permeates our whole business, and that's always your strategic advantage. You serve the customers, do it in a good way, and you have a process so it's replicable and consistent across the country. And we're getting real good at that.

Karen Short

Okay. And then my separate question would be, you made a comment in the prepared remarks, the discount format outperformed your peers. Wondering if you could give a little more granularity on that? And why you think that's the case?

Michael Medline

From all the studies we looked at and our own internal and external work we've looked at, we gained market share against our discount competitors across the industry.

Karen Short

Okay. Great. Thanks.

Operator

Thank you. The next question comes from Mark Petrie from CIBC World Markets. Please go ahead.

Mark Petrie — CIBC World Markets

Good afternoon. With regards to Project Horizon and your financial targets, could you give us a sense of how to think about the timing and the composition of the improvements you have planned?

Michael Vels

Sure. As we said, many of the Horizon benefits are a continuation of work that we started during the first three years, and so benefits from the new Farm Boy stores, the discount rollout, the immediate quick wins we're having on some of our promotional optimization, continued work on indirect cost reduction, just to name a few—those are all initiatives that we're invested in and will clearly be a part of our F21 and going-forward numbers.

But there are other initiatives that start either increasing their contribution to earnings or beginning their contribution to earnings in years two and three. We have a renovation program, for example, that'll continue all the way through the three years. But by the time we get to the third year, and we're almost complete, touching 30 percent of the network, we expect that compounding effect of the sales to be greater in year three, for example.

Some of the work that we're thinking about doing on changing adjacencies, store layouts, that sort of thing, is likely to only begin in year three and towards the end of year three. And I guess that's a long answer, which says that we expect fairly steady and consistently increasing earnings throughout the three years, with the implication being that the third year will be the largest. But there's no significant delays or big chunks of benefits that are anticipated to kind of show up in year three, similar to what we had, for example, with category resets, which was a very long-term project in the planning, and ended up paying off mostly in year three. We don't have large, lumpy numbers like that.

So I think you can expect fairly steady earnings accretion over the three years, with the third year being the greatest.

Mark Petrie

Okay. That's helpful. Obviously, you're only a few months into Voilà. But I just wanted to ask a bigger picture question about the sort of connection and the synergies between the online platform and your physical store business. Obviously, we can see the Farm Boy and Chalo products and branding on Voilà. But thinking beyond that and just wondering how you look at that sort of connection? How important that is to leverage? And how we should sort of think about that over the next 12, 24 months?

Michael Medline

Yeah. You're thinking about it the right way. As we gear up, and it was part of our plans at the beginning. And obviously, we see synergies across our business, as you pointed out. But it's bigger than that. I mean, the ability to understand customers in different times they're shopping with us or shoppers who are currently shopping our competitors, who we can now, when they do their bricks-and-mortar shopping, we can more readily attract to our bricks-and-mortar stores. Our interaction with current customers, new customers, being able to use personalization and data to be able to serve those customers is a huge part of our plans and is already well underway. So we think it's big.

And the other thing that is— I can't remember, Mark, if you agree with me on this; I think you do. But when you're really good at e-commerce, that it really does reflect well back onto the brand, into the bricks-and-mortar. And we expect that to accrue to us as well.

We're not newbies at this. Right? We're not rookies. We have had the number one market share in Quebec for a long period of time. And so we've done this before. It's just not at this level. So thanks for the question.

Mark Petrie

Understood. And I guess, sort of related to that, just my last question. In terms of the all-in economics of the losses to the existing business, how does that change when you launch into markets where you have a stronger physical store presence and a greater market share? I'd expect you'd be able to leverage some of the infrastructure you've already built but, also, the level of cannibalization or the risk is much higher. So just wondering how you think about that. And I don't know if you can put it in the context of the $0.20 of year one dilution for the first CFC? How we should think about that for two, three, and four?

Michael Vels

Our perspective on this, Mark, is—and I think we've said this before—we have not assumed that our success in Voilà is going to end up with any cannibalization or any significant cannibalization on existing bricks-and-mortar stores.

We do think that done properly, and in particular our ability to link customers that shop online with customers that shop in our bricks-and-mortar stores—that synergy and the halo effect is going to help both of the formats. So we're not assuming a negative impact on our stores. We just think the brand will become stronger, and that we'll win in both formats. That's been our experience in Quebec. We've been at it, as Michael said, for some time. And I think, in Quebec in particular, it's just going to get better because we're going to have an even improved offering. But we think that's still going to be a positive for the IGA store network.

Michael Medline

Yeah. It's interesting, Mark, as we can argue it both ways. And in the Greater Toronto Area, we're not taking any business from ourselves. We're just taking customers from everybody else because we currently have a lower market share. We're building that, and so that's all good.

And then when we go to Quebec, we have a built-in customer group who is already dying to try it, so our volume goes up quicker. Our basket size is going to be larger. And our costs, obviously, at scale, are so much better, and the customer experience is better. So in a weird way, I could argue both. I'm excited about both, and I was going to say one is better than the other, but I'm not sure. So, it's either good to already have that business, or it's good to not have any business – one or the other. It's interesting.

Mark Petrie

Yeah. No doubt about that. All right. All the best. Thanks for all the comments

Michael Medline

Thanks.

Operator

Thank you. The next question comes from Peter Sklar from BMO Capital Markets. Please go ahead.

Peter Sklar — BMO Capital Markets

Okay. I believe you said that you're going to be spending 15 percent of your CapEx on advanced analytics. That is a lot. Can you elaborate a little bit about how you're spending that money? What you're spending it on? And like I assume you have an advanced analytics team, or you're developing a team. And how do you recruit and find those people? Because it just seems like every retailer is talking about analytics now, so maybe just talk a little bit about that?

Michael Vels

Thanks. So many people have told me over the years that I speak too quickly. So what I actually said is advanced analytics and other technology investments. So that would encompass all of the investments we're making in new processes, personalization, analytics, improving our regional SAP boxes, et cetera. So sorry if I misled you on that, Peter.

It's absolutely not advanced analytics only; it's our technology spend. So what I'm really trying to point out is that we've made a decision, as part of our strategy —similar to a decision that Michael made three years ago—, to invest consistently in marketing, which we've done over the three years.

We've also made a decision to invest very consistently in information technology, which would include advanced analytics and other tools for our merchandising and operations people, in every one of the three years of our Horizon. And we decided to put a number to it in this year, and you can expect that to be pretty consistent going forward.

Peter Sklar

Okay. And then the other area I would ask if you address, can you talk a little bit about store conversions and new stores, how you're doing? So, for example, there's the FreshCo conversions out West, and then there's the Farm Boy expansion in Ontario. Can you talk a little bit about how those stores perform? And what the ramp looks like? And over what period of time do they lose money? And how long does it take before they generate the sales level and returns you're looking for?

Michael Vels

So the two are a little different. I'll deal with Farm Boy first. So that format has proven to be a winner every time we've opened a store since we bought the company. And certainly, when we looked at and did the due diligence on that business, the ramp-up is quick, the margins are strong, and that's a format that gets to maturity pretty quickly and is profitable very, very shortly after launch. So that is one of the things we certainly like about that format.

And it's something that JL and his team are just exceptional at. It doesn't happen easily. It's a massive amount of planning and an incredible amounts of recruiting the right team, and training them, and making sure that they're doing it the Farm Boy way from day one, so. But that's a quick ramp-up and a fairly quick path to profitability.

In terms of the discount expansion, two things happening there. First of all, some of them—in fact, probably most of them—are going into stores that are really either ill-suited for the area that they're in, because it's more suited to discount, or potentially we have other full-service stores in the area that can pick up the slack.

And so we're frequently taking over a store, obviously, with lower capital costs and an ability to immediately increment the margins and improve the sales performance. So we do start with that benefit. But at the same time, we're going into a new market with a new format, and new employees in many cases. And so the ramp-up for those stores is slower.

We have said in the past that we expect a new store in that geography to be dilutive in year one, at least, and that has proven out. But now that we have stores that are lapping, they are doing well in spite of pretty significant competition. Nobody likes to lose market share. But we are happy with their performance and the new team, particularly as we start to get to scale, which means more than one or two stores in an area or a geography. We're also able to consecutively improve our labour efficiency and our margin expectations.

So that's a slower build, just because of the nature of the expansion. But it is performing to our expectations, and we're comfortable with the rate.

Peter Sklar

And, Mike, when you do these conversions, how does that get incorporated into the same-store sales numbers that you provide? I assume, when a store is closed for conversion, it comes out of the calculation. And when does it come back in? I assume not on the day one of launch; you wait 13 months or whatever.

Michael Vels

It would come back in when it's open. And we comp against the old Safeway sales, so we treat it as a same store.

Peter Sklar

Okay. Great. Thank you.

Operator

Thank you. The next question comes from Patricia Baker from Scotiabank. Please go ahead.

Patricia Baker — Scotiabank

Thank you very much. Michael, I just want to come back to Voilà for a second. So you market that offering as Voilà by Sobeys. It's probably too early to tell yet, but I'm just wondering whether you foresee that Voilà itself is actually going to provide some halo effect to the Sobeys stores? And then, secondly, some enhancement or strengthening of the Sobeys name and the Sobeys brand?

Michael Medline

Yeah. I mean, it's a great question. And completely, that is exactly what we did. I mean, you have a lot of choices when you're putting together a new company. In this case, we wanted to take advantage of a couple things. We wanted to be clear that this was a new business that was e-commerce and with different—I don't like it when people call it sobeys.com. I just don't like it. And I don't think it works that well.

At the same time, we wanted customers, because there's so much trust in the Sobeys name, and that some of these e-commerce companies—how do I say it nicely—don't have a great supply of quality food. We wanted people to know it came from Sobeys, and when we go to other markets from that local market.

But at the same time, we believed both could have a halo effect on the other. So you would trust Voilà more because it was associated with Sobeys, which has a very good strong brand connotation, but I mean, we've seen studies that show when you're great at e-commerce, the brand loyalty can be as high as 14 times as strong. It would put a halo effect on us, especially because it is the best in the market, that the customer service is second to none, and it's really cool. So that's the way we thought about it.

Patricia Baker

Okay. Thank you. That's very helpful. Then in your opening remarks, you did talk about the renovations as being one of the key drivers to drive market share. And you know that those are the highest return projects within the Company. I think you've mentioned that you've got 21 underway currently. Just curious, of those 21, are those geographically dispersed? Or geographically concentrated?

Michael Vels

Just thinking about how best to answer that. The easy answer is that they're geographically dispersed, Patricia. So over the whole three years, we'll really be covering the whole country. But in any one of the three years, we're probably a little more overemphasized towards one region, just because of the way it works out.

So for 2021, it's across the entire country —probably a little less so in Ontario, I think, in this year, and a little more in the East and the West, but nothing that I'd point to as a very significant overweighting.

Patricia Baker

Okay. Thanks. And the curbside pickup in Nova Scotia. Two things —in the opening remarks, you talked about the curbside pickup in Nova Scotia. And then you said, you'll be going out West.

So I'm assuming that curbside pickup in Nova Scotia's being done because that's in a market where you'll never have the CFC. And the West is referring to you doing your B option, which is seeding curbside pickup before you put in a CFC. Is that correct?

And then, secondly, how many locations are you doing it in Nova Scotia? And is it both in urban and more rural markets?

Michael Medline

Yeah. Your supposition is exactly in the right direction. And we're not going to divulge how many stores we're going to put in right now —just for competitive reasons. Why help anyone.compete against us?

But at the same time, we're looking at all sorts of range of stores that—right now, we're testing it in an urban centre in Halifax, and we're testing it in a less urban centre in Pictou County. So we think it has attributes to Canadians in urban, suburban, and rural.

Patricia Baker

Okay. That's very helpful. And then my last question is just a clarification. You talked about Farm Boy and how that their same-store sales were down because of the removal of the food service, et cetera. But you said that their sales are now stronger than normal. And I just want to make sure that what you're saying is that Farm Boy is now seeing same-store sales that are stronger than they've even had in their history?

Michael Medline

I don't know their whole history because I've only known it for a couple years.

Patricia Baker

Well, since you took over.

Michael Medline

JL and Jeff will chastise me if I try to guess. They're used to very, very high same-store sales. In fact, when we were doing our due diligence, Mike and I were looking at the numbers, and we had to do a little bit more due diligence, it was so good. And I'd say that they're doing even better now because of the changes they made in the store and because of the awful pandemic we're going through.

So historically better, as far as I know. Mike, what do you think? You're in accord?

Michael Vels

Yeah. I think the message is that their business has been reconfigured, to some extent, in their service departments. And they have reacted well to adverse circumstances in those parts of the store—extremely well—and the sales have come up materially in the first quarter. I think that's really the message

Patricia Baker

Super. Well done. Thank you.

Michael Medline

And well done to Jeff and JL and their teams.

Operator

Thank you. The next question comes from Vishal Shreedhar from National Bank. Please go ahead.

Vishal Shreedhar — National Bank

Hi. Thanks for taking my questions. Michael, I know you're very focused on return on capital. And when the Farm Boy acquisition was announced initially, there was some surprise at the actual multiple number. I'm just wondering, as you reflect back on Farm Boy, if that acquisition is hitting your hurdle rate?

Michael Medline

No. I was wrong. It's much better than I thought it would be, this acquisition. So we hadn't even planned for the sort of success or growth, and even the conversions we're seeing, where we're seeing that. So it's performing on all levels, much better.

At the time, people asked, why'd you pay that multiple? And we said it was because it was worth it. And it's even more worth it, as we look back over whatever it's been, a year-and-a-half, two years, whatever it is now, that we've been partnered with Farm Boy. So very, very, very pleased.

Vishal Shreedhar

Okay. And I know that Farm Boy merchandise is being offered by Voilà. But has any of their thoughts regarding merchandising—has any of that percolated back into the Sobeys network? And are you seeing any of these kind of reverse synergies flow across the rest of network?

Michael Medline

Great question. I was speaking to someone here today, and I said, I think we're getting the financial and strategic returns. But I don't even know how to quantify what bringing great merchants with new ideas brings to a larger organization with more scale that's open to those ideas.

And probably the proudest I've been, in terms of the team, other than COVID, is how Pierre St-Laurent, our COO, Mike Venton, who runs Discount, and Sarah Joyce who runs Voilà

I'm very proud of what we're doing, and we're bringing in all the expertise from Farm Boy in areas like private label, in produce and merchandising, in customer service. And it's helping us across discount, full service, and in e-commerce, so very, very pleased to see what you would call reverse synergies. We never anticipated such a benefit, and it is difficult to quantify but very, very big.

Vishal Shreedhar

Okay. And just switching topics here, on Voilà, I'm not sure you're able to provide us with specific detail, but even high-level detail on basket size, margin, composition, promo intensity—any of that colour. Is it in line with what you thought? And maybe if you can reference your store network and how it compares?

Michael Vels

Sure. As I mentioned, we're not going to be providing specific statistics because it is competitive. But, yes, some of the things that you point out—so how we're doing on our basket size, for example, compared to our expectations—our basket size is significantly greater than the minimum basket we require on the site and is probably just a snick short of where we expected to be at this point.

The reason for that is that, because of the supply chain challenges some of our suppliers had, we started off with a smaller assortment, which we've been adding to materially every week since we started. And so that, just by mathematics, drives a slightly smaller basket size. And we've been very, very happy to see that it's only slightly smaller, so as we get to our full assortment, we expect that to be a very positive number.

In terms of all of our other statistics, like, drops per van, our customer retention rate, the repeatability, the frequency of reordering, all of those statistics are either running at or ahead of our expectations at this point.

Vishal Shreedhar

Okay. And maybe I'll risk asking another question here just in terms of Voilà. Is the amount of two-hour orders, let's say—is that in line with what you thought it would be? And it's a rather small percentage, and the vast majority has, like, 24-hour orders? Is that a fair way of thinking about it?

Michael Vels

Yeah. So that’s really not how their system’s designed to operate, or how we measure it. You get to select a delivery slot. Depending on when you order and where you live, that delivery slot could be same day, but it is more generally likely to be next day.

But we have some customers who start ordering early in the week, say, on a Monday or Tuesday, and they want a delivery slot on the Thursday or the Friday or the Saturday. And so they’ll adjust and work on their order all week. So it really does vary right across the gamut. And it’s way, way too early to be able to say where that’s going to fall out in total, in terms of how far ahead customers will place their delivery slots.

So it’s very muchthe customer’s choice. The customer decides when they want it delivered, and that’s when they get it. We can’t do that two-hour turnaround, for example. That’s not how we’re configured. I mean, we’re configured to capture your entire weekly shop and deliver it to you in good order and in good time.

Vishal Shreedhar

Thanks for the colour.

Operator

Thank you. The next question comes from Irene Nattel from RBC Capital Markets. Please go ahead.

Irene Nattel — RBC Capital Markets

Thanks and good afternoon, everyone. I’d like to talk a little bit more, if you don’t mind, around the changes, the store layout changes, the category, and how that ties in with private label.

And also what your objectives are with private label? And how much you are taking that Farm Boy private label and incorporating it into what you're planning on doing.

Michael Vels

We're not going to spend a lot of time talking about details, just because it's competitively level sensitive. But I'll give you a bit of colour for it. So obviously, you know we've taken the Farm Boy private label and put it on the Voilà site, both Farm Boy and Voilà are super excited about that. It's doing very well.

But beyond that, there's some obvious synergies in taking the thought leadership and what the Farm Boy team has done in terms of building a really premium and very successful private label business. And we have active and very collaborative conversations between our private label team here and theirs. And we've recently moved that into a higher gear. And we have made that a little more formal.

So there is more and more integration of, I'd say, on more of the creative and innovation side at this point, in terms of putting a program together for, really, both companies' private labels. So they've benefitted from our scale, and we're benefitting from their experience.

Irene Nattel

That's great. That's very helpful. And as you think about the category resets, or the early thoughts around it, is there anything that you can share with us around thoughts with respect to store layout? And where we should expect to see the changes? And how extensive all of this may be?

Michael Medline

Obviously, I'm not going to share the details of it. And it depends on which stores and what we're trying to accomplish. But I think we have to be cognizant that we not disrupt the customer while we're putting this through. So we have, sort of, the plan that, first of all, go stage by stage and then don't all occur at the same time. So that's what we're up against here.

And I think some people, they think that when we use data, we just use data, and it's some algorithm that tells us what to do. Data helps smart merchants and smart operators make smart decisions. Data's not going to help a bad operator. And a good operator, using the right data, we're seeing, makes just better decisions because they can't see all the permutations and the billions and billions of different data points.

So what we're saying, and I think is not stressed enough in this industry, it's not data or people, it's data and people, and that the best results we're seeing—and they're very good—are when we have our great merchants working with that data and being given the tools to do their job properly.

Irene Nattel

That's great. Thank you. And then a question, if I might, around sort of competitive intensity. As we're seeing traffic ever so slowly come back a little bit, are you seeing anyone sort of getting their elbows out, trying to maybe get a little bit more aggressive to take advantage of that?

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

I think it's a different pattern now. We're coming back to the new normal. So, I think during the pandemic, as we said, the promo mix had been different, basket size was bigger, and the ratio of promotion was lower. So now, with the new normal, we're seeing every player coming back in a pre-COVID mode. So yes, we're seeing more promotional intensity than we saw during the pandemic.

But I think we're coming back to a pre-pandemic normal, I would say. And September is a very hot time in merchandising; it's back to school. But this year, it's very different. It's not comparable with last year with the pandemic still there.

But yes, I think we're seeing that everybody adjusted their promotions. And now, we're more back to a new normal. So yes, we're seeing a bit more promotional intensity these days than we saw during the summer and during the pandemic.

Irene Nattel

That's very helpful. Thank you. And just one final one, if I might. What kind of conversations are you having with suppliers around potential price increase and request for price increases as they themselves are facing higher operating costs?

Pierre St-Laurent

We took the hard line not increasing retail prices during the pandemic. And I think everybody had to focus on manufacturing and producing stuff and merchandise for filling the shelves. And it's what we focused on, on both sides, us and the supplier. I think everybody saw a growth. We continued to maintain that hard line on not increasing retail price at this time, and it's same thing for the costing, except some commodities where we have to play with the market conditions, so like meat and produce. But it's where we are.

In terms of relationship with suppliers, I think we stayed true to our value at Sobeys. I think we had a strong partnership with suppliers. We addressed some issues, supplier by supplier, category by category and we are talking with them, we're negotiating with them like we did in the past. And I think we have strong collaboration with them, and that's how we want to be going forward.

Michael Medline

That's a great answer. And the only thing I would add, Pierre, is that I think that the relatively stronger Canadian dollar helps as well in some of these matters as well, to keep down the cost to Canadian consumers, and for us to continue to put pressure on ourselves and others to make sure that the goods are flowing at a competitive price in produce.

Irene Nattel

That's great. Thank you.

Operator

Thank you. The next question comes from Michael Van Aelst from TD Securities. Please go ahead.

Michael Van Aelst — TD Securities

Thank you. You've covered a lot already. I'll just touch on a few things.

In the past, you've given us some insight on the pharmacy performance and how that impacted same-store sales. Can you give us an idea how that's trended during the quarter and into Q2?

Michael Vels

Sure. Because of some changes in some of the regulations in terms of how we were able to do scripts and the amount that we were able to fill through the pandemic, we did see some negative impact on our pharmacy sales and our script counts. That has normalized much more. And our pharmacy business has returned to, I would say, more normalized levels. And we're very comfortable with our performance in the first quarter.

Michael Van Aelst

Okay. Great. And I believe, in the fourth quarter you guys were forced to focus more on supplying your own stores rather than all your wholesale business. I'm wondering, it does seem like the wholesale business and the wholesale volumes is back to normal levels. Is that accurate in Q1?

Michael Medline

Yeah. It's Michael. And now we always, because it's important to the Canadian consumer, and because we have great relationships with our wholesale customers, we were supplying them at least as well as we were supplying ourselves.

And so, as things return to what Pierre called, I guess, the new normal, as things slowly get better and better, it's still not the same food supply chain that it was before COVID, given the trauma in terms of factories and processing plants not being able to put people close together to each other, and the fact that consumption in grocery stores is so much still elevated and will continue to be elevated.

So there's still pressure on the system, but we treat our wholesale customers at least as well as we treat ourselves.

Michael Van Aelst

Okay.

Michael Medline

Good question.

Michael Van Aelst

The e-commerce penetration has clearly gone up in Quebec and B.C. But are you willing to give us an idea of roughly where that stands right now?

Michael Vels

Our numbers through the peak period in our existing e-commerce business are up 7 to 10 times. So there's those crazy numbers. And it's settling at roughly about 3.5 times last year's level as well.

Michael Van Aelst

So would that kind of put you in that 3 percent to 4 percent range in those markets?

Michael Vels

Yeah. I'm not sure I want to try and give you a number without researching it. But it is certainly significantly higher than last year.

Michael Van Aelst

Okay. All right. And just finally, you alluded to some increased competitive activity in discount. I guess, based on the success of the rollout of FreshCo, others aren't happy about giving up share. So how has that changed during Q1 and into Q2? And how are you positioning yourself if this continues to ramp up?

Michael Medline

It's Michael. And I wish I had Mike Venton on the phone because he could be more articulate on this, because he's on the ground fighting it. It's what we expected. As Mike said, I think, earlier, we expect people to try to retain market share, even if it's fake market share, just because we closed a Safeway. And then, as there's a few months before we reopen the FreshCo, we've been highly successful in using, basically, the same game we usually do in fighting out there, and being competitive, and telling our story, and marketing correctly.

We believe that there's—especially in the markets we've chosen to put in FreshCo, there is a very hungry competitor who wants to come to our stores. We believe that the smaller box, if I may say so, discount chain, has a value and appeal to customers in the West, like we always thought. And I think that we fulfill a need that we believe that we met where we fill in Ontario and that FreshCo could, when we were planning it.

So it's no more competitive. In fact, it's probably a little less competitive than it was when we first started opening these stores because we're not going away. We're going to keep opening them. But you've got to play your own game. You can't get thrown off your game.

And the greatest compliment that you could ever be paid is when people start putting your flyer up in their stores, on the bulletin boards or online, and start saying we'll match them. I hope they continue to do that. I love that kind of marketing. We don't have enough marketing to pay for all that. So I love it, and Mike Venton loves it.

Michael Van Aelst

Perfect. Thank you.

Operator

Thank you. And the last question comes from Chris Li from Desjardins. Please go ahead.

Chris Li — Desjardins

Thanks so much for squeezing me in. Just first, a quick one on Voilà. Can you tell us how many SKUs is the CFC able to fulfill currently?

Michael Medline

We don't have the exact number as of the moment.When we announced Horizon, we said, I think, we were around the 15,000, and we continue to add SKUs as we speak.

And those of you who are customers, and I know some of you are because you've told me—we recently put on a page you can go on, where we highlight some of the new products we've added to the site. Because if you went on and you didn't find—Boursin cheese or whatever you want to find—when we add it, we put it on there, so you know it's new to the site. We hurried to get this out there for Canadians during the end of the heat of the pandemic, and now we're just adding SKU after SKU on a daily basis.

Just as a nice warning, I don't want our competitors to know exactly the number of SKUs. I guess they could go online and count them, but it would take a long time. We're going to be bigger than everyone else in terms of SKU count, and bigger than in any store. So I just don't want everybody to know every SKU we have. And Pierre's nodding, so he agrees.

Pierre St-Laurent

Yes.

Chris Li

That's fair. And then maybe just a high-level question. What are your thoughts generally on subscription programs? As you know, they're gaining popularity quite a bit in the US, but not as much here in Canada yet. Do you see them in Sobeys' future at some point?

Michael Medline

I think—yeah. I mean, if it's good to the customer, it's good. But we're not contemplating it right now. But if we think it's an advantage we can put online, and it's good for the customer, and good for us, we'll do it.

That's a good question.

Chris Li

Yes. Thanks. And last question, just Farm Boy, obviously, has been a good, successful acquisition. I'm just wondering, are there other regional ones in Canada that are like them out there that would complement your strategy in the future?

Michael Medline

I wish we could buy more Farm Boys that are out there, but there doesn't seem to be any that are quite like that. So I haven't seen anything quite like Farm Boy, where it was such a great asset with great leaders and great brand.

Chris Li

Great. Well, thanks for the answers and best of luck.

Michael Medline

Thank you.

Operator

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

Katie Brine

Great. 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 email.

We look forward to having you join us for our second quarter fiscal 2021 conference call on December 10th. Talk soon.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating, and we ask that you please disconnect your lines. Enjoy the rest of your day.