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# EDITED TRANSCRIPT

L.TO - Q2 2017 Loblaw Companies Ltd Earnings Call

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## OVERVIEW:

Co. reported 2Q17 results.



JULY 26, 2017 / 2:00PM, L.TO - Q2 2017 Loblaw Companies Ltd Earnings Call

## CORPORATE PARTICIPANTS

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

**Richard Dufresne** *George Weston Limited - President & CFO*

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## CONFERENCE CALL PARTICIPANTS

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

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

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

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

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**Tal Woolley** *Eight Capital, Research Division - MD of Equity Research*

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

## PRESENTATION

### Operator

Good morning, my name is Sharon, and I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies Limited Second Quarter Results Conference Call. (Operator Instructions) Mr. Roy MacDonald, you may begin your conference.

### Roy MacDonald

Okay. Thank you, Sharon. Good morning, everybody. Welcome to the Loblaw Companies Limited second quarter 2017 results call. I am joined in the room here by Galen Weston, our Chairman and Chief Executive Officer; and Richard Dufresne, our Chief Financial Officer. And 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 the financial performance in 2017 and in future years. These statements are based on certain assumptions and reflect management's current expectations and they 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 directly comparable GAAP financial measures.

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



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### **Richard Dufresne** - *George Weston Limited - President & CFO*

Thank you, Roy, and good morning, everyone. In the second quarter, we continue to deliver against our financial framework. We grew revenue by 3.2% and adjusted EBITDA by 6.6%. Adjusted net earnings grew 8% and our EPS grew by 9.9% compared to last year. In food retail, the market remained highly competitive and the deflationary environment, which began in the fourth quarter of last year, continued in Q2. Against this backdrop, we delivered same-store sales growth of 1.2%, or flat if we exclude gas and a positive impact of Easter. Our internal food price index declined, but was marginally higher than the CPI deflation of 1.4%. Positive trends for same-store stores and drug retail continued in Q2. Excluding the impact of Easter, drug retail same-store sales grew by 2.9%; Front Store same-store sales grew by 2.3%; and pharmacy same-store sales grew 3.5%. Adjusted retail gross margin excluding the impact of consolidating franchises improved by 30 basis point to 26.7%, driven by shrink improvements in food, which were partially offset by lower drug margins. SG&A of the percentage of sales excluding the consolidation of franchises was 18.1%, worse by 10 basis points. Continued deflation in our revenue along with one-time items negatively affected SG&A rate in the quarter.

Our consolidated adjusted EBITDA was \$985 million, an increase of \$61 million or 6.6%, and EBITDA margin stood at 8.9%, an increase of 30 basis points from the same period in 2016. Free cash flow was \$547 million in the quarter and we continued to return capital to shareholders buying back 3.4 million shares at a total cost of \$260 million.

Looking ahead, our 2017 outlook remains unchanged. That said, in 2018, we expect incremental pressure on our business model. We estimate the impact on our labor expenses from recently announced increases in minimum wage rates to be approximately \$190 million. Additionally, incremental healthcare reform will impact our pharmacy business. This means that going forward, we need to increase our focus on cost reductions and accelerate our plans to realize efficiencies. At this point, I'll turn over the call to Galen.

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

Thank you, Richard, and good morning, everyone. I am pleased with our performance in the second quarter. As Richard has highlighted, we delivered another set of solid financial results. Competition remained intense as the grocery industry marked a third consecutive quarter of deflation. And in the quarter, traffic declined and basket grew in our food business as we benefited from favorable mix. We continue to leverage our data and analytics to drive our business forward, delivering superior value through targeted one-to-one offers to our loyalty customers. Overall, we were satisfied with our tonnage performance in Q2.

Our drug retail business also performed well during the quarter. Adjusted for Easter, total drug same-store sales increased 2.9%. In pharmacy, prescription count grew 4.4%, offsetting a 1.1% decline in the average script value. Front Store growth was led by a strong quarter in food and OTC. I would like to follow-up on Richard's comments regarding recent changes in the market.

Every year, we work hard to keep our prices low by improving processes and driving efficiencies within our cost structure. Every year, we face increased competitive intensity, particularly in our pharmacy business, pressures also from government to lower costs.

As we look forward to 2018, we expect significant incremental regulatory headwinds from both accelerating healthcare reform and aggressive increases in minimum wage. As many of you know, in recent weeks, the Québec government announced a further reduction in generic drug pricing in the province. This will put increased pressure on our pharmacy business model, both in Québec and across the country.

In Ontario and Alberta, the recently announced changes to the minimum wage rates, which we expect to come into effect in 2018, are the most significant in recent memory and will have a meaningful impact on the operating cost for all our retail businesses. These recent developments create a gap for 2018 that we must work hard to close. We are in the midst of our 2018 planning process and are looking carefully at every aspect of our cost base to find ways to accelerate efficiencies across our business. This means speeding up what we already have planned, such as using analytics to reduce inventory and increase our in-stock performance, using predictive tools to improve promotional profitability, turning heavily manual invoice processes into digital processes, and rolling out custom-designed self checkouts to help efficiently manage peak periods in our Shoppers Drug Mart stores, and finding new sources of cost reduction.



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We have a lot of work ahead of us as we are still assessing the extent to which we can mitigate these headwinds. That said, we remain confident in our strategic plan and committed to our long-term financial model. We are focused on delivering the best value to our customers and will continue to invest for the future. One of the more topical of those investments is e-commerce. Since we introduced click-and-collect 2 years ago, I am pleased to report it has become the largest online grocery offering in Canada, with the best mobile app rating and we have delivered more than 1 million grocery orders to our customers' cars. Today, we offer click-and-collect in 140 of our busiest stores. By year-end, that number will be over 200. We have a strong and comprehensive e-commerce strategy in place. To-date, this multifaceted plan includes delivering omnichannel experiences for customers in apparel, prestige beauty, online pharmacy and groceries. We will continue to update you as we invest in these promising online businesses.

Operator, please open the call for questions.

### QUESTIONS AND ANSWERS

#### Operator

(Operator Instructions) Your first question comes from Jim Durran from Barclays.

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

I just wanted to follow on Galen's comments about the e-commerce. Can you give us any idea as to what percent of revenue your e-com platform currently would present? Or how many are the click-and-collect enabled stores? I assume you're going to some of your bigger volume stores. If you can give us any sort of size of how consumers are now exposed to e-com from a positive benefit standpoint.

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

Yes. So is the question how much approximate national coverage we have, or is the question what's the sort of expected penetration of sales in the individual stores?

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

Well, I'll take both, but I'll start off with, if 200 stores by year-end, I assume as a percent of revenue is far greater than it would be as a percent of store count.

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

Yes, I think that's fair to say. We have -- they are all at various levels of maturity as well, so the ones that have been opened longer would have higher penetrations of the existing sales base. We have good clear numbers on a portion of that, which is actually incremental which is very promising. And then in terms of geographic distribution, we're now covering all geographies. Although, as you can imagine, where we have a high level of density in some of the major markets as opposed to others. I think at this stage, that's probably all I can give you.

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

Okay. So just shifting gears then. Home delivery, is there any thought about moving to a home delivery model incrementally to click-and-collect? And if so, when might we see that in the market?



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

Yes. So look, we've said for a long time that we believe that click-and-collect has a very, very high level of customer appeal. We see that in markets that are more mature than Canada. Places like France, the increase of click-and-collect propositions in countries like the U.K. However, there is a delivery model that you see in many of these countries as well. And at this stage, we still feel that click-and-collect should be the predominant strategic focus for our business. But our job is to meet customers' needs and customers tell us what they want and to the extent that delivery needs to become part of that, we are certainly open to considering it. And at this stage, we don't have any announcement to make about that.

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

So as we think of fiscal '18, is e-commerce another potential drag incrementally to the minimum wage in drug reform? Or how are you viewing it's deployment in 2018?

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

Yes. It's a little too early, I think, to comment on what the outlook for 2018 is. As we said in our press release, we're working hard to overcome specific cost inflation issues. Things that weren't to say in our long-term plan. We've also been pretty clear that we intend to make investments in the future. We have our strategic initiatives, and at this point, we don't see any reason to slow down our planned investments in those areas.

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

Okay. And on Québec drug reform, I assume you're in the same boat as everybody else that you know you're not going to have tendering, but you don't really know exactly how the metrics are going to work on the eventual 40% drop in generic drug price cost.

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

You're saying specifically in Québec? Or are you asking about the rest of the country?

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

Well, specific to Québec. I mean, I am assuming that either through the national buying group or other provinces deciding to mimic or adopt what Québec has done, there's obviously, [contingent] risk. But within Québec, as you said here today, how far are you from knowing exactly how it's going to be deployed?

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

Yes. So -- I mean, as you know, this is very recent news, so we are processing it and are trying to develop our best estimates and what the impact will be and ultimately, how those impacts are going to flow through the business. And that's clearly what we need to do inside the pharmacy business and elsewhere to try and mitigate that impact.

**Operator**

Your next question comes from Patricia Baker from Scotiabank.



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

I have a few questions. And thank you very much for sharing with us the impact of the minimum wage in 2018, very useful number to have. But I guess the most important thing is the work that you're doing now with respect to coming up with strategies and plans on how you can mitigate that. Would -- Are you -- when you get -- I understand that you're not there yet and you can't share with us the degree of mitigation and that's probably the most important number we need to look at right now. When you get that work done, will you be sharing with The Street and perhaps providing some sort of guidance of what (inaudible) '18 will look like or how much realistically think you can offset in the first year?

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

Look, I think to the extent that we try not to give guidance, we don't give guidance as you know. But later on in the year, Q3, or more likely in Q4, we'll share what we can if there's any kind of impact on our traditional outlook. As we said, our focus is to close the gap and to do everything that we can to do that. And I think what we are flagging today is that these are big numbers. And so we are going to have to move outside the realm of our expected plan to close the gap and we're going to work really hard to do it.

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

No, I certainly understand that and I'm sorry to belabor this, but I really want to get out -- I really want to understand exactly what you're messaging is here. And so initially when I listened to 190 certainly a big number, then we've got the pharmacy as well. And I thought, you were sort of saying you do everything, but it looks like it's a pretty big ask to offset all of that in a 12-month period. But now, just listening to what you just said to me about closing the gap, you're sort of indicating that you've got the confidence that you're going to be able to come up with a plan where you can -- you will be able to cover up all of that. So I just want to make sure what I'm interpreting and be directionally more accurate.

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

Yes. So to be I think very clear, we are not providing an outlook today on 2018. What we are doing is, we are flagging a significant set of financial headwinds and the organization is mobilizing all of it's resources to see whether or not it can close that gap. At this point, we don't know the answer and when we have more clarity on the subject, then we will make sure that we include it in our disclosure.

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

Okay, really appreciate that. Now completely different, everybody's talking about online, we're focused on minimum wage or focused on drug reform. But one of the other big things that's happened and is a topic when we talk to investors, it is hard discount and I realize that, that's in no way shape or form a near-term headwind for the Canadian grocery industry. But I do -- it reminded me that a few years ago, I can't member how long ago, you guys were testing a concept that was looking at the viability of a real hard discount model in Canada and that was The Box and I think you're out of that business now. Would you be willing to share with us, kind of, what you learned, what you were testing, what worked, what didn't work? Is there any insight we can get from that exercise?

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

Well, I'll try and give you some high level sort of perspective. So we learned a lot, first of all, and it was a very good exercise. Clearly, we concluded that sort of developing our own small hard discount box was not a strategy we wanted to pursue. It's fair to conclude on that basis that we have a lot of confidence in our existing hard discount formats. We think they bring an enormous amount to bare, and that they are powerful assets that, with the right strategic tactical and operational improvements, are the place that we are going to fight any eventual arrival of the German hard discounters. I am proud to say that as of, I think, it was last week, the Maxi business was recognized as the favorite supermarket in the province of Québec, which is something that we are very proud of. And I think is an indication of how strong and how resonant certainly our hard discount formats are across the country.



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### Operator

Your next question comes from Tal Woolley from Eight Capital.

### Tal Woolley - Eight Capital, Research Division - MD of Equity Research

I was just wondering, Galen, if we look back to the entry of Walmart slightly over a decade ago. And if you could compare the size of the competitive threat coming from future omnichannel entrants. Do you see the size and the risk of the competitive environment as similar, greater, lesser? And then maybe, also there's a tremendous amount of work Loblaw did to get prepared, to reorient the business around discount retail. How do you see the quantum of work that needs to be done to reorient the business around online? So just, yes, comparing the size of the threat and the amount of work internally that you think compared to that challenge just over a decade ago.

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

Well, that's a big question. Typically, I don't think it's our place to comment on the strategies of other retailers or other competitors. We certainly have, in our own analysis, strong comparisons between the -- this very different and very compelling threat that omnichannel, and particularly Amazon, represents to Canada. We did the same level of assessment as you correctly point out when Walmart was arriving in the Canadian market as many as 15 years ago. One of the advantages that we have is we can see with 5 or 6 years of advanced notice about how certain categories or how certain formats compete and fare against these new models in the United States. That gives us an extra level of intelligence on exactly what the most effective strategies need to be when these new entrants come into the market. There have been lots of speculation about retailers of one sort or another over the years taking over the world, that hasn't happened yet. And that's not because these formats or these concepts are not incredibly powerful and incredibly innovative. It's because the retailers who are facing those threats respond. They make strategic changes, they take costs out of the business, they change the way that they meet customer demands and you should expect us to do similar things. And as I said in my comments, we have a thoughtful and robust multifaceted e-commerce strategy. We feel confident about that strategy and it's sort of potential for us as a business. But we are still in the very early stages of it and it's going to take years for these things to play out.

### Tal Woolley - Eight Capital, Research Division - MD of Equity Research

Okay. And just one follow-up. Owing the rollout of SAP across the organization. You discussed in your opening commentary about addressing an omnichannel offering across all of your retail platforms. Does having all of that in place make that process less daunting than maybe it would've been in the past?

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

Yes. So even in the face of these 2018 costs, the fact that SAP is now fully embedded across the entire breadth of the non-Shoppers Drug Mart parts of the business. Now the tools, the processes, the things that we can layer on to that get far, far, far more powerful. A great example of that, we'll launch a new promotional management tool in the later stages of this year. We expect that to significantly improve the accuracy and the efficiency of the way we bring promotions to market across the business. That simply would not have been possible had we not successfully deployed and embedded SAP.

### Operator

Your next questions come from Michael Van Aelst from TD Securities.



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

Looking at the inflation trends, the price -- food price has been moving higher since, I think, it was October of last year. It looks like deflation could disappear in the next few months. But now we're seeing the strong Canadian dollar as well start to have an influence. So can you -- how do you see inflation trending? And in the last quarter, you said you don't expect inflation this year. But how do you see it trending at this stage? And what do you see the impact of the stronger Canadian dollar being?

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

Yes. So I think to be clear about my comments in the last quarter, what I said was, I did not see a return to high inflation. But there has definitely been a moderating force and that's really the function of us lapping prior years of -- prior quarters of aggressive deflation. Circumstances are changing. The Canadian dollar increase tends to have a deflationary effect. I wouldn't say that we were anticipating that. Incremental costs are coming at retail that historically has had an inflationary effect. And then you have competitive threats that the industry is anticipating which is likely to have a deflationary effect. So at this point, I continue to be of the view -- I'm committed and I think as a management team, we're committed to being as competitive as necessary to maintain our position. And as far as predicting where inflation is going to go, that right now, is a bit of mug's game.

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

Okay. Can you give us some color on the one-time items in SG&A line?

**Richard Dufresne** - *George Weston Limited - President & CFO*

Well, Michael, it's a few legal things that we faced in the quarter. And so that's why we call them one-time because we don't expect them to be recurring.

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

Okay. And then so they didn't slip into Q3 at all?

**Richard Dufresne** - *George Weston Limited - President & CFO*

No.

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

And then the financial services side of the business, you don't talk about that much, but the revenues were up 5%, but margins got hit. Can you explain what's going on there and what we should be expecting from that division?

**Richard Dufresne** - *George Weston Limited - President & CFO*

It's a little bit more -- we are pushing a little bit more on our high end-cards, which essentially come with higher loyalty costs and so that's effectively what we've seen in the Financial Services business in the quarter and that's what we expect for the next few quarters.

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

So you are expecting the higher revenue (inaudible) here but the significant margin contraction to stay in place.

**Richard Dufresne** - *George Weston Limited - President & CFO*

Some margin contraction, yes.

**Operator**

Your next question comes from Kenric Tyghe from Raymond James.

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

Galen, could you speak to your food deployment and shoppers, and perhaps more specifically to some of the key learnings from that food deployment and how that might impact you or later in your refinement of that rollout going forward?

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

Absolutely. No change from what our comments in Q1. So we continue to be very, very, very pleased with the performance of the fresh food deployments in the urban markets. We continue to work in some of the suburban pilot areas to determine exactly what the right suburban model is going to be. And as a vote of confidence in the urban proposition, we opened our first store at the end of the first quarter in Vancouver, and we continue to open fresh food enhancements in Shoppers Drug Mart in Vancouver.

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

And Galen, and a follow-up on that. Is part of those, the confidence around that offering reflects the cross coordination of Optimum and PC Plus, is that how you're getting this offering as right as you are getting and your initiatives with respect to loyalty moving ahead on the back end as expected?

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

Yes. The loyalty analytics and using that information to make better merchandising decisions both in food, drug, front-of-store, these are all -- this is a major priority for Sarah and for the organization. And we are seeing promising results, pretty much across the board. And we are seeing promising results in food in Shoppers Drug Mart -- fresh food in Shoppers Drug Mart. I think what's at the heart of the success is that people are looking for a pop-up fresh food shop that is very close in proximity to where they live. And so high density urban markets, it's a natural. And instead of customers coming in to buy aggressively promoted Pepsi or milk customers are coming in with more frequency to pick up fill-in fresh baskets, that has a very positive effect on margin and an equally positive effect on sales.

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

And then just a final one from me, Galen. How is your use of loyalty and loyalty analytics impacting your private label business on your -- on President's Choice and the like? Is it proving effective in terms of your private label penetration as well?



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

Well certainly, it's helping us make smarter decisions. Is it the biggest driver of our controlled brand success? I don't know the answer to that. But what I can say is that our controlled brand performance is something we're very pleased with. It continues to grow both in Shoppers Drug Mart and in Loblaw, led by President's Choice, but no name is also very strong. So you will see us continue to invest in that area and using more customer specific data to make better decisions will be a part of that plan.

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**Operator**

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

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

Could we just spend a couple of minutes please talking about competitive intensity, competitive activity? And when in the past, Galen, you alluded to this, we've seen periods of cost pressure. How has that typically played through in terms of offer, pricing and what gets absorbed versus what gets passed on?

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

Oh goodness. I don't think I'm expert enough on history to comment much about it. I think the way to try and analyze this is to look at today and to try and understand what the incremental competitive pressures are ultimately today, and what they're likely to be in the short term or, let's say, the short to medium term. Now that's the way we're looking at it. And I think meaningful cost inflation that translates into meaningful price inflation is not a good thing for the long-term health of the industry. So certainly from our perspective, our priority is to be as competitive as possible, both in today's market and in anticipation of the threats that we see in the future and we will do everything we can to maintain that and to try and deliver against that financial plan.

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

That's very helpful. Can you talk a little bit about what you saw in Q2 around consumer behavior, discount versus conventional, where the traffic trends are? And also, you mentioned private label. What's been the response of consumers to some of the PC organics in the discount boxes? In project.

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

Yes. So probably the starting point is, no meaningful change in consumer trends between Q1 and Q2, and there hasn't been a radical change for the last couple of quarters. There is still an enormous appetite for better value and where we invest in price intelligently. In our market divisions, we see a good response and where we invest intelligently in our discount business, we see a very good response and also the building of a profitable business. What we're trying to get away from aggressive investments in the discount business that are essentially buying sales or buying share and then don't actually build new business over the long term. Our access to data is really helping us make better decisions. You saw that in Q2 in the way that we dialed back some aggressive promotional programs in the discount division in Q2 from last year. So I think it's the same. Discount is a strong area for growth and as you put organic products in the discount business, we see a pretty strong response. So we feel pretty good about our discount business today and we think we're bringing product offerings to market that our other discount competitors struggle to match.

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

That's very helpful. And just if you could provide a little bit of color again. You did -- you mentioned food in OTC at Shoppers and front of store, can you talk a little bit about beauty and anything else that stuck out in the quarter in terms of trends?

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

So again, I think a steady quarter for all aspects of Shoppers Drug Mart. But notable would be this appalling, cruel spring and this very disappointing weather in the summer. I am learning that the Shoppers Drug Mart business in some respects maybe more impacted by some of these things. So allergy season, that's a big part of the Shoppers' OTC business. Sunscreen, that's a huge part of the seasonal Shoppers' business. Both of those have traded in a very unusual fashion relative to prior years.

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

And just finally one last one. One is from the subject of poor weather. I'm assuming that we're seeing lower sales of barbecue-related items as we go even in early Q3.

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

Yes. That's another garden -- on the food side garden centers, barbecues, seasonal GM, these are all places that have struggled.

**Operator**

Your next question come from Vishal Shreedhar from NBF.

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

I'm going to jump back to one of the questions that's been asked before maybe to see if you can give me a little bit more color. Investors have come to think about Loblaw delivering on a growth framework. That's quite a (inaudible) to you and your team over the years, changing the perception on Loblaw that in fact values the expectations or requirements of your minority shareholders. And me, so I could be wrong, I think of this framework something like a low single-digit topline, some operating leverage and that translates something like a low double-digit EPS. That's kind of my thinking about it. And I know you've highlighted these 2018 challenges. So that to me is a partial 2018 outlook, I understand you're still looking into it. But I guess my question is like this, do you perceive these challenges are so significant that, that framework or that investor promise maybe isn't the right word, that could be impaired? Or are we not there yet?

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

Well, certainly, in our comments, we don't believe we're there yet. And if that were to change, we would certainly let you know.

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

Okay, wonderful. Loblaw's balance sheet, steadily improving cash flow continues to build. Maybe you can talk about your view on how that (inaudible) deal has progressed when you made it versus where you are today, if you're pleased with it or not? And Loblaw's appetite for future acquisitions?

**Richard Dufresne** - *George Weston Limited - President & CFO*

Sorry, Vishal, I'm not sure I got the question.



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

Sure. So just talking about appetite for future acquisitions.

**Richard Dufresne** - *George Weston Limited - President & CFO*

Our focus remains like it's been a few years since we completed the Shoppers' acquisition but we still have a lot of work ahead of us and that remains our focus. We've got a series of strategic initiatives that are going to be key to driving growth in the business and that remains our focus as of today.

**Operator**

Your next question comes from Mark Petrie from CIBC.

**Mark Robert Petrie** - *CIBC World Markets Inc., Research Division - Research Analyst*

I just wanted to follow-up on a few things. One, I guess, just on the competitive environment comments, have you observed any change in any specific geography or channel, be it discount or conventional?

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

No. But we are competitively positioned across really all 3 of our big retail divisions. It's always true that there are ebbs and flows depending on the geography, but nothing that I would consider significant in the context of our broader strategy.

**Mark Robert Petrie** - *CIBC World Markets Inc., Research Division - Research Analyst*

Okay, thanks. And just circling back on click-and-collect, could you just give us a bit of an update in terms of the trends that you're seeing in that business, be it bigger basket and regular price, promotional price mix? And then, I guess, in your mature stores, would you say that those are now profitable on that click-and-collect business?

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

Yes. So we're, I think, not ready to comment on our view of the financial outlook for click-and-collect. We consider it a very promising channel and we look at the investments that we make in click-and-collect with a rigorous return on investment framework. And we also look at it through the lens of what is it that customers are interested and what are they going to demand from us as a retailer in the future. Very simply on the topline on how is the customer shopping. So typically they have a larger basket. This is in part driven by the fact that they are consumers typically who have bigger baskets. But we are also seeing an incremental shop. These are people who are motivated by convenience and if you can serve up products that meet those convenience needs intelligently, they are prone to adding incremental items to the basket.

**Mark Robert Petrie** - *CIBC World Markets Inc., Research Division - Research Analyst*

Okay, thanks. And then just back to your opening comments around intensifying focus on cost reductions and you outlined some of the tactics and plans that you have in place or will be pursuing in order to address that. But I wonder if you could just comment in broader terms about the culture of cost containment within Loblaw and Shoppers. And where that stands today versus maybe a few years ago. And if you feel like that is -- that's been part of the change or if that needs to continue to evolve?



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

I would say that we are significantly ahead of where we were 3 years ago, and I would say that as a management team, we believe we have some distance still to travel. And there is opportunity as the culture gets more and more increasingly cost focused, we will get at increasingly more cost opportunity.

**Mark Robert Petrie** - *CIBC World Markets Inc., Research Division - Research Analyst*

And is that simply just making it part of the everyday rigor of how do how you do business? Or how do you actually go about that cultural change?

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

It's a combination of things. It's toned from the top. It's how you manage the smallest expenses and how you make decisions about the largest expenses, ultimately, choosing what to prioritize strategically and what to leave for another time or another year. There is no silver bullet, I think, to becoming a cost-oriented culture. I think our business is complex, it will always be complex. So the techniques that we use and need to use more to improve our cost base are not the same techniques that a mono-format hard discount concept would use. Technology, process improvement, these are the kinds of things that we need to focus on as opposed to things like having to steal your pencils from hotels because there are none available in the office. That's not the culture that we aspire to. There are other ways in our judgment to become a more cost-oriented business.

**Mark Robert Petrie** - *CIBC World Markets Inc., Research Division - Research Analyst*

Okay, thank you. And then one other question with just regards to Sanis within the Shoppers' business. Could you just give us a sense of penetration of Sanis products within the generic business overall? And then broadly speaking, is that business relatively evenly spread in terms of geography across the country? Or are you more developed in certain provinces or regions?

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

Well, let me get back to you on the specific number of Sanis. Suffice to say, is a high penetration and very important part of our business model when it comes to the pharmacy business and we think that there is opportunity. It wouldn't be appropriate for me to comment there. There are different regulatory environments in each of the provinces that have an impact on what the penetration is by geography and it wouldn't be appropriate to comment on where we're stronger versus not.

**Operator**

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

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

Just a question on Shoppers Drug Mart. I know you do not provide segmented reporting below the same-store sales line. But I am just wondering, in this environment of ongoing drug reform, as I recall before you acquired the company, the operating profits of the company were kind of flat to -- kind of flattish in this kind of environment of ongoing drug reform. Are you prepared to say qualitatively, is that how you Shoppers Drug Mart continues to perform in this kind of environment because this drug reform halo just seems to be never ending. Just wondering if you could comment qualitatively at least.



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**Richard Dufresne** - *George Weston Limited - President & CFO*

Well, what we've said, Peter, is that since we've acquired Shoppers, we've actually been able to grow earnings and more than offset the impact of drug reform.

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

Okay. And the other question I had just on shrink. It seems quarter-after-quarter now you're recording that you're making improvements on shrink. And I'm just wondering what's underlying that. Is the implementation of the SAP facilitating that? And are there other factors at play?

**Richard Dufresne** - *George Weston Limited - President & CFO*

Yes, it's essentially SAP, which is providing us much better information about shrink and so we're now able to attack it from different points and it is getting better. So from a rate perspective, (inaudible) shrink since last year markedly, and we still see it as an opportunity for the future.

**Operator**

Your next question comes from Patricia Baker from Scotiabank.

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

Quick follow-up on the good information you provided in answer, I think, to Mark's question on click-and-collect and you talked about the better basket -- the larger basket and incremental shop. Am I right in assuming that the mix in that basket is also favorable?

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

Yes.

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

Okay. And you also talked about in the quarter, mix being a factor. Can you talk specifically about what specific items are driving the better mix overall in the business?

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

I won't go through the entire list. I'd say, it's broad-based and part of more intelligent merchandising plans focused specifically on trying to build the basket and to do work in a way that improves the mix as opposed to dilute the profitability. But one specific example, it's been a real focus both of the market division and of the discount division is [club back]. And as you can imagine, club back increases the average ring. It allows us to deliver the customer superior value. And we do see a very, very positive take up from our customers on these kinds of specific offers. We over-index in club back and controlled brand which contributes to growing our controlled brand penetration. So these would be the kinds of things that the teams are working on.

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

Okay, that's useful. It sounds, Galen, like you've also got a better handle on being able to measure the efficacy of different programs whether you're add effectiveness and whatnot appears well.



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

Absolutely.

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

Okay. And then, forgive me, if I missed this, but did you give a number for the impact of the drug reform? Pan Canada?

**Richard Dufresne** - *George Weston Limited - President & CFO*

No. No, we didn't.

**Operator**

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

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

Just a quick follow-up, please. In terms of the proceeds from the sale of the gas bars, anything you would like to share or you're prepared to share with us in terms of potential, let's say, stepped up NCIB, or what your thoughts are there?

**Richard Dufresne** - *George Weston Limited - President & CFO*

No, general corporate purposes, Irene, that you will know that, if you look at share buyback this year versus last year, we upped the pace a bit.

**Operator**

(Operator Instructions) Your next question comes from Keith Howlett from Desjardins.

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

I had a question on your specialty banners like TNT and Fortinos and the movement of, I guess, multicultural products elsewhere throughout the chain. I wonder if you can just comment on how those banners are doing or how that process of broadening the consumer offer is going.

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

Yes, absolutely. So TNT has had a banner year and terrific business, really doing an excellent job across the country of meeting the shopping needs of the Asian consumer. And Fortinos has always been a very specific format for the Hamilton, Burlington, Brampton area. That business continues to perform well. And the broader multicultural strategy which is getting out expertise from those businesses and deploying the products and the promotional strategies elsewhere in the network is something that we are very pleased with as well. It's hard to do. It is a key point of differentiation we think for incumbent retailers in Canada, and we are very pleased with our own progress on that front.

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

And then just on the online. Is -- are meal programs or subscription services -- meal subscription services something that you would be studying or looking at or contemplating?

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

I'm not quite sure how to answer the question. I don't want to leave you with the wrong impression. But we look at all of these things because they are all aspects of how customers think about eating food and there are so many different models that are being tried, that are being tested, many of them that are being spun up in different parts of Canada and a whole other raft of them that has been -- that are being deployed in some cases achieving meaningful scale the U.S. So we keep our eyes and ears open. We look out opportunities to partner, in certain cases, to test these concepts. What I would say is, which ones are going to work, which ones aren't, is still a long way from being proven. So our strategy is pick one we think that is the best for us and we've commented on click-and-collect in food as being the right channel. But keep our options open to see what other services gain traction and adopt them or partner and deploy them as appropriate.

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

And then just if I could on the drug reform issues, I just had two procedural questions. One, whether you've actually threw your Sanis division or another ways seeing the actual agreement between the Minister Of Health of Québec and the Chairman of Drug Industry. That's the first question. And the second question is, whether you have any superior insight than I do or than we typically do here on the sale side on how quickly the Council or the Federation will reach an agreement with the drug manufacturers.

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

So -- look, this is very recent news. We have a good proactive relationship with the Québec government. We have a good proactive relationship with the Council of Federation. But at this point, it would be too early to comment on exactly how it looks or what we anticipate happening.

**Operator**

(Operator Instructions) We do not have any questions at this time, Mr. MacDonald, I will turn the call over to you.

**Sophia Bisoukis** - *Loblaw Companies Limited - VP of IR*

Great. Thank you everybody for your time this morning. As always, if you have any follow-up questions, please give me a shout after the call. And Mark your calendars for November 15, when we will be discussing our Q3 results. Thank you very much, everybody.

**Operator**

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



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