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L.TO - Q4 2018 Loblaw Companies Ltd Earnings Call

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OVERVIEW:

Co. reported 4Q18 consolidated adjusted fully diluted EPS from continuing operations of CAD1.03.

CORPORATE PARTICIPANTS

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

Roy MacDonald *Loblaw Companies Limited - VP of IR*

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

CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator

Good morning. My name is Chris, and I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies Limited fourth quarter results conference call. (Operator Instructions)

Mr. Roy MacDonald, Vice President, Investor Relations, you may begin your conference.

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

Good morning, everybody, and thank you, Chris. Welcome to Loblaw Companies Limited Fourth Quarter 2018 Results Conference Call. I'm joined in the room this morning 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 in future years. These statements are based on assumptions and reflect management's current expectations and are subject to a number of 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 statements 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 is required by law. Also, certain non-GAAP financial measures may be discussed or referred to today. Please refer to our annual report and other materials filed with the Canadian securities regulators for a reconciliation of each of these measures to the most comparable GAAP financial measure.

And with that, I'll turn the call over to Darren.

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

Thank you, Roy, and good morning, everybody. We're pleased to end the year with another quarter of strong operational and financial results.

On November 1, we completed the spin-out of Choice Properties to GWL. As such, just less than 4 weeks of Choice's financials are reflected and recorded as discontinued ops in our fourth quarter results.

Looking at continuing operations. On an adjusted consolidated basis, revenue grew by 2.1%, EBITDA increased by 1.5% and fully diluted earnings per share grew by 1% to $1.03 in the quarter. Including discontinued operations, we came in at $1.07 per share.

On an IFRS basis, net earnings available to shareholders from continuing ops increased by $252 million year-over-year. The increase was mainly due to charges recorded in the fourth quarter of 2017. We continued to deliver on our financial plan in the quarter. Our same-store sales grew 0.8% in food retail and 1.9% in drug retail. We were pleased with the underlying performance of our food business as we delivered same-store sales growth while driving margin expansion in the quarter. Our year-over-year food retail sales were negatively impacted by approximately 100 basis points in the quarter, primarily due to softer sales in general merchandising and from health care reform impact to our in-store pharmacies. Excluding this, our food, retail same-store sales grew at 1.8%.

Food retail benefited from mix in the quarter. We brought more traffic into our stores and drove an increase in the basket. Similar to last quarter, our CPI-equivalent internal inflation metric came in moderately below CPI. However, when you look at the various indicators, such as mix and average item price, we see inflation generally in line with CPI.

In drug retail, Front Store same-store sales were higher by 2.8%, with growth in all major categories. Positive pharmacy same-store sales growth of 0.6% was attributable to strong prescription growth of 3.1%, which more than offset the negative impact of drug reform.

Total retail gross margin was 29.6%, an improvement of 20 basis points from the same quarter last year. 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 improved in the quarter as we continue to make progress with our focus on promotional effectiveness and shrink improvements.

Retail SG&A as a percentage of sales of 21.9% were 20 basis points higher than the prior year. Excluding the impact of franchise consolidation, retail SG&A improved by 30 basis points. We were pleased with our progress delivering savings for process and efficiency initiatives, effectively offsetting cost headwinds, while enabling investments in the business.

At PC Financial, revenue grew by 22.6%, supported by continued growth in our credit card portfolio and a very strong holiday season at our mobile shops. Adjusted EBITDA declined $13 million compared to Q4 last year as revenue growth was offset by the termination of our daily banking services and increased investments in the business.

Free cash flow from continuing operations was negative $162 million this quarter and positive $670 million for the year. The fourth quarter and full year were negatively impacted by timing as a result of advancing certain first quarter payables to the year-end as we transitioned our Shoppers back office to SAP. This impacted our cash flow by almost $300 million.

In the quarter, we repurchased 3.9 million common shares for cancellation for a full year total of 16.6 million shares or 4.5% of our outstanding shares at a total cost of almost $1.1 billion.

Turning to the full year, our financial plan was set to deliver essentially flat adjusted net earnings growth in a year where we phased in to more than $440 million in expected incremental cost headwinds. This required the underlying business to deliver strong double-digit earnings growth. Against our 2018 full year outlook, we delivered full year same-store sales growth in food retail of 1.1% and 2.4% in drug retail, and adjusted retail gross margin was flat compared to the last year. Adjusted net earnings grew by 0.2% and adjusted earnings per share grew by 5%. We are very pleased to have delivered on our financial target while making meaningful investments in the business.

Looking ahead to 2019, on a full year comparative basis, excluding the impact of the spin-out, we expect to deliver positive same-store sales and stable gross margin in the Retail segment, deliver positive adjusted net earnings growth, invest approximately $1.1 billion in capital expenditures and return capital to shareholders by allocating a significant portion of free cash flow to share repurchases.

Related to the spin-out of Choice Properties, the company now expects to record a prospective incremental noncash, annual depreciation and amortization expense of approximately $85 million as a result of the change in estimated useful life of certain building components owned by Loblaw.

We expect to see continued cost pressures in 2019, including the previously announced health care reform, which we will not lap until the second quarter. Our focus continues to be on driving process and efficiencies throughout the business, while we accelerate our investments.

Finally, let me provide a few comments regarding IFRS 16. As required, we will implement IFRS 16 in the first quarter of 2019. On a go-forward basis, there will be a decrease in rent expense and an increase in depreciation and amortization and net interest expense and other financing charges. Although we continue to work through our analysis, at this time, we do not expect the new standard to materially impact the company's net earnings.

In conclusion, we are very pleased with our strategic progress and operational performance again this quarter. We are delivering process and efficiency gains supported by a culture of operational excellence. These savings are helping offset cost pressure and are enabling our investments in our strategic growth areas.

I will now call -- 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. Q4 brought a fitting close to 2018, a year in which we set thoughtful, but ambitious, financial targets and then followed through on them. We saw strengths in the underlying food and drug results, delivered through strong sales, core gross margin expansion based on data-driven margin decisions and SG&A discipline with new process and efficiency wins. In turn, we intensified investments in the right strategic areas.

Our strategy is designed to rapidly accelerate growth in 3 important areas that matter to our customers: everyday digital retail, payments and rewards, and connected health care. We've made significant progress in each of these areas. It was just over a year ago that we launched PC Optimum and we now have more than 18 million members. The launch was followed by a strategic partnership with Esso and the continued rollout and enhancement of our PC Insider subscription service. Together, these products and services have created a loyalty loop that rewards customers personally, while encouraging them to return to our stores and services more frequently.

Similarly, last spring, we pledged to blanket Canada with digital conveniences and, looking back, we did just that. Today, PC Express pickup is only 10 minutes away from 75% of Canadians and 85% of the GTA and home delivery is available to 65% of Canadian households. We have 670 PC Express pickup locations in grocery stores, Shoppers Drug Mart locations and GO Transit stations with more locations on the way. We've shortened time frames so customers can order groceries online for pickup in as little as 1 hour, delivering greater convenience and flexibility to our shoppers. In many regions, more than half of our online food orders are for same-day with less than 4 hours from order to fulfillment.

Our tendency to speak about -- to speak most about our digital food business often overshadows our broader digital initiatives across beauty, pharmacy and apparel. Though grocery leads our omnichannel offers, each of the others has become a meaningful business, growing, adding categories and brands, driving online sales. In 2018, our e-commerce sales surpassed $0.5 billion.

And as 2018 was about scaling our digital services, 2019 is about execution, making further investments in technology, driving customer adoption and improving customer satisfaction. In other words, we will strengthen the ties that bind our customers, services and offers.

Our key performance indicators show that we are on track. So we will continue to invest with confidence. In 2019, it is equally important that we deliver significant process and efficiency savings. This too is on track. I'll give you a few examples. We are adding self-checkouts at pace with plans to be in over 1,000 grocery and drug stores by year-end. With over 1/3 of customers choosing self-scan, this not only increases efficiency but has notably driven up customer satisfaction scores. We are rolling out an app-based service, called Flash Foods. It connects customers with our stores. It shows them food items that are nearing their expiration date and allows them to buy these items online at significant discounts. This not only pleases customers, delivers value and draws traffic, it moderates our shrink cost and food waste, 2 major focal points for 2019.

We have also introduced electronic shelf labels in 5 stores, with plans to expand to 50 stores this year. They look just like our paper labels, but are digitally and centrally controlled. They give us greater pricing accuracy and reduce the time that goes into manually changing shelf label over and over again for promotions and corrections. Changing price labels is one of our colleagues' least favorite tasks and the change to electronic shelf labels has allowed us to reassign hours and people from old analog time-consuming role to new highly productive role, such as picking for PC Express.

And on the topic of colleagues, in Q4, we gave our corporate store colleagues access to digital schedules, accessible on their mobile devices, providing the ability to view their schedules or request a shift change. This not only allows us to have more efficient interactions with colleagues, it is representative of our efforts to improve the colleague experience with the expectation that in turn we will improve our customers' experience. Our strategy is gaining momentum, and we continue to make significant investments with confidence, investments in our people, our culture of operational excellence in delivering more for our customers and in continuing to deliver shareholder value.

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. I don't have too much more to add other than to say that during a year of more or less flat earnings performance, when it came to delivering against our long-term strategic priorities, 2018 was an extraordinary success. We launched 3 key products as part of our payments and rewards strategy, with the new digital credit card platform, PC Insiders, and of course, PC Optimum; we achieved scale and rapid growth across 3 of our major everyday digital retail platforms, grocery, beauty and pharmacy, significantly improving customer satisfaction along the way; and we continued to cement the technology foundation for connected health care. Equally important is the remarkable traction we see from our data insights initiative and our process and efficiency work, fundamentally improving our core business for both our customer and our colleagues.

Successfully achieving these kinds of strategic objectives, while at the same time delivering our financial plan is our job. What is particularly exciting about 2018 is how well they are actually working and the potential incremental opportunities that are emerging as a result. As we look ahead, the market environment continues to be challenging. We remain focused on executing our strategy and on accelerating our investments where our confidence is high that they will deliver long-term growth.

We'll now open the call for questions.

QUESTIONS AND ANSWERS

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

(Operator Instructions)

Operator

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

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

My single subject is same-store sales and revenues. And there were a lot of numbers that you kind of walked through early on, but can you really, please, just walk us through what was going on in food, in general merchandise and sort of tonnage, pricing, all of that sort of stuff, please?

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

Okay. Irene, it's Sarah. So I'll start with the Shoppers side of the business because that one's a little bit cleaner. So the drug Front Store sales was 2.8% comp in the quarter so we feel good about that. Pharmacy comps were 0.6% as a result of drug reform and the script growth was around 3.1%. So strong growth in sales on the Shoppers side. On the food side of our business, as reported, same-store sales were 0.8%. But when you actually look at just the core food, so you exclude the GM side of our business, we had growth of 1.8%. So what happened in the quarter was a decline in some of the GM side. So in particular, the pharmacy in store, inside the grocery stores, would have declined as a result of drug reform and the other piece was our general merchandise business was down as well, which the 2 of those basically accounted for 100 basis points of a reduction. So we're happy with our core food. We're not happy with our GM performance, but it was by design. We changed our promo strategy to go from a Hi-Lo to everyday low price. We're pleased with the margin performance that actually improved the margin percentage, but we would've liked to have seen more sales. Having said that, they are profitable sales that we've got coming in so along our strategy of booking for more profitable sales.

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

And then in terms of...

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

If you want to go into tonnage and some of those areas, I could go there too.

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

Yes, please.

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

Okay. So in terms of tonnage, remember that our goal is to maintain tonnage share and not chase bad tonnage share in any 1 quarter, and we've given ourselves a little bit of margin in each quarter. And in Q4, when you look at the pure street math, it would show that we gained tonnage shared, but when you look at the mix of basket that we have, it would be closer to flat tonnage. And so in terms of tonnage, we're satisfied with that. It falls within our stable trading and what we're looking for in having more profitable tonnage share.

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

And part of that, Irene, is that we demonstrated just the increase in our gross margin in food. So strategy certainly worked in the quarter. So we're quite happy with where we ended up on the food side.

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

That's very helpful. And you mentioned that you now have a total of around $1 billion in sales from e-com or from online, which kind of suggests that you're around 2%. So are you -- is that cannibalizing your bricks and mortar? Are you seeing net gains, do you think? What's going on there?

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

So just to correct you, it's $0.5 billion. So $0.5 billion is what we've got and what we reported in 2018 and consider 2018 was a ramp-up year. So really ending the year with the 670 locations and over $0.5 billion in sales. We would say that there -- it's a little of both. Some of our sales, we would say, were incremental, certainly, the baskets and then online sale is higher, the basket size is higher, but clearly, there would be some cannibalization of our own bricks-and-mortar sales as well.

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

And just to add to that, the overall from those investments brought incremental revenue to us, even considering the cannibalization, and then the basket is also -- tends to be higher-margin basket as well.

Operator

Your next question comes from Mark Petrie of CIBC.

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

I actually also just want to be the one to start with a follow-up and just a clarification. With your comment, Darren, with regards to free cash flow, and I think $300 million of drug inventory build in 2018, could you just clarify exactly what was driving that and then how that impacts expectations for 2019?

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

Mark, I'm glad you asked the clarification. No, so what -- we successfully transitioned as part of our transition to SAP at Shoppers, we successfully moved the back office over at the start of the New Year. And as a result of that, we had payables that, frankly, would have gone right at the cutoff and to make sure we kept our suppliers happy and had no issues. We advanced it in a matter of days and -- in that -- for those payables. So as a result of that, we had almost $300 million more cash leave this year that would have gone out at the beginning of Q1.

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

Okay. And that normal there is -- so it's a no impact in 2019 basically?

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

No, other than it should get the pickup of that in 2019, which is purely timing.

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

Yes. Okay. And then, Sarah, I just appreciate all the commentary on process and efficiency and understand that this is part of an ongoing discipline, but 2018 obviously had a lot of moving parts on SG&A. So just wondering if you could please give us a sense of the savings generated from your work last year and then just in terms of your expectations for magnitude in 2019 and beyond.

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

Okay. So I would say when you think about 2018 and you consider what we did, so basically -- and we're not going to -- so basically, we had $450 million of headwinds coming into the year, which we offset through process and efficiencies and other initiatives like the supply chain handling charge and came with flat earnings. So -- and also invested in the business. So that's the sort of the size that we're talking about. When we look forward to 2019, we'll continue with the process and efficiencies, and we'll continue with investing, actually, at a higher rate. So our plan is to invest more in the new initiatives in 2019 than we did in 2018. And in terms of financial outlook, I mean, Darren put in his words what -- and it's on our written disclosure what we think that will result in.

Operator

Your next question comes from Kenric Tyghe of Raymond James.

Kenric Saen Tyghe - *Raymond James Ltd., Research Division - SVP*

Sarah, on the digital food initiatives, an impressive -- very impressive sounding numbers and impressive reach. Could you speak to where the traction has surprised most and perhaps how that is impacting your plans looking to 2019 and beyond?

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

In terms of where we've seen the most traction? Is that where you're -- what you're saying?

Kenric Saen Tyghe - *Raymond James Ltd., Research Division - SVP*

Yes. Absolutely, Sarah. Is it that the -- is it deliver to home where you already got very high uptick, is it the PC Express? I'm just trying to understand sort of what's working best with respect to your digital food today and how that's influencing...

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

Okay. So I would say in terms of what we feel is working well. There's a few things that maybe have surprised us. We thought it would maybe more of an urban play, but we've actually seen quite a lot of traction in our West Superstore business, and so that's been interesting for us. The other piece, I would say, is we've been surprised by the immediacy that people want in their -- so wherever we've opened up a new window, particularly for same-day and in a couple of areas we've done within 4 hours. So we're piloting different things, seeing what customers are most attracted to. It does seem that they really do like the quick turnaround. So that's what we're working on in 2019, to improve that and offer that to more customers. In terms of click-and-collect versus delivery, pickup versus delivery, it's still strong -- or pick and collect -- pickup would be stronger than delivery. But we have brought the 2, the Instacart, the 2 apps together so you can now order online in the app and be able to have pickup or delivery and it has "powered by Instacart," or you can also go on to the Instacart website. So really our whole strategy is about giving our customers options seeing what they like the most and going from there.

Kenric Saen Tyghe - *Raymond James Ltd., Research Division - SVP*

That's great. And just along a similar sort of line, where have you noticed the biggest change in competitive intensity in the market? Is it sort of competitive intensity within store and between categories? Or is it more one of the battle being fought on brick-and-mortar versus e-commerce? Is it sort of channel or category in terms of the change in competitive intensity or the step-up in competitive intensity?

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

I think we still feel that the competitive intensity is stronger in bricks-and-mortar and in our traditional competitors, particularly on foods, because there hasn't been a lot of real online in the food side.

Operator

Your next question comes from Patricia Baker of Scotiabank.

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

And I have a single topic. And I want to come back to the impact of general merchandise and in-store pharmacies on the comp in the quarter, because it's an important part of your business. And I just want to ask a number of things about that. It sounds like what you did, Sarah, was change in the merchandising strategy around the whole GM side of the business. So I'd be curious about when you instated that change, did it take place in Q4 of this year? And then, more broadly, in the past, has general merchandise been accretive to comps? Can you speak to what particular categories might have been weak in general merchandise? And when you look at the fact that EDLP is different for the consumer than Hi-Lo, is that something that you believe over time, the consumer will come to accept that or learn to work with that? Or do you think that you just have to assume that you will be definitely getting the better margin by giving up a little bit of sales. Just love your thoughts there. And then more broadly, what is your longer-term view on general merchandise? Are you adding more there, doing more there, and is it a core part of your business?

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

Okay. All right. I'll try to get to them all, if I can remember them all. So on -- in terms of we would've changed the strategy throughout 2019 -- I mean, 2018, in terms of going to EDLP. It's just the impact was much bigger in Q4 which is why we're highlighting it and it's bigger in Q4 because Q4 would be the quarter where we have the largest GM sales. And so in terms of -- we still like the strategy, but we might go to a combination. When we look forward to 2019, we are planning. We're anticipating growth in GM. So we don't anticipate it to be deteriorating to our business. Our plan would be to grow, but we are rethinking having seen what happened in Q4. We might have gone too fast to the new strategy, and we will look at fine-tuning that for 2019. In terms of what types of categories within GM, so this would be apparel -- not really, not include -- not really talking about apparel. It wasn't a big factor. It would be pure GM, and it would be any of the high-priced items, like TVs, any of those types of things that we have been moving out of in terms of our business anyways for high-ticket items. And then it would be any of the Christmas items as well that didn't perform as well as prior years. And then in terms...

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

Sorry, sorry, keep going...

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

Okay. Sorry...

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

No, go ahead.

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

It's okay. I think I've forgotten the other questions. Keep on -- ask me again.

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

Okay. Just when you mentioned the bigger ticket item, so it just popped into my head. Does that -- you're doing some thinking about them, what you'll do in the spring, summer season with the higher-priced items, like the patio furniture and the barbecues, think that you might need to be more on the Hi-Lo there? Or is it too early to see the traction?

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

Yes, that's right. So I think -- yes, I think when we look at the barbecue and all of those, we have been fine-tuning that over the years to get to very simple, very few. We used to have more complicated sets. So definitely looking at the category and then we will -- we probably will do a combo of every day and then a little bit of Hi-Lo as well in the spring.

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

And then, if we looked at Q4 this year versus Q4 last year, would you say that the average unit price, what you did sell, was higher than the prior year because of the EDLP strategy?

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

Not about the average unit, but definitely the average margin. The margin percentage would have been up in Q4 over Q4.

Operator

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

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

I've got 2 questions less shorter, but on slightly different topics. But first of all, on the financial services, they were restated lower $7 million -- by $7 million last year. And I'm wondering is that something that carried forward this year and what that was tied to? Because it does seem like financial services profitability was weaker than expected in the quarter and wondering what your outlook for 2019 is on that segment.

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

Mike, I mean, on the financial services, we're actually quite pleased with the business and its performance. Very good growth and great key indicators and KPIs within the business. What you're seeing on the profitability is really getting out of the day-to-day banking with CIBC and investments that were making the business. I would say they were both right on our plans. So no surprises from our perspective on that. And as we look forward, when you think about next year, I think that pressure should continue in Q1 because we won't lap the banking till April and when you think about just in terms of those investments, you would have probably noticed that we made a significant upgrade to our platform in the fourth quarter.

We've rolled that out. We're quite happy with that and that sets the foundation for future financial platforms -- or certain products that we would be able to roll out. So stay tuned on that. We will give more as the year goes on what other products we're considering there.

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

Okay. And just a small one on the Flash Foods app that you discussed, how available is this across the country? Is it going to be available on all stores or -- eventually? And how many stores is this available in now?

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

It's only available in a few stores right now, but we are going -- as we speak, we're rolling it out to Québec. So it's starting in Maxi. It'll go across all the Maxi and then we'll take it from there. So right now, it's pretty interesting because it's something that has come from some of the work we have. So understanding the actual item-level inventory in our stores, understanding the code date on each item is something that we now have the ability to use an app like this that can really save our customers some money and save us some shrink at the same time. So we're pretty pleased with this. But right now, it's only in a few stores, and it'll be rolling out in Québec, as we speak. I think it's actually in a few Maxis now. But yes, our attention would be -- our intention would be that there is not a reason why we wouldn't want to have it across the country.

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

Have you tested it enough to find out whether the added labor to pull all these products aside in that is -- it more than offsets the shrink?

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

Yes, yes. We're comfortable with the model. It's items that would have been thrown out. So there would be labor going to throw it out as opposed to being able to sell it. So we actually are pretty happy with it. Less food going to the landfill too.

Operator

Your next question is from Jim Durran of Barclays.

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

Just wanted to go back to comp store sales and inflation. So just listening to the adjustment number. Would you say that you feel that the inflation you're achieving is competitive to the marketplace's rate of inflation as we've seen cost of goods sold pass-through?

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

Yes. We would say, we're -- yes.

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

And then you were indicating that on a tonnage basis, you're comfortable that you're holding market share of tonnage at this point?

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

Yes.

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

So as we look at 2019 and, obviously, a good thing to be deemphasizing low- or no-profit promotion activity, how much longer should we see this as having a material drain to the comp store sales number, but an enhancement to margin like a magnitude? I mean, obviously, it's an ongoing initiative, but I assume that right now there is maybe some low-hanging fruit that may having -- be having an outsized benefit on margin and maybe some drain to comp.

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

Yes, that's fair. I mean, I wouldn't say -- we're trying not to have a drain on our comp store sales. Certainly, I wouldn't like to give us that excuse. And so we should expect to perform at the same as our competitors on comp store sales. But it is -- but we are looking for a bit of a margin improvement. I think we have room in 2019. We really only got started in the back half of 2018 in this in any meaningful way. So we've got a little bit of lapping to do in the first part of the year and then we can continue. And you can always fine-tune, to your point -- you can always fine-tune your margins algorithms as well.

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

And on e-commerce, how do you feel from a market share standpoint you're performing? Like, are you gaining penetration of e-commerce in Canada in grocery as you roll out? Or do you feel that the competitive framework is keeping pace with you?

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

We feel like we're gaining share on -- in digital sales in Canada.

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

And on the Instacart, there's been a couple of retailers in the U.S. that have opted to not charge a premium to the retail price to embed the incremental charge and to -- shipping and handling fees. What's your experience been so far in terms of consumer feedback on Instacart? And would you contemplate a change in that strategy if you felt that you weren't keeping pace with home delivery as a competitive option?

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

So our feedback, we haven't had a lot of negative feedback on the additional charge. I think the people who are choosing it are willing to pay that. But yes, definitely, we would consider doing something with the charge if it became a competitive barrier.

Operator

Your next question comes from Vishal Shreedhar of National Bank.

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

I'm just intrigued by the shift to EDLP, like others. Will this thinking of EDLP, will that migrate to Shoppers as well? Or do you think it's a Loblaw thing for now?

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

It's only a Loblaw thing, and it was only in GM. And so I wouldn't take it as a theme across the business.

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

Okay. And what inspired it, just for that category just given that it's -- you have such a long history of that Hi-Lo?

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

I think our thought was that we could more profitably -- it would be more profitable to go to an EDLP strategy and not have the ups and downs. It would be easier in the store as we look for efficiencies across the business, it would be easier across the whole end-to-end supply chain. And so in the effort of looking for process and efficiencies, we thought it was a simpler model. And we thought it would end up with a higher margin, which it did in terms of rates, but we underestimated the impact on sales.

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

Okay. And was increased, I guess, price visibility on behalf of the consumer, was that also something that you thought about as you implemented this EDLP in the general merchandise section of Loblaw?

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

No, I don't think that, that was really a factor. What we did see is that some of our most-loyal customers were those that stayed with us. What we lost was a few nonprofitable cherry-pickers who came in for the deals. So we're not overly disappointed. We just would've liked to have had more sales.

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

Okay. And just shifting gears here, and it's an easy one. Can you just help me describe -- help me understand what is meant by connected health care, maybe give us an example of that, and how that will help drive value for shareholders and how large is that opportunity?

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

Okay. So connected health care would be a piece of our strategy that's maybe not as developed as the other pieces, being digital, retail, and payments and rewards. But we've made some pretty good traction in terms of setting up all of the infrastructure. So it is in the pharmacy part of our business, the digital health part of our business. And when you look at what we did in 2018, we're now in -- we've got the new HealthWATCH system in over 740 of our Shoppers stores. We have 13,000 providers now on EMR, which is the electronic medical record, through QHR. And we're looking at different things to basically digitize the pharmacy. So we're looking -- it would consider things like central fill as well as C Pack, all of which are gaining traction in the Shoppers stores. But the ultimate goal -- so this is all what I would consider some of the infrastructure or the plumbing to set us up to be able to have a connected network that connects the consumer to the pharmacist to the doctor, to the payer and that is what we're working to build. In terms of size of the price, we think it's a large part of -- there's a lot of money there in terms of our share. We haven't really given out what we think it would be. But right now, we're still working on doing the infrastructure, which will help our stores run more efficiently as well, and we then we'll have the added benefit of being able to have perhaps a revenue opportunity as well.

Operator

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

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

Darren, you've mentioned before that Loblaw could have an interest in becoming a retailer of cannabis in the recreational channel. As you know, Ontario has really tightened up retail distribution, where they had a lottery system where they only allowed 25 retail licenses to begin. So I'm just wondering if how unfolded -- how Ontario has unfolded? If that's tempered your enthusiasm for retailing cannabis? And what Loblaw's plans are in terms of retailing cannabis to the extent you can talk about it?

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

Yes, I mean, from our perspective, the medicinal or medical side it's certainly been the area that we've been mostly focused, and on the rec side, it's been little bit more experimentation in seeing where the market goes. So we have launched in Newfoundland, and we're seeing a lot of success in there, but every province is quite different and you have to work through a number of things to figure out if it's going to work. And Ontario, as you know, there are a lot of moving parts to that. So at this point, we're just staying close to it, but we're going to keep checking the market and seeing if there is an opportunity. And we got a lot of focus on the medical side, while that all plays out.

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

So could you describe what you have in Newfoundland right now? And then on the medical side describe -- I believe your website is up and running and how it's performing and are you able to secure product from your suppliers?

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

Okay. So I can sort of add in. In Newfoundland, we have about 10 stores and it's basically offered in the smoke shop so where we would have had the tobacco shop and so it's a separate door. It's a separate point-of-sale and separate entrance from the grocery store. We actually quite like that model because the infrastructure is there and the building is there, the door is there, and it's not disruptive to the grocery shopper, but is, obviously, attached to the store. So we like that model. But so far, Newfoundland is the only province who has allowed that to happen in that way. So as Darren said, we are interested in it, but it would have -- every province has a different set of rules. So it would have to meet our criteria as well. In terms of the medical side, we do have it up on our website. At the moment, we only have the ability to sell in Ontario and only through delivery on the website and then delivery to the home. We would like to expand it to the rest of Canada, but at this point, we don't have the license to do so.

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

And Sarah, the -- your store, these kind of isolated stores-within-the-store in Newfoundland, how are they bannered?

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

They would be Dominion stores in Newfoundland. But the actual -- it doesn't actually -- there is no banner on the -- if that's what you're getting as to Marijuana Act (sic) [Cannabis Act] banner. It's not. It's just in the smoke shop adjacent to the Dominion grocery store.

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

So there's no retail banner identification you're trying to...

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

No, there isn't. We don't -- no, we don't.

Operator

Your next question comes from Keith Howlett of Desjardins.

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

Yes, I'd like to ask about the demographics you're seeing of the online shopper. I think you got some tests at Maxi and No Frills, and you mentioned Real Canadian Superstore out West is getting quite a bit of interest in online. So now that you look across the network, what are you seeing as to who is attracted to online?

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

I wouldn't say there's a single demographic. It seems to be attractive to a whole lot of different people and it also varies -- it also could be people who do both, the combination. So we have circumstances where customers shop at our stores most weeks, but on certain weeks where their -- actually their family is busy, they're ordering online and in some cases, they're actually doing delivery for infill as well. So we have customers who are -- it really is an omnichannel experience for them, where they'll interact with us in any one of those 3 ways. In terms of what we're seeing, it -- as I mentioned, we are seeing higher than we expected in the West Superstores. There -- that would be where our highest penetration is actually. And I mean, you can maybe attribute it to the fact that it's a big store and a big shop, and people love the convenience of being able to order online and then just driving in and picking it up. But we also see the traction in the urban centers, like Toronto and Vancouver, as well. And I would say, I don't think from a demographic, it's not just young. I think it skews young and older, so nothing specific to seeing that in terms of age that we're noticing.

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

And how does the No Frills or Maxi customer, are they going -- are equally interested?

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

Yes, it's a different model, where it's a little bit more -- there's less labor and it's a bit more self-served, and it's still fairly new. So those No Frills and Maxis would have been the last ones we rolled out. So we don't have a lot of data, but so far, there is interest in the model there as well, and we've chosen to go with a bit of a lower-cost model.

Operator

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

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

Just turning to the 2019 outlook and the 2018, I guess, annual report that says "Focused" on the cover. And in the commentary, you talked about commitment to delivering industry-leading financial results. So I was wondering how you define that, what are the key metrics, and how -- where you think 2019 fits along that path?

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

Yes, I mean, I think it's hard to say what industry-leading financials would be in 1 year, but I think you got to look at track record and the long-term value that we're looking to create for shareholders. So Irene, we're not -- don't have a specific answer for you rather than just say we're focused on the stable train, and we're focused on delivering earnings growth, but in a smart way. We're trying to do things in 1 quarter; we're trying to do things over the long term. And hopefully, as evidenced by the conversation today, we feel we've had a ton of traction on our investments. And we're going to keep making those while balancing the cost savings and process and efficiencies that we need. And when you put all that together, over the long term, we think our metric should stand as industry-leading within the industry. But it's hard to know about bright-line test of a point, a date or a time on that.

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

And I think in terms of the word "focused," it really is about maybe more of an internal method that we're focused on the things. There is a lot of ideas and there's a lot of different ways you can go. And what we're doing is focusing on the things around our strategy, which we've highlighted, it's the process and efficiencies, the data-driven insights in the 3 investment areas and just continue to focus in those areas and to deliver on the financials, as Darren highlighted.

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

That's right. And then one final on the subject to the 2019 outlook. When you talk about positive same-store sales, what are you thinking in terms of inflation? And are you referring to positive including inflation or more of the stable tonnage, so excluding inflation kind of flattish?

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

So probably not going to get that specific on it too, but I'd say that we expect normal inflation, so call it 1% to 2% range and that's how we're thinking about 2019 overall at this time.

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

And our goal would still be to maintain our market share tonnage.

Operator

Your next question comes from Keith Howlett of Desjardins.

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

I just wanted to ask what your view is on the meal kit segment and also more generally on your prepared meal sections, what you're thinking about doing going forward there.

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

That's a good question. So we are thinking of sort of in -- we call it solved meals. So how do you actually solve meals for Canadians across in a variety of different ways and not necessarily specific to meal kit, but that would be an element of it. So it is in the plan for 2019, and we'll talk to you more about it when we've got more to say, but definitely part of the plan.

Operator

There are no further questions at this time. I will now return the call to our presenters.

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

Great. Thanks, everybody. Thanks, Chris, for hosting us here. If you have any follow-up questions, please give me a shout and mark your calendars for May 1, when we'll see you back online to discuss our Q1 results. Thanks, everybody. Have a great day.

Operator

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