

Imasco Plan 1995-1999

A CEC meeting to discuss the key issues arising in the Imasco Plan for 1995-1999 was held in Louisville on 21st October 1994.

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Present: Mr M F Broughton, Mr D P Alvey, Mr U G V Herter, Mr P Crawford, Mr B L Levitt, Mr R E Guyatt, Miss H C Barton.

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**Canadian Economy**

1. GDP is expected to grow at 4% to 4.5% p.a., but real interest rates are high reflecting the high debt levels. Unemployment is expected to fall below 10% in 1995 but inflationary pressures are unlikely to be felt until it reaches about 7%.
2. The government's objective is to reduce its debt level from 4.75% of GDP to 3.5%, which would require reducing the debt by C\$6bn. Higher taxes would drive business away from Canada while cutting social programmes is very unpopular. The Budget is due in February.
3. There will be a referendum in Quebec on separation within the year. The polls are currently showing 60% against separation. A Yes vote would lead to a chaotic prospect of negotiations on how to split the government debt, the ownership of assets, and recognition by other governments.

**Financial Performance**

4. The recently published Q3 1994 results were up 27% on prior year and were 17.6% above plan, with strong performances across the board, but particularly in tobacco.
5. A 15% dividend increase has been built into the 1995 figures for planning purposes, but a substantial increase is expected, to achieve a 40% payout ratio.
6. Capital expenditure is projected to increase in 1995, due to Shoppers Drug project "Eagle", and the investment by Imperial Tobacco of C\$30m in a primary at Guelph.
7. The share buy-back is believed to be a good investment. The cost, at C\$37 a share, would be about C\$80m.
8. There is a dialogue between CT and National Trust about joint activities, such as an MIS benchmarking exercise. Although an acquisition of NT now seems unlikely, the principle owner has expressed some interest in taking Imasco stock, although this would dilute BAT, albeit only temporarily.

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### **Imperial Tobacco**

9. **Cost Competitiveness:** Imperial Tobacco is conducting an activity based costing exercise with external benchmarking which will be presented to the CEC in December. It is showing that a few products provide most of the value, and it may lead to the closure of Montréal, although the issues are not simple. An implementation plan is expected in Q1 1995.
10. **"Triple I" - Integrated Information at Imperial:** Consultants are being used to design and implement a cross-functional information system that will lead to productivity and communications improvement. Implementation is scheduled for January 1996. The system, SAP, is German and is already used by BATCF.
11. **Competitors:** RJR's Montréal factory is operating at capacity, providing exports to Asia. This is likely to be a temporary position as a result of the US Leaf content law, which is changing to a quota system. RBH is more dynamic than RJR in Canada, but RJR has lower costs.
12. **Leaf:** Leaf will be a key issue to be examined in 1995. Increased demand is leading to leaf constraints which is driving changed blends. The Canadian leaf price is slightly higher than the world price. The industry negotiates with the government marketing board. It could reduce its purchases, but this would need to be done incrementally.
13. **Plain Packaging:** The government had no evidence that plain packaging reduces smoking, therefore it is now seeing whether it can collect such evidence. Plain packaging would cause a problem for printers, it would provide another opening for smugglers, there may be retaliation against Canadian trade marks outside Canada, and there may be a claim for compensation by the trade mark owners. Imperial Tobacco is discussing the developments with Wills, Australia, and is developing alternative packs for a variety of outcomes.
14. **Smoking Issues:** Imperial Tobacco should liaise with Brown & Williamson about actions to stop under-age smoking, and the issue will be raised in the next Smoking Issues meeting. Imasco's new VP, Corporate Affairs, should attend the meeting.
15. **International Development:** If the Canadian market continues to decline and costs are reduced as much as possible, Imperial Tobacco will achieve earnings growth only by developing internationally. A presentation will be made on this to the CEC in December.

### **Canada Trust**

16. **"Best personal bank":** CT is focusing on the needs of individuals. It aims to become relationship driven, which means offering a competitive array of products and services. Services such as broking, insurance and personal loans are being added to fill gaps in the range.

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17. By Q2 1995, CT will be able to give customers one comprehensive statement covering their whole relationship. CT will be one of the first banks to provide this, but it will quickly become a necessity rather than a competitive advantage.
18. The selling approach will be to have relationship managers supported by product specialists. The customer will be able to choose the distribution channel he prefers from ABMs, branch, telephone, and the charges will be the same.
19. CT has offered mutual funds for three years only, but already has C\$4bn mutual funds under management. This success is credited to the strength of the CT name in wealth management. Earlier in 1994 when mutual fund redemptions were running at a high rate, most of the funds were transferred into CT deposits, demonstrating the strength of offering a range of products.
20. Not all the products offered need to be CT's own products, as CT seeks to offer the most competitive product. It is unlikely therefore that it would seek to manufacture its own Life or P&C products when this is permitted.
21. CT believe that it will have the advantage of offering a full range of banking products, without behaving like a bank or being perceived as a bank. It is perceived as having higher friendliness, and it tries to meet its customers' needs, for example, through Saturday and evening opening.
22. A second telephone banking centre has been opened in New Brunswick, mainly for enquiry and bill paying. A PC-based system is also being developed. CT's criterion for offering a distribution channel is that it should offer the best service from the customer's point of view.
23. **Cost Competitiveness:** CT's cost/income ratio is 65%. The average for Canadian banks is 61% but this is made up from a mixture of Commercial and Retail business. The Retail cost/income ratios are believed to be in the 67-70% range. The re-engineering work has produced good results with a 10% reduction in staff, and flat salaries. Expenses were increased by government mandated deposit insurance premium increases, the addition of brokerage, and severance costs in the first half of the year. CT are targeting one percentage point per annum improvement in the cost/income ratio. CT will be asked to discuss some of their work on cost/income ratios and product costings with the CEC over dinner in December. The CEC expressed disappointment at the slow progress in reducing the cost ratio.
24. **First Federal:** The possibility of FF products being sourced from CT are being examined. FF's cost/income ratio is 61% compared with about 50% for US Savings & Loans. However, the accounting systems are different, for example, the amortisation of mortgage acquisition costs.
25. During 1995 Inasco will be considering their future strategic direction in the US, including whether and how value can be added to FF.

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### Shoppers Drug Mart

26. **Project Eagle:** Shoppers will centralise distribution into three centres by Q1 1996 which will reduce the inventory in the stores. The management of the distribution centres will be outsourced. The administration will be centralised, reducing the need for accounting, book-keeping and auditing at the individual store level.
27. Gross margins are being held flat which is an excellent performance given the entry of Walmart into the Woolco stores with big drug sections and many other common SKU's. Profits are expected to be flat in 1995 and 1996 while the changes are implemented, and then to increase strongly from 1997 onwards.
28. **Prescriptions:** 40% of prescriptions are paid for directly by the government and most of the rest are reimbursed. The government, employers, insurance companies and drug stores all have an interest in the future of the market and are attempting to control the outcome. Government purchasing effectively sets the drug prices, removing the possibility of competing on the acquisition cost of drugs, for example, by volume rebates from manufacturers to retailers. Shoppers is developing preferred provider arrangements to assist employers to prevent their costs rising, without having to reduce Shoppers' own dispensing fee.
29. The mail order dispensing business which has proved successful in the US has been unsuccessful in Canada so far, because the companies cannot buy more cheaply as a result of the Government's rules.
30. Independent pharmacists are under increasing pressure from competition, government reducing the dispensing fee, and the probable loss of tobacco sales. There is likely to be some consolidation, providing opportunities for Shoppers to buy prescription lists.

### Hardee's

31. **Consumer Positioning:** Hardee's positioning is not distinct enough, and its execution does not live up to the position it says it has. Some fundamental customer segmentation work is being carried out. Concept modifications will be tested in the first half of 1995, supported by advertising. Results will be known in one year's time.
32. Hardee's believes that it stands for taste, freshness and variety. It has a more senior image than McDonalds which is more attractive to "kids" and people not looking for food quality. Hardee's is known for its breakfast, and it is the second biggest chicken business in the US after KFC.
33. **FFM:** Manufacturing is not a strategic part of Hardee's, and a buyer is being sought for FFM manufacturing.

### UCS

34. There are some buyers interested in acquiring UCS. Imasco would be prepared to sell it for its book value of C\$18m.

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**Genstar**

35. Genstar is continuing its plan to ensure that it is a low cost producer. It is a long cycle business. In 3 to 4 years' time the profit will be at about C\$50m based on the current land inventory. The figures included in this plan are more realistic than those in last year's plan which were unduly low.

**Imasco**

36. **Management of Change:** Until the last two or three years, Imasco would have characterised itself as a strategic monitoring company. More recently it has become more closely involved in driving forward actions within the companies. The mechanism for this is the use of the business development group and outsiders to focus on the process, agree the issues and ensure the quality. Once the process has become continuous by being institutionalised in the companies, Imasco will not be so directly involved.
37. **Shareholder Value:** A realistic target for Imasco's share price is C\$45, compared with C\$37 today, based on DCF calculations, comparisons of P/E ratios, and analysts' recommendations.
38. The Canadian stock market is dominated by resource stocks and hence has a high P/E ratio and low dividends. In contrast, both Tobacco and Financial Services companies have low P/E ratios. Imasco's dividend is at the top end of the range, with a yield of 4% compared with the average of 2.5%. Over the past four years, earnings have increased faster than dividends, but Imasco is now seeking to return to a 40% payout ratio. BAT's experience is that an aggressive dividend policy supports the share price providing the market believes that the dividend can be maintained.
39. Imasco's institutional investors like the share buy-back scheme. The possibilities of splitting the stock, and of obtaining a US listing, are also being considered. BAT will consider the impact of the share buy-back, and the proposed dividend policy, on BAT, and give the feedback to Imasco as soon as possible.

**H C Barton**  
12th December 1994

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