Start of Transcript

Operator: Thank you for standing by and welcome to the Woolworths Group Q3 sales announcement analyst briefing. All participants are in a listen-only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question you will need to press the star key followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr Brad Banducci, CEO, please go ahead.

Brad Banducci: Good morning, everyone, thank you for joining us this morning for the Woolworths Group third-quarter sales result for F18. Joining me in the room this morning is David Marr, our CFO; Richard Dammery, our Chief Legal Officer; Claire Peters, Managing Director of Woolworths Supermarkets; Dave Chambers, Managing Director of Progressive Enterprises; Dave Walker, Managing Director of BIG W; and last, but not least, Martin Smith, Managing Director of Endeavour Drinks. They will assist me in answering your questions today.

Today we're reporting group sales from continuing operations for Q3 of F18 of $14.2 billion, up 4.3% or 3.6% on a comparable Easter-adjusted basis on the same period last year. This result is despite cycling strong prior year sales growth and the impact of the New Year's Day calendar shift into Q3 from Q2 in F17.

In Australian food, our customers are continuing to notice the improvements we are making, with consistently high scores in our overall customer satisfaction and store-controllable Voice of the Customer. I should add that our store-controllable Voice of the Customer now includes an additional measure, an eighth measure, ease of pickup, reflecting the increasing the importance of pick up to our customers.

Australian food sales for the quarter were $9.6 billion, an increase of 4.7% on the previous year. Comp sales increased by 4.4%, or 4.0% on an Easter-adjusted basis, which was the result of strong growth in comp transactions for the quarter. We continue to accelerate our digital investments, aiming to deliver increasingly personalised and convenient shopping experiences for our customers. Our online sales growth for Q3 in Australian and New Zealand food grew at circa 30% and we delivered a number of key digital initiatives in the quarter, including the commissioning of two new customer-fulfilment centres, one in Melbourne and the second in Sydney.

We completed six renewals and 20 upgrades in the third quarter and we expect to complete around 70 renewals and over 50 upgrades by the end of the financial year.

Endeavour Drinks delivered pleasing sales growth, with an increase of 6.9% in the third quarter to $2.0 billion, with comp sales increasing by 6.1%. On an Easter-adjusted basis, comp sales increased by 3.3%. Dan Murphy's and BWS both delivered solid sales growth in store and online, with online sales growth of just over 20%. New Zealand food sales increased by 3.4% for the quarter to NZ$1.6 billion, with comp sales increasing by 3.5%.

Easter-adjusted comp sales increased by 3.8%, with a material improvement in comp transaction growth which was somewhat offset by less items per basket. New Zealand sales growth has been consistent with improving their promoter scores and has benefitted from our investment including [key lines], fruit and vegetables and online. Online sales momentum continued, with a strong increase in pick-up sales in particular.

BIG W sales increased by 3.2% to $770 million, with comp sales increasing by 3.3%. On an Easter-adjusted basis, comp sales declined by 1.2%, impacted both by the timing of the shift of New Year's Day into Q3 and the timing of school holidays in New South Wales.

Hotel sales for the quarter were $390 million, an increase of 3.3%. Comp sales increased by 3.2%, or 3.9% on an Easter-adjusted basis, with growth across all key categories and benefitting from the performance of our refurbished venues. Petrol sales for the quarter were $1.2 billion, were largely in line with the prior year. Easter-adjusted comp sales declined by 0.8%, with lower volumes offset by higher fuel prices.

In summary, we are pleased with our progress during the quarter and remain energised by the number of opportunities to continue to improve our business. I would like to thank our customers and our team for their ongoing support. Our focus for the remainder of F18 is on delivering consistently good shopping experiences across all of our stores and on all days of the week and continuing to improve our online offer. I will now turn the call over to questions and can I please ask that you limit your questions to two per person and re-join the queue if you have any thereafter.

Operator: Thank you. To ask a question please press star one on your phone. To cancel your question please press star two. If you are on a speakerphone please pick up the handset to ask your question. The first question today comes from Shaun Cousins from JP Morgan, please go ahead.

Shaun Cousins: (JP Morgan, Analyst) Hi, good morning, all. Just a question on food, I'm just curious about how your Voice of Supplier is going? You're sort of quite public and you've got a Voice of Customer and that's sort of moving in the right direction. I'm just curious how you're finding Voice of Supplier and if there's been any changes in recent quarters or the like there?

Brad Banducci: A great question, Shaun. Voice of the Supplier is up materially on where it was a year ago. But in the last quarter it plateaued; at an all-time high but still it was a plateau, so something for us to work on. What's in the context of the plateau, we actually got very good feedback for [adroit] business planning, the work that we're doing on the Grocery Code. The issue that we got a little bit of negative feedback on was accessibility of our team and we intend on working very hard on that, and a little bit of feedback on opportunities to improve the execution. So, look, still improved, we'd like to have improved. It's given us some focus going into our next [unclear].

Shaun Cousins: (JP Morgan, Analyst) Sorry, just on that accessibility of team, obviously you've had a lot of change there with Steve going to liquor and then…

Brad Banducci: Yes.

Shaun Cousins: (JP Morgan, Analyst) …Peter and Paul taking on. Is that accessibility to Claire or is that accessibility to [unclear]?

Brad Banducci: Yes, we think it's a combination of all of the above, in truth, Shaun. So just something for us to be clear on. Steve as you said has gone and Paul and Peter stepped up to really take on his portfolio and, of course, Claire's now firmly in the seat. So it's just really getting around and making sure we're accessible. But it is also, I think, just coming back to the basic courtesies of response times to suppliers and making sure they're good and focused. So the score hasn't gone down but it's given us something to focus on in terms of improvement.

Shaun Cousins: (JP Morgan, Analyst) Great, and my second question is just regarding BIG W. Obviously, you've invested in price and that's helping items per basket out. But your transaction growth has actually shifted into a slight negative, or flat at 0.1% down, but it was growing at 1.5% and 1.7% in the second and first quarter respectively.

What's driving that reduction in the rate of transaction growth? I'm just curious about how that plays out. Because that seems to have contributed to your shift back into negative comps even, and you're actually cycling a pretty undemanding comp as well in the third quarter, '17, as well please.

Brad Banducci: Yes, look, I think this is related to the points I made. You know, the move of New Year's Day into Q3 which we don’t adjust for but obviously is quite a large impact, as you know, because it's a zero sales day that comes into the quarter. So you get a direct impact from the number of transactions you have, this argument really does fall away from that.

Then the big difference, in New South Wales in particular, of Easter and school holidays being separate and the way we do our adjustments means that we actually adjust in a way that you could say sort of penalises the underlying trend line. So there's nothing we can see that alarms us on it. That said, we still have a long way to go and we're very realistic that we've got still a lot more work to do to attract new customers into our stores. We feel we're not doing a bad job of growing the basket of our core customer, but have a lot of work to do still on getting our non-core customer to shop us.

Operator: Thank you. The next question comes from Michael Simotas from Deutsche Bank, please go ahead.

Michael Simotas: (Deutsche Bank, Analyst) Good morning. I was hoping we could talk a little bit about the food pricing environment. So your headline deflation improved a little but it looks like it was driven by fruit and veg. Can you just talk more broadly on what you're seeing on an underlying basis, please?

Brad Banducci: Yes, so look I think, Michael, we still see, as we have said for the last couple of years, a very competitive but rational marketplace. I think it was quite a positive sign, in rationality terms, that we saw adjustments to bread prices and to roast chicken prices. Because they were, in many ways, very low in the context of margin that could be achieved in those categories.

Michael Simotas: (Deutsche Bank, Analyst) Yes.

Brad Banducci: So we're still seeing a very rational market. If I then come back to deflation itself, we did see deflation soften somewhat during the quarter. As we called out, it was somewhat driven by fruit and veg prices and the fact that we still have material deflation in fruit and veg, but in particular avocadoes and bananas have gone back into inflation. So the big volume items, tomatoes and lettuces, are very deflationary. But it's somewhat been offset by those, so that's been helpful, but full, full materially deflationary.

We have, however, then seen some inflation in perishables and the chiller category with cream and butter, given what's happening on the international commodity markets.

It's very hard to break it down, but it does seem clear to us that our impulse category has seen a softening of deflation and that's been driven, we think, somewhat by the container deposit scheme although it's very hard to get very precise. So it's not only been one category that's driven the softening, but a couple. But we see a very rational and competitive market right now.

Michael Simotas: (Deutsche Bank, Analyst) Okay, so it sounds like the message is still pretty competitive, but at the margin maybe a little bit of improvement coming through in some categories.

Brad Banducci: Yes, absolutely.

Michael Simotas: (Deutsche Bank, Analyst) Yes, okay. Then…

Brad Banducci: Yes.

Michael Simotas: (Deutsche Bank, Analyst) Sorry, go ahead.

Brad Banducci: No, I was going to say, there's a sort of movement in meat, it goes up and down. But we've seen lamb prices up a little bit but we've seen some deflation in beef. So, yes, it does vary, as you know, by category. Sorry, carry on.

Michael Simotas: (Deutsche Bank, Analyst) Yes, okay. Then a related question. If I look at your comparable item growth in food, it's actually a very similar number to your like-for-like sales growth. Now, we know that prices are in deflation so it implies that ASP is very different to what's happening with average prices. What's moving the mix there to boost your numbers there?

Brad Banducci: Yes, so it is clearly a mix, as you called out. The pleasing growth we've had in perishables actually in the quarter, it's been a very strong category for us as we've done our customer-first range and done a lot of work on in-store availability. So perishables, in particular the chiller but also including frozen, have shown some very strong performance during the quarter.

Michael Simotas: (Deutsche Bank, Analyst) Okay, thank you.

Operator: Thank you. The next question comes from David Errington from Merrill Lynch, please go ahead.

David Errington: (Merrill Lynch, Analyst) Morning, Brad. Brad, you seem to have had a very strong March. I remember when we were talking when you were doing your rounds, you were a bit concerned that with Coles coming at the Sport for Schools, et cetera, and those programs, you thought that you might drop a little bit in terms, they might buy some short-term sales. So my question is, did you do anything differently in March? I suppose it begs the question, these sorts of promotion programs, whether it be Sport for

Schools and these sorts of things, do you think that they're productive in terms of being able to generate sales growth? Or do you think it's best to keep the programs directly in line to customers wallets and their basket sizes rather than ancillary schools? I'm interested to see what your thoughts are on that.

Brad Banducci: Thanks for the question, David. These meetings come around all too often. But we were concerned and we've seen from our own very real experience what happens with continuity programs, which is you do tend to get a short-term bounce but that tends to be quite temporal in nature and we can't - that's not a comment on the Coles business, that's a comment on our experience with continuity type programs such as Sports for Schools.

I think what we did in March really, that's really a credit to Claire and the team, is just focus on running our own race and executing. We've been very - tried to be very thoughtful on major events and just doing a much better job of them. So whether it's even the Lunar New Year or the move all up into Easter, we just want to really execute well on those events. So I think you're seeing focus and execution coming through.

David Errington: (Merrill Lynch, Analyst) Is it continued into April, this thing? Or is it…

Brad Banducci: Well, it's too early, as you know, to talk to it. But the only point I would make about April is it's a very hard month to get a clear read on, in truth, with the move of school holidays, particularly in New South Wales, and where they were relative to Easter. Then Anzac Day on a Wednesday. It's just been a very hard month to get a very clear read on. But obviously we don't want to get into forward projections.

David Errington: (Merrill Lynch, Analyst) Okay. The second question, you called out - oh geez it would have been probably six to 12 months ago now and I'm just trying to get an idea of where you're at today. You called out some shoppers that you believed that you weren't hitting the mark on, whether they be the large Sunday shopper or the discount shopper and that. Can you give a rundown where you're currently at in terms of the targets you're trying to hit with the - you know, where you're at getting the shoppers and where you think you've still got plenty of upside potential? Where do you reckon going - this is a question for the next 12 to 18 months.

So it's not the next three months, it's the next 12 to 18 months. Where do you reckon is the most leverage to sustain uplift in sales from areas that you're not currently hitting the mark on at the moment?

Brad Banducci: Well, we'd like to get more out of our existing shoppers, of course, and more shoppers in our stores. So they're two different areas. But we know that, at the moment, on our existing shoppers, and particularly with our more premium existing shoppers, we still have a relatively low share of wallet. So we'd like them to, of course, spend more of their overall food spend with us in store. It's why we're working very hard on our renewal program and the quality of our fruit and veg and general fresh offers, to really get share of wallet in the premium customer.

The area that we are under-indexing with customers choosing to shop us is really the young family, in particular the value young family. That's a slightly different strategy we're working on, which is really around making sure we deliver a price perception and impact and have a very strong EDLP program in place for those shoppers so that they can trust us to help them manage their budgets.

In the context of that program, we're very focused, as I say, on our red EDLP program, Low Price, Always and Prices Dropped, on the rebranding of our own brand and just the way we talk about visual prices in store. Which is why a renewal store like Plumpton is very important for us in that context and Marrickville is very important in the premium context.

So we've got to the point of granularity of knowing where we sit with each segment. Then trying to make sure we do a better job in the context of a local store to meet the needs of that segment. But the customers I was alluding to eight to nine months ago were still the young value families and they do tend to shop in very large baskets on weekends.

David Errington: (Merrill Lynch, Analyst) Okay, thanks, Brad.

Operator: Thank you. The next question comes from Tom Kierath from Morgan Stanley, please go ahead.

Tom Kierath: (Morgan Stanley, Analyst) Morning, guys, a couple of questions. You mentioned that online is up about 30%. Is it fair to say that your market share's in line with the market there in online at about kind of 2%? So it's adding kind of 60 basis points to the like-for-like number in round numbers?

Brad Banducci: Sorry, Tom, I'm not certain I fully understand your question. I'm just looking at David Marr to see if he does. Could you just repeat it? Sorry, I don't know if I've fully understood.

Tom Kierath: (Morgan Stanley, Analyst) That's alright. So is online about 2% of sales? If it is, should we think about it contributing about a 60-basis-point uplift to like-for-like sales for the food business?

Brad Banducci: Got you. It's 3% - it's just under 3% of sales, actually. So that's the way to think about how you might go and back-solve it. When we talk about online as well, just to be clear, we talk about our home delivery as well as pick up in stores. The real growth for us, as you might understand, has been in pick-up in store. Which, as we've activated pick-up at all of our stores, has shown very pleasing growth.

Tom Kierath: (Morgan Stanley, Analyst) Okay, great. Then just secondly, you mentioned there the [CDS]. This is the first quarter where we've seen New South Wales go through it for the full quarter. Has that driven the like-for-like number in the food business? Is there a number you can call out so we can…

Brad Banducci: So not - you know, it's a different scenario in the drinks business which Martin Smith can talk to. But in the food business, as we've looked through it, in truth we have seen customers moving from smaller containers to bigger ones, so just given the price differential that's happened. But the increases we've seen have been generally offset by lower purchase of the product. So it hasn't been meaningful for us. I mean it's still a very portion of our overall sales, so it just doesn't have material impact in overall top line sales. It did, as I alluded to in the previous message, contribute somewhat, we think, to a reduction in deflation because of the path through it but no, not a material driver best we could tell.

Tom Kierath: (Morgan Stanley, Analyst) Okay. Thanks, Brad.

Operator: Thank you. The next question comes from Bryan Raymond from Citi. Please go ahead.

Bryan Raymond: (Citi, Analyst) Good morning. My first one's more of a clarification just around the New Year's Day impact across the components of comp growth. You talk about the items per basket being flat year-on-year is largely due to the shifts in New Year's Day timing. I would have thought that would be shared across both transactions and items. Was there - was it outside the items for some reason or how should we be thinking about if we are going to make an adjustment to New Year's Day to your reported [unclear], how should we think about (1) the magnitude of that New Year's Day impact overall and then (2) how it impacts the components of your [unclear].

Brad Banducci: Thank you. Yes. So, Bryan, the truth of it, it has - the New Year's Day timing has a different impact on each one of our businesses. So let me just talk to supermarkets and we can come back - the other question was really more of a BIG W question. Hopefully everyone on the call well understands New Year's Day fell in Q3 this year. So the big buy up that happens on New Year's Eve was in Q2, and then the day where we had no sales really is - or diminished sales was in Q3 in [unclear] food so it actually has quite a material impact on - when you look at the food numbers. We called out at the end of H1 that the overall impact on our business was between 30 to 50 basis points. In food it would be at the top end of that and less...

Bryan Raymond: (Citi, Analyst) For quarter.

Brad Banducci: For the quarter, yes, and less than that for the other businesses. So if you look at - so in food itself it would've impacted the transactions and items probably the same in a way. Maybe I - probably just - we haven't really broken it down. So probably we had some bigger baskets. So maybe it's impacted items a bit more than transactions, but nothing that I would call out about.

Bryan Raymond: (Citi, Analyst) Okay. Just to follow on from that question then, just on the BIG W impact is school holidays and New Year's Day - it might be tricky to do, but will you be give us a feel for what the underlying like- for-like growth would be there if you adjusted - would it be closer to zero, or how should we be thinking about your underlying trend given it's obviously deteriorated quarter-on-quarter?

Brad Banducci: Yes. You're in the right ballpark. We could have gilded the lily on this one, quite frankly, but we're very early in our turnaround. We still have a lot of work to do and we wanted to take a very tight straight line on how we did the adjustment. So we could have done slightly different adjustments and got to zero or above that, but we're very clear that we want to have a consistency of approach on how we do adjustments across our group. Secondly, we wanted to take a pretty tough line on this one just so - as I say, with our issue of being very early in our transformation process.

Bryan Raymond: (Citi, Analyst) Okay. Great. Then just my second question, if I can, is just on - you mentioned one [HOD] and one store in your commentary in food - Australian food is probably where I'm most interested. I'm just interested in the economics of that and how that plays out through the P&L. Is this something that contributes more to [COD] efficiencies or the stock loss improvement and overall materiality? Given you're talking about it, I assume there's some materiality there. Could you just explain a little bit about what's involved there?

Brad Banducci: Yes. Look, it is both an enabler and - well, it's an enabler to both sales opportunities as well as process improvement or costs opportunities. So it can do both for us. It's just a card based much more flexible system for running our stores. We need to get it in for 30 June - just, by the way, so everyone knows - to really make sure we have a low costs way of complying with country of origin labelling which could, if you don't have a system like this, have a lot of costs into your business just to actually - to adhere to it to the standards that the government has said.

In terms of the productivity opportunities which it has, it is a system that should give us some scanned speed outside at the front end. It's easier to train people to use it. It's easier to do refunds and track refunds at the front end. So there's quite a lot of front end productivity, but there's also improvements in the aisle on real time inventory management, how we print tickets, how we deliver tickets to the stores. So there is also an inventory management opportunity that sits there as well. So there's quite a lot of process improvement.

Then the system itself gives us the ability to deliver real time customised offers to customers. Right now we have constraints with our systems on how many offers we can deliver to us - the Woolworths Rewards type offers and how they look and how they manifest in the store. This system changes a lot of that for us in terms of what capabilities it provides.

So cost and revenue, that - opportunities, that's there. The draft to get in for 30 June is for country of origin labelling reasons, but it's terrific to have it in so we can get on with realising these benefits.

Bryan Raymond: (Citi, Analyst) Okay. Just to follow up on that then, the high-profile outage you had from a few weeks ago, was that related to the 1POS system or something else or…

Brad Banducci: Yes. So it was very unfortunate. As I said to the Board yesterday, it really was a black swan event that we had, which essentially our data centre at Eastern Creek went down on the Sunday. It came back up, but in the process of coming back up a series of actually personalised offer files were sent to the stores in the wrong sequence. The 1POS system did not expect this and froze for 30 minutes before it autocorrected and went back into accepting customer's transactions or scanning them through the front end. So it was a combination of a bug in the software with the data centre going down and file centres put in the wrong sequence. The issue's been addressed. We're not happy about it though, I must say. It has cost us some sales.

Actually, our customers have responded much better than they probably - we deserve. I think that's a testament to the way our [FORE] team responded and engaged with our customers in store, but technically these things shouldn't happen but it was these two related incidents that caused the outage. It wasn't an outage. It was a system freeze for 30 minutes.

Bryan Raymond: (Citi, Analyst) Okay. Great. Thanks for that.

Operator: The next question comes from Ben Gilbert from UBS. Please go ahead.

Ben Gilbert: (UBS, Analyst) Good morning, all. Just the first question from me is interested around service, and particularly around service staff first and wages, just how you're seeing that because I think your wage costs as a percentage of sales at store are probably quite a bit higher than your peers or your major competitor. How are you managing that? If the stronger sales are coming through are you able to start fractionalising those costs, or whether you're putting in staff at a similar level to sales.

Brad Banducci: Thanks, Ben. This is a sales call so I'm not going to talk at this stage to the profit implications of what we're doing. We're aware of the challenges, of course, of always balancing sales and service. We feel like in the quarter we actually got that right, as should be seen in our Voice of the Customers calls which may have been flat versus Q2 but the January blues are well-known in food retailing and it was very nice to be in a position this year where we didn't have them and we managed to hold the consistency of our customer experience over the quarter instead of having this which we've historically tended to have in January. So we feel we've got the balance right. We're not going to talk to the costs implications at this call.

Ben Gilbert: (UBS, Analyst) No problem. Maybe then just a second one from me then just around the renewals and the upgrades. Can you just talk to the benefit you're seeing from those? I think there's a number flying around a while ago a third of a contributed growth was the renewals and the upgrades, just how you're seeing those in terms of the benefits flowing through. Are you still getting similar type uplifts to where you have been or are they starting to fade off a bit as you move further into the fleet?

Brad Banducci: No. I think - we feel that they're still consistent with where we were before. We're learning a lot more as we go. So the program is clearly evolving and will continue to evolve going forward. Really increasingly the way I certainly think about the program is we'll all take each store and optimise for what that store needs to best service its customer needs. Right now we do a full - the full lot and action on the store.

Actually going forward, we really want to be much more thoughtful on what we do where. So we now know - have a long list of things that we would like to do to the store. We know which kinds of customers and which kind of stores they resonate in and we'll go around to more individual store optimisation. We won't have a renewal and an upgrade program. They'll morph.

But at this stage we do run the two programs. They're tracking in line with expectations in terms of the performance we're getting out of them. So no new news to report on that front.

Ben Gilbert: (UBS, Analyst) That's great. Thanks, Brad.

Operator: The next question comes from Grant Saligari from Credit Suisse. Please go ahead.

Grant Saligari: (Credit Suisse, Analyst) Good morning. Thanks. So BIG W, you did have some - I guess, as you said - some pleasing slowing, I guess, in the sales decline and some good performed in some of the Easter products, but you did call out that clothing was probably underperformed to expectations. I'd imagine that's fairly core to the turnaround. So could you maybe just expand a bit on how the different categories, I guess, that are core to the repositioning of BIG W are performing?

Brad Banducci: Thanks, Grant. I wouldn't say clothing per se is core to the turnaround. It's a component of it. As you know, BIG W is generally more of a hard goods retailer than a soft goods retailer. So we're more indexed to non-apparel items, actually. So it is only one component. The challenge we have is the lead and lag times of getting the product into the country given it is all generally direct sourced out of Asia. So it's a more challenging lead and lag category but it's only one component of the business. We are continuing to be challenged with apparel.

I think hopefully everyone's aware of the impact of this with the delayed onset of winter which is, I think, impacting the whole sector, not only ourselves. So it is an ongoing challenge, there's no question about it. It is the part of the business that has performed least well, but it has been offset by some of our other core categories that we're very focused on as well.

Grant Saligari: (Credit Suisse, Analyst) Okay. Thanks for that, Brad. On the online in food, I thought it was interesting comments that a lot of your growth in online is coming from click and collect, so pick up from store as you roll out that capability. So I guess that's quite pleasing, but then you have the two new fulfilment centres, which are presumably for the delivery side of the business. So I'm just wondering how you're feeling about utilisation of those centres and whether the growth coming through in delivery is presumably sufficient to - well, to build utilisation in the new fulfilment centres.

Brad Banducci: I think it's a great question Grant. We were really trying to move in a situation of online into growth-for-growths sake, more sustainable growth, or customer led growth. So that's our focus. So we're trying to actually go forward not to try and get a headline number of online growth, but just meet the needs of our customers. If we don't of course they'll be met by someone else.

So our overall growth rate is not - trying to drive it up is not an objective of ours but it's just meeting customer need. Now, in terms of your question on the customer fulfilment centre balanced with an in store pick up, which is the real issue, we know that for home delivery our preferred model of delivering to the home is through a customer fulfilment centre or CFC and we can get a much better experience for the customer through that through basically our in stock position on the order that they have as well as giving them an extended range.

So our current thinking is we would like most of our home delivery to be done through our CFCs and then our pick-ups would be done through our stores. So this was a step in that regard to try and get to the right balance. In truth right now, the two CFCs, adding to the third one we have, when they're at full capacity will do no more than 40% really of our home delivery business. So it's not - we haven't built capacity ahead of demand, if that's what the heart of your question is.

Grant Saligari: (Credit Suisse, Analyst) Okay. All right. That helps. Thank you very much.

Operator: The next question comes from Richard Barwick from CLSA. Please go ahead.

Richard Barwick: (CLSA, Analyst) Good morning, Brad. I just wanted to ask or talk about the renewals and upgrades. The first one's a bit more of a clarification. Can you just remind us of the difference between - how you define a renewal versus an upgrade?

Brad Banducci: Yes. Look, as I was saying, there are about - our definitions are changing as we learn more and more as we go, but right now the difference is when we do a renewal we change everything in the store to be - the whole flow of the store. It's generally all of the equipment in the store. We retrain the team. It really is a new store, in essence, that you see when you walk in. It's a very extensive process that costs $4 million to $6 million, depending on what kind of store and what you're trying to achieve.

An upgrade is - when we started actually it was taking a leaf - funnily enough - out of the Coles' book - in some ways was about changing the front end of the store and the entry and just getting a more logical flow. As we've evolved though our upgrades are starting to address fixtures and fittings in fruit and veg. They're starting to address some of our macro space opportunities of how we allocate macro space in the store.

That program is already changing quite dramatically as we learn more and more, but an upgrade is essentially - we just touch portions of the store, and a renewal is when we touch everything. But, as I said, the upgrade program is the one that will evolve going forward. I hope that makes sense.

Grant Saligari: (Credit Suisse, Analyst) Yes, it does, thank you. Where - in the context of your 1000 or so stores, what's the, I guess, plans here for how many stores actually will need a complete renewal and how many are still yet to be upgraded?

Brad Banducci: Oh look, the good news is we've got lots of up sides. I'd say it is thinking about the sales - I forget our CFO - who thinks about it from capital perspective - so we may have slight divergence on this one, but in all seriousness, we - our issue with upgrades is our ability to do them well.

We started the program, as you may be aware, so we wanted to do 120 a year. We're finding, really, we can't execute as well as we would like more than 80. This year we're only going to do 71. I'd like us to get to the 80 next year. We're just finding, with the renewal, you get this amazing opportunity and you have to get it right. You have to plan. You have to execute the amenities in the centre as well as the store, so it is actually the capacity constraints of doing more than 80. As we look forward we can see plenty of opportunity to continue to do in that order.

While we see that’s what we are - execution constraint on renewals - we look at - we are quite excited by lifting the number of upgrades we do, and we're looking to see whether we can do more of those going forward. You'll probably see us do as many upgrades - if not even more upgrades - going forward, than renewals. We see a lot of up side out there. We're just being quite cautious on how we evolve the programs and make sure we execute well.

Grant Saligari: (Credit Suisse, Analyst) Is it a case of weighting up - so in some instances stores that might have been renewed as you evolve this upgrade process - you might say an upgrade is enough rather than a complete renewal.

Brad Banducci: Yes, absolutely, no question. There'll be a whole series of stores that you end up just doing upgrades on and you never do a full renewal. I'd like to - it's a world where you actually just - each store has a plan and each store is - you know what the plan is for the next five years or what you're going to do in that store, so you don't get into these major disruptions, which - an upgrade is 10 to 12 weeks of material disruption. I mean a renewal, sorry, it would have to be more of a rolling type upgrade process, if possible.

Previous Analyst: Okay. Thank you. And just the approximate CapEx tied in with an upgrade.

Brad Banducci: This one varies a lot based on what we choose to do. It's something under $2 million. It could be $800,000, but it could be $1.5 [million] if it's something a bit more dramatic.

Previous Analyst: Okay.

Brad Banducci: It really does vary dramatically depending on what we try to achieve.

Previous Analyst: Yes, okay. All right. Great. Thank you, Brad.

Operator: The next question comes from Craig Woolford from Citigroup. Please go ahead.

Craig Woolford: (Citigroup, Analyst) Morning, Brad. I just wanted to ask about the petrol division. It's still a discontinued operation - and the way - the words you've used previously - because the BP agreement is still in place. I just wanted to clarify, is there a sunset clause on the BP agreement if the business doesn't change hands? Is there any dates we need to be aware of around an appeal to the ACCC if that's the path you're going to take?

Brad Banducci: Yes. Craig, thank you. A good question. I wish we didn't classify it as a discontinued business. It's terrible for the close to 7000 people work in there to be classified as such. Obviously, it's a technical issue in our accounts. The BP deal is [unclear foot], as you know. There is a sunset clause towards the middle of this year as to when it expires. We, of course, could [unclear] agreement to extend it.

The truth is we are still working through the - a myriad of options we have. There's been a lot of expressions of interest on a range of policies in the business. We're very cognisant of the challenges posed by the ACCC, so as we look at all of our options making - developing a package that is acceptable to the ACCC is very top of the list in terms of our priorities in that regard. We've still got a bit more work to do, but the good news is there's a lot of interest and the business, in the context of its situation, is performing well.

Craig Woolford: (Citigroup, Analyst) Okay. Thank you. The comment you made in the release about the sales result, which was a good result, was against what has been stronger baseline. As we move to the fourth quarter, the June quarter, it's a much higher baseline for the food segment. Is there anything that we should be mindful about that may have artificially boosted the fourth quarter of last year? Is there anything that will make it a tough quarter to lap in this fourth quarter that might impact the results in three months' time?

Brad Banducci: No. I mean I think we had a - the June month of - well, was it 6.5% [unclear]? 6.4% is obviously a very challenging number to lap, but that’s what we've been calling out consistently. Really, we're driven by produce inflation, as you know, on the back of Cyclone Debbie, so we had this very material inflation and we're now in quite dramatic deflation.

It has softened somewhat in Q3 versus Q2, but that is still our big concern. As we look out at Q4 it's hard not to believe we're still not going to be in material produce deflation. That’s our concern in terms of - that’s the real underlying anxiety we have about what we cycle in Q4. Nothing material to call out outside of that because cycling the deflation will probably be good next year, but it's still painful to go through.

Craig Woolford: (Citigroup, Analyst) Okay. Thank you.

Operator: The next question comes from Rob Freeman from Macquarie Group. Please go ahead.

Rob Freeman: (Macquarie Group, Analyst) Good morning, guys. Have you noticed any change in behaviour from your major competitor in the last few months, either around price or ranging?

Brad Banducci: Thank you, Rob. In the last quarter there's nothing I couldn’t particularly call out. We are still in a very competitive market in terms of pricing. I don’t think it's become less competitive. It may have become slightly more rational in the context of bread and roast chicken, as we talked about.

It's still a very competitive market, and I think it's in line with their comments during their sales call as well, so a competitive market on range. Again, we see them being much tighter on range than we are and much more - trying to drive a lot more efficiency. You do get a lot of benefits as you manage down a range, so we don't see a major change in their ranging strategy.

What we would like to do, of course, is we want to lead on range that has this balancing issue for us on availability and our underlying store cost to maintain the range [when we] maintain the store. We want to make sure we stay competitive on price. That's in the story of Q3 for us.

Rob Freeman: (Macquarie Group, Analyst): Thank you. Then, on their sales call they were willing to stand behind comments made in February around profit expectations for the business. Just to confirm your comments in February around the levels of investment in the business, whether it be OpEx, price, whatever it might be, is the current view consistent with that mindset in February? Or has there been any change?

Brad Banducci: Look, we are very focussed on executing our plan, so there's nothing changed really our plan, which is we need to be competitive on price, we need to differentiate our business from range and fresh, in particular fruit and veg, and provide a great in-store service experience. We're just focussing on executing against that set of priorities.

Rob Freeman: (Macquarie Group, Analyst) Did the rate of investment - has there been any change since February?

Brad Banducci: Look as I say this is a sales call, but we haven't changed materially our modus operandi at this stage, but it is a sales call.

Rob Freeman: (Macquarie Group, Analyst) Thanks, guys.

Operator: The next question comes from Scott Ryall from Rimor Equity Research. Please go ahead.

Scott Ryall: (Rimor Equity Research, Analyst) Thank you very much. Brad, I was hoping this is an easy question. In terms of your onlines, what's the rough proportion of deliveries versus pick-up please? And where are you planning for that to be in, say, three to five years' time in terms of the plans? I recognise you're at the will of the customer, but some of the intelligence you've gathered so far. I'd be interested in your thoughts on that please.

Brad Banducci: Well, as you know, Scott, it varies dramatically across the globe. The balance between pick-up and home delivery in the French market is the leading pick-up market in the world. It's about 90% pick-up versus 10% home delivery, and the [unclear] through the UK. In a short stretch of water you have two businesses with virtually the opposite mix between home delivery and pick-up.

Then we've seen - certainly in North America - a real focus on pick-up in particular by – particularly by Walmart is their major point of differentiation against Amazon. The [unclear] across them all are very disparate and it's very hard to look at those and use those to inform what we do.

In truth, right now pick-up is just over 20% of our sales in food. It's actually closer to [40%] or closer to [50%] just looking at Martin Smith in Endeavour or in [unclear]. They're quite different in terms of where the balance is right now. It's actually - it's just over 30% in our New Zealand business. I think we would reasonably expect - in our New Zealand food business we reasonable expect pick-up to get to 30%. It's hard to understand or believe whether we'll go much higher than that, but we'll let the customer lead us there.

It goes back to the previous call being quite prudent involving customer performance centres because you don’t want your capacity to get ahead of demand, although on the other hand you don’t want to be too out of balance. We're approaching the balance issue with caution. I hope that make sense.

Scott Ryall: (Rimor Equity Research, Analyst) Yes, it does. Then I know you keep stressing it’s a sales call but you have mentioned in your hotels division the investigation that you’ve got going on. Can you please tell me why it's worthwhile owning that business, or Woolworths, given every newspaper article writes it up as Woolies' pub division or Woolies' gaming division when it's less than 3% of your sales, but the potential for brand damage is immense?

Brad Banducci: As you know, it is a joint venture. I can turn to our chief legal counsel to elaborate on why we wanted to put the clarification in our announcements. But you're right. The bottom line is sales clarification.

The reason we're in this business is because it provides us with a vehicle to really grow our retail drinks and it really started of course, you may know, with the history of Queensland and where you need [unclear]. You do need [unclear] in order to have a retail liquor licence, so that's been - from that logic that we've entered this joint venture with the Mathieson Group.

As to why we put the clarification in there, there's been a lot of wording around independent reports and whatever else. We just wanted to be clear as to what we're doing in the context of this business given the comments we made at the AGM back in November of last year. It's really just a point of clarification. Richard was there anything you'd like to add.

Richard Dammery: Oh, Brad, hey, look, I mean I think the main thing is that there's been so much interest in the whistle blower allegation that we wanted to give an update on the investigation process, which is being conducted by the ALH board with support from a number of advisors, including Responsible Gaming Canada who we've talked about previously doing a benchmarking exercise to ensure that we have a proper understanding of what best practice looks like.

Scott Ryall: (Rimor Equity Research, Analyst) Okay. And the timing of those reviews, please.

Richard Dammery: Underway. We're not going to commit to a hard timeframe, but we're making good progress.

Scott Ryall: (Rimor Equity Research, Analyst): Right. Okay. But you'd expect this calendar year, right, prior to your next AGM because...

Richard Dammery: Most certainly. Yes. Most certainly.

Scott Ryall: (Rimor Equity Research, Analyst: Okay. All right. Thank you.

Operator: The next question comes from Phillip Kimber from Evans and Partners. Please go ahead.

Phillip Kimber: (Evans and Partners, Analyst) Hi, guys. Just my first question was I couldn't find it in the results. Do you - are you able to give us the sales per square metre improvement in the third quarter?

Richard Dammery: For the - thanks, Phillip. I'll just turn to David to talk to that.

David Marr: Phil, we effectively do that at the full year end and the half year, but it is fair to say given our sales improvement we have an average - we have an increase in average space across all of our businesses. So the sales per square metre is going up but we'll detail that at the full year.

Phillip Kimber: (Evans and Partners, Analyst) Okay. Can you just remind me, because I know you have spelt it out before that. It does look a bit unusual that total sales for food is pretty close to the like for like, but I think your stores are about 0.6% or 0.7% higher, but I think you've highlighted in the past there was something to do with the way you changed your accounting for maybe newspaper and magazine sales. So I just wanted to reconfirm that, but also when that washes through.

Brad Banducci: Thank you, Phil. David's been waiting for this question the whole call, so over to you, David.

David Marr: Thanks, Brad. So, Phil, firstly effectively there's 94 - I think it is - per cent of our stores are in the comp calc. So the difference between comp and total will always be pretty small on that basis or at least at the moment. There is a contribution from new stores but, as you know, we strip out that contribution and we also strip out the cannibalisation impact from those new stores on existing fleet. So they effectively net out each other, so that's why the difference is quite small. The agency adjustment you referred to is in there, but it's actually very minor, and we start to lap that in Q3. So you won't see that as a big impact coming forward.

Phillip Kimber: (Evans and Partners, Analyst) Okay. Do you think we'll ever get back to - in the past I think there was typically a 1% gap between your total and like-for-like which broadly matched your space, maybe a little bit less. I mean, I think you talked to space in the 1% to 2% growth range. I'm just thinking going forward, should we think that that gap might expand, or is it likely to stay pretty narrow in the next year or so?

David Marr: Well, look, I mean, you're right. It will just entirely depend on how many new stores we open on a net basis and what the ongoing impact of cannibalisation is. So in the very short term I wouldn't expect to grow materially, but as we look forward and we look at the opportunities in the market for new stores, that gap may widen somewhat. Yes.

Phillip Kimber: (Evans and Partners, Analyst) Okay. Thank you.

Operator: Once again, to ask a question please press star one on your phone. The next question is a follow up from Richard Barwick from CLSA. Please go ahead.

Richard Barwick: (CLSA, Analyst) Thank you. Just a quick follow up on petrol. You mentioned you're happy enough with the performance, but that volume outcome is the weakest in some time. So in terms of market share, at least in a petrol sense, are you suggesting that you're at least holding market share?

Brad Banducci: We are - all the majors in Australia are actually losing some market share to the smaller independents, often the value players. The fact seems to have been in effect by our esteemed colleagues from the ACCC. So there is a move. So in the majors we have been holding our share quite consistently over the period.

Richard Barwick: (CLSA, Analyst) Is there - again, this might be a tricky one to answer, as you say, given the sales call, but that loss of market share...

Brad Banducci: It's been really driven by new site openings.

Richard Barwick: (CLSA, Analyst) Yes. Okay. I'm just wondering if it's meaningful from a valuation point of view in terms of what you think you can sell this business for.

Brad Banducci: Look, we can't get into that on the call, I think.

Richard Barwick: (CLSA, Analyst) Yes. Okay. Understood. No worries. Thank you.

Operator: Thank you. At this time we're showing no further questions. I'll hand the conference back to Mr Banducci for closing remarks.

Brad Banducci: Thank you, everyone, for joining us this morning and for all of your questions. We look forward to speaking to you soon on the rest of the year. So have a great day and, as I say, thank you for all your questions.

End of Transcript