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L.TO - Investor Teach-In Conference Call: Financial Reporting in a Post-REIT World

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PRESENTATION

Operator

Good morning. My name is Tracy, and I will be your conference operator today. At this time, I would like to welcome everyone to the investor teach-in, financial reporting in a post-REIT world conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

(Operator Instructions)

Thank you. And I'll now introduce and turn the call over to your host, Ms. Janet Craig. You may begin your conference.

Janet Craig - *Loblaw Companies Limited - SVP of IR*

Thanks, Tracy. And good morning, and welcome to the Loblaw Companies Limited teach-in on financial reporting in a post-REIT world. This call is also being webcast simultaneously on our website. I'm joined here this morning with 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 report. A summary may also be found on slide 2 of this presentation.

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 and other materials filed with the Canadian Securities regulators from time to time for a reconciliation of each of these measures to the most directly comparable GAAP financial measures.

The figures referenced in this presentation are primarily drawn from our 2012 annual report, as well as the preliminary prospectuses of Choice Properties Real Estate Investment Trust, each dated May 24, 2013 and filed on SEDAR. Pro forma figures in this presentation represent estimates of the impact that Choice Properties Real Estate Investment Trust might have on Loblaw's 2012 financials, had it been a public vehicle during fiscal 2012.

An archive of this conference call will be available on our website.

I'll now turn the call over to Sarah.

Sarah Davis - *Loblaw Companies Limited - CFO*

Thank you, Janet, and good morning, everyone. Slides 3 and 4 of our presentation are a review of some of the high-level reasons why Choice Properties REIT will be complementary to Loblaw's core retail business. The IPO will unlock the value of one of Canada's largest commercial property portfolios for the benefit of Loblaw shareholders. This value was not reflected in the Loblaw share price prior to the announcement we made in December that we were planning to create a REIT. We feel that our shareholders will benefit over time from exposure to this independent public growth vehicle. The REIT will also enable us to optimize the return on store development by creating a standalone vehicle with a lower cost of capital that is focused on creating value through retail real estate investment. We expect that the REIT will enable reduced capital expenditures on the retail side of the business on a longer-term basis, though spending will remain approximately the same in the near term.

Intensification is a good example of the value that a standalone vehicle can create. Intensification describes the process of further leveraging the development opportunity of a given property. And there is meaningful potential to execute this type of activity on some of the initial properties that are being transferred. Prior to this transaction, intensification was not the focus of our capital investments as a food retailer. For a separate REIT with preferential access to capital for this type of activity, the range of opportunities is certainly broader. We estimate that the initial portfolio offers at least 3.5 million square feet of at-grade growth leasable area expansion potential. Loblaw shareholders will benefit directly through payments from the REIT as it intensifies properties vended in, as well as indirectly through a majority effective ownership interest in the REIT.

The REIT will act as a long-term source of capital for Loblaw. One of the drivers will be future vend-ins. We have retained 12 million square feet of space at Loblaw, which we intend to vend into the REIT over the next 10 years. Capital will also flow to Loblaw as the REIT refinances debt in the public markets in order to repay the transfer of notes and to redeem the Class C units over time. Loblaw will also benefit from the intensification payments I just mentioned.

Continuing the thought onto slide 4 now -- the REIT has an experienced management team, and will have a mandate to grow not only through the opportunities presented by the strong relationship with Loblaw, but also by pursuing third-party acquisition opportunities, as well. This is something that we really haven't done in a concentrated way in the past, outside of the shopping centers that we own, which are moving into the REIT. All of the initial properties are subject to amended and restated Loblaw leases, with a weighted average remaining term to maturity of 14 years. It will take approximately five years to reach a steady-state weighted average annual rent escalation of approximately 1.5%. On some properties, lease terms will be as short as 10 years, and in other cases will be as long as 18. The rent escalation is staggered, and we expect both of these elements -- the term of the leases and the structure of the escalation -- to help ensure stability in the retail business. We hold a series of five-year renewal options with a total remaining term, including all extension terms, that can extend up to a maximum of 100 years depending on the province.

We will continue to have a strong strategic relationship with the REIT going forward. Following closing, we expect to hold an over-80% effective interest in the REIT. Our parent, George Weston Limited, will purchase 20 million units from the REIT at the offering price, for a total subscription price of CAD200 million for an approximate 5% interest. Loblaw has advised the REIT that it expects to continue to own a majority effective interest for at least the next 10 years. And both Loblaw and George Weston have agreed not to sell any units for at least 18 months following the closing.

On the closing of the IPO, Loblaw will enter into a strategic alliance agreement with the REIT with an initial term of 10 years. This agreement will govern the relationship between Loblaw and the REIT with respect to future growth, and will outline the REIT's right of first offer on Loblaw-owned real estate, as well as site intensification protocols and payments. We feel that this will be a mutually beneficial relationship going forward.

I'm sure by now most of you are broadly familiar with the indicative capital structure at the REIT. This can be seen on page 5. The REIT will indirectly acquire interest in the initial properties from Loblaw. And in exchange, Loblaw will receive promissory notes, which we refer to as transferor notes, as well as a portion of the trust units in all of the Class B LP units and Class C LP units. The trust units will be offered at a price of CAD10 per unit. The total enterprise value will be based on market conditions at the time of the IPO. The REIT will be issuing CAD400 million of equity units in the public offering. George Weston will be subscribing for an additional CAD200 million in equity units. And the balance of the equity units will be held by Loblaw.

I should just note that Class C units are equity instruments, but are considered debt for accounting purposes by the REIT. They have redemption rights that start 14 years after the IPO closes, and are entitled to a fixed cumulative distribution of 5% per year, paid monthly.

Let's move to slide 6 now to talk about the use of proceeds. To ensure that we are clear as we discuss the use of proceeds, this is from the Loblaw perspective, not the REIT's perspective. The proceeds from both the proposed debt and equity offerings of the REIT will ultimately flow to Loblaw. If we start at the bottom of the page, the REIT has filed a prospectus to issue unsecured debentures. The REIT expects to issue a total of CAD600 million in Series A and Series B debentures, with 5- and 10-year terms. The REIT will use all of these proceeds to repay CAD600 million of the CAD2.6 billion in transferor notes initially held by Loblaw. As a result of the repayment, Loblaw will have CAD600 million in additional cash, and will hold CAD2 billion in the form of transferor notes from the REIT following closing.

Our intention on the Loblaw side is to use the CAD600 million to recoup cash already used to repay a tranche of US private placement notes in May, as well as to pay down more of Loblaw's third-party debt. This transaction is a good example of how we view the process going forward, as well. As the REIT refinances the transferor notes with third-party debt, and repays Loblaw, Loblaw expects that it will look to repay its own third-party debt. From a cost of capital standpoint, we feel it makes more sense to have a higher third-party debt level in the REIT, and lower debt in the retail business. It continues to be our intention to maintain an investment-grade debt rating going forward.

With the proceeds from the equity offering, which will also flow to Loblaw, we have pointed to three broader potential uses for the capital. One is to pay down more debt, if it makes economic sense to do so. Another is to invest in our Business and look for growth opportunities. And another alternative is to buy back shares. The maturity profile of the transferor notes lines up closely with our own debt maturities. This will allow us to pay down our debt over time. So it isn't our plan at this time to prepay a large amount of debt. It is our plan to allocate a portion of the proceeds from the equity offering to buy back some shares, as well as to invest in the growth of the Business.

Currently we are not planning a dividend increase or a special dividend. We have raised our dividend twice this year. And we have said that going forward we plan to review it on an annual cycle around the time of our AGM.

Turning to slide 7 -- we have approximately CAD1.3 billion of Canadian notes and US private placement notes maturing from 2013 through 2016. In May of this year, we repaid a CAD150 million US private placement note, and going forward our plan is to pay down the Loblaw debt rather than to refinance it. This is to align ourselves with the long-term vision I described earlier, which is to lower the debt in the retail business, while balancing that off with higher third-party debt in the REIT.

Looking at slide 8 now -- this is a summary of the approximate impacts to our financials if we overlay the REIT looking back over 2012. Revenue increases by approximately CAD60 million, and SG&A increases by roughly CAD80 million. The CAD60 million increase in revenue, and the CAD60 million of the CAD80 million increase in SG&A, represent a reclassification of rent, property tax recoveries, and recovery rent on ancillary properties which were previously netted out of SG&A. The easiest way to think about ancillary properties is that they are properties that generate rental income outside of the four walls of our stores. The reason for the reclassification is that we used to view this income as an offset to the cost of running our retail operations -- it wasn't our core business. With the REIT, this rental income will be a primary component of the REIT's core business, so it will be moved up to revenue on a consolidated basis.

Outside of the reclassification, we expect to see a CAD20 million increase in SG&A, which is related to the REIT, the management team public company costs, and any other related costs. Depreciation and amortization will stay virtually the same on a consolidated basis, with a small amount of incremental D&A on top of what you see here, in the CAD1 million range, which is related primarily to IT and related infrastructure at the REIT. The incremental interest expense of up to CAD25 million for debentures is related to interest paid on the CAD600 million in debentures issued to third parties by the REIT. I would just note that the actual impact on a consolidated basis will depend on what Loblaw decides to do with the proceeds of the IPO and the proceeds from the repayment of transferor notes. I have just finished telling you that with the proceeds from the repayment of transferor notes, we intend to pay down Loblaw third-party debt, and these numbers do not account for that scenario.

Going forward, you should also think about the fact that the REIT should have a lower cost of funding than Loblaw. So even in a rising interest rate environment, the REIT should give us consolidated savings on interest expense compared to refinancing the debt at the retail level. The incremental CAD40 million interest expense for distributions that you see here accounts for distributions made on units owned by public unitholders, as well as those owned by George Weston. Under IFRS, these payments are treated as interest expense. In substance, however, these payments could be considered payments to the non-controlling interest.

The liability for the trust units, which, again, relates to the non-controlling interest, will have to be marked to market on a quarterly basis, and this will cause some variability in our P&L going forward. We estimate that a 10% increase in the market price of the trust units will result in an approximate CAD60 million loss in Loblaw net earnings. The math there is fairly simple -- on a CAD10 initial price for the units, and 60 million units owned by the public and George Weston, if the REIT unit price moves CAD1, this is what drives your CAD60 million loss. We plan to highlight the mark-to-market impact in our financials going forward. We do not expect the REIT to materially impact our consolidated tax rate.

Let's turn to a summary of these impacts on slide 9. You can see that on a pro forma basis, revenue is higher by roughly the CAD60 million we discussed on the last slide. EBIT and EBITDA are down by the CAD20 million in incremental SG&A expense. The interest expense component, both from interest payments made on third-party debt, as well as distributions made on trust units, will have an impact on our net earnings and earnings per share. Modeling it through on 2012, you can come to a roughly CAD0.22 reduction in consolidated earnings per share due to the impacts we have just discussed. As you look at this slide, just remember that we expect some of the incremental interest expense attributable to payments of the CAD600 million in debentures at the REIT to be at least partially offset by the repayment of third-party debt on the Loblaw side. In addition, you have to remember that a large part of the reduction from EBIT to net earnings is attributable to the distributions made to the non-controlling interest.

On slide 10 we have broken out a segment view to give you an idea of what you are going to see when we start to include the REIT in our reported results in Q3. Starting from the right, in the Financial Services segment, nothing will change from a disclosure point of view, and we will continue reporting the key performance indicators we have reported to this point. For the REIT segment, we plan to highlight the key performance indicators that the REIT will report in its own published financials.

The Retail segment is going to look very similar to the way that it looks today. The stores used by the retail business will still be reviewed by management on the same owned basis that has always been used, and the related assets will be held at historical cost with the associated depreciation. The only difference from today is that ancillary properties will be totally removed, including the depreciation associated with these properties, because those are now part of the REIT's business, and will be reflected within that segment.

On slide 11, I would just point you to some high-level valuation considerations. For the Financial Services business, nothing will change. There are a number of routes to valuation, given what we report -- EBITDA and EBIT seem like the most obvious ones, but there are other routes to valuating this business, as well. For the REIT, there are a number of ways to approach it, but it will be publicly traded so you will have a tangible estimate of fair market value at any given point in time to measure against.

On the Retail side, as I mentioned, the segment numbers we report will not be net of market rent, nor will they include distributions. One of the potential routes to separating the performance out for valuation purposes would be to extract the EBITDA we report as part of our retail segment, adjust it for cash rent on Loblaw sites, and then add back the Class B distributions. Going forward, we will provide you with these figures to give you the option of adjusting it as you see fit.

In conclusion, the addition of the Choice Properties REIT strengthens our Business. It is a public vehicle with its own access to capital, and an experienced management team that will focus on maximizing the value of its portfolio, and growing through its relationship with Loblaw and external channels. Loblaw Companies Limited is Canada's largest grocery retailer. We are home to a growing financial services business. And following the close of the Choice Properties REIT IPO, we will also own a large interest in one of Canada's largest REITs.

With that, I will turn the call back to Janet to manage the Q&A session.

Janet Craig - *Loblaw Companies Limited - SVP of IR*

Thanks, Sarah. Before we begin Q&A, I would like to highlight a couple items. The first is -- when we report our second quarter on July 24, we plan on releasing our results at 6 AM. The second is that we actually plan on having our Investor Day on November 21 this year, and we hope that you save the date, and we look forward to hosting you there. Lastly, later today we will be sending out slides from this presentation that are married with the transcript for your use and review.

And finally, for today's Q&A, I would request that you limit yourself to one question and a follow-up. And please feel free to join back in the queue after that.

And at that point, I will turn it over to Tracy for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Irene Nattel, RBC Capital Markets.

Irene Nattel - *RBC Capital Markets - Analyst*

Just wondering when we might get historical restated financials. And if the answer is as it happens, my follow-up question is, can we just take what the numbers you're giving us and divide it by 4, or divide it by the number of periods, and assume that there is minimal seasonality?

Sarah Davis - *Loblaw Companies Limited - CFO*

Hi, Irene. It's Sarah. First of all, we won't be restating because the REIT didn't exist. And so, really, what you'll see in Q3 is just the first quarter of REIT performance. So there won't be comparatives in the REIT or in the Loblaw consolidated results. So I think if you want to calculate the impact on what you think it will be, it's probably a pretty good estimate to take the 2012 and the numbers we've shared here and divide by 4.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. Thank you.

Operator

Jim Durran, Barclays.

Jim Durran - *Barclays Capital - Analyst*

I was just wondering if you can give us any dialogue on CapEx in terms of how the REIT is going to impact what the CapEx is going to be spent on the food ops on a 2012 pro forma, or whatever reference point you can give us.

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. Really, on CapEx, certainly in the short term we don't expect any substantial change. So, going forward some of the CapEx associated with the ancillary properties will be moving over to the REIT. On a consolidated basis, the CapEx will be essentially the same. So the CAD1.1 billion that we already talked about for this year will not change. And then we will give you some highlights on what we expect for 2014 later in the year. And the way that we see it in the short term is that Loblaw, the properties group in Loblaw, will still be responsible for site selection, developing stores, any new stores, purchasing the land, developing the stores. And then the process would be to vend it into the REIT, so the CapEx would still be spent in the retail business. That might change over time but that's certainly how we expect in the short term to happen. And then the REIT will be responsible for some of the maintenance CapEx. And that's all described in the prospectus. And some of that would have been happening in the retail today. So, really, on a consolidated basis in the short term you shouldn't expect a significant change in the total value of the CapEx. And over time it will start to move between retail into the REIT.

Jim Durran - *Barclays Capital - Analyst*

Okay. And if I can, just one last question. On the REIT distribution or dividend that Loblaw is going to receive, how is that going to be treated from a tax standpoint? Does it go straight into the Loblaw dividend or do you pay tax? Or how does that work?

Sarah Davis - *Loblaw Companies Limited - CFO*

We pay a tax on that.

Jim Durran - *Barclays Capital - Analyst*

Okay. Great. Thank you.

Operator

Chris Li, Bank of America Merrill Lynch.

Chris Li - *BofA Merrill Lynch - Analyst*

Just a quick question. If you can, Sarah, just maybe a quick overview on how does the REIT impact the free cash flow that's available to the Loblaw shareholders?

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. So there won't be a significant impact on free cash flow in the short term. So, when you look at the EBITDA of Loblaw it will be down the CAD20 million that we referred to, as a rough estimate. The CapEx we don't see as being significantly different. And so from that perspective the free cash flow won't be that different. However, we will have cash coming in from the distribution, obviously, from the IPO. And then as we vend in properties over time, there will be additional cash coming back to Loblaw. And depending on whether we take it in cash or REIT units, our ownership, will have an impact on the cash that we have at the Loblaw level, as well.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. And just a quick follow-up in terms of the interest expense. The CAD25 million that you referenced in your slide 8, I just want to be clear. Right now that's assuming you don't use the CAD600 million of debentures proceeds to repay any of the Loblaw third-party debt. Like, let's say, assuming you use the full CAD600 million to repay the Loblaw third-party debt, would that CAD25 million really be zero because you're just basically refinancing?

Sarah Davis - *Loblaw Companies Limited - CFO*

I doubt it's going to be zero, which is why, really, we're saying up to CAD25 million. So, yes, it's a very conservative scenario in that we were assuming that we don't have any. We've already paid down the debt to the US private placement, which is at a higher interest rate than what we're actually refinancing the REIT at. And we do have other MTNs coming due this fall and early in 2014. But it's not going to be perfect timing so we're not going to be repaying at the exact same time we get the financing out of the REIT. So there will be some impact. And then the other thing is that we will have some additional cash which we will earn interest on, but it is actually at a -- right now, the markets being what they are, it is a lower interest rate that we're earning from income perspective. So that's why we're saying up to CAD25 million. But, yes, we expect it to be less than CAD25 million but we don't expect it to be zero.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. Thank you.

Operator

Michael Van Aelst, TD Securities.

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

The trust unit liability number that's going to be volatile, what line item does that fall into?

Sarah Davis - *Loblaw Companies Limited - CFO*

We're going to put it in a new line item. So we are going to have a line item just for that so it's pretty clear to people where it is and they'll be able to see it. It will be in interest but it will be well segregated so you can see it.

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

Okay. And on those properties, the remaining properties that are going to be vended into the REIT over the next 10 years, is there any rough time frame? Do you expect this to be gradual? And how soon could it start?

Sarah Davis - *Loblaw Companies Limited - CFO*

We're giving ourselves a bit of time by saying 10 years. I expect it to happen quicker than that. I think it's possible that there will be some later in 2013. And definitely in 2014 we will start to vend in from that. And we'll be able to give you a little more detail once the REIT's up and running and we've got a better sense of that. But I do expect it to start.

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

Okay. Thank you.

Operator

Keith Howlett, Desjardins Securities.

Keith Howlett - *Desjardins Securities - Analyst*

I just wanted to confirm, are all the fixtures and equipment, and the responsibility to maintain and replace them, et cetera, does that reside with Loblaw?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes. The inside of the store, the fixtures are the responsibility of the retail business. The outside -- the parking lots, the roof -- would be the responsibility of the REIT.

Keith Howlett - *Desjardins Securities - Analyst*

Thank you.

Operator

Irene Nattel, RBC Capital Markets.

Irene Nattel - *RBC Capital Markets - Analyst*

Just following up on questions around timing, you referenced the 3.5 million square feet of intensification potential. How should we think about that and the related payments coming through? And then the second question is, just in terms of the timeline for the redeployment of the proceeds from the REIT, both the debt and the equity component of it, how should we think about how long you're going to take to deploy that?

Sarah Davis - *Loblaw Companies Limited - CFO*

On the 3.5 million of intensification, the REIT has already started to look at that and look at opportunities. It's not quick because, in some cases, it does require them to build something. So in some cases, a good example would be we would have an extra large parking lot where there is room for other retail opportunities to go in that parking lot. So, whether it would be a Tim Hortons or some other type of retail business, they do have to build it. So I would say it's not quick. You're not going to see it in the next six months but you should be able to see some intensification happening in 2014, I would say -- late in 2014. But it's not as quick as the potential for the vend-ins. So the 12 million square feet the stores exist today, that's an easier thing to vend into the REIT. So it's a little shorter time frame than what you'd expect from the intensification.

As far as how quickly are we going to deal with the money we get, the proceeds from the IPO, the debt IPO, will be at the time of closing. So basically as soon as the REIT gets the CAD600 million, it will reduce the transferor notes. So it will be simultaneous basically as they get it. And their transferor notes will be reduced to CAD2 billion into Loblaw. And then Loblaw will have that cash and, as I said, we'll use it to repay debt that has already been repaid as well as any new debt coming due. So that will happen. And then as far as the proceeds from the equity deal, we have said that we're planning to buy back some shares. So that is something that you should see in the near future. And I would say growth opportunities, it depends on what comes up. We're looking at a few different types of new formats. So we might invest a bit in that. Those would be the two key pieces. Maybe a little slower on that piece.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. Thanks.

Operator

Vishal Shreedhar, National Bank.

Vishal Shreedhar - *National Bank Financial - Analyst*

Just on the share buybacks, hopefully you can tell us how much you plan to buy back in 2013. And if the buybacks, do you view them to be an ongoing part of your capital return strategy to shareholders?

Sarah Davis - *Loblaw Companies Limited - CFO*

I think on our -- I don't have the specifics on how much we're planning on buying back in 2013. It might be something that we'll be able to talk about on the Q2 call. So I will write that as a note to myself. We might be in a position to talk about it then but not today. As far as is it part of our program? Yes. Galen did mention it on the Q1 call that it was our intention. So I would say that, yes, it is part of what we plan to do.

Vishal Shreedhar - *National Bank Financial - Analyst*

Thank you. And on D&A, Sarah, is there any way to figure out D&A attributable just to the retail business? I know the policies of D&A might be different between consolidated Loblaw and the REIT.

Sarah Davis - *Loblaw Companies Limited - CFO*

Well, what can you do? You be able to see it in what's attributable to the REIT when you have the standalone statements of the REIT, which will also be in the segment statement in Q3. So you would be able to have that. Would we be able to split it now? Basically, what we do know right now, the approximate amount of the D&A going to the REIT is about CAD80 million. So if you subtract that off from the total consolidated, you'd have a good split between retail and the REIT.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. So taking out CAD80 million is a reasonable proxy?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. Thank you.

Operator

(Operator Instructions)

Jim Durran, Barclays.

Jim Durran - *Barclays Capital - Analyst*

I just wanted to follow up on the intensification question. I would assume, though, that, given that the REIT doesn't have significant rent increases until year five on the rent agreement, that there will be a fair amount of effort put into intensification, as well as you doing your vending to justify enough growth on the REIT. Is that correct?

Sarah Davis - *Loblaw Companies Limited - CFO*

It would definitely be part of the plan that they would have to increase the growth in the REIT. And it wouldn't be that there's no rent escalations until year five. It's just takes until year five to get to 1.5%. They're staggered so that we don't have all of the rents coming with an increase in the same year. We do have staggered rents so there would be some increase from rent increases in the earlier years. But the growth, they are looking, in order to have growth in the REIT, they are definitely looking at the intensifications, as well as the vend-ins.

Jim Durran - *Barclays Capital - Analyst*

And has the REIT management, or do you expect that the REIT management, will provide some guidelines or guidance in terms of what they're targeting in terms of growth?

Sarah Davis - *Loblaw Companies Limited - CFO*

No, I don't think that they are at this time. Maybe once they get into running the business, they might be able to provide some guidance. But so far, no, there isn't any of that.

Janet Craig - *Loblaw Companies Limited - SVP of IR*

And, Jim, we can't really speak to what the REIT's management's intentions are.

Jim Durran - *Barclays Capital - Analyst*

Understood. Thank you.

Operator

Keith Howlett, Desjardins Securities.

Keith Howlett - *Desjardins Securities - Analyst*

Is the strategic alliance agreement inked, as it were, or is it still open?

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Sarah Davis - *Loblaw Companies Limited - CFO*

It's in the preliminary prospectus, so it's pretty well inked.

Keith Howlett - *Desjardins Securities - Analyst*

Okay. And so when it comes to something like a plaza, how do you deal? If Loblaw wants to change from a Loblaw to a nofrills, or, for example, wants to expand the store, or doesn't like a tenant that the REIT has picked, a co-tenant, how is that dealt with?

Sarah Davis - *Loblaw Companies Limited - CFO*

It would be dealt with within the strategic alliance agreement. There is the ability for Loblaw to change its banners. So within the Loblaw, from a Loblaw's to a nofrills, that would be within. And, as we would today. It's not that different from what we would do if we were renting from RioCan. We would have the ability to change the banner name. So that is part of the agreement, as well. As far as -- I forget the second one that you mentioned. The third one, as far as if we weren't happy with a tenant, it would be worked out within the strategic alliance agreement. But it's not part of the agreement for Loblaw to pick the tenants of who the REIT is planning on having.

Keith Howlett - *Desjardins Securities - Analyst*

The middle part was if you wanted to increase the square footage by 10% or 20%.

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. Yes, we would be able to do that within the agreement, within the individual leases. What you also have to understand is that we have individual -- they are not blanket leases. We have a separate lease agreement for each of the 425 properties that are going into the REIT. And there would be some standard terms definitely within that, but each one has a little bit of a different circumstance. But it is all governed by the strategic alliance agreement, which is in the prospectus that you could read. It's quite long but the details are there.

Keith Howlett - *Desjardins Securities - Analyst*

And on the unused density, the 3.5 million at grade, is there much air right or opportunities for going up on the sites? Like apartment buildings or office towers.

Sarah Davis - *Loblaw Companies Limited - CFO*

I would ask that actually to the REIT management team because they're the ones that will be managing that. I don't really want to put my perspective on that. I think I would prefer that you ask them about what their intentions on that would be.

Keith Howlett - *Desjardins Securities - Analyst*

So when you say 3.5 million square feet at grade, it doesn't include anything above grade? Or it does?

Sarah Davis - *Loblaw Companies Limited - CFO*

It doesn't. That's on the ground. The 3.5 million square feet is on the ground.

Keith Howlett - *Desjardins Securities - Analyst*

Great. Thanks.

Operator

Kenric Tyghe, Raymond James.

Kenric Tyghe - *Raymond James - Analyst*

Sarah, you mentioned the new format reference. I'm just curious, is that really going to be captured by the real estate that is yet to be vended in? Or is that going to see some reprocessing of the real estate that has already been vended in? Is this just about a shuffling? Or is it just about a new development protocol or thinking going forward with respect to new formats?

Sarah Davis - *Loblaw Companies Limited - CFO*

It's not reformatting what has moved to the REIT at this stage. It's basically looking at new square footage. We did open a new store called The Box by nofrills. It was opened in Calgary a couple weeks ago. And what that format is, it's 10,000 square feet. It's a small format, hard discount, everyday low price. So we are trying that as a pilot to see is it something that we would be able to infill in a lot of areas of Canada because it's only 10,000 square feet. So, from that perspective, it's not reformatting properties that have gone into the REIT. It's trying out new formats with new real estate.

Kenric Tyghe - *Raymond James - Analyst*

Great. Thank you. And just with respect to the new formats, that new one you mentioned in Calgary, The Box, sounds intriguing. Is anything further that you are able to speak to, or that you see being an opportunity with respect to the real estate for development?

Janet Craig - *Loblaw Companies Limited - SVP of IR*

Kenric, I think we're going to pass on that one right now. We are actually really trying to focus on the accounting in a post-REIT world. And we'll save any other more business-related questions for the Q2 call.

Kenric Tyghe - *Raymond James - Analyst*

Fair enough. Thank you. I'll leave it there.

Operator

Chris Li, Bank of America Merrill Lynch.

Chris Li - *BofA Merrill Lynch - Analyst*

Just a quick question just on leverage. Sarah, you mentioned in your opening remarks that the focus would be to lower debt at retail business, and balance it with higher debt at the REITs. And I'm just wondering, internally, how do you think about leverage at the retail level over the longer term? Do you have an optimum range in mind? And what I'm trying to understand better is that as the CAD2 billion of transferor notes get paid through the REIT back to Loblaw, I think you will end up with a pretty substantial cash position at retail. And I'm just wondering how do you think about leverage in that context?

Sarah Davis - *Loblaw Companies Limited - CFO*

In the short-term our leverage at the retail business will actually be higher because we'll have all of the operating leases associated with the REIT. So what we do intend to do is pay down the third-party debt in retail in order to bring it back to the same levels it would have today. And then from there, to your point, yes, we do have the opportunity to have a substantial cash balance, which we will have to determine what to do with that cash going forward. But as far as from a -- we have been looking at it from a consolidated basis. We definitely want to stay BBB where we are today. If anything, we could look for an improvement but we're fairly happy with where we are now. And that's the leverage that we're comfortable with.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. That's helpful. Thanks.

Operator

Jim Durran, Barclays.

Jim Durran - *Barclays Capital - Analyst*

Just back to intensification, the 3.5 million square feet, does that include downsizing existing larger stores?

Sarah Davis - *Loblaw Companies Limited - CFO*

No.

Jim Durran - *Barclays Capital - Analyst*

Okay. So that's purely just identified property that's not necessarily needed for parking or adjacencies.

Sarah Davis - *Loblaw Companies Limited - CFO*

That's right. It's just the additional properties.

Jim Durran - *Barclays Capital - Analyst*

And so if there was any significant effort at downsizing some of the larger stores, would Loblaws incur the CapEx to reuse that space? Or would that go to the REIT?

Sarah Davis - *Loblaw Companies Limited - CFO*

I think we'd have to -- I don't know the specifics. I don't want to get into the specifics of how each one is going to work. At this moment we don't have a big downsizing effort going on. So the specifics of how it would work, we'd have to work it out as we went through.

Jim Durran - *Barclays Capital - Analyst*

Okay. Thanks, Sarah.

Operator

Vishal Shreedhar, National Bank.

Vishal Shreedhar - *National Bank Financial - Analyst*

I just wanted to follow up on the question about debt attributable to retail versus debt attributable to the REIT. From your standpoint, the way that you'll look at the Company and how it is levered, I understand from a capital allocation standpoint and the pricing of the debt you'll place it where it's most effective. But when you look at the balance sheet of Loblaw, are you going to be looking at it on a retail basis and a REIT basis to determine how much leverage is appropriate for the Company? Or will you be looking at a consolidated basis?

Sarah Davis - *Loblaw Companies Limited - CFO*

I think really we'll look at it both ways. So what ends up happening is in the REIT we've said from the beginning we'll be capitalized 50-50 debt to equity, is our intention from the beginning, and we'll see. It will be in that range. And then we will look at it on a retail basis as well as the consolidated basis. Consolidated for me would be what my primary focus would be, understanding what the REIT plans are, as well.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. So just to be clear, when the REIT repays the transferor notes, on a consolidated basis not really much will change. Is that a correct way to look at it?

Sarah Davis - *Loblaw Companies Limited - CFO*

That's right.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. Thank you.

Operator

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

Janet Craig - *Loblaw Companies Limited - SVP of IR*

Thanks, Tracy. And just before we close I wanted to thank everybody for their time and attention today. And if there are any follow-up questions, you can certainly call me or Jonathan Ross on my team will be happy to answer any questions that you might have. Thanks and have a good day.

Operator

Thank you for joining, ladies and gentlemen. This concludes today's conference call. You may now disconnect.