

Imasco Plan 1994-1998

A CEC meeting to discuss the Imasco Plan for 1994-1998 was held in Windsor House on 7th January 1994.

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

1993 Estimate

1. Earnings from operations are estimated to be C\$23.8m lower than shown in the Plan mainly as a result of the sale of the Roy Rogers branches, but also due to lower profits from UCS in the crucial Christmas trading period. This shortfall is recouped mainly through lower income taxes, so earnings per share are now estimated at C\$3.17 (up from \$3.15 in the Plan although below the original budget of C\$3.25), but may rise slightly on finalisation of the numbers. Cash flow in the final quarter was much stronger than forecast.

Economic and Political Outlook for Canada

2. Inflation is expected to continue at about 2%, and economic growth is improving mainly as a result of export growth. The actions of the new government have been well received so far. NAFTA has been accepted and is expected to be beneficial for Canada. The government is not currently suggesting increasing taxation to tackle the deficit.
3. Smuggled cigarettes are now about 50% of the market in Québec which is causing the government to lose revenue and is creating problems for small retailers. The government seems prepared neither to police the border effectively nor to harmonise tax levels with the US, leaving an unstable situation. If taxes were reduced, the government would probably ask the cigarette manufacturers to contribute by reducing their profit margins. It is expected that tobacco will be removed from pharmacies in Ontario somewhat sooner than previously anticipated.

1994 Plan

4. The Plan projections are slightly better than the Preview. There could be downside risks in both ITL and Shoppers depending on government action, in Genstar with lower land volumes, and in UCS which is now expected to make a loss in 1994. However other costs and administration and interest expense are expected to be lower than shown in the Plan.
5. Removing the impact of tax mix in tobacco and interest rate changes in CT, revenues are projected to increase by about 7% in 1994. Return on equity at 14% is approaching the objective of 15%. The EPS is running slightly behind the objective, and the level of dividends will be reviewed.

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Imperial Tobacco

6. 1993 volume is estimated to be higher than forecast in the Plan because some sales may have been pulled forward from 1994 into 1993. The Plan assumes no change in taxation. Canadian cigarette margins are high, therefore if taxes were reduced considerably, it would be possible for competitors to compete more effectively on price.
7. IITL has been very successful in supplying the Canadian taste for Canadian cigarettes, but if there continues to be a high price differential over US blended products, this preference may erode over time. IITL has cigarette stocks in the US, and contingency plans for manufacturing outside Canada and for producing blended cigarettes if necessary.
8. The Plan assumes 3% p.a. price increases but also that operating margins will improve by a further 2% p.a. either from higher price increases or from lower costs. A major strategic review of costs and the product range will report in June 1994. Over the medium to longer term, Mr Herter believes that it is not reasonable to plan to continue with two manufacturing plants for less than 26bn volume.
9. There is concern about the Leaf programme as the Ontario crop needs to be three times the total amount of Leaf that IITL uses in order to meet its quality requirements. Therefore IITL's Leaf costs are rising more quickly than those of its competitors, and the competition for Leaf exports is becoming more fierce.
10. 300m export volume may be possible in 1994 but is not included in the Plan. A small office is being established in the US to develop a fine cut niche opportunity. Mr Brown has visited China and is liaising with BATCO over the possibility of exporting there, but nothing is included in the Plan.

Canada Trust

11. CT has continued successfully to reduce staff by attrition during 1993, and has increased market share slightly for the first time for several years. CT's cost ratio at 65% is at the high end of the range of Canadian banks (60% to 66%). The Bank of Montreal at 60% is improving its ratio through the use of telebanking and ATMs. CT should be challenged to reduce their costs more quickly than planned to improve their competitiveness.
12. The biggest risk is that the deposit mix will change even more quickly towards mutual funds and away from demand deposits. Revenues appear to rise very slowly because interest rates are reducing. Spreads are also narrowing which emphasises the need for cost reduction. CT is also bringing in more Treasury expertise.
13. Very few new commercial loans are being made. It is considered unlikely that CT will need higher loan loss provisions than those in the Plan. On a like-for-like basis, CT provisions are at a similar level to the industry average.
14. CT are experimenting with a salaried mortgage sales force whose objective is to win new customers by providing their mortgage needs before they contact their own bank branches.

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15. CT already has about C\$30m revenue from credit life of mortgages and personal loans, and further insurance opportunities are being studied. The banks are becoming major providers of commodity protection products because their costs are lower than those of the insurance companies. A bank may not retail through its branches the products of its life assurance subsidiary, but it may retail the products of its life assurance parent. Therefore Imasco could introduce a life company between itself and CT and sell its products through CT branches. Liberalisation is expected perhaps by 1997 and Imasco will have contingency plans in place to take advantage of this. There may be some benefit from sharing experience with Farmers' life operation in Seattle. CT is less enthusiastic about selling P&C than Life products as disputes with customers may undermine the main banking relationship.
16. CT is still studying the possible acquisition of National Trust at about C\$1bn.

First Federal

17. FF's strategy to provide "all the needs" of their customers means that they wish to provide the same range of products as CT. It may be possible to do this profitably at lower scale in the US than in Canada because of the availability of external corporate services but may be seeking an unattainable objective. FF want to compete with non-deposit taking institutions who have lower costs, as they do not have to pay deposit insurance. Therefore FF are planning drastic cost reduction actions and ways to develop their asset gathering. Imasco and CT will work on defining FF's future direction.

Shoppers Drug Mart

18. Shoppers is thought to have peaked in its current format. However, Imasco believes that it has much potential from its market dominance and demographic changes. This potential will not be seen in 1994 as releasing it will require: changing the relationship with the franchisees; developing preferred supplier schemes for drugs; rolling out the new technology more quickly; improving productivity; growing corporate brands; and centralising accounting and buying.
19. Shoppers may suffer from price reductions later in 1994 as a result of actions of the Ontario government and major employees to reduce their healthcare costs, although neither these nor the possible restructuring charges are included in the Plan.

Hardees

20. Hardees has made an impressive recovery but Mr Broughton still does not see it as a long term member of the Imasco portfolio. The Plan concentrates on: customer segmentation and research in order to clarify positioning with respect to competitors; the re-engineering of the restaurant back room; and the redefinition of the role of FFM. The international business is small and its long term viability must be questioned. The Plan will be revised to reflect the sale of the Philadelphia Roy Rogers stores, which will benefit 1994. The Plan leaves the impression that Hardees responds to market initiatives but is not an initiator in its own right.

Genstar

21. The business continues to perform well. The Plan does not include projected land acquisitions because they are volatile, and hence it appears to show a run down which is not the strategy. Imasco are discussing with Genstar how better to plan for the business perhaps using three year rolling plans. Mr Crawford is concerned that the planning, performance measurement and incentive systems should not pressurise Genstar into buying land, which was agreed.

UCS

22. The 1993 loss is now forecast to be worse than that in 1992 and the profit turnaround is further away. The business has been more devastated by the increase in tobacco smuggling than expected. The new chief executive is writing off past problems such as old inventory. Loss making stores, including Den for Men, are being closed as quickly as possible. The future of the Woolco stores is unclear as Woolworths are questioning their continued interest in owning them. IFL may still have some interest in the distribution especially if the sale of tobacco in drug stores is banned. A major strategic planning initiative has been started with the objective of adding some value to the assets so that they can be sold.

H C Barton
17th March 1994

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