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L.TO - Q1 2019 Loblaw Companies Ltd Earnings Call

EVENT DATE/TIME: MAY 01, 2019 / 2:00PM GMT

OVERVIEW:

Co. reported that 1Q19 revenue from continuing operations grew 3.1% YoverY and fully-diluted EPS came in at CAD0.78.

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PRESENTATION

Operator

Good morning. My name is Mariama, and I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies Limited First Quarter Results Conference Call. (Operator Instructions)

I would now like to turn the call over to Roy MacDonald, Vice President of Investor Relations. You may begin your conference.

Roy MacDonald - *Loblaw Companies Limited - VP of IR*

Good morning. Thank you very much, Mariama, and good morning, everybody, on the line. Welcome to Loblaw Companies Limited First Quarter 2019 Results Call. This morning, I am joined by Galen Weston, our Executive Chairman; Sarah Davis, our President; and Darren Myers, our Chief Financial Officer.

Before we begin today's call, I want to remind you that today's discussion will include forward-looking statements, such as the company's beliefs and expectations regarding certain aspects of its financial performance in 2019 and future years. These statements are based on assumptions and reflect management's current expectations and are subject to risks and uncertainties that could cause actual results or events to differ materially from our expectations. These risks and uncertainties are discussed in the company's materials filed with the Canadian regulators.

Any forward-looking statement speak only as of the date they are made. The company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than what's required by law.

Also, certain non-GAAP financial measures may be discussed or referred to today. Please refer to our annual report and to other materials filed with the Canadian securities regulators for a reconciliation of each of these measures to the most directly comparable GAAP financial measures.

And with that, I will now turn the call over to Darren.

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Thank you, Roy, and good morning, everyone. I'm pleased to report we delivered strong financial and operational results in the first quarter. Looking at continuing operations, revenue grew by 3.1%. Adjusted EBITDA normalized for IFRS 16 increased by 3.4% and normalized adjusted earnings per share increased by 3.7%.

Before I go through the details, let me provide an overview of the first quarter impact of IFRS 16. Implementation of the new standard resulted in a year-over-year decrease in rent expense of $282 million, an increase in depreciation and amortization of $207 million and net interest expense and other financing charges of $82 million for a reduction in net earnings available to common shareholders of $6 million or $0.02 per share on a fully diluted earnings-per-share basis.

On the balance sheet, we recorded a right-of-use asset of $7.6 billion and a lease liability of $9.2 billion.

Turning back to our results. We continue to deliver on our financial plan in the quarter. Our same-store sales grew 2% in Food retail and 2.2% in Drug retail. Our Food retail sales were negatively impacted by 60 basis points, primarily from the health care reform impact of our -- on our in-store pharmacies as well as some softness in general merchandising. The timing of Easter negatively impacted our same-store sales by approximately 20 basis points in the quarter.

Food retail continues to deliver favorable mix. We drove an increase in average basket and had relatively flat traffic in our stores. Our CPI-equivalent internal inflation metric came in slightly lower than CPI of 3.3%.

In Drug retail, Front Store same-store sales were 3.1%, with continued growth across our categories. Positive pharmacy same-store sales growth of 1.2% was driven by strong prescription growth of 2.6%, which more than offsets the negative impact of drug reform. The timing of Easter had a negative impact on Drug retail same-store sales of 30 basis points.

Total retail gross margin was 29.6%. Excluding the consolidation of franchises, retail gross margin declined by 30 basis points, driven by the negative impact of health care reform. Food retail gross margin was flat in the quarter. Retail SG&A as a percentage of sales was 20.2% and included $282 million reduction related to IFRS 16. Including this reduction and the impact of franchise consolidation, retail SG&A improved year-over-year by 30 basis points.

Our SG&A performance benefited from certain onetime items in 2018 and our focus on process and efficiency initiatives, while we continued to invest in the business.

At PC Financial, revenue grew by 15.7%, driven by growth in our credit card portfolio and higher year-over-year sales at The Mobile Shop. Adjusted EBITDA declined $6 million compared to last year as revenue growth was offset by the termination of our daily banking services and increased investments in the business.

In the quarter, fully diluted earnings per share were $0.78. On a comparable basis to last year, excluding a $0.02 per share negative impact from IFRS 16 and a $0.04 per share from incremental depreciation due to the spin-out of Choice, the quarter's fully diluted earnings per share were $0.84, an increase of approximately 3.7%.

IFRS net earnings available to shareholders from continuing operations decreased $14 million year-over-year, primarily due to the IFRS 16 and the incremental depreciation associated with the Choice spin-out. Free cash flow from continuing operations was $419 million this quarter. The first quarter included the positive impact of accelerated payments we made in the fourth quarter of 2018 as we transitioned our Shoppers' back office to SAP. Please note, the free cash flow definition was updated to normalize for the impact from the implementation of IFRS 16.

In the quarter, we repurchased 3.7 million common shares at a total cost of $235 million. Today, we are pleased to announce a 6.8% increase in our quarterly dividend. This marks our 8th consecutive annual increase in the dividend rate on our common shares. Reflecting on our first quarter of

2019, we are pleased with our financial performance. We continue to deliver process and efficiency gains supported by a culture of operational excellence. These savings are offsetting cost pressures and are enabling us to accelerate investments in our growth areas for the future.

I will now turn the call over to Sarah to provide additional color.

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Thank you, Darren, and good morning, everyone. We executed well against our stable trading framework in the first quarter and continued to deliver gains from our process and efficiencies initiative. We have seen an incredible shift in our ability to use the data from across our organization to provide better consumer offers, make better promotional decisions and more efficiently manage our supply chain network. We are really starting to get some traction.

In the quarter, we further refined our data and analytics center of excellence, and welcomed a new leader for the team. We now have over 400 colleagues and counting working in data and analytics-related roles. Across our stores, brands and services, be it in-person or digitally, our focus is centered on our customer.

As we mentioned last quarter, 2019 is about making further investments in data and technology to drive customer adoption and improve customer satisfaction. At PC Express, customers are telling us that they want faster turnaround on their orders. We deployed a new technology to track our efficiency and ensure service times are less than 5 minutes. We are rolling out 2-hour click-and-collect windows in more stores every week. And we're testing our ability to offer customers a 1-hour cutoff on pickup orders. That means that customers can add a last-minute item to their baskets in as little as an hour before they swing by their store to pick up their groceries on the way home.

The quick turnaround time with PC Express is just one way we are helping solve meals for Canadians. We believe the combination of our assets, including our trusted brands, our data on personal preferences, our store locations and our omnichannel presence places us in a unique position to help Canadians with this everyday challenge in many ways.

We have built some of the countries favorite brands, with President's Choice, the #1 brand in the country. We also have no name and farmers market, rounding out the top 5 brands in Canada. In fact, just today, PC was named the most trusted packaged food brand in Canada.

Over the past few months, you may have noticed another one of our brands in your local store around PC Express called From Our Chef. We now have 20 meals that offer home-cooked options in under 30 minutes, heat-and-eat favorites like pad thai and butter chicken. We'll also be introducing a meal kit into 92 Loblaws and various stores in Ontario following the May long weekend. We are inspired by the challenge of helping our customers solve meals for their families in a convenient way, with solutions that bring home-style, restaurant-quality innovation inspired by our head chef.

At Shoppers, we continue to focus on bringing new value to our customers and new customers into our network. Recently, we've realigned our beauty teams to combine cross-functional expertise. Already, we are seeing this group hone in on key priorities and improve how we execute across our omnichannel beauty.

In the quarter, the team began to launch new educational how-to tutorials, on-trend looks that are resonating with the younger generation. We also added 7 next-generation beauty boutiques in the quarter. This format includes smaller displays, focused around the indie beauty trend and it's helping us gain access to brands not currently at Shoppers Drug Mart. In Q1, we delivered consistent performance in our businesses. We continue to deliver value to our customers, while also continuing to generate operational efficiencies that allow us to fund our investments for an exciting future.

I will now turn the call over to Galen.

Galen G. Weston - *Loblaw Companies Limited - Executive Chairman, CEO & Member of Management Board*

Thank you, Sarah. In Q1, our focus was on execution. During a challenging quarter, the team delivered sales and tonnage in line with our stable trading range, coupled with gross margin and operating leverage that are on strategy and driving strong bottom line results. On the back of that performance, we remain confident about accelerating our investments in innovation throughout the rest of the year. These investments continue to show positive results, successfully unlocking value in both our core business and across our growth initiatives. What excites us most is how these investments, combined with our increasing experience and growing pool of talent, are helping us uncover and explore new opportunities.

Take for example, the pilot of our Loblaw media business. By leveraging the technology in our loyalty platform, we are allowing our customers to see more relevant ads when they surf the web. Another example, is the combination of our growing range of ready-to-heat and ready-to-eat meals. Now available through our increasingly popular 1-hour delivery and pickup services. Whether removing clutter from the ads our customers see online or helping to solve their last-minute meal needs at 4 p.m. on a Wednesday, we are now able to stand up and scale these customer-centered ideas more quickly and with less cost than ever before.

Not all of these new ideas will create significant new businesses for us, but as we become increasingly agile and even more customer-centric, we believe that some of them will. And when we combine these promising avenues for growth with the stability of our core business and the benefits we are realizing through process and efficiencies, we cannot help but be excited about our future.

I'd now like to open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Irene Nattel with RBC Capital Markets.

Irene Ora Nattel - *RBC Capital Markets, LLC, Research Division - MD of Global Equity Research*

I would like it if you could just spend a minute talking about the owned brands, the private-label brands. Because I think last year, the focus really was the rollout of PC Optimum, but it sounds as though, for this year, you're kind of getting back to basics with really sort of focus on President's Choice, no name and farmers market. Is that fair?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

I think our brands have always been part of our strategy, but it's fair to say, we didn't talk about our control brands very much last year as we talked a lot about our digital retail strategy. So we're happy with the performance of all our brands. PC is #1, no name is #2 and farmers market sort of moves around between #4 and #5. And so -- and life brand is actually in the top 10 as well. So we're excited by that. And I would say our new brand, that I mentioned, From Our Chef, is a new one that's coming out as well. And we would like to -- we do have a plan to increase our penetration of control brands across our network. You can see it in some of our categories, such as frozen fruit and veg, where we -- you can see the control brand playing a pretty important role in some of those categories.

Irene Ora Nattel - *RBC Capital Markets, LLC, Research Division - MD of Global Equity Research*

That's great. It also is worth switching stores for. Just on the subject of all of the data analytics, I think it was on the Q3 call, Sarah, you were talking about sort of the improvements that you've made in promotional effectiveness, the enhanced ability really to drive consumer behavior and offer value-added promotions. I was wondering if you could just sort of update us on how that's continuing to evolve and maybe what -- how that benefited Q1?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. So I would say, we have been focused on using the vast amount of data that we have in order to have more effective promotions. So this could be through loyalty having more direct promotions to personalized -- to customers and some -- maybe a good example would be in the way that we've been doing our spend structures, where traditionally, we would have given every customer the same spend stretch, whether you spend $20 in our store, on produce or you spend $50 in our store on a weekly basis in produce. We would get everybody a $30 spend stretch. Meaning that, if you spend $30, you would be able to get some additional points. So for the person who spent $50, it was just free money. They were spending it anyways. And so the person who spent $20, it might be too big a stretch for them to go from $20 to $30. So we really are fine-tuning it to say, the person who is spending $20 maybe we'll stretch them to $25. The person who's spending $50, maybe we'll stretch them to $60, and that type of work. So lots of work on that. It does mean that in certain circumstances that we're walking away from tonnage that isn't as productive as we would -- as traditionally we would have gone after that tonnage and more focused on productive tonnage, which we would have seen in Q1. So definitely where you see it in our Q1 results would be in our flat food margins and that would be where you would see it.

Irene Ora Nattel - *RBC Capital Markets, LLC, Research Division - MD of Global Equity Research*

That's great. And then just finally, if I may, so it sounds as though general merchandise continued to be a drag this quarter. How long before that noise is out of the numbers?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. I mean I hope to be able to say that in Q2. So I would say, what we did see in Q1 -- so if you remember, in Q4, we highlighted that the right-hand side, which is not just GM but it would be a big portion of it, but it's also the impact of drug reform in our grocery store pharmacy would also be part of that impact. And it was 100 basis-point impact in Q4. In Q1, it was a 60 basis point impact with the majority of the impact being actually the drugstore reform. So we are starting to see improvements in both -- in the performance of both our general merchandise and our apparels. So I hope I don't have to talk about it as a reason in Q2.

Operator

Your next question comes from Mark Petrie with CIBC.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

You showed some good progress on SG&A leverage. Sarah, you called out a few areas where the organization is benefiting, but also is that a scenario where you want to continue to invest? So are those investments sort of being funded by those benefits and other efficiencies allow for modest leverage? Or how should we sort of think about how you want to balance that in 2019?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. So I think it does, that's true. So we're basically investing in technology to improve our efficiencies, and so that is -- so we are trying to offset the investments with the efficiencies, and we would continue to see that in 2019 and 2020. And I don't know, Darren, if you want to add some color?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Yes. Mark. I'd just say, it's well entrenched in the company the understanding that in order to invest in the business, we have to drive further and further process efficiencies. So as we've talked about in the past, we're excited by the process efficiency road map. We see it's across 6 major streams and we're seeing great progress on there, and we'll continue to invest in the business. So it was a great quarter from an SG&A point of view. Some of that onetime from last year and a big part of it though the success we're having with the process efficiencies.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

And could you help quantify sort of the benefit of the onetime from last year, I guess, mostly, the PC Optimum launch?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

That and a little bit of FX, maybe it's, call it, half-half between the onetime and the progress that we're making.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Yes. Okay. On Loblaw media, obviously, that's just sort of recently launched, but at a high-level, how material do you think that can be for your business? How does it ramp? And when it comes to you -- sort of your relationships with these consumer brands, is this incremental? Or do you feel like this is incremental or does it sort of replace some of the ways those brands sort of spend and promote with you today?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

So it's still early days. We just launched the pilot of this advertising service, and we're mostly, so far, the ones that we've done have been focused on our own brands. So President's Choice has been the one that we've been targeting, but we have had a lot of interest from the CPG companies, who have been able to do this in other parts of the world. So they are very excited by this opportunity. We think it could be a big opportunity, but it's too early to tell. In terms of whether it's incremental or not, we do see it as incremental spend, it's different spend that a CPG company would be spending. It's their advertising as opposed to their product cost. So it is different. So we do see it as potentially being incremental.

Mark Robert Petrie - *CIBC Capital Markets, Research Division - Executive Director of Institutional Equity Research & Research Analyst*

Great. And then just last, if I could. I just wanted to ask a question on financial services. I understand it's a relatively small part of the business, but you're trying to grow the credit card and you have greater control with no third-party involvement in the banking offer. So going forward, how much importance do you place on the financial services offer? Is it really a sort of a strategic lever to sort of more deeply embed yourselves with your customers? Or is it is a business where you see superior financial returns versus other opportunities?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

I'll give a strategic piece and then maybe Darren can add on the financials. So I would say, yes, we actually think that President's Choice Financial is an integral part of our strategic plan, which is why we sort of have it in our strategic growth area called Payments & Rewards. So we have actually combined the teams of the loyalty team and the PC Financial teams. We think that there's a nice synergy between those 2 teams.

We are planning to come out with a new payment product that will be later piloted this year but primarily next year, and so we do see it as part of our strategy. Our most loyal customers are our PC Financial MasterCard customers, so there's a nice link there. And in terms of the financials, I can turn it over to Darren.

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Yes. Mark, I would just add to what Sarah said. I mean it's a great business financially, but really it comes to the integrated values that the payments and rewards can bring to us, and that's really where the values come from in the future.

Operator

Your next question comes from Patricia Baker with Scotiabank.

Patricia A. Baker - *Scotiabank Global Banking and Markets, Research Division - Analyst*

I have 2 questions. Just the first one, can you just talk about the dynamic behind the relatively flat traffic because we've seen over the course of the last several quarters, traffic, I think, has been up. I just want to know if you can address what you think is happening there with traffic?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. I would say, from a traffic perspective, it would have been impacted a little bit by the Easter shift as our comp sales were as well. But it wasn't -- I wouldn't say it was enough to worry us. We were comfortable with our improved mix and our increased average basket. So we've got a higher basket in the quarter as well. And traffic was pretty flat, and we had the Easter mix. So nothing material there, I don't think.

Patricia A. Baker - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay. And my next question, just gets -- going back to the process efficiencies, and in addition to permitting you to have a lower SG&A and improve there, but also, you talk about the strategy to drive a more efficient business model also will be used to provide funding to -- for investment in growth areas and you've called out your future growth areas are the, digital payment and rewards and then, of course, Connected Healthcare. I'm just wondering, from an investment perspective, if you could provide us with maybe the magnitude or the relative order of magnitude of the investments in those 3 areas? And then secondarily, what shall we think about the pacing of investment in these areas? And when we're going to see material growth to come from these 3 areas? Some of it in '19, but a lot of it further down the road? Just provide a little bit more detail on that, that would be great.

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Okay. I'll start this one too. So I would say, certainly, our -- the plan that we've talked about is that we're finding process and efficiencies in our business in order to fund our future growth and still deliver on our financial model that we've highlighted. So that would -- that's our ultimate goal to be able to deliver on that. I would say, some of the investments we're making are more defensive than they are offensive when you consider digital retail, that we see as a more of a defensive strategy but we hope it also drives additional customers to our stores. When it comes to Payments & Rewards and to Connected Health, we see them -- well, certainly Payments & Rewards, we do see as partially defensive, partially offensive, which we think we should get incremental earnings from that. And in terms of Connected Health, we really do see that as the opportunity for an offensive play. But on Connected Health, it's also the one that's further from being realized. Whereas, we feel that was quite -- we've got quite a long way along in our investments in certainly digital retail as well as Payments & Rewards. So that's sort of the overall strategy and then maybe on some of the specifics, as much as Darren is willing to share, about the specific investments.

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Patricia, and I know you and your colleagues on the phone here would love for me to give you how much we're investing on these areas. But we're not going to do that. I think what I would say to frame it is we understand that we have to drive the process efficiencies to fund it. We're committed to the long term -- our financial framework. I would say, if any color I would give you, is that this year based on the success we've seen, we have amped up and are amping up our investments. So we're committed to the financial framework over the long term, but this is still going to be a year of investing and we think we will start to see the benefits of these investments in the next year and beyond.

Patricia A. Baker - *Scotiabank Global Banking and Markets, Research Division - Analyst*

Okay. If I could just tease one more fact out of you or Sarah. So you've been on the digital investment route for quite a while now, where are you on that journey? And would you think that you're 50% through? 60% through?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Well, I think that's a good one because I would say, certainly, in 2018, it really was all about doing the rollouts. We are close to 700, and we really haven't been adding very many more. In 2019, it really is about improving the execution. So not much incremental in terms of rollout but we would be spending some money on technology, like the technology we put in stores to make sure that we can track how long it takes us from the time somebody shows up at our store to the point that we put the groceries into their car. So we're tracking that very carefully so there'd be new technology in some of those areas. But it is fair to say that based on what we're seeing now, the big investments in digital have been made.

Operator

Your next question comes from Michael Van Aelst with TD Securities.

Michael Van Aelst - *TD Securities Equity Research - Research Analyst*

So when you talk about your smart tonnage initiatives, I think, this -- you first started mentioning it early last year. So can you just give us a kind of a time line as how you -- like, when you rolled it out to the various segments and when we should see, I guess, the lapping of the first year of impact? And then I'd assume after that, the year-over-year impact is more modest on tonnage?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. I think the first time I did mention it was probably on this call last year. So -- and we would have started the rollout. So Shoppers, as you know, has been involved and had the data with their Optimum program for many years. And so it really was bringing some of the best practices from Shoppers into the food businesses. And we really started in earnest with the market division last year, where they really would have gone category by category. And they would have tried a few things and decided what worked and what didn't work. So I would say you never 100% done, but they have evolved through the year, Q3, Q4 would have been certainly in that area they would have felt like they were really starting to understand it. So I would say -- and then discount was also joined in. They were focused on a few other initiatives but they've also joined in this initiative as well. So I would say probably the back half of this year is when you're really starting to see some of that. And I would say that we're comfortable with our tonnage, and it's within our tolerance range. We set a tolerance range within -- that we said we're going to live within. But we are keeping an eye on it. We certainly want to make sure that we don't lose tonnage every quarter. And that we're comfortable with our position but it is part of our strategy. So we did intentionally pullback on some of the unproductive tonnage.

Michael Van Aelst - *TD Securities Equity Research - Research Analyst*

And just on that as you get through this and let's say, into next year, once you're kind of clear of all these, like the major rollout of this program, into discount and market. Are you really comfortable in letting tonnage stay flat when your competitors continue to report 1%-plus?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

I would say it would be tonnage market share that we're focused on. So our market share within our -- within the industry. So as we maintain flat to slightly positive tonnage market share without adding significant new real estate, I think, we are comfortable with that.

Michael Van Aelst - *TD Securities Equity Research - Research Analyst*

Okay. And then the IFRS 16 impact was, I think, a couple of pennies higher than the neutral or so that was somewhat implied when you guys first talked about it. So is that $0.02 a quarter impact mostly on depreciation? Is that kind of a good run rate for the year? Or do you see that easing up at some point?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Mike, yes, it's difficult to predict it every quarter right now in the first year of limitations, probably a little difficult. So probably, it's a good proxy to have in your head, and we'll just keep updating, giving you the transparencies, noncash accounting change. But I think for the time being, that $0.02 a quarter is a reasonable place to go with.

Michael Van Aelst - *TD Securities Equity Research - Research Analyst*

Okay. Because you had provided, I think, 406 adjusted originally for the spin-out of Choice, and then as kind of a 2018 comparable, but then you have higher depreciation that kind of was discovered post the spin-out and then on top of the CIFRS. So would you hazard a guess as to what a comparable 2018 EPS would be for all those who kind of just look at the top line numbers and the -- an EPS and they're looking to see why other people are forecasting growth?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Probably don't want to get into that on the call here. But I think for your purposes and for others, I mean, it was $0.06 impacts of those 2 things this quarter, and probably reasonable to use those run rates. And when you normalize that out, I mean, that's how you should look at everybody's numbers. It's probably the best I can do today.

Operator

Your next question comes from Jim Durran with Barclays.

James Durran - *Barclays Bank PLC, Research Division - MD, Head of Canadian Equity Research & Senior Analyst*

Galen at the top of the call just talked about the challenging quarter outside of drug reform and the Easter shift. Like are there any other dynamics in the marketplace that are making life more difficult in the industry?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

I would say those are the big factors. So we've sort of highlighted that we were lapping drug reform for one more quarter based on what was announced in for last year. So -- and then we would say we have a little bit of minimum wage still coming through that's impacting us, but those would be -- and then, of course, just the ongoing competitive industry, those would be the items in the quarter.

James Durran - *Barclays Bank PLC, Research Division - MD, Head of Canadian Equity Research & Senior Analyst*

And so as we look at Q2 now, I think, a quarter or 2 ago, there might have been some indication, there still might be some drug reform incrementality versus last year into Q2 just based on timing and the number of changes introduced. Is that still the case in your mind?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

I think you should think about as normal levels of drug reform now. There's a little bit of timing in everything, but it's -- we're back to normal-ish levels.

James Durran - *Barclays Bank PLC, Research Division - MD, Head of Canadian Equity Research & Senior Analyst*

And we're all, obviously, very focused on the weakening of retail sales in Canada. Any changes in consumer spending habits? Increased promo focus? Shift to private label? Shift from conventional to discount?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

I wouldn't say so. I wouldn't say that we're noticing anything significant. There is a shift from market to discount, that's been going on for quite a few number of years, and it is where the retail -- the real estate growth is going as well. So many of the retailers are moving to more discount formats. So that would -- that trend is continuing. But other than that, I wouldn't say anything. There is a bit of a -- we're happy to have a bit of a switch over to control brand items. I don't know if that's consumer-driven or whether it was our great marketing. So I'm not sure, but there has been a move over to more control label items as well.

James Durran - *Barclays Bank PLC, Research Division - MD, Head of Canadian Equity Research & Senior Analyst*

And any change in the write-off rate on the credit card business?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

No. There's some noise with IFRS 9, but no real changes in the fundamental write-off rates.

James Durran - *Barclays Bank PLC, Research Division - MD, Head of Canadian Equity Research & Senior Analyst*

We love IFRS.

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Certainly.

Operator

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

Peter Sklar - *BMO Capital Markets Equity Research - Analyst*

You've talked at length now for a number of quarters about your processing and efficiency initiatives. And Darren, you've talked about 6 product cores, but it's still a little bit opaque, could you maybe call it out 1 or 2 examples of things you've specifically done and how that's been reflected in savings for the company?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. Well, I could to start. I mean there's 6. I think Darren has talked about the 6 core areas, which would be the largest expenses in our business. So it would be all encompassing across the business in the areas. I can highlight a few that we did -- that we've been rolling out. So certainly, self-checkouts, I've talked about that a lot. We started that rollout. We've had it in the food business for a number of years, but we started the rollout in Shoppers in 2016. We're continuing to roll them out, it's actually been picked up quite well, and we have had increased penetration. So we're doing 2 things: rolling more out and increasing the penetration of the use in the stores that have them. And I would say, on the food side of the business, we've increased -- we've changed the technology to make it a little bit more customer-friendly, and we've also increased some of the penetration and increased the amount of the self-checkouts across our business there. Another one that we've talked about was the Flash Foods app, where basically it's a shrink initiative where customers can go onto Flash Foods and they can see food that's coming up to being co-dated and they can get good deals on it, go into the store and buy the item before for reduced prices. That would be another one. So lots of many, many different initiatives across our business. Those are just a couple of them that we could highlight.

Peter Sklar - *BMO Capital Markets Equity Research - Analyst*

And so Sarah, when -- like there must be hundreds of initiatives that you're doing under the 6 verticals. So when you -- like, with respect to these 2 initiatives, like the processes that you put in place, are you actually measuring? Like, do you have some measure of what the savings and the returns are?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. So we probably have 400 initiatives, 20,000 lines of projects that we're actually tracking. So it is as we said -- it's like a very large project for the company. And yes, we're basically ranking which project we're going to do based on the returns. Another good example is the electronic shelf labels. So we actually -- that one's worked to be better than we expected and that's basically changing the labels from being paper labels to being electronic. It reduces the amount of labor in the stores, it's focused on sort of a nonvalue-add job in the sense of putting up labels, separating them all. And so we've been able to put some of those in. We've highlighted a few in Q1, and now we're starting a bigger rollout in that one as well. So yes, lots of initiatives, lots of tracking.

Galen G. Weston - *Loblaw Companies Limited - Executive Chairman, CEO & Member of Management Board*

And the initiatives are both capital in nature and noncapital. So some are just process improvements, but each one is being tracked and where there's capital investments, the IRR is reviewed and they're very healthy IRRs. And we're quite pleased with where we're at.

Peter Sklar - *BMO Capital Markets Equity Research - Analyst*

And who in the company is the steward of all these initiatives? Is that you, Darren, or like?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Well, I would say, it's a combination. I would say, ultimately, I am and then Darren, of course, would be part of it. But every management board member owns a different initiative. So all of our management board in our operating businesses would be the sponsor of a specific initiative across the division. So if it's a shrink initiative there's one management board member, who's responsible for shrink, and that shrink is tracked in Shoppers and in both food divisions with one accountable exact. And all of the process and efficiency initiatives have been budgeted into the plans as well. So everybody knows what they are driving towards.

Operator

Your next question comes from Vishal Shreedhar with National Bank.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

All these process efficiencies, are they more of an SG&A item or gross margin or is it mixed?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

It's mostly SG&A. But strength shows up in gross margin. And there's some supply chain initiatives that would be a combination of both SG&A and gross margin.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. So given that food gross margins were flat year-over-year and you've increased promo effectiveness, would that suggest that, on average, Loblaw is a little bit more aggressive on pricing than they were about a year ago on the food side?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

I mean that's what the math would show. So I mean based on what you're saying, yes, that would be it. It's always hard to exactly know. But yes, we feel like our pricing is in a very good position.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And I just want to make sure I have the definitions correct, but in food, if we add basket growth plus traffic growth, does that roughly equal same-store sales?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Yes.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. And the internal inflation that you use, is that LPI? The one you give us now?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. Yes, it is. Sorry, I was just going to say, it's not a perfect measure, but it is what we've been using.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. So just for our internal, so we can get our bearings straight, if I were to -- how would LPI compare to your average ticket price year-over-year? Maybe you can't give us numbers, but you can give us which one' stronger or weaker?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Well, we've seen improvement in our mix. So when you look at ticket price at all, the mix is going to be very important factor in that. So that would be higher -- I'd say it's higher than what we're seeing with LPI. LPI is an item-to-item comparison similar to what CPI would be. So as we get to a more effective on the promo effectiveness and we changed the mix. You shall see a healthier basket.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. So LPI is higher than your average ticket price comparison year-over-year?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

No. LPI would be kind of lower than the average ticket price.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Got it. Okay. And so -- okay, I think I have the story straight, but in terms of investors trying to understand, obviously, you have many efficiency initiatives going on and it seems like a very big focus at Loblaw, and if we want to -- and you're investing as well, but you're not giving us the magnitude of the investment, so we don't know. So how would an investor be able to tell if these efficiency initiatives are successful? What metrics would we look at given that we don't know the 2 numbers?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Well, I think, ultimately, you should look to see continued SG&A performance because we -- as I've said, it's a balancing act. We have to balance it all. It's what we're doing. We're investing, but we need to find the process and efficiencies. If you saw our SG&A go up a large amount, you'd be coming back in as investors and challenging us as to why that would be unless we had massive amounts of revenue growth on that. But that's not the plan here. The plan is to keep things stable with stable trading and to deliver the financial framework over the long term and that's what we should be judged by.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. Yes. Is -- so you mentioned the financial framework, so the way I understood it in the past, I understand 2018 was a bit of outlier year, is the EPS with all the drivers, ultimately, something 8%-plus kind of thing? Is that what we should expect for 2019, EPS?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

For the long term, that's what we're driving for. We -- as we've said before, we can't give guidance for 2019, but I will preface that it's a year that we are investing more heavily. I'll leave it to everybody to put their number where they'd like to put it.

Vishal Shreedhar - *National Bank Financial, Inc., Research Division - Analyst*

Okay. So that financial framework, that's more of a long-term measure and it may or may not apply to 2019?

Darren G. Myers - *Loblaw Companies Limited - CFO & Member of Management Board*

Yes. That's a long-term framework.

Operator

Your next question comes from Keith Howlett with Desjardins Securities.

Keith Howlett - *Desjardins Securities Inc., Research Division - VP, Consumer Products & Merchandising Analyst and Retail Analyst*

Yes. I had some questions on the discount business. Firstly, I was wondering about the consumer take up on the pilot click-and-collects at, I think, both at Maxi and No Frills.

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. I mean it's still fairly early because those would have been the ones that we've rolled out later. So -- but it's got some positive take up. I think people are quite excited about it. It's a little bit different, it's a little bit more self-serve, where you actually -- the picking is done for you but you actually have to go into the store to do your pickup and your pay. It's not brought out to your car. So it's a little bit of a different model. But I think so far the take up's been good and people -- we're still working through the feedback that we're getting to determine if that's the way we're going continue to go for that -- for the discount model.

Keith Howlett - *Desjardins Securities Inc., Research Division - VP, Consumer Products & Merchandising Analyst and Retail Analyst*

And I was wondering in Western Canada where you've got a combination of mostly Real Canadian Superstore and No Frills, and I think, the loyalty is applicable everywhere whether you see that it's the same customer with different shopping occasions going to one or the other? Or if it's sort of a different segment that prefers to go to No Frills versus Real Canadian Superstore?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. That's a good question. I would say across our business and what we can see in the loyalty data that we have is that many of our customers shop multiple formats depending on the occasion. And they also sometimes are in-store Shoppers and sometimes they're digital Shoppers. And so definitely we see -- though the same would be in Western Canada. I think fundamentally it is a different person. Generally people will choose to go to superstore or -- and maybe do an in-sale with the No Frills or just a quick trip where you're going in for a few items or/and people who are No Frills Shoppers are pretty dedicated to No Frills. But there's cross shop across all of our banners and the same thing happens in Western Canada.

Keith Howlett - *Desjardins Securities Inc., Research Division - VP, Consumer Products & Merchandising Analyst and Retail Analyst*

And then I was wondering about the digital media pilot. I don't know how much you can share about the structure of that experiment. But have you, sort of, made an offer to some PC Optimum users to opt into this program? Or how is this done?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. So basically what it would be, so let's use, I don't know, if we could pick any vendor but we could pick -- maybe we'll pick QUO, so one of our own brands in beauty, and basically the idea would be that you would target people who are likely to -- who have purchased a QUO product or maybe another product, and basically the idea would be that these people are selected to be part it, they can opt out of the program if they choose to. They don't get any more incremental advertising than what they would get before, but what they do get is the advertising that's more relevant to what they're interested in. And so we're not -- there's no additional advertising. It's just a change in the type of advertising they see. And they can actually earn points on by looking at the ads as well. So it's an interesting thing. We think it's very customer-friendly as well.

Keith Howlett - *Desjardins Securities Inc., Research Division - VP, Consumer Products & Merchandising Analyst and Retail Analyst*

And does this apply to their normal web browsing activity that sort of you're there with them and you feed them ads or something on new site?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

That's right. Yes. No, it would be part of their regular web browsing. But they would get whether they're on different properties, Facebook, any of them where they would be getting different ads that come to them. This just allows their ads to be more relevant.

Operator

Your next question comes from Irene Nattel with RBC Capital Markets.

Irene Ora Nattel - *RBC Capital Markets, LLC, Research Division - MD of Global Equity Research*

On the PC Express piece. So as -- I recognize we're in the early stages of maturation process. Above and beyond sort of the desire to have shorter windows, what other kind of feedback are you giving around what would drive sort of higher uptake? And are you continuing to see the uptake build? And what would you be at right now in terms of an annual run rate on sales?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

So I don't know if I'm giving you the annual run rate. So you know that last year on our digital properties, we were over $500 million. So definitely looking -- and it was a rent year. So at some point, we will give you how we did in 2019. We're not giving out what we're expecting quite yet. But we would say that we're seeing comp store positive on the -- or across the properties. So we have a combination. We're seeing significant growth, partially because we rolled out later in the year last year and partially because we're seeing comp growth. So we are seeing an increase across our properties. I would say -- what do we need to do? I would say we haven't been out marketing yet very much as we work through some of the things, trying to figure out exactly what the customers like. We've been piloting a lot of different things, different times and different time slots. So we haven't been out marketing. So I would say, definitely some marketing would probably help. And I would say just continuing to improve the offer and making sure that we don't -- didn't want to market as we rolled out because we wanted to make sure we had a good service before we marketed it as well. So definitely focusing on improving the wait times and things like that and the product substitutions would be another area. So definitely focused on that now. But good uptake. And people who like it, really, really like it. So we have very good return stats that -- where people will continue to use it once they're on.

Irene Ora Nattel - *RBC Capital Markets, LLC, Research Division - MD of Global Equity Research*

Anecdotally, I've heard kind of mixed feedback depending sort of on the store-by-store basis in terms of the experience. Is that something that you're tracking? Sort of have you identified -- with stores who do it really, really well, what they do differently?

Sarah R. Davis - *Loblaw Companies Limited - President & Member of Management Board*

Yes. I think that's probably true for stores in general that some stores perform better and are more customer-centric than others and we definitely have the data. So we do track our customer satisfaction scores by stores and if we see a store that isn't performing as well as we would like, we would put measures in place to improve it.

Operator

There are no further questions at this time. I will now turn the call back over to the presenters.

Roy MacDonald - *Loblaw Companies Limited - VP of IR*

Great. Thanks, everybody, for your time this morning. I'm more than happy to address your questions -- follow-up questions off-line, and please mark your calendars for July 24 when we'll be back online to discuss our Q2 results. Have a great day.

Operator

This concludes today's conference call. You may now disconnect.