FINAL TRANSCRIPT

Empire Company Limited

Fourth Quarter 2023 Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Empire Fourth Quarter 2023 Conference Call. (Operator Instructions) Also note that the call is being recorded today, Thursday, June 22, 2023. I would like to turn the conference over to Katie Brine, Vice President, Treasury, Investor Relations, ESG Finance. Please go ahead.

Katie Brine

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 line for questions. This call is being recorded, and the audio recording will be available on the Company's website at 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, Matt Reindel, Chief Financial Officer, Pierre St-Laurent, Chief Operating Officer, and Doug Nathanson, Chief Development Officer and General Counsel.

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

Thanks, Katie. Good afternoon, everyone.

The end of fiscal 2023 marked an important day for Empire Company - the end of our three-year Project Horizon transformation. After six and a half years, we are very pleased to announce that our turnaround is now complete. Through Project Sunrise and Horizon, we have delivered over $1 billion dollars in EBITDA improvement since the end of fiscal 2017. We now have the tools, capabilities, team, and assets needed to compete and win. We will now transition to our next chapter and focus on consistent and sustained execution and results. I'm going to focus on four topics today: the completion of Horizon; our go-forward strategy; our Q4 results; and some key market trends.

First, Horizon. We delivered on Project Horizon, we deepened our analytical capabilities and built a promotional optimization tool, enhanced our Own Brands portfolio, strengthened our stores through renovations and the expansion of FreshCo in the West and Farm Boy and Longo's in Ontario, and launched our new Scene+ loyalty program nationally. On top of that, we launched our Voila e-commerce business, starting with our CFCs in Toronto and Montreal to give customers more choice on where, when, and how they shop and we did this all while facing a global pandemic, strong inflationary headwinds and the most challenging market environment we've seen in decades. These efforts resulted in $500 million dollars in annualized incremental EBITDA added to the Company, translating to an EPS CAGR of approximately 13 percent, and approximately 60 basis points of EBITDA margin growth.

As you know, this was the second three-year transformation we've completed. Over the last six years, we've shared all of the details of our many strategic initiatives with you and delivered each of them on time and on target or in many cases, better than target. We told you what we were going to do and we've done it. The turnaround is complete and we now have everything in place to succeed win and grow market share.

Since the start of Project Sunrise in fiscal 2018, we have improved almost 50 percent of our network through renovations and new stores and we generated a compound annual growth rate of 26 percent in adjusted EPS, leading the industry. I said it after Sunrise and I'm pleased to say it again today, there are very few Canadian retailers that have executed a transformation of this magnitude with this level of success, and I want to thank, from the bottom of my heart, every single Empire teammate, who is part of this journey for their herculean efforts.

As for what's to come, we will not be publishing details of our next three-year strategy going forward, as we are now through the transformation. Going forward, we aim to deliver on a financial framework that grows our adjusted EPS at an average annual rate of 8 percent to 11 percent over the long term through operating earnings growth and share repurchases. We may exceed or miss these goals in any given year, but that is our goal. To achieve this growth, we will focus on priorities such as, an even greater emphasis on our store network, including our supply chain and enhanced focus on digital capabilities and data, and a continued drive for efficiency and cost control. We will do this by continuing to advance our key initiatives including Scene+, store renovations, own brands, space productivity, and others, while also beginning new strategic programs that support our stores and enhance customer experience.

From a capital allocation perspective, the business now generates a healthy amount of cash and we will continue to invest your capital wisely. During our transformation period, we needed to increase our capital investments to develop new tools, capabilities, and assets. Now, starting in fiscal 2024, capital discipline will be more crucial than ever and we estimate we'll invest $775 million dollars this fiscal year. It's intentionally lower than what we planned to spend last year, but at the right level now that we're out of the turnaround, and Matt will give you more details on this shortly.

We're announcing a 10.6 percent increase in Empire's quarterly dividend per share, which brings our five-year dividend CAGR to 10 percent and represents an increase in our dividends for the 28th year in a row. We also announced that we renewed our NCIB to repurchase up to 12.6 million shares, representing 9 percent of our public float. We plan to repurchase approximately $400 million dollars of shares in fiscal ‘24, an increase from the $350 million dollars we bought back last year.

Now, on to our results. We're pleased with our Q4 performance. Overall, we delivered adjusted EPS of $0.72 this quarter. This translates to 18 percent EPS growth year-over-year when excluding the extra 53rd week last year. This was supported by solid sales growth with same-store sales of 2.6 percent and total sales growth of 2.7 percent, excluding fuel and the extra week in Q4 last year.

Our full-service business in particular showed a noticeable upswing in same-store sales growth versus prior quarters with higher unit counts and increased traffic in stores. FreshCo continued to deliver very healthy sales growth with double-digit same-store sales.

Our gross margin excluding fuel grew 60 basis points; this was primarily due to Horizon initiatives that have provided continuous margin rate growth including consistent growth of our Own Brands portfolio. We launched another 100 private label SKUs this quarter for a total of over 1,000 new SKUs introduced since the start of Horizon. We continue to drive product innovation and value-focused offerings through this assortment.

We made significant progress against our strategic priorities this quarter. In late March, our banners in Quebec & Thrifty Foods in BC joined Scene+, marking the final phase of our national rollout. We are off to a very strong start with sales penetration above target in both Quebec and Thrifty Foods. Overall, this program continues to exceed expectations across regions and Scene+ now has over 13 million members, over 3 million new members have joined the program since launching last August.

We also continued to prepare for the integration of Grocery Gateway into Voila in Q1, which will go live officially in July. We are looking forward to providing Grocery Gateway and Voila customers access to each other's assortment by offering Longo's as a significant shop-in-shop on the Voila platform. We also had our first customer deliveries from CFC3 in Calgary, earlier this week, and are thrilled to be bringing our world-class e-commerce grocery business to the great Alberta market.

Moving to market trends. While food inflation remains high, we are pleased to see that it is beginning to moderate. Although we continue to navigate through supply cost increases that are higher than pre-pandemic levels, it appears we reached the peak in our Q3 as supplier requests moderated this quarter in both magnitude and volume. We expect supplier cost increase requests will continue to moderate over the coming quarters. This is supported by most ingredient commodities coming off their highs, such as wheat, flour, and various cooking oils.

For several quarters, we have said that as inflation abates, Empire will be well positioned, and in Q4 we began to see early indications of this reflected in our sales performance and in our tonnage. We are also continuing to see traffic in our stores improve, with higher transaction counts in Q4 across all regions. Although basket sizes are still lower than last year, we are seeing this trend improve. Our category managers continue to work in collaboration with our supplier partners and to leverage the promotional optimization tool we built to provide value to customers, and we are seeing higher promotional penetration than last year as customers stretch their dollars.

Our team continues to focus on providing value to customers, including by growing our value size product offering, deploying Scene+ member days across English Canada, and launching our new Serving Up Value program to offer budget-friendly recipes to customers using our Compliments products. Although we faced some of our greatest challenges in fiscal ‘23, I'm extremely proud of this team for continuing to deliver results and scrupulously execute against our strategy in the face of significant external headwinds. Six years ago I'm not sure our business could have withstood shocks of this magnitude. But our annual results and Q4 in particular, highlight the underlying strength of our business today. And I truly believe the best is yet to come.

With that over to Matt.

Matt Reindel

Thank you, Michael. Good afternoon, everyone.

We are very happy with our Q4 performance, delivering an adjusted EPS of $0.72, which was $0.04 higher than last year's $0.68, or $0.11 higher than last year, if you exclude the impact of the 53rd week last year. Our results are also slightly better than what we communicated at the end of Q3, and very consistent with our expectations with the business beginning to benefit from a gradual improvement in momentum as inflation begins to abate.

Moving to the top line, we delivered solid same-store sales of 2.6 percent, which is a notable improvement versus our flat performance in Q3. As expected, with the cybersecurity event behind us and with inflation starting to abate, we started to see same-store sales momentum return. In e-commerce, after excluding the 53rd week of operations last year, total sales from our four platforms were 13.5 percent lower than last year. This was primarily due to Omicron last year, which had a large effect on our legacy non-Voila businesses.

Sequentially, our Q4 e-commerce sales were flat versus Q3. For Voila specifically, again excluding the impact of the 53rd week last year, our sales were 7 percent lower, mainly due to Omicron last year, but most importantly, Voila continued to grow market share.

Our gross margin rate excluding fuel grew by 60 basis points versus last year. This progress is consistent with numerous prior quarters now with benefits being generated from our Project Horizon initiative, such as promotional optimization and sourcing efficiencies. We are also starting to benefit from lower supply chain costs versus last year, mainly in transportation. It's also worth noting that last year's gross margin was adversely affected by the Terrebonne strike, which had a 19 basis points impact last year.

Our SG&A rate was 89 basis points higher than last year when you exclude the impact of the 53rd week last year. Consistent with prior quarters, this was mainly due to planned investments in Horizon initiatives, although partly offset by lower incentive accruals.

Other income in Q4 was $14 million higher than last year due to capital gains on a planned sale of a proxy, partly offset by the gain on a lease surrender that we recorded last year. For the year, benefits from other income and real estate income were very much in line with our plans and are a consistent source of income for the Company.

Our EBITDA margin increased by 60 basis points, which is the net impact of all of these various puts and takes.

Our effective income tax rate was 25.3 percent in Q4. For fiscal ’24, excluding effects of any unusual transactions or differential tax rates on property sales, we’re estimating that our effective income tax rate will be between 25 percent and 27 percent.

Now, let me talk briefly about the end of Horizon and our financial framework moving forward. We are very pleased with our performance during Horizon. It's a testament to all of our teammates across the country, that despite navigating through a pandemic, extremely high inflation, and a cybersecurity event, that we successfully delivered Horizon. More details can be found in our MD&A, but most importantly, Empire is now in a strong position to deliver consistent, sustainable growth for its stakeholders.

With our turnaround now complete, the Company will be focused on executional excellence and delivering consistent results. Over the long term, we aim to deliver average annual adjusted EPS growth of 8 percent to 11 percent from both net earnings growth and share buybacks. In our core food retailing business, we intend to continue improving our sales, gross margin, excluding fuel, and adjusted EBITDA margin. We expect income from our real estate and other investments to be relatively consistent on an annualized basis.

There are several priorities which will enable us to achieve these expectations. Firstly, a strong focus on our stores, including the continuation of our store renovation program, new stores, and enhancing our Own Brands program. Near-term initiatives for Own Brands include rolling out a set of SKUs under the Chalo brand, enhancing our value size assortment and introducing new SKUs that align with our organic and green initiatives.

Secondly, we will enhance our focus on digital and data, including our expansion plans for Voila, our loyalty program through Scene+, improving space productivity, and focusing on personalization.

Thirdly, we will focus on driving efficiency and cost-effectiveness through initiatives tied to strategic sourcing and supply chain productivity.

Now on to capital allocation. Our capital allocation strategy is supported by a solid balance sheet and the continued momentum in our business. We announced earlier today, a 10.6 percent increase in our dividend. On share buybacks, we completed our 2023 NCIB program last week, repurchasing 10.5 million shares since July of last year. Today, we announced that we have renewed our NCIB program to purchase up to 12.6 million shares. Our NCIB intention of $400 million dollars in fiscal '24 is higher than last year, reflecting our increased confidence in our underlying business, as well as capitalizing on our low valuation.

This year, we invested $797 million dollars in capital, just shy of our estimate of $800 million dollars. Capital discipline is paramount to Michael and I. We expect to invest approximately $775 million dollars in fiscal '24. As in prior years, we expect about half of this capital to be allocated to renovations and new stores. Over the next three years, we plan to renovate approximately 20 percent to 25 percent of the network and about $50 million of the capital will be allocated to sustainability initiatives, such as refrigeration system upgrades, HVAC system upgrades, and other efficiency initiatives.

Before I turn the call back to Katie for your questions, let me update you on our adjusted metrics. Reported earnings per share and adjusted earnings per share were both $0.72, which was due to two adjustment items that offset each other. We had a net recovery from our cyber event, primarily due to insurance recoveries, which was offset by the one-time costs associated with the integration of Grocery Gateway into Voila.

With that, I'll hand the call back to Katie and open the call for your questions.

Katie Brine

Thank you, Matt. Sylvie, you may open the line for a question-and-answer session.

Q & A

Operator

Thank you. (Operator Instructions)

Your first question will be from George Doumet at Scotiabank. Please go ahead.

George Doumet — Analyst, Scotiabank

Good morning, Michael and Matt, and congrats on the conclusion of Horizon. I just wanted to ask a little bit on the intra-trend, for the quarter on same-store sales, maybe how that looks like? We're well into Q1, if you could maybe talk to that and how the conventional banners are performing?

Matt Reindel

Hi, George. Thanks for the message on the quarter. We don't give information about the forward-looking quarters. But what I would say is, the momentum that we've built in Q4 has continued into Q1. Now, I kind of need to disclaim that a little bit, because as we've been saying for quite some time now, our expectation is that once inflation starts to abate that this will gradually move the tide in our favour. But the keyword there is, gradually, this won't happen overnight. So what we're expecting over fiscal ‘24 is a gradual and consistent movement of the tide in our favor, and that will give us that momentum throughout the year. So, I realize it doesn't specifically answer your question because I'm sure you after a number, but suffice it to say, that our momentum is gradually improving.

George Doumet

That's really helpful. Thanks. Michael, can you talk about which areas of the business are seeing the highest engagement? I guess, redemption activity from Scene+ or just generally highest engagement and is it more discount, is it more conventional? Once we get to personalization where you'd like it to be, can you maybe share what you expect it to ultimately contribute, maybe to same-store sales or margins, I guess, longer term?

Michael Medline

We're seeing Scene+ positively impact every banner, every region where it’s at. I'd say that, because FreshCo did not have a loyalty program prior to Scene+ that obviously it has an even bigger impact for FreshCo than it may even have on full serve. But we're seeing very good results across full serve community, Quebec, everywhere. Quebec is, obviously, the most recent addition, and I think that the customers there have embraced it and we even got better at implementing it, because we had already gone through three other regions.

We haven't disclosed publicly what we think it will result in, but I can tell you, that we expect it to drive sales and deliver value to customers and make it a much more sticky relationship and fruitful relationship between us and our customers. What's great is are all these new customers that are being exposed to us through the Scene+ program, already in these less than 10 months. And remember that was all staged. We've grown over 3 million new Scene+ members mostly because of the new grocery addition. Now with Home Hardware joining, and they started, but they're going to be in full force in the next month or two, that is going to be very exciting from a customer point of view, some great Canadian brands put together. So, I got to tell you there's nothing but good coming out of this right now.

George Doumet

I appreciate that. Thanks. Just one last one if I may for Matt. On that 8 percent to 11 percent EPS longer term, there is a line of sight there of three years. Maybe I guess more near-term, how should we think about EPS growth for fiscal ‘24? Maybe put in another way, is there anything getting in the way of us maybe not being able to do 8 percent to 11 percent this year, assuming obviously that inflation continues to moderate?

Matt Reindel

So the reason that we say long-term is because that's exactly what it is. This is our long-term ambition and goal. Frankly, I think, after the six-year turnaround where we gave, very, very specific metrics for a long period of time. With the success of that turnaround, I think we've earned that privilege. I think, we're now at a point where we can give this long-term guidance. So, no, we're not saying it's three to five and we're not talking anything specifically about F24. I'm sure you can draw your own conclusions with our momentum as we go into next year, but we're not going to give a specific number for ‘24.

George Doumet

All right. Appreciate all the colour. Thank you.

Operator

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

Tamy Chen — Analyst, BMO Capital Markets

Hi. Good morning. Thanks for the question. First is, I wanted to start off a bit higher level. I think we all appreciate that as inflation gradually decelerates, your mix of banners should disproportionately benefit. I wanted to hear how you think about the gross margin or even just gross profit dollars in a decelerating inflation environment, because so far with this elevated inflationary environment, your Own Brands have grown over national brands. I'm just wondering as we come out of that, what are you expecting on gross margins?

The other question I have is, how should we think about wage inflation going forward? Because I do think unlike some of the other retailers, this has been more of a lagging impact for you guys given much of your workforce is unionized.

Matt Reindel

Okay. Maybe I'll start. Tamy, it's a great question, and then I'll pass you on to Pierre to give a little bit more detail. Just in terms of how we look at gross margin going forward, as we've kind of said, our Horizon initiatives have improved gross margins. You think of promotional optimization, Own Brands our renovation programs, they will continue moving forward. So, we're expecting to get incremental benefits from that moving forward.

In addition, we're also expecting a mix benefit. As you think about, as we exit this inflationary period our full-service banners will be stronger, our full-service banners are margin accretive. So, we should get a mix benefit too. So yes, we are expecting gross margins to continue to improve. But to answer your specific question on Own Brands and others, I'll pass it to Pierre.

Michael Medline

And labour.

Pierre St-Laurent

For Own Brands the impact on our gross margin will be positive. On average, we have a better margin rate on Own Brands than national brands and we’re also delivering more penny profit with Own Brands than national brands. The growth in Own Brand right now is significantly higher than national brand growth. It's accretive to our gross margin rate and gross margin dollars right now. So that's for gross margins and Own Brands.

On the labour side, as you all know, we saw minimum wages increase, almost in every province over the last year. But again, we're working on different initiatives to generate efficiencies at the store level, without compromising the service to our customers. So, we have a roadmap in place to mitigate those increases the best we can. We're not seeing a major impact on our results, based on those increases on wages.

Tamy Chen

Got it. Okay. Thank you. My second question is on the e-commerce segments, I think last quarter was up 9 percent and this quarter was down 13 percent. There's a lot of noise, of course, because this quarter you were lapping Omicron a year ago. I wanted to ask for Voila specifically. Can you talk a little bit more about how that's been performing versus your expectations right now versus what you need to get closer to profitability in Ontario and Quebec? Thanks.

Matt Reindel

Yes. Sure. Another good question. Yes, it's a little bit convoluted. You're absolutely right because we're lapping against Omicron and we're also sequentially comparing versus Q3, which includes the winter, which is obviously a peak seasonal time.

But let me give you specifically the numbers, I'll start with total e-com. Total e-com was minus 19 percent. If you exclude the 53rd week, we were down 13 percent and most of that, of course, is due to the comparison versus Omicron. Sequentially, total e-commerce was flat, so again showing a good progression versus the peak winter period. For Voila specifically, total Voila was minus 15.7 percent.

Normalized for the 53rd week, we were down 9.3 percent, again due to Omicron. Sequentially, we were down 1.5 percent versus Q3. And again, that's really due to Q3 containing the winter period.

Overall, again, I repeat my message from previous quarters, we're really happy with Voila. We have said previously, that the total size of the pie, the total market in Canada is a little bit less than what we had expected, that remains to be the case. But overall, very, very happy with this progress.

Tamy Chen

Okay. Thank you.

Matt Reindel

Thanks, Tamy.

Operator

Thank you. Next question will be from Chris Li at Desjardins. Please go ahead.

Chris Li — Analyst, Desjardins

Good afternoon. Maybe just following up just a few questions on Voila. First, did the earnings dilution for Voila come in line with your expectation in fiscal ‘23? Can you provide sort of some colours on what do you expect the dilution to be in fiscal ’24, just maybe even directionally? Thank you.

Matt Reindel

Well, I'll answer two parts for the question, Chris. In terms of dilution this year, again, if you go back to our messaging during Sunrise and Horizon, we gave very specific guidance, including the dilution figures on Voila. As we exit Horizon and move into F’24, we're not giving that level of transparency anymore. Voila is a long-term investment and we want to keep the focus on it long term.

Having said that, yes, the Voila, the dilution was broadly consistent with what we expected. Sales were slightly lower than what we had planned, so the dilution was slightly worse as well. But having said that, the most important thing is your second part of the question, which is, what's the progression moving forward? What I can tell you is, what we have seen and what we expect to continue is that each CFC, which of course are at different stages of development based on the launch timing, are improving their profitability, as expected. So, CFC 1's profit got better, CFC 2's profit will get better in F’24. And of course, CFC 3, which has just been launched, that will have its peak year of dilution in its first year.

So, it's a long-winded way of saying that the profitability progression is exactly as we expected it to be, CFC by CFC.

Chris Li

Okay, that's great. And I know this is probably a very difficult question to answer. But in light of this morning's speculation about Amazon potentially interested in buying Ocado, how does that impact your partnership with Ocado? Are there any sort of provisions that would protect you in the event of a change in control?

Michael Medline

Yes. Thanks for the question. And that's a good breaking news question. Well, if this deal that's being reported does indeed occur, I think my first take is that it underlines once again that we made the right strategic decision to partner with Ocado, that it's the best way to go to market. If that's true, that particular company is interested in acquiring it. And yes, we have all sorts of legal controls in place and contractual controls in place in terms of our deal with Ocado that would continue, our agreement with Ocado contains very strong exclusivity language regarding retail grocery and the Ocado operating system in Canada and any potential sale will not affect that.

I don't know whether this deal is going to go forward or not, but if it goes forward, I feel pretty good about it. If it doesn't go forward, I feel pretty good. So it doesn't really change my perspective—thank heavens we made that deal way back.

Chris Li

Great. Thanks. Maybe my last question, I think it was last quarter, Pierre, you mentioned, most of the trade-down that you're seeing is really happening in fresh. It may still a bit early, but at least based on the latest CPI data, it seems like fresh inflation, while still elevated is trending gradually back to that mid-single-digit rate and should continue to trend lower if the Canadian dollar continues its upward trend. I guess, my question is, are you seeing sort of the trade down in fresh starting to stabilize here?

Pierre St-Laurent

Good question, Chris. Yes, I think the worst is behind us. We are seeing some positive momentum on fresh. But yes, customers remain concerned with their budget and they are looking for deals and we are seeing that in our promo penetration week after week. But in fresh in particular, I think the worst is behind us and we are seeing positive trends right now. So I think people adjusted their spend and now we are seeing more stabilized behaviour in fresh.

Chris Li

Great. Thank you. Have a great summer and all the best.

Pierre St-Laurent

Thank you.

Matt Reindel

Thanks, Chris.

Operator

Next question will be from Mark Petrie at CIBC. Please go ahead.

Mark Petrie — Analyst, CIBC

Yes. Good afternoon. I wanted to follow up on the topic of the CFCs and the ramp-up. I'm wondering if you could sort of contrast the expectations for ramp-up across the three: Toronto, Montreal, Calgary, and I'm thinking of things like SKU ramp-ups or number of SKUs at introduction, the relative growth in volume expectations, marketing spend, those kind of metrics.

Michael Medline

Yes. It's Michael. I mean, there is a huge difference. We opened up CFC 1 in Toronto in the midst of the highest levels of the pandemic. And even in June 2020, we only had 10,000 SKUs, but that was to serve customers, so we opened it earlier than when we were completely ready. In contrast, Alberta is getting 20,000 SKUs and growing. In terms of marketing spend, I wouldn't say the marketing spend is higher. In fact, I think it's probably lower but because we have all the experience of how to open and how to market it, it's more efficient.

Obviously, we are more and more confident in the operating system and the way to go to market. And also we had a bit of a difference from Toronto when that we already had a lot of stores doing e-commerce in Alberta, which we did to set up. So we already have some customer base figured out in Alberta. But I mean, I think we're getting better and better. I thought when we opened Quebec, we were very strong as well, but this is even stronger, I think. Like any opening of anything that's a new store or even a CFC, take them a while to gear up. From my experience in retail is that, the Alberta market is a good e-commerce market. So I look forward to seeing how we do.

Mark Petrie

Okay, thanks for that. Also hoping you can give a little bit of commentary just with regards to the same-store sales growth cadence. In Q4, as you noted, it was a bit of a noisy period, just in terms of what you're lapping, especially in the early part of the quarter. Was it consistent at that type of growth of 2.6 percent through the quarter or was there a variance kind of month-to-month?

Matt Reindel

It was broadly consistent, but again very gradually increasing through the quarter. Pierre is smiling to my right here, because this is what we have kind of planned, and what we hope occurs throughout all of F’24, is this gradual improvement and momentum as inflation abates. So, we were really, really pleased with people because that's exactly what we saw, it just gradually improved momentum through the quarter.

Mark Petrie

Okay. Perfect. Thank you. My last question is just around SG&A growth. I guess specifically SG&A dollar growth was pretty well controlled in Q4, especially adjusting for D&A. You called out incentive accruals. Wondering if you could quantify the impact of that? I know you're obviously not giving guidance specifically, but wonder if you could talk about the dollar growth you're expecting in fiscal ‘24 and is it possible that it's in line with fiscal ‘23 or above or below or how you might think about them? Thanks.

Matt Reindel

Thanks, Mark. On SG&A dollars, so, yes, it's a little bit bumpy because of the comparison year-on-year because of the 53rd week. The way I look at it, our SG&A dollars actually went down very slightly, but obviously last year we had the 53rd week. On a normalized basis, our SG&A dollars went up by about $19 million and most of that is our continued investment in our Horizon initiatives. We will not call them Horizon initiatives anymore but that long-term, medium-term investment.

Depreciation was higher year-on-year due to our ramp-up in CapEx, which as you know, we're controlling, moving forward. Incentives were lower, I'm not going to tell you the number Mark, I'm sure you understand why, but—so incentives were a little bit lower year-on-year.

Now the second part of your question as to what we would expect moving forward. We are expecting SG&A dollars to increase. First of all, we expect to grow next year. When we think about retail labour and the variable component of SG&A, that will continue to grow. As we've consistently said, that we're not going to take our foot off the gas in terms of our strategic investments. CFC 3 will come online, which will increase SG&A. So, there are those continued investments. The only other thing just to call out is the west fuel divestiture. So, when that deal is confirmed by the competition authorities, that's a high-sales, low SG&A business that we'll have to adjust for.

So, those are kind of some of the moving parts. But yes, we do expect SG&A in dollars to increase next year for the reasons I just mentioned.

Mark Petrie

Okay. I appreciate the comments and yes, all the best.

Michael Medline

Thanks, Mark.

Matt Reindel

Thanks, Mark.

Operator

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

Vishal Shreedhar — Analyst, National Bank

Hi. Thanks for taking my questions. I was hoping you could help me better understand in particular what's driving your improvement in comp and even through the quarter, the gradual improvement. I know we've talked a lot about it already through the call, but you know the consumer situation with the mortgages renewing is still tough, inflation is still high. Is this a general industry comment with the inflation not getting higher at the same rate, or is it an Empire improvement situation? Anything you can help me to understand what in particular is driving that improvement that you are seeing.

Michael Medline

Yes. Great question. I can't comment on our competitors. I mean, I just know what we're seeing out there and that we're seeing inflation slowing as I mentioned in the script. I think with that and the fact that we had some weird COVID stuff happening last year, plus the fact that we are executing far better and we have a great loyalty program, we're doing better in our stores, we got better merchandising, our ops are doing well. It's a bunch of different things; it is not one silver bullet out there.

But, I'd say that the improvement throughout the quarter is a combination of us continuing, I hope to get better, but a lot of it has to do with the fact that we're seeing full serve strengthen as inflation even starts to abate. These are tough times out there for everyone. You're absolutely right, like when you look at what people are paying in terms of mortgages or rent, anything else, these are still tough times, it's not over and hopefully we'll be through it soon.

Vishal Shreedhar

Okay. Just to follow up on that, so you're seeing more strength in conventional, but at the same time, you're seeing promotional intensity increase. And does that align with the understanding that you had at the time that you indicated to us that when the inflation cadence starts slowing and you would anticipate the conventional business just starting to improve?

Pierre St-Laurent

It remains volatile right now. So we're not out of the woods, inflation remains high. We are seeing, as I said earlier, some normalization on fresh. But we need to remain extremely focused to manage those changes. So, the penetration is the challenge, because people are looking for deals. Intensity, I don't think so. I think it remains competitive like it was and like it will be. But the penetration, we have to be careful with that. Our teams are doing an amazing job to manage it and to provide relevant value to our customers through the different programs we've launched over the last years, especially with Scene+ and member pricing. It's new tools we have on hand to make sure that we are providing value to our customers, without affecting our overall results.

Vishal Shreedhar

Okay, thank you for that colour. That's very helpful. And just changing topics here, on the capital allocation. A lot of cash commitments this year, you got the dividend going up, you got the buyback, you have the CapEx program. How should we think about management's orientation with respect to leverage levels and the cash outlay? Are you satisfied with the level of levers that you have in terms of levels or do you want to bring that down? And if so, what's the right level that Empire should run at?

Matt Reindel

Yes, it's a great question, Vishal, and something that we've spent a lot of time looking at. Because I mean, our ability to do share buybacks is based on our amount of cash. So it is something that we've looked at in great detail. We do expect our cash flow generation to return to what I would call normal in fiscal ’24, which generates a lot of cash. Fiscal ’23 as you correctly stated was a bit of an unusual year. Our expectation is that our credit ratios for example, our leverage ratios will remain approximately the same. We hope that they will improve very, very slightly. And as you know, we would never do anything to threaten our investment grade rating. So, yes, a lot depends on our ability to generate cash next year, but we do expect that that's going to return to, like I said, what I would refer to as normal.

Michael Medline

Great question.

Vishal Shreedhar

And the buyback, you anticipate to be fully active on that?

Matt Reindel

Yes. Thanks, Vishal.

Operator

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

Michael Van Aelst — Analyst, TD Securities

All right. Thank you. Would you mind talking a little bit about some of the differences in the consumer behaviour geographically, because we've seen some credit card data that would suggest that the BC customer is certainly more pressured than the Quebec customer, for example. I'm wondering if that's something that you're seeing as well.

Pierre St-Laurent

We don't see major differences by regions to be honest. The only difference we're seeing regionally is on labour. Labour shortages are more pronounced in BC than in Quebec maybe. But in terms of customer behaviour, we're not seeing major differences on our side.

Michael Van Aelst

Okay, that's interesting. Okay, thank you. Then, when you look at your e-commerce sales trends and I know they improved a little, some sequentially and they've held up from the winter. But when you look at it relative to your peers, your peers are comping flat to slightly higher on the same, on an apples-to-apples basis and yours are declining. What could explain that difference?

Michael Medline

I don't know, because what we're looking at—Mike, I think we talked about—Matt can talk more about it. But in terms of the market and how we're doing, some of it may be different timing, I don't know, we'll have to take a look. But we're pretty confident in terms of our ability to hold and grow market share here.

Matt Reindel

Yes. I mean, it's a very interesting question. The only thing I would also point out is, we have a very different customer. I think we said before that some of our peers are going after kind of the immediacy, with a very small basket. Whereas for our customer, our average basket sizes, as we said before are 3.5 times the size of somebody in a store. So, that's really what the main differences are, I think. It's just a different timeframe and a different customer.

Michael Van Aelst

Okay. Finally, should Ocado change ownership, and I know this is highly speculative, but if there was a new owner, and they had less incentive, let's call it, to focus on the external customers who want to focus on growing their own e-commerce business. What kind of protection does Empire have in terms of like the length of the support agreement within your facilities?

Michael Medline

We have a lot in the long, and I have our Chief Development Officer, he is also our General Counsel, and he is nodding away here. So, look, this is so speculative. If there is a deal, who is the buyer, would they then cut down, that would be very problematic for that entity if they were to do that. In fact, I would think that would not be the case.

Matt Reindel

The international CFCs is a very important piece of that business. So, I don't why they would change.

Michael Medline

We're not the only partner.

Matt Reindel

Yes.

Michael Medline

I'm not going to lose too much sleep about something that hasn't happened. But secondly, something which if it does happen, I'm sure that we'll keep putting the best offering in the market to our customers.

Michael Van Aelst

All right. Thank you.

Michael Medline

Thanks, Mike.

Operator

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

Irene Nattel — Analyst, RBC

Thanks, and good afternoon everyone. Lots of great colour, so thank you. Just a couple of points of clarification. So, trying to understand the commentary around the cadence of investment or if you want to call it, dilution as you open CFC 3, but CFC 1 and CFC 2 gain maturity, but the market is a little bit challenging. So, should we be assuming similar overall dilution or maybe a little bit more or maybe a little bit less?

Matt Reindel

Well, I think I'm going to leave that with you, Irene, to be honest with you. Like I said, we're really trying to move away from giving specific guidance on dilution. Your overall trend is right though. As we said, when we launched CFC that's highest point of the dilution. And as you get volume passing through the CFCs dilution decreases and ultimately you'd have to break even and then you make money. So CFC 1 is well on its way. CFC 2 is on its way and CFC 3 is just starting.

The other initiatives we're looking at of course will improve that path to profitability. So, the merger of Grocery Gateway into Voila for example in CFC 1, and the other efficiency initiatives we're looking at across all of our portfolios will all help. So, yes, that's about as much guidance as we're going to give at this point.

Irene Nattel

Understood. Thank you. The next question I had, when you initially announced Scene+, you noted that there were significant if you will, pent-up points value in existing Scene+ customers, in part because they're just—they have limited ways in which to redeem. So, as you look at sort of the evolution, are you actually seeing the benefit in your sales from redemption using pent-up points?

Matt Reindel

It's a great question and I'm going to give you a very early answer, which is a very simple yes. But then I'm going to give you a little bit more detail.

So firstly, those are the two things that really excited us about the transition. One was the fact that there was all this—all these points in the market. Many, many, many millions of points in the market that could be now used at Empire stores. But there was also a large number of existing Scene customers, who were not shopping at Empire. So, a combination of those two, we believe, would actually result in us having incremental net new customers to our banners.

So, when I said the easy answer is yes, it's because the data that we see so far is showing that we are taking new customers into our stores and are using those points in our stores. But it's early, as we said a lot with the Scene+ program. We're not even a year into its journey yet. So, this is something that we with our partnership with the Scene+ program itself we're closely monitoring, because we do expect that increase in demand. Early signs, very good, but like I said, it is early. So, I don't want to overstate the benefit here.

Irene Nattel

That's really helpful. Thank you. Sort of tying the whole issue of promotional intensity to Scene+, I recognize that it's relatively early days, but presumably, you're being able to sort, if you will, kind of move some of that straight-up dollars and cents, promotional activity, to points multipliers or personalized. Can you talk about where you are in that journey?

Pierre St-Laurent

It's a new promotional tool. The team is working well to manage the promotional mix. Of course, we are investing meaningfully in Scene+, to give value to our loyal customers. It’s good for both sales and margin. We are seeing improvement in the transaction count quarter-to-quarter. We are seeing improvements on basket size quarter-to-quarter. That means it's not only Scene+ activities, but it's the overall promotional mix management with new tools. So, like we said earlier with promotional optimization. Now in the Scene+, the loyalty promotions are in our promotional optimization tool. So, we are managing all those promotions through our optimization tool and it's why we're able to generate good sales and margins. So, it's a combination of multiple factors that drive that performance. And Scene+ is a new addition to our tools and we’re leveraging it right now, and it's well received by customers - ahead of our expectations so far.

Irene Nattel

That's great. Thank you.

Operator

Thank you. At this time, I would like to turn the call back over to Katie Brine. Please go ahead.

Katie Brine

Thank you, Sylvie. We appreciate your continued interest in Empire. If there are any unanswered questions, please contact me by phone or e-mail. We look forward to having you join us for our first quarter fiscal 2024 conference call on September 14th. Talk soon.

Operator

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