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**Sarah Davis** *Loblaw Companies, Ltd. - CFO*

## CONFERENCE CALL PARTICIPANTS

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**David Hartley** *Credit Suisse - Analyst*

**Perry Caicco** *CIBC World Markets - Analyst*

**Jim Durran** *Barclays Capital - Analyst*

**Keith Howlett** *Desjardins Capital Markets - Analyst*

**Mike Van Aelst** *TD Newcrest/Waterhouse Securities - Analyst*

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**Kenric Tyghe** *Raymond James - Analyst*

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**Chris Li**

## PRESENTATION

### Operator

Good morning. My name is Melissa, and I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies, Limited First Quarter Results Conference Call. (Operator Instructions)

Ms. Janet Craig, Senior Vice President, Investor Relations, you may begin your conference.

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**Janet Craig** - *Loblaw Companies, Ltd. - SVP of IR*

Thank you, Melissa.

Good morning, and welcome to the Loblaw Companies, Ltd. First Quarter 2013 Conference Call. This call is also being webcast simultaneously on our website at [loblaw.ca](http://loblaw.ca).

I'm joined here this morning by Galen G. Weston, Executive Chairman; Vicente Trius, President; and Sarah Davis, Chief Financial Officer.

Before we begin today's call, I want to remind you that the discussion will include forward-looking statements, such as the Company's beliefs and expectations regarding certain aspects of its financial performance in 2013 and 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 current expectations. These risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulators from time to time, including the Company's annual reports.



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 as required by law.

Certain non-GAAP financial measures may be discussed or referred to today. Please refer to our Annual Report or other materials filed with the Canadian securities regulators from time to time for a reconciliation of each of these measures to the most direct comparable GAAP financial measures. An archive of this Conference Call will be available on our website.

Before I turn the call over to Galen, I just would request that you limit your questions to one and a follow-up. And now, I'll now turn it over to Galen.

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**Galen G. Weston** - *Loblaw Companies, Ltd. - Executive Chairman*

Good morning, and thank you for joining us.

Before we begin the call, I'd like to speak briefly to the tragedy that occurred last week in Bangladesh. I'm deeply shaken by the event, as are our colleagues throughout our Joe Fresh and Loblaw business. Our thoughts and prayers continue to go out to those who were injured and to all the families who have lost loved ones.

We have taken action to address the situation, including the announcement of a fund to provide relief to victims of this tragedy. There is more we will do, and we'll make that public over the next few days.

And now, we turn to our results. We've made significant progress in our business. In today's numbers, you can see the underlying momentum we've been describing over the last few quarters now coming through in the overall performance of the business. We've seen progress across banners and regions, with positive same-store sales, market share and tonnage.

The results are directly correlated to the initiatives outlined in the management strategy -- improved competitiveness, better service and assortment, lower admin costs and consistent execution. This performance instilled in the Board of Loblaw the confidence to increase the dividend for the second time in less than six months.

In terms of our REIT -- the expected launch is on track and fast approaching. We expect to file a preliminary prospectus in late May and hope to complete the offering in July. The senior management is now in place. John Morrison has joined the REIT as President and CEO, and Bart Munn will be joining shortly as CFO. They join Jane Marshall as Chief Operating Officer. John, Bart and Jane are experienced senior real estate executives, and I look forward to their contribution. We will continue to update you as things progress.

Looking forward -- Loblaw Companies continues its focus on long-term value creation. While there is still considerable work to do, we believe continued momentum in the business, the creation of the REIT, our dividend increase and ultimately regular share buybacks will deliver on that goal.

With that, I'll now turn the call over to Vicente to share some specifics on our performance.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Thank you, Galen. Good morning, everyone, and thank you for joining us.

Today, I'm going to focus my remarks on same-store sales, tonnage and [passthrough] (technical difficulty) we're seeing strong broad-based results.

Same-store sales growth came in at 2.8%, a significant improvement from last year. Our average quarterly internal food price index was flat. The same-store sales improvement was primarily driven by our core food and drug business.



Fresh led the way. Fresh is an area where we have invested significantly. And while we saw relatively high inflation in produce during the quarter, the comps outpaced inflation.

We also saw same-store sales growth in our drugstore business, with [stripcome] growth of 6.9%-plus in the quarter. Our same-store sales were positively impacted by approximately 50 basis points by two factors -- the timing of the start of our quarter relative to New Year's -- the period started on December 30th this year -- as well as a slight benefit due to early buying before Easter. We have 83 shopping days in Q1, which is the same number of shopping days as the prior year.

Tonnage was also positive, building on our Q4 results. The areas where we have been investing are performing well. One area in Fresh, for example, had strong comps last year including inflation. As the inflation has moderated, comps have stayed positive, showing good tonnage growth.

On the discount side -- during 2012, we executed a number of Fresh focused renovations in a particular region while investing in volume to shelf and working on our general merchandise offering. As a result, comps turned positive this quarter after a number of periods of decline.

We also saw improvements in Conventional. In one region where we have invested, in all three components of the customer proposition -- assortment, experience and volume -- we saw a similar story unfold, with an even better tonnage share story as well as positive comps.

During the quarter, we continued to invest in our customer proposition. You can see the lower gross profit margin year-over-year, which is due to investments in shrink and price, with a focus on shelf versus promo. This investment, as well as other initiatives like our category reviews, resulted in more customers with bigger baskets.

While we're pleased with the positive trends we have seen in our business, we have not lost focus on driving cost out of the business and implementing SAP. We have line of sight [on] opportunities. SAP is on track for an accelerated rollout commencing this quarter. The system is doing what it's supposed to do, and we have not encountered any unusual issues.

On the cost side -- our retail operating expense rate is the same as last year, in line with our expectations. Going forward, we do expect to reduce our operating expense rate through efficiencies. We have been focused on delivering on our strategy of having best-in-class customer experience, assortment and volume. On Friday, we launched PC Plus in Ontario Loblaw stores. It is the first all-digital intelligent retail loyalty program in the grocery retail space. We expect this program to build on our business momentum, increase customer engagement, further enhance the customer experience and drive share of wallet.

On Monday, we will be holding both investor and media events to take you through the features and benefits of this product. I don't want to give away too much, as we will be able to provide you all of the details on Monday, and you will be able to see how the program works firsthand. I will just leave you with one teaser -- its functionality and feature set is so rich that we believe it will become an integral part of customers' grocery and dining experience.

I will now turn the call over to Sarah to walk us through some financial highlights.

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

Thank you, Vicente, and good morning, everyone.

Before I get into the results, I wanted to point out some additional disclosure this quarter. We are now breaking out our comps with and without the inclusion of our gas bar business. This quarter there was no impact -- same-store sales were 2.8% with and without the gas bar, but there can be volatility in the gas bar business, and we felt this change would provide additional clarity going forward.

Q1 was a strong start to the year for both our retail and financial services businesses. On the retail side, we continued to invest in price and fresh assortment during the quarter. This continued investment, in combination with better execution at our stores, drove top-line growth of 3.4%. As Vicente mentioned, sales results were driven by our core food and drug businesses, which registered comps of 2.9%.



While we haven't seen sales turn in our GM business quite yet, profitability continues to improve as we change the mix of products and manage inventory better. We had less seasonal carryover this year, which allowed us to make room for new products and to avoid some of the markdown activity we saw last year.

Gross profit of 22.4% was down 10 basis points from 22.5% last year. This decline was the result of investments in food prices and fresh assortment as well as the shift in sales mix, partially offset by a reduction in transportation costs and margin improvements in our drugstore, GM and apparel businesses.

Retail operating expenses as a percent of sales, excluding the \$51 million pension gain, were 19.2%, in line with last year and our expectations. Year-over-year we saw some additional in-store labor that went along with the sales volume we drove in the quarter, some additional advertising, higher depreciation -- mainly associated with the IT project -- and a negative FX impact versus last year.

As Vicente mentioned, on a full-year basis, we believe there are opportunities to drive cost savings and efficiencies in a number of areas while continuing to push the top line. One area of efficiencies is SAP. I hope to be able to share more details in the next few quarters as we accelerate the rollout. We now have eight stores and three [DCs] live.

On the financial services side of the business, revenue grew 27.9%, with both our PC MasterCard business and Mobile Shop Kiosk business contributing to the growth. PC financial earnings before tax grew by \$15 million. \$5 million of that was due to the renegotiation of a vendor contract that took effect in Q4. Roughly \$2 million of the \$5 million could be considered one-time and was related to a performance hurdle we had arranged with the vendor.

Consolidated basic net earnings per share grew by 41.9% in Q1, or 11.6% excluding the impact of the pension gain. Q1 financial results came in higher than our expectations, but we are not changing our outlook for 2013 at this time. We continue to expect modest consolidated operating income growth for the year.

As Galen mentioned, this morning we announced an increase in our quarterly dividend payout by \$0.02, or 9.1%, to \$0.24 per common share as our confidence in our performance continues.

Before I close, I would like to formally introduce Janet Craig, our new SVP of Investor Relations, who opened the call. I also wanted to take this opportunity to thank Kim Lee, who headed up the Investor Relations function at Loblaw for the last several years. Kim oversaw the growth of the Investor Relations function and was instrumental in a number of important initiatives. And while she will be very much missed on the Loblaw side, she will not be far away, as she has taken on a new challenge heading up Investor Relations and Financial Planning and Analysis at the REIT, where I know she will add significant value.

With that, let's open the call to questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Patricia Baker, Scotiabank.

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### Patricia Baker - Scotiabank - Analyst

Vicente, you made a very strong case in your opening remarks that it was the investment made in Fresh in [value] in the store experience. And then also, with Sarah's accompanying remarks, in labor, that led to the positive same-store sales and volume increase in the quarter. Can we assume that, given that outcome, we should expect you to maintain that level of investment going forward -- that there's a real commitment to the fact that it is the investment that you need to do to be able to win on an ongoing basis?



**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Patricia, good morning. It's a very good question.

We're very, very pleased -- what I can say is we're very, very pleased with our performance this far. And really, what it shows is that our strategy's working.

Now, what I'd like to do as well is put a little bit of context behind Q1, right? So we had a little bit of a difference because of New Year's and Easter, which amounts to 50 basis points. And we should keep in mind as well that last year was one of our softest quarters. Actually, we had a 0.7% decline; excluding [gas] would've been a 0.9% decline. But all in all, we're actually doing very well, and we're pleased with our performance.

Now, we should keep under consideration as well that the market is very competitive. And we and Target opened, what, 24 stores -- we'll have maybe another 110 stores until the end of the year. So at this time, we like to maintain our guidance or our outlook as modest in sales growth and modest in earnings.

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**Patricia Baker** - *Scotiabank - Analyst*

I think that's very helpful, Vicente. And I guess what you're saying is we shouldn't get carried away.

I have got other questions, but I'll respect Janet's wishes and get in the queue.

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**Janet Craig** - *Loblaw Companies, Ltd. - SVP of IR*

Thank you.

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**Operator**

Irene Nattel, RBC Capital Markets.

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**Irene Nattel** - *RBC Capital Markets - Analyst*

If I could, just building on Patricia's question -- you did allude to promotions and shelf price, and investments in both. If you drill down and look at that tonnage growth, could you give us a little bit more color around what proportion of it might have come from incremental investment, what proportion of transactions are being done on promotion? Is it continuing to rise? And other than Fresh, can you give us a little bit of color around what other categories might have seen some nice improvements?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

We have seen positive performance, actually, across -- I would start by saying, across all of our banners, across all of our provinces. Some places may be a little bit better, obviously, than others. We have seen a very good performance, with flat inflation, actually, across most of our categories. And it shows that the category reviews are working. We've gone through 20 category reviews, and we still see for the most part increase in tonnage and sales.

In Fresh, it's a great story. I mean, Fresh -- we started leading with Fresh over a year ago. We're getting good sales increases, outpacing grocery. And we're getting tonnage across most of the categories in Fresh. So we feel comfortable with where we're at.



**Sarah Davis** - Loblaw Companies, Ltd. - CFO

If I could just add one piece to that -- as far as the promo pen, it's actually down in the quarter. So the promo pen would've actually been down in the quarter.

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**Vicente Trius** - Loblaw Companies, Ltd. - President

Yes, that's a good point, Sarah, and I should've addressed that. So yes, the promo penetration is down [and in place] to our strategy that we're building on shelf. So our shelf price is better, and our baskets are growing, which means our loyal customers are buying more from us.

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**Irene Nattel** - RBC Capital Markets - Analyst

That's great. I too will be a good girl and not ask another question.

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

Thank you, Irene.

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**Operator**

David Hartley, Credit Suisse.

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**David Hartley** - Credit Suisse - Analyst

I have to ask two questions. The first one is -- the outlook hasn't changed, better-than-expected quarter. Yet you did increase your dividend. If you can kind of square that up for me? And the second one is for Vicente. And I just got to ask -- how is his [Loblaw Grana] going to do this afternoon?

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

I'll start with the question on -- first of all, the results were better than we were expecting. But at this time, it's still a little bit early in the year, with just one quarter done and a lot of the competitive activity that Vicente talked about not having -- we haven't seen a lot of it so far from Target. So we weren't prepared to change our outlook at this time. But we are focusing on shareholder value and creating additional value there over the long term. And we did think that it was a good time, based on our performance and confidence we have from our Board, to increase our dividend \$0.02 at this time. And we will be getting into the rhythm of reviewing our dividend on an annual basis, and you should expect it to be at this time going forward as well.

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**Vicente Trius** - Loblaw Companies, Ltd. - President

On the first question -- I'm sorry, I missed it -- did you say La Grana team? What was the question? Could you please repeat?

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**David Hartley** - Credit Suisse - Analyst

Sorry, it's on your FC Barcelona team, Loblaw Grana.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Oh, my God, my God. Now you got me down [the valley] here. Not good.

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**David Hartley** - *Credit Suisse - Analyst*

Thank you very much, guys.

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Thank you.

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**Operator**

Perry Caicco, CIBC World Markets.

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**Perry Caicco** - *CIBC World Markets - Analyst*

Vicente, how would you characterize the promotional environment now versus earlier in the year and versus a year ago? And tied to that, what's your outlook for inflation or deflation over the next few months?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Well, I see the competitive environment getting more and more intense. The market tends to be penetrating more on promotions, which -- all along, I said I believe that that is not a strategy that's sustainable for the future. We're not penetrating as much, and we're investing on shelf, which is driving more customers into our stores and better overall baskets.

Could you repeat the second part of the question, please?

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**Perry Caicco** - *CIBC World Markets - Analyst*

Yes, I just wonder what your outlook is on inflation or deflation for the next few months.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

I always say that I hate to make comments on future inflation. But I can tell you that in this quarter inflation was basically flat. And that reflects the competitive as well of the market and what we're doing on improving competitiveness internally.

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**Perry Caicco** - *CIBC World Markets - Analyst*

And the investments that you've been making on price and labor -- I mean, the idea, obviously, is that they should be offset by operating efficiencies. Can you just detail what the largest pieces of those efficiencies should be -- where they should turn up in the P&L? And are we talking pretty sizable reductions in SG&A expenses?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Let me say that for the quarter, our expenses were on plan and, let's say, from a rate perspective, flat against last year. We had some bright spots, actually, when we look at labor across the network -- we were able to leverage about 13 basis points. Now, there are areas that hit us a little bit, like foreign exchange -- less favorable than last year, advertising at [one time] that we had by about three million, and then a little bit more on IT, mainly in depreciation and amortization, though we see it leveling off by the end of the year.

Now, as we continue, I think one of the great things is that we can be a lot better. And that's the great thing about this business. And I believe that we can be a lot better on the efficiencies, on the supply chain, on strength and productivity across the network. And that's the upside.

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**Perry Caicco** - *CIBC World Markets - Analyst*

Sorry, but specific to my question -- would you see fairly sizable reductions in SG&A expenses over the remainder of the year?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

No, I would not. But we see us being able to drive efficiencies.

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**Perry Caicco** - *CIBC World Markets - Analyst*

That's fine, thanks.

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**Operator**

Jim Durran, Barclays.

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**Jim Durran** - *Barclays Capital - Analyst*

There was obviously a lot of Zellers stores that were closed for six, nine months, being renovated by Target, yet to be reopened. Do you see that closure and the freeing up of those customers as any part of the driver to your improvement in comps in the quarter?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

No, no, actually. And I'll tell you what -- the performance of the stores, as these stores have reopened, is in line with our expectations. To be honest, on Friday, I was visiting stores in the market. And in some locations that I visited, we're getting additional traffic, because of the type of format that we have, and the Target opening. And in some cases, obviously, we have a slight decline -- but all in all, according to our expectations.

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**Jim Durran** - *Barclays Capital - Analyst*

Okay. Thank you.

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Thank you.



**Operator**

Keith Howlett, Desjardins Capital Markets.

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**Keith Howlett** - *Desjardins Capital Markets - Analyst*

Yes, I wondered in terms of the script book that you bought from Zellers -- how they're performing in the centers where Target has opened a pharmacy.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Yes, overall, for the quarter, we got a 6.9% of increase in script growth, which is really solid. And the good news is that our retention level is right on plan, or slightly ahead actually. So this means that we're not losing anything that we gained.

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**Keith Howlett** - *Desjardins Capital Markets - Analyst*

And would Loblaw consider introducing your own brand generic drugs, or not?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

We're always looking at all options, to be more and more competitive in this marketplace. And that could be one of them, but nothing at this stage.

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**Keith Howlett** - *Desjardins Capital Markets - Analyst*

And then, in terms of your gas bars -- do you think you'll tie gas even more tightly with your loyalty program? And would you think you might expand your presence in gas in Eastern Canada?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

No specific plans at this time. It is a good business for us and does add value to our stores. But no specific plans at this time of accelerating growth behind gas bars.

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**Keith Howlett** - *Desjardins Capital Markets - Analyst*

And then, just on new formats -- you mentioned that you were looking at -- well, I guess you're always looking -- at new formats. But do you have anything that you can share with us on new formats that you're looking at or might be introducing this year?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Yes. We said all along that we're looking at possibilities behind smaller formats. Because we believe that in Canada the trends behind the organization and convenient shopping [it] fits. And we're looking at possibilities on both sides of the business -- conventional as well as discount.

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**Keith Howlett** - *Desjardins Capital Markets - Analyst*

Great.



At the risk of being insensitive, given it's a very difficult topic -- but could you speak about -- was there any impact of Joe Fresh sales to JCPenney during the quarter?

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**Vicente Trius** - Loblaw Companies, Ltd. - President

I'll tell you -- this is, in my mind, a real tragic situation. And I hate to mix the situation with sales. But having said that, I can tell you that we have not had any impact on our sales at this stage. But it is an evolving situation that we need to be very close to.

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

And Keith, we're going to go to the next caller.

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**Operator**

Mike Van Aelst, TD Securities.

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**Mike Van Aelst** - TD Newcrest/Waterhouse Securities - Analyst

I just wanted to circle back on the IT timing -- relatively slow, I guess, in the first quarter. But you sound pretty optimistic that you're going to be ramping it up quite a bit in Q2. So are you still on track to get to get your big stores done in '13 and the smaller stores done in 2014?

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**Vicente Trius** - Loblaw Companies, Ltd. - President

Yes. We have today eight stores already on SAP. We should probably have one district by the end of this week running on SAP. We have three DCs up and running. And all in all, actually, we're cautiously optimistic. We feel good about where we stand, and we will start doing a further rollout across larger formats during Q2.

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**Mike Van Aelst** - TD Newcrest/Waterhouse Securities - Analyst

At this stage, you don't see any reason why it might get delayed, the rollout?

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**Vicente Trius** - Loblaw Companies, Ltd. - President

No, no, absolutely not. On plan. I think we told you the last time about 300 stores this year, and that's our target.

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**Mike Van Aelst** - TD Newcrest/Waterhouse Securities - Analyst

And how many stores --

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

And Mike, we do plan to have all the DCs done this year as well. So that would be a big step forward as well. So we've got three so far, but we expect to complete them all this year.



**Mike Van Aelst** - TD Newcrest/Waterhouse Securities - Analyst

And, sorry, how many stores do you expect to do next year?

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

The remaining. So what we don't get done this year we'll get done next year.

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**Vicente Trius** - Loblaw Companies, Ltd. - President

Remember that what we said all along -- this is a process that you go slow to then go fast. It's about building a model that's scalable. Okay? So the eight stores, or the district, is a pilot district, to make sure that all variables are in place, that you can scale it up. At one point we could scale it up as much as 10, 15, 20 stores a week.

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**Mike Van Aelst** - TD Newcrest/Waterhouse Securities - Analyst

And moving from one district to another shouldn't make any difference? It's really just about getting all the --

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**Vicente Trius** - Loblaw Companies, Ltd. - President

Yes, don't get so much hung up on the district. But it's moving from [potential] one region to another, or two regions in parallel, at the same time.

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**Mike Van Aelst** - TD Newcrest/Waterhouse Securities - Analyst

All right, thank you.

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

Thank you.

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**Operator**

Chris Li, Bank of America.

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**Chris Li**

With respect to the 39 or so Wal-mart stores that were opened late last year, can you talk a little bit about what the impact of them has been on Loblaw stores nearby?

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**Vicente Trius** - Loblaw Companies, Ltd. - President

Good question. We have not seen an impact, a measurable impact, from those other stores into our network. We have the correct strategy. We prepared on all those stores before the Zellers reopened, whether it's a Target or a Wal-mart, in the strategy, which is led by food and Fresh and what we've done in the right-hand side, in improved customer experience. And it's actually right on our expectations and doing fairly well.

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**Chris Li**

Okay.

And maybe just a quick follow-up -- sorry if you've mentioned this already -- with respect to the rationalization of your non-apparel GM business -- is it pretty much done? And also, did it have a meaningful impact on your increase in your gross margin this quarter?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

We said all along that we would finish this this year. So during Q1, we did about nine stores on the right-hand side; we have another 20 stores going.

Now, one note that actually I think is very positive is that -- remember, we said that we downsized some of the GM departments by as much as 20% to 28%. And we're seeing sales per square foot increase. And we're seeing at the same time contribution per square foot increase in both cases, which is positive.

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**Chris Li**

Thank you.

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

And the rate was helped -- the margin rate was helped by GM and apparel in the quarter.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

True.

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**Chris Li**

Thank you.

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Thank you.

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**Operator**

Peter Sklar; BMO Capital Markets.

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

Just going back to the same-store sales growth -- you kind of had this abrupt breakout of same-store sales. You talked about the reasons behind it. But it didn't come gradually; it seems to have abruptly popped out this quarter. You talked about the 50 basis points, the fact that you're up against a weak quarter. Was there anything else that caused it to come to fruition this quarter just in terms of timing?



**Vicente Trius** - *Loblaw Companies, Ltd. - President*

No. From a timing perspective, not. I think this is about the strategies, step by step, taking hold. And we were [signaling] this -- just that we had quarters that we couldn't give you [as much as of] growth. But were signaling this, because we're seeing the tonnage increase, we're seeing the categories working. Remember, we used to talk about eight categories, 10 categories being done; today I'm talking about 20 categories being done.

And the beauty is that -- it's like on the efficiencies. In this business, we have a lot of opportunities in 20 categories. I have 60 categories. And if I look at Fresh, for example, when we look at Fresh, we did a lot on the quality of the assortment and the variety. But we're taking Fresh to the next level. We're looking at Fresh end-to-end.

And I don't want to linger more on that, but I'm going to give you one example. For example, we are introducing in Ontario 100% traceable corn-fed beef through DNA testing. This means that I know the cattle from the time it was farmed to the way it's been slaughtered to what it has been fed, and the age that it has been slaughtered. So it guarantees you, for example, on the shelf, a best sort of taste experience.

And I'm [proudly] to say -- I don't know if you know -- there's an Institute called the Belgian Institute of Taste in Belgium, in Brussels; with a very extensive panel of experts, probably more than I am, in food, although I like it very much to eat. And they give us a three-star, which is basically the highest rating, on the AAA Platinum Corn-Fed Beef.

And I'm giving you this example because one thing is improving assortment presentation, and the way we manage [green] labor. But the next step is about an end-to-end supply chain behind Fresh.

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

Okay.

I just had a follow-up question for Sarah. Sarah, you talked about some of the factors that negatively impacted G&A costs in your retail business during the quarter. You talked about FX, more advertising. I'm just wondering, overall, how did your G&A track during the quarter versus your expectation? Were you satisfied, or were you over where you thought you were going to be?

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

We were right where we expected to be, so pretty much in line with what we had. The advertising is just timing. The FX is the nature of the dollar. So that is always difficult to predict. But everything else was in line with what we expected.

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

Okay, thank you. That's it.

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Thanks, Michael.

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

Peter.

**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Peter, sorry.

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**Operator**

Kenric Tyghe, Raymond James.

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**Kenric Tyghe** - *Raymond James - Analyst*

You provided some valuable color in terms of by banner and category. I wonder if you could give us any further insight into the relative performance by geography -- and I think, most specifically, performance outside of Ontario -- given that that's where we've largely focused the questions today, is on the Target impact or otherwise -- to the extent you're able?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

No. I'll tell you the same thing that I said a few minutes ago -- that we see this performance across, I said, all banners and across all provinces, with some provinces actually doing better than others. But we see positive trends in performance across all our banners and divisions, whether it's discount or conventional, which is good. It shows that we're actually running all the strategies correctly across all of our system and getting traction with our customers.

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**Kenric Tyghe** - *Raymond James - Analyst*

And just to follow up -- if I'm understanding you correctly, Vicente, it's not that there is specific relative outperformance of any magnitude in anyone geography, be it Western Canada or Québec or otherwise? It is sufficiently broad-based [but there are no] outliers?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Sufficiently broad-based. But like I said, there are provinces that are doing better than others.

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**Kenric Tyghe** - *Raymond James - Analyst*

I'll leave it there.

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Thank you. Next caller?

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**Operator**

Vishal Shreedhar, National Bank.

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**Vishal Shreedhar** - *National Bank - Analyst*

Just wondering on the SAP -- Sarah, what metrics should investors look at to evaluate how SAP is doing? Are there certain key metrics that you would point us to?

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

I think right now, what you should look to is the rollout -- our continuing progress on the rollout. And I would say we are planning to ramp up, so we talked about finishing a banner and starting to roll out. And we said that we'd like to get all the DCs done in a big portion of the stores. So I'd say focus on that.

And then, with also said for 2013 we expect our IT expenses to be roughly flat with last year. So you should hold us accountable to that. They were actually higher in Q1, so we do expect the back half of the year to have them starting to decrease. So you can hold us to that.

And then, as far as the benefits [comp], it is something that I know everybody's waiting to hear from us. As we roll out to more and have a bigger sample, we'll be able to provide a little bit more detail on that. But the key areas where we expect to have savings coming out of the rollout would be in the flow of inventory, which would allow us to have more productive labor in the store, less shrink, and more productive supply chain -- so costs there could come down as well -- and a better store experience, as you have store colleagues focus on the customer more so than on moving the inventory around. So those would be the big areas.

And we would like to be able to give you some quantification on that, but we're just not quite ready yet. But it's soon to come.

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**Vishal Shreedhar** - *National Bank - Analyst*

Thank you.

And as SAP is gradually rolled out, is there an order that we should expect these benefits to start showing? For example, the better store experience might be last. Would we expect the shrink and inventory improvements to manifest first?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

I would say the areas on the system that really helps -- it is availability of product, it is replenishment, it is productivity at store level, which at the end of the day allows you to execute better in the store and to treat better towards the customer.

Having said that, this is something that comes over time, right? Just because you implement the system to any one store doesn't mean that you get it automatically. The next [day, it's] about training the individuals, it's about change management. But at the end, it's how you flow the product into the store, availability of product. And it allows you to be more productive and execute better.

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**Vishal Shreedhar** - *National Bank - Analyst*

Thank you.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Yes.

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

Great, thank you. Next caller?

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**Operator**

(Operator Instructions) Irene Nattel, RBC Capital Markets.

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**Irene Nattel** - RBC Capital Markets - Analyst

Just continuing with the whole SAP discussion -- obviously, it's a big ramp from eight to 300. So how should we think about the way in which it will evolve over the year? And Sarah, you said that the IT expense was higher in Q1 than what it would've been -- than what you expected it -- sort of in the run rate by year end. So what were the key learnings from that Q1 experience that will enable you to actually reduce those expenses as you accelerate the rollout?

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**Vicente Trius** - Loblaw Companies, Ltd. - President

Let me talk a little bit about the rollout. Within the next couple weeks, we will start going into different formats in different provinces. And we see ourselves getting more of a scalable model probably by sometime in July. And from that point on, we will be scaling it up to achieve the sort of level of 300 stores by the end of the year. So it does unfold [late], more late Q2, and then mainly Q3 and early Q4.

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

Okay. And when you talk about the expenses, they are higher in Q1, which is on plan. So it wasn't that it was unexpected; it was planned that way. So the phasing is the way we expected it. And the IT costs aren't necessarily associated with the rollout of the stores. Those are more the training and the costs at the store level. The IT costs that we're seeing, which is mostly depreciation now, is related to the design of the system, which is essentially complete as we roll out -- we've completed the design of. And so it really is just the phasing of the costs, the cash costs, of the remaining design that needs to be done. And then, what we're going to phase into is really the rollout cost, which is felt by the cost in the store and the training of the people in the store. But they aren't IT-expenses.

So that's why we're fairly confident that we'll be able to -- these costs will be able to reduce in the back half of the year.

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**Irene Nattel** - RBC Capital Markets - Analyst

So just continuing with that --

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**Sarah Davis** - Loblaw Companies, Ltd. - CFO

Irene?

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**Operator**

The line has dropped.

David Hartley, Credit Suisse.



**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Operator, if Irene gets back in the queue, please make sure that we get her to ask the question.

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**Operator**

Certainly.

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**David Hartley** - *Credit Suisse - Analyst*

Just wanted to come back to the promotional comments you made. You talked about your promotional penetration in decline. Is that yours that you're talking about, at Loblaw? Or is that an industry-wide thing? And if not, could you talk a little bit about what's going on in the industry from a promotional perspective?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Yes, I'm referring a lot more to Loblaw. The market in general is aggressive and penetrating more. And I think the reason behind that are the dynamics behind a more competitive marketplace, and, let's say, that people fighting more for those customers.

Now, our belief is that that's not a sustainable long-term strategy. The strategy behind being more competitive on the shelf is the right one, and we're seeing traction, because we're getting larger baskets and more customers.

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**David Hartley** - *Credit Suisse - Analyst*

Would it be fair to say that where you're not investing in promotion you're kind of offsetting that, if you will, with investments at shelf?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

On a balance, yes. On a balance, yes. But we still maintain that certain level of promotions, and we compensate that, obviously, as well by investing in the shelf. And remember, we're accelerating our investment on the shelves through the category rollouts. So as part of the 20 categories, one of the pieces is to position those categories correctly at the right level of shelf price.

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**David Hartley** - *Credit Suisse - Analyst*

Right. And you mix in different category management tools with that, I imagine.

And just wondering if the old rules apply when you're investing in price at shelf -- that it takes 12 months or so for the consumers to really see that. And it that perhaps why you saw a bit of lift in this quarter on same-store sales growth, which I suspect would be more or less sustainable as we move forward?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Yes. I never heard of the rule of the 12 months, by the way. (Multiple speakers) --

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**David Hartley** - *Credit Suisse - Analyst*

I made that up.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Oh, you made that up. That's good.

My rule. actually -- it's interesting that you said it -- because my rule is more around six to eight months.

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**David Hartley** - *Credit Suisse - Analyst*

Okay.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

And that's really when we started, to be honest, when we started really investing a little bit more, if you go back.

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**David Hartley** - *Credit Suisse - Analyst*

That's really helpful. Thanks.

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Thank you.

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**Operator**

Irene Nattel.

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**Irene Nattel** - *RBC Capital Markets - Analyst*

Sorry about that, I got muted.

What I wanted to clarify, Sarah, was -- again, coming back to the fully loaded cost of the SAP rollout -- should we be thinking, as you accelerate in the back half of the year, that we should see SG&A as a percent of sales start to creep up? Or really, on a fully loaded basis, we should expect it to be solid, because you will be able to incorporate the learnings, and so not have some of those costs?

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

I think you should expect it not to be significantly different than Q1. But we do expect to have some efficiencies coming through. But I think Vicente had mentioned that earlier -- that we don't expect significant decreases, but we should expect it to be slightly lower as the year unfolds.

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**Irene Nattel** - *RBC Capital Markets - Analyst*

That's great, thank you.



**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Thank you.

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**Operator**

Jim Durran, Barclays.

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**Jim Durran** - *Barclays Capital - Analyst*

Yes. Just wondered if you could give us an update on cross-stocking. Because my understanding [usually] was that your ability to do cross-stocking would be enhanced by SAP being fully in place. I just don't know how much of your business is now already cross-stocking, and whether you're trying to go as far as you might've thought you were going to go four or five years ago when you talked about it.

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Definitely, obviously, SAP is a huge enabler for cross-stocking. And I believe that as being a great opportunity of driving additional efficiencies in our supply chain network. Today at this stage, we're about a 5% level of cross-stocking.

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**Jim Durran** - *Barclays Capital - Analyst*

And so would you expect a significant portion of the categories to fall into the cross-stocking bucket down the road, once SAP is fully in place?

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**Vicente Trius** - *Loblaw Companies, Ltd. - President*

Yes. Actually, if you look at global best practices -- I mean, you could see almost levels of 40% cross-stock, 60% -- what you would call staple stock. So we'll be able to get to that level. I'm not going to commit to that here, but let's say that we see a lot of opportunity from increase in cross-stocking.

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**Jim Durran** - *Barclays Capital - Analyst*

That's great, thank you.

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**Sarah Davis** - *Loblaw Companies, Ltd. - CFO*

Thank you.

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**Operator**

There are no further questions at this time. Ms. Craig, I'll turn the call back over to you.

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**Janet Craig** - *Loblaw Companies, Ltd. - SVP of IR*

Thank you, Melissa.



Before we end, I just wanted to thank everybody for your cooperation today on our new system. And wanted to remind you that you should get details very shortly with respect to the teach-in we're having on Monday on our new loyalty program.

Thank you very much.

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**Operator**

Ladies and gentlemen, this concludes today's Conference Call. You may now disconnect.

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