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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 Loblaw Companies Limited second-quarter results 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)

I'll now turn the call over to Ms. Janet Craig. You may begin your conference.

Janet Craig - Loblaw Companies Ltd - Senior VP, IR

Thanks, Tracy, and good morning. And welcome to the Loblaw Companies Limited second-quarter 2013 conference call. This call is also being webcast simultaneously on our website at Loblaw.ca. I'm joined here this morning by Galen Weston, Executive Chairman; Vicente Trius, President; and Sarah Davis, Chief Financial Officer.

Before I 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, and the Company's plans and projections with respect to Shoppers Drug Mart Corporation, which the Company recently entered into an agreement to acquire. 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 risks -- 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. 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 -- 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 directly comparable GAAP financial measure. I will now turn the call over to Galen.

Galen Weston - *Loblaw Companies Ltd - Executive Chairman*

Thank you, and good morning. Earlier this month, we announced the successful IPO of Choice Properties REIT. And in doing so, we unlocked significant value for shareholders and established an attractive new growth platform for Loblaw. Last week, we announced a transformational combination with Shoppers Drug Mart. These two transactions mark the beginning of a powerful new chapter for Loblaw. Combining Loblaw and Shoppers Drug Mart will build on the strong base Vicente and his team have developed over the last two years, providing an excellent strategic complement to our existing assets and setting the stage for further shareholder value creation. Together, the two businesses will leverage each other's strengths to capitalize on the two most important demographic trends driving the Canadian consumer in the foreseeable future -- health, and urbanization.

Given the compelling strategic rationale, Shoppers Drug Mart has been at the top of our strategic acquisitions list for several years. And, despite extensive analytical work and detailed discussions between both parties, until now, the timing wasn't right. Today, with a strong foundation built on the completion of our supply chain project, entering the last phase of the implementation of our IT infrastructure, clear traction in improving our customer proposition, and as a result increasing competitiveness, the timing now makes sense. We have a thoughtful approach to integration and confidence in our ability to deliver on the synergies.

Turning to the quarter, our strategy is clearly working. The investments we've made to advance our customer proposition once again translated into improved same-store sales performance in an intense competitive environment. At the same time, better mix and good expense management delivered improved earnings during the quarter. To reflect our year-to-date performance, we are raising our outlook to expect mid-single-digit operating income growth for fiscal 2013. I'll now turn the call over to Vicente to share some of the specifics on our performance.

Vicente Trius - *Loblaw Companies Ltd - President*

Thank you, Galen. Good morning, everyone, and thank you for joining us. During the second quarter, we continued to see positive momentum in our core business as a result of the investments we have made in our customer proposition. Same-store sales growth came in at 1.1%, a significant improvement over Q2 last year, which was the strongest quarter of 2012. Like Q1, the growth this quarter was primarily driven by our core food and drug business, with particular strength in fresh. Our continued investments across banners, our category reviews, our strategy on improving everyday shelf pricing versus promo, as well as our relentless focus on improving the customer experience, leading with fresh, are yielding sustained results. Our internal food price index was flat, and during a very competitive quarter we grew both basket and traffic compared to last year.

With fresh and the customer experience being at the core of our customer proposition, I wanted to spend a bit of time speaking to you about the improvements we have made in the conventional side of our business in Quebec. Last week, we opened our first new store in Quebec under the Provigo Le Marche banner. We plan to convert six additional stores to this unique concept by the end of 2013. The stores will be focused on outstanding fresh, with a number of distinctive features, including in-house aged beef, as well as a large selection of Quebec-produced cheese. Our conventional business has seen improved same-store sales performance in the province over the past two quarters, with tonnage share recently turning positive. We intend to continue to focus our efforts in Quebec and feel that the market atmosphere and unique offerings available in the Provigo Le Marche stores will resonate with our Quebec customers.

As we continue to see traction across different banners and across different regions, I also wanted to share with you another example of where our investments are paying off. Several months ago, we started to invest in pricing assortment, as well as our fresh offering, in one of our banners in

Ontario. At the same time, we also improved in-store messaging and changed the format of our flyer. Customers took note, and this strategy is yielding results. In Q1, both same-store sales and share turned positive, and that trend has continued in Q2.

Our drug store business continued to grow this quarter, with script count growing plus 3.5% as we began to lap the Zellers acquisition from last year. While business momentum is extremely important, we also need to ensure we are able to leverage expenses to deliver bottom-line results. This quarter, we made some good progress on expense management. As we move through the year, this will continue to be a focus for us. Our SAP rollout continues. We are on track for our target to have the bulk of our stores rolled out by the end of 2014, and we're working towards a scalable model.

Before I hand the call over to Sarah, I want to also spend a moment on Shoppers Drug Mart. This is a game changer for how we trade to the customer. Being able to present our customers with best-in-class food and health and wellness offerings, while at the same time delivering on convenience and value, will provide us sustained competitive advantage in the years to come. As transformative as this transaction is, we will not be successful without execution. That is why we're building a comprehensive integration plan, which will be led by a member of our senior executive team. In the months to come, as we finalize our integration plan in consultation with Shoppers Drug Mart, we will be in a position to share with you a more detailed plan with both our timing and targets. And now I turn the call over to Sarah.

Sarah Davis - Loblaw Companies Ltd - CFO

Thank you, Vicente, and good morning. I wanted to take a moment to touch on the synergies we expect to realize on the Shoppers Drug Mart acquisition before turning to the quarter. As we discussed last week, we expect CAD100 million in net synergies in the first year, CAD200 million in the second year, and CAD300 million in the third year following the transaction. The majority of expected synergies in year one are related to COGS. We have calculated the savings on national brands, control brands, on leveraging Shoppers generic drug pricing, as well as some incremental control brand penetration. We also see some additional savings in marketing expense, like the distribution and printing of flyers, as well as goods not for resale. In year two, the greatest contribution is still in COGS, as well as the other items I just noted, with additional opportunities coming from supply chain. In year three, we see incremental opportunities from supply chain, as well as additional synergies in IT and store support. It is important to note that the synergies in the first two years are not dependent on integration, and they are in addition to the efficiencies we expect from SAP.

I will now turn to our second-quarter results. Retail sales, growth of 1.9%, was primarily driven by our core food and drug businesses. Same-store sales grew 1.1% in Q2, or 1% excluding the Gas Bars. While we had the same number of shopping days year over-year, Q2 of 2013 lost one week of pre-Easter shopping that we estimate adversely impacted our comps by approximately 15 to 20 basis points this quarter. Apparel sales were strong, primarily driven by our US wholesale business, while sales in our general merchandise business declined marginally versus Q2 last year. Gross margin was flat to last year, at 22.3%. During the quarter, a shift in sales mix, as well as continued investments in food margins, were partially offset by margin improvements in our general merchandise and apparel businesses. We also benefited from improved shrink, as well as a reduction in transportation costs during the quarter.

Retail operating expenses as a percent of sales were 18.3%, approximately 20 basis points better than the second quarter of last year. While we still have progress to make on efficiencies, we are doing better year over year in targeted areas. We continued to benefit from the restructuring in Q4 last year, and we effectively managed retail labor during the quarter, which was roughly flat year over year on a dollar basis, despite a higher level of sales. In addition to these two factors, we also realized efficiencies in warehouse costs, which we attribute to our supply chain investments. Year over year, operating income also benefited from a foreign exchange gain of CAD7 million related to a currency swap linked to the US private placement note we repaid during the quarter. We also saw higher depreciation in the quarter compared to last year, which was primarily associated with the IT project.

On the Financial Services side of the business, revenue grew by 6.5%, with contributions from both our PC Telecom and PC MasterCard businesses. PC financial earnings before tax grew by CAD14 million year over year. Consolidated basic net earnings per share grew by 14.5% in Q2. Given our strong results in 2013 to date, we are raising our outlook to reflect an expectation of mid-single-digit consolidated operating income growth for the year, up from our prior low single-digit estimate. This outlook excludes the impact of the REIT, the Shoppers Drug Mart acquisition, as well as a number of one-time items which can be found in the outlook section of our news release.

There are a couple of additional items I would like to note for Q3. When we consolidate the REIT, we will reflect a charge of approximately CAD40 million in interest and other financing charges, which is related to the REIT IPO costs. In addition, subsequent to Q2, we early settled the Company's remaining \$150 million USPP note, which was due in May of 2015, and as a result, we will also realize an additional CAD18 million in early settlement fees that will be recorded in interest and other financing charges in Q3. We did not repurchase any shares during the quarter, but subsequent to quarter end, we repurchased approximately 1.5 million shares under an automatic share repurchase program. Through the end of the year, we do not expect to make any material purchases, as we will be preserving cash for the Shoppers Drug Mart acquisition. With that, I'll pass the call back to Janet to moderate the Q&A session.

Janet Craig - Loblaw Companies Ltd - Senior VP, IR

Thanks, Sarah. Before I turn the call over to questions, I just wanted to remind you that I would like you to limit your questions to one question and a follow-up. You're welcome to go back into the queue after your first two questions. I also would request that you limit your questions to our second-quarter results. While we wanted to provide additional color on the transaction, we will not be answering any questions regarding the acquisition of Shoppers Drug Mart on this call. And now I'll turn the call over to questions. Tracy?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Irene Nattel, RBC Capital Markets.

Irene Nattel - RBC Capital Markets - Analyst

Good morning, everyone.

Vicente, I was looking for a little bit more color around some of the progress that you've made that's driving the top line. And I was wondering if you could update us on where you stand right now in terms of the category reviews, how much further you have to go, and what the key drivers were of the same-store sales growth?

Vicente Trius - Loblaw Companies Ltd - President

Good morning, Irene.

Our top line growth is mainly driven by our core business, which is all about food, grocery, and drug. And I would say, especially in Fresh, our category reviews are on track. We are on track and doing about 25 to 30 category reviews this year. And as we said before, this we see about on a 2.5-year cycle, which is about 50 to 60 categories. And they are all performing very well, with -- let's say -- sales growing and tonnage growing in those categories, for the most part.

So we feel good. We feel good about the performance of the business. Actually shows growing trends as you compare to last year.



Irene Nattel - RBC Capital Markets - Analyst

So as we think about the evolution as we move forward through the year and into next year in terms of same-store sales, how confident are you that the initiatives that you put in place to date, including the category reviews, will enable you to maintain this kind of growth despite the competitive environment?

Vicente Trius - Loblaw Companies Ltd - President

We feel pretty good on the performance that we have this far. And if you take Q2, we feel pretty good on that performance going forward. Having said that, we should not underestimate the dynamics of the market, with over 3% square footage growth, and having an additional, let's say, 70 target stores opening before the end of the year. But we are very confident in our strategies and we are competing in that environment and delivering.

Irene Nattel - RBC Capital Markets - Analyst

That's great. Thank you.

Janet Craig - Loblaw Companies Ltd - Senior VP, IR

Thanks, Irene.

Operator

Chris Li, Bank of America.

Chris Li - BofA Merrill Lynch - Analyst

Good morning.

Sarah, I was wondering if you can help us in terms of the IT expenses increase for the quarter. What was the year-over-year change in IT expenses, both on a cash basis and also for D&A for the quarter and maybe for the first half of the year?

Sarah Davis - Loblaw Companies Ltd - CFO

Okay. So we haven't -- we're not splitting out the costs any more, because basically what we did say is that for the year they're roughly going to be flat, with an increase in depreciation and a decrease in cash expenses that will roughly offset.

Having said that, during the quarter the depreciation was up about CAD12 million. The cash expenses were down slightly less than that; so we did have a bit of an impact in the quarter, but it's not material. So it's not something that we are splitting out any more. But for the year, we're still on track to be roughly in line with last year at the same level as last year.

Chris Li - BofA Merrill Lynch - Analyst

Okay, and as a follow-up, given that your adjusted operating income for the first half of the year, I think it's up about 10% compared to last year. Do you think your mid single-digit growth target for the year is conservative? And if not, are you expecting either the operating environment to get tougher, or do you expect the expenses to accelerate in the back half of the year and that's why you are only targeting mid single-digit growth.

Sarah Davis - Loblaw Companies Ltd - CFO

Year to date, I calculate about 9.4%.

Chris Li - BofA Merrill Lynch - Analyst

Okay.

Sarah Davis - Loblaw Companies Ltd - CFO

And I would say that we're pretty comfortable. We did raise our guidance, which was important to us, but I think it's a reasonable estimate. We have a lot of competition coming in. And to Vicente's point, you can't underestimate the power of the competition that -- and the number of stores that Target and Walmart will be opening in the remainder of the year.

Chris Li - BofA Merrill Lynch - Analyst

Okay. Thank you.

Janet Craig - Loblaw Companies Ltd - Senior VP, IR

Thanks, Chris.

Operator

Patricia Baker, Scotia Bank.

Patricia Baker - Scotiabank - Analyst

Thank you very much.

Vicente, when we look at the trend on the sales line, it was great to see that continued momentum there in Q2 after the strength we saw in Q1. Can you talk about specific dynamics and what the differences were in the trading environment in Q2 versus Q1? Because in the press release and in your discussion, there's slight differences in the nuance of how you describe how food, drug, and other areas did. So just really interested in the dynamics and differences between Q2 and Q1.

Vicente Trius - Loblaw Companies Ltd - President

Yes. For us, internally, I'm assuming you're asking the question. I'm going to give you an internal view and an external view from a market perspective.

An internal view would be that Q1 broadly would be the softest quarter that we had the prior year. And Q2 would be, let's say, the strongest quarter that we had the prior year from a sales perspective. And then you have a little bit of a flip in New Year's and Easter. So for example, Easter would have been about 20 basis points, and New Year's, about 30 basis points. So when you add it all up, all in all, our trend, when you compare it against last year, is doing actually better in Q2.



From a market perspective, we see a market that is actually intense, a little bit, from a standpoint that you have the square footage growth and then you see competitors actually going a little bit more intense on the promotional activity. But we don't see any other changes beyond that.

Patricia Baker - Scotiabank - Analyst

Okay. That's very helpful. My follow-up question is a broader one.

If we look at the way you've talked about and showcased Maple Leaf Gardens and indicate that, that store would be a living lab and we could see some of the things that work there extended outwards into other stores; and I would assume that what we've seen in Sherbrooke opening last week and what's to come in Kirkland would take some of that?

And additionally, you also opened what looks like a really exciting store in Vancouver last week. I'm just curious -- if we just think about it in a blue sky -- how large an arena or platform do you think you have for that kind of a store -- the 40,000-, 42,000-square foot box with all that Fresh in there, that sort of new thing that you've revealed to the market?

Vicente Trius - Loblaw Companies Ltd - President

Well, thank you for asking that question, Patricia.

We are very pleased with the performance of the stores and how we trade to the consumer. We believe that when we talk about the overall experience of the customer and where we take the Fresh, specifically, and how we localize to the local consumer and the different demographics, it's really -- I'm going to go out on a limb and say it's best-in-class, in my mind.

Patricia Baker - Scotiabank - Analyst

I don't think I would argue with that, based on what I've seen.

Vicente Trius - Loblaw Companies Ltd - President

Okay. Well, thank you. Thank you.

As far as how far you see, I think it has different dimensions. We said all along that we have an inspired format and that has X amount of stores -- I'm not going to give you a number -- but has X amount of stores, depending on demographics and neighborhoods. But I believe that all of those learnings are also being taken to what we call our neighbor stores. There's a lot of learnings that are being transferred there and that's one of the reasons that you see our Fresh performance especially doing a lot better.

Patricia Baker - Scotiabank - Analyst

That's very helpful. Thank you.

Janet Craig - Loblaw Companies Ltd - Senior VP, IR

Thanks, Patricia.



Operator

Perry Caicco, CIBC World Markets.

Perry Caicco - *CIBC World Markets - Analyst*

Thanks. Just on the increased outlook for the year, is your confidence in that number due to plans on expenses and expense control in the back half? Or is it more some optimism on sales and gross margin maintenance?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Hi, Perry. It's Sarah.

So I would say it's a combination of both. And it's based on the performance we've had so far in Q1 and Q2 as well. So based on coming out of those two quarters and what we know we have in place from a cost basis, as well as the sales we expect to have, that would be the combination would be what was factored into the outlook.

Perry Caicco - *CIBC World Markets - Analyst*

And then when you talk about the investments that the Company's making in IT, and prices, and labor, that those will be offset by operating efficiencies. Are you suggesting, potentially like a reduced head count in the back half? Or is it more that volume increases will occur over relatively flat expenses?

Vicente Trius - *Loblaw Companies Ltd - President*

We believe that we can continue to leverage our efficiencies, like we've done in Q2. And it's in many parts of the business, so it's from productivity to the stores to supply chain. And we believe as well in the second half of the year, we will continue to perform as we have on the top line in how we treat the customers. So again, supporting sales is a combination of the two. That's why we raised our forecast and operating income to mid single digit.

Perry Caicco - *CIBC World Markets - Analyst*

And on gross margins -- just to be clear -- did sales mix have a positive or a negative impact? I wasn't clear from the release.

Vicente Trius - *Loblaw Companies Ltd - President*

What's that again? Could you repeat?

Perry Caicco - *CIBC World Markets - Analyst*

Does sales mix have a positive or a negative impact on gross margins in the quarter?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay. It's Sarah.



It was a negative impact. We had higher food sales, which have a lower margin. And so the higher sales in food resulted in a lower GP associated with that, but it was partially offset by the good performance -- margin performance in apparel and in general merchandise.

Perry Caicco - *CIBC World Markets - Analyst*

But you referred to, also to sales strength in apparel.

Sarah Davis - *Loblaw Companies Ltd - CFO*

That's right.

Perry Caicco - *CIBC World Markets - Analyst*

Yes, and is that specific to the core Joe Fresh program in Canada? Or was that related to Joe Fresh in the US?

Vicente Trius - *Loblaw Companies Ltd - President*

We did -- actually, our performance in Canada, we're very pleased, okay. And obviously, our performance in the US, as well. But the performance in Canada was very solid -- very solid.

Perry Caicco - *CIBC World Markets - Analyst*

Okay, that's good. Thank you.

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thanks, Perry.

Operator

David Hartley, Credit Suisse.

David Hartley - *Credit Suisse - Analyst*

Hello. Thank you very much.

Just want to ask you on the basket, if you can share with us the trend. Obviously, there's not a lot of price in there, and there's some good tonnage. But in terms of the basket size, how is that moving?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, the basket size -- we had solid customer count growth and our basket is increasing. And this is based on our customers buying more and more across the breadth of our assortment. It means that our strategies are working.



David Hartley - *Credit Suisse - Analyst*

Okay, great. Thanks.

And on the foreign exchange, could you share with us any -- I saw the ForEx impact that Sarah talked about, the gain there. But in terms of ForEx going forward with the dollar strengthening, do you expect material impacts to your P&L as we move forward should the dollar continue to strengthen? Or do you think it's immaterial at this point?

Sarah Davis - *Loblaw Companies Ltd - CFO*

I would say in every quarter, we would have some sort of FX impact, either positive or negative. We sometimes talk about it as being an impact on our gross profit.

In this particular quarter, we just highlighted it because it wasn't the day-to-day business impact of FX. It was related to retiring a swap. I would say going forward, if Canadian dollar increases, it does have a positive impact on our earnings, but it's not something that would be material. If it was, we would highlight it.

David Hartley - *Credit Suisse - Analyst*

Got you. And there's my two questions. I'll leave it at that.

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thanks, David.

Operator

Jim Durran, Barclays.

Jim Durran - *Barclays Capital - Analyst*

We know we've seen some of the manufacturers and suppliers take price increases in areas like baked goods and deli and meats. Are you seeing any consistent increase now in cost of goods sold inflation? And are you finding an ability to pass it through, given your zero inflation for the quarter?

Vicente Trius - *Loblaw Companies Ltd - President*

So again, so our internal inflation, especially on the food side of the business, is flat. And that's a mix. It depends on how you look at it in categories. So in some areas of Fresh, we have seen a little bit of inflation, but not a lot. In some areas, actually none. And in our case, in some areas we are actually deflating. So, nothing major, if that's your question.

Jim Durran - *Barclays Capital - Analyst*

And you don't see a lineup now of companies coming forward with intended price increases at this point?

Vicente Trius - *Loblaw Companies Ltd - President*

No, no.

Jim Durran - *Barclays Capital - Analyst*

Okay. And on the SAP, are you going to be providing us with more details about expected cost savings? And if so, when?

Vicente Trius - *Loblaw Companies Ltd - President*

Cost savings due to the SAP implementation?

Jim Durran - *Barclays Capital - Analyst*

Yes.

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, we will. We said all along that it is our intention, as we roll out this plan, that the SAP roll up. And as we see efficiencies coming down, we'll give you more color. We're not yet at the stage of that, but we do see in the future efficiencies coming through this program.

Let me give you a little bit of where we are today. So we believe that we are making very solid progress on the foundation, which for us is a lot on the data quality, as we roll out to the stores. We rolled out 19 stores and 8 DCs, and we feel we're very close to a scalable model and will look at having the final rollup by the end of 2014, give or take.

Jim Durran - *Barclays Capital - Analyst*

I know we're not supposed to go there -- but just directionally, would the Shoppers integration affect that at all?

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Jim, Jim. Hey Jim -- number one, it's question number three. Number two, it's on Shoppers. (laughter)

Vicente Trius - *Loblaw Companies Ltd - President*

The answer is no.

Jim Durran - *Barclays Capital - Analyst*

Okay. Thank you.

Operator

Peter Sklar, BMO Capital Markets.



Peter Sklar - *BMO Capital Markets - Analyst*

If you look at your SG&A margin, or I think what you call it, your operating cost margin, it's down. And I believe you attribute it to savings in labor and supply chain. So my question is, the labor you're talking about -- I think you're talking -- I want to confirm you're talking about store labor. And on the supply chain, if you can talk about where you're seeing the savings in the supply chain, if you would attribute that to the efforts you've made so far in terms of IT and SAP rollout.

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay. So when we referred to -- there's a couple pieces.

On operating costs, it would involve labor in the stores, so efficiencies associated with the labor in the store. It also involves -- we did do a restructuring in Q4 of last year, so that is flowing into this year as well. So there is savings associated with that. And when we look at the supply chain costs, it is related to the investments we made in the supply chain -- the new warehouse management systems, as well as the transport management systems. And we are starting to see efficiencies in both of those areas. And that is where the savings are coming from.

Peter Sklar - *BMO Capital Markets - Analyst*

Right. Is this the first quarter where you've really seen that? Or do you think you've been getting some of the benefit in previous quarters? You just noted it now for the first time.

Sarah Davis - *Loblaw Companies Ltd - CFO*

We have seen it in other quarters, but it's starting to become something that's worth talking about. So it's a little bigger in this quarter.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And Vicente, when you were talking about Quebec, your discussion of Quebec, I believe you said that tonnage trends recently turned positive. I wasn't too sure, because you were talking about Quebec in the context of your conventional business. So, have your tonnage trends turned positive in the conventional business? Or also in your discount banners? Or were you talking overall?

Vicente Trius - *Loblaw Companies Ltd - President*

On the Quebec, I was just talking about an example where we repositioned the business, and we're doing actually quite well, and we've seen a solid trend change. As we look at the overall business, I would say our tonnage would be flat, but we see good trends in conventional and solid trends in discount.

Peter Sklar - *BMO Capital Markets - Analyst*

So when you said that in one part of your business you saw the trend turn positive, is that conventional? Or are you just talking about one small part of conventional?

Vicente Trius - *Loblaw Companies Ltd - President*

That was an example, but it's not the only example I would have in conventional. I have other banners in conventional that actually have positive tonnage as well.



Peter Sklar - *BMO Capital Markets - Analyst*

Okay. Lastly, Sarah, I just wanted to ask when do you think the Company will be in a position to provide detail on the purchase equation for Shoppers in terms of allocations to good will, et cetera, and amortization periods?

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Peter? Peter?

Peter Sklar - *BMO Capital Markets - Analyst*

When and how will you disclose that?

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Question number three, and it's a Shoppers question, so we're going to have to decline to answer that.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay.

Operator

Michael Van Aelst, TD Securities.

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

Most of the questions have been asked, but I wanted to ask you about the financial services and how we saw a bit of a drop in revenues on a sequential basis. Looking back, Q1 usually looks like it's the weakest, but Q2 wasn't so strong. The earnings were obviously very good, but the revenue growth definitely slowed. Is that something that's seasonal? Or are we just kind of starting to max out on where the revenues can go?

Vicente Trius - *Loblaw Companies Ltd - President*

Actually, we're pretty pleased with the revenue growth and the performance of the bank. We continue to have an objective of getting 1.2 million apps every year in this, translating in revenues in our MasterCard and other parts of the business, whether it's insurance or mobile shops. So we actually -- we see it as a really core piece of our business.

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

But is that growth starting to level out a little bit, given all the initiatives that were put in place in the last two years? Or is it just --?

Vicente Trius - *Loblaw Companies Ltd - President*

I wouldn't look at it that way. I would say maybe it slowed down a little bit in Q2, but overall, we're growing. It's got good revenue growth. And going forward, we're actually foreseeing solid revenue growth.

Michael Van Aelst - TD Newcrest/Waterhouse Securities - Analyst

Okay, and just so I can understand the operating expense comments -- looked like it was flat in retail in the quarter, and you did point to some labor cost reductions and things like that, or containment. Is that something -- is there some seasonality also into that, those numbers, that shifted around from Q1 to Q2, or Q2 into Q1? Or are you actually expecting this trend to flat same-store sales -- I'm sorry, flat operating expense growth to continue for a few quarters?

Vicente Trius - Loblaw Companies Ltd - President

No seasonality impact. And again, we feel pretty good on what we're doing from a standpoint of productivity at the store level and from a standpoint of productivity in the supply chain. So we would foresee going forward to be able to leverage efficiencies, as we always said, and to focus on the customer proposition.

Janet Craig - Loblaw Companies Ltd - Senior VP, IR

Thanks, Michael.

Michael Van Aelst - TD Newcrest/Waterhouse Securities - Analyst

Great. Thank you.

Operator

Kenric Tyghe, Raymond James.

Kenric Tyghe - Raymond James - Analyst

Thank you, good morning.

Vicente, you've highlighted the share and tonnage trends, Quebec and nationally. I wonder if you could call out what other pockets of strength you've seen, either by region or by format. Just trying to tease out what's working and where, by format and by province.

Vicente Trius - Loblaw Companies Ltd - President

I'm not going to go into every province, so we give you a highlight a little bit, just to give you an example. The only color I would give you is that we see good trends in both divisions, but I would have to say that we see better trends in discount than in conventional.

Kenric Tyghe - Raymond James - Analyst

Fair enough.

And apology if I missed it earlier -- the Easter timing shift -- what was the headwind there on same-store sales (multiple speakers)?



Vicente Trius - *Loblaw Companies Ltd - President*

20 basis points on same-store sales.

Kenric Tyghe - *Raymond James - Analyst*

Great. Thanks very much. I'll leave it there.

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thanks, Kenric.

Operator

Keith Howlett, Desjardins Capital.

Keith Howlett - *Desjardins Securities - Analyst*

Yes, on the SAP implementation, how many stores do you expect to have on the platform by the end of 2013?

Vicente Trius - *Loblaw Companies Ltd - President*

Our overall goal is to get around a number of about 300 by the end of 2013. And that's our expectation at this date. Again, we're building a solid foundation behind the data. We're rolling it out banner by banner, which is important to get the data quality and getting to a scalable model. But this far, we feel we can get around that number.

Keith Howlett - *Desjardins Securities - Analyst*

Then on the financial services business that had a very good profit improvement -- was there something one-time in that? Or was that -- you mentioned there was a vendor agreement. Was there any one-time payment? Or is that a pure operating number?

Sarah Davis - *Loblaw Companies Ltd - CFO*

It's a pure operating number. So it is comparable. Having said that, we did renegotiate a vendor contract in Q4 of last year. We had the one-time benefit in that quarter, but the ongoing benefit is helping us on a year-over-year basis. But it's a run rate now.

Keith Howlett - *Desjardins Securities - Analyst*

Thank you.

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thanks, Keith.



Operator

Vishal Shreedhar, National Bank.

Vishal Shreedhar - *National Bank Financial - Analyst*

Thank you. Vicente, I might have misheard you, but did you say that tonnage in the quarter was flat?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, I did say that.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. I was hoping that you can help me better understand how that tonnage metric is calculated, briefly, if there's some description. That's number one. And number two -- internally, do you use the metric where you take your same-store sales growth and net that from internal food inflation? Is that a metric that you use internally?

Vicente Trius - *Loblaw Companies Ltd - President*

No. Internally, I can do it, but we don't use that metric. At the end, we measure our comp sales, which to me is the most important number. As far as the calculation on market shares, the one that everybody in the market -- on tonnage, so it's the one that everybody in the market uses, and it comes out of Neilson data.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. All right. Thank you.

Vicente Trius - *Loblaw Companies Ltd - President*

So it's a very public, you know?

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thanks, Vishal.

Operator

(Operator Instructions)

Irene Nattel, RBC Capital Markets.



Irene Nattel - RBC Capital Markets - Analyst

Thanks. Just wondering on PC Plus. I know that it is still early days, but wondering on the initial consumer response and reaction, whether it is in fact driving traffic? And I believe that last weekend you did a promotion, CAD80 spend and you got CAD20 worth of PC Plus points. I was just wondering if this is something that we should expect to see more of on a go-forward basis.

Vicente Trius - Loblaw Companies Ltd - President

Irene, did you get that promotion on your digital PC Plus on your smartphone -- just curiosity?

Irene Nattel - RBC Capital Markets - Analyst

I did. And I got it by e-mail also.

Vicente Trius - Loblaw Companies Ltd - President

So let me give you a little bit of color. Again, we're only on the Loblaw stores, which is about 44 stores. We have today about 500,000 members, of which 200,000 are digital. And this is over the last 2.5 months, which I would say it's pretty good from going to zero to that. If you ask me about a number that we would like to have out of those 44 stores, I would say a 700,000 number of members will be a solid number, which would be about 70%, give or take, of our customers on a weekly basis.

The reason of that promotion is very interesting. It is actually -- it has had a very great engagement, because what we see is that out of the customers that are digital, we're getting much better basket. We get a good basket with both, but the ones with digital, it is exponential. So this is a promotion that's designed to the ones that are -- let's say, the other 300,000 that are not digital, to convert to digital. And that's what we did and had a very good reaction in the stores. So that's the reason behind that promotion. But overall, we're pleased, and today we're getting about a 30% penetration already on sales to the loyalty card.

Irene Nattel - RBC Capital Markets - Analyst

That's great. Thank you.

Janet Craig - Loblaw Companies Ltd - Senior VP, IR

Thanks, Irene.

Operator

David Hartley, Credit Suisse.

David Hartley - Credit Suisse - Analyst

Thanks again. Just two questions again.

On the distribution warehousing -- I know in the past there we've talked a little bit about sourcing more internally on the supply side. Can you tell us the progress on that and cross-docking and limiting DSD in your warehousing and how that's contributed in the quarter?



Vicente Trius - *Loblaw Companies Ltd - President*

Well, I wouldn't say that the DSD or the cross dock has a substantial yet impact, even though we're working the substantially yet impact. It's -- the bulk of it is driven out of our own efficiencies across the network. So it would be productivity and transport.

Having said that, we're making progress on DSD. We're looking at centralizing more. And as we roll out SAP, which is the biggest enabler in proper forecasting, we'll go into a much more aggressive cross dock model, which I would see that -- those are efficiencies, when you ask SAP, that would be one solid one towards the future.

David Hartley - *Credit Suisse - Analyst*

Okay. That's helpful. Thank you.

And on the credit card business -- can you give us a sense of the gains there that are coming from new accounts versus increasing balances? Or how is that trending, those two metrics?

Sarah Davis - *Loblaw Companies Ltd - CFO*

It's Sarah.

So it is a combination of both. What we have seen is, even though we do have the highest payment rate in the industry from paying down the credit card, we have seen an increase in a bit of interest income, which is actually a good thing -- helping the business from existing. Plus we are on target to increase the number of MasterCard applications by 1 point -- over 1 million this year, so we are on track. So it's a combination of both.

David Hartley - *Credit Suisse - Analyst*

Okay. Thank you.

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thanks, David.

Operator

Keith Howlett, Desjardins Capital.

Keith Howlett - *Desjardins Securities - Analyst*

Yes. I wondered if you could speak to what it is that you've opened in Vancouver? And also how the box is doing in Calgary.

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. What we opened in Vancouver -- that Patricia was referring to is a 40,000-square foot urban conventional store. It is an independent grocer and it's, let's say, an inspired store, which would be a lot like Maple Leaf Gardens, where we see potential and actually trading very well. The box plays a lot more to the opportunity we've seen in this marketplace long-term behind convenience and value. So we're talking about smaller stores,

close to home, that offer tremendous value. One case can be health and wellness, nutrition experience; another case could be low prices and a full shop of groceries, and that's the case of the box.

It is a store that would have around the neighborhood of about 3500 SKUs. Early stages -- remember, we just opened it, it has basically two months. But let's say, all in all, we feel pretty good about the performance. Still on a test. We'll roll out a few more stores before, let's say, we start opening more stores, more aggressively. But all in all, initially it's pretty good.

Keith Howlett - *Desjardins Securities - Analyst*

And wonder if you could speak about the Nutshell. Is this going to be a one-store test, or will it similarly be four or five stores tested?

Vicente Trius - *Loblaw Companies Ltd - President*

This would be more than one store, but actually we have about two stores at this stage slotted. And in place to that, health and wellness and nutrition for an urban consumer, which I think there is a big opportunity. And I know we decided not to talk about what we announced about a week ago, but it plays to the whole view of this convenience and value close to home, in that -- in health and wellness and nutrition area.

Keith Howlett - *Desjardins Securities - Analyst*

Thank you.

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thanks, Keith.

Operator

Peter Sklar, BMO Capital Markets.

Peter Sklar - *BMO Capital Markets - Analyst*

Vicente, if you could just clarify in response to one of the questions. Just a few questioners before, you said that overall traffic trends for Loblaw was flat. (multiple speakers) If you can reconcile, because if traffic is flat and retail inflation is flat, how are you getting 1%-plus same-store sales? (multiple speakers) Thought maybe I misheard or maybe you miss-said.

Vicente Trius - *Loblaw Companies Ltd - President*

No, no, I didn't -- well, I don't think I miss-said, but anyways, what I did say that was flat was tonnage. Our customer count is up, which that translates to traffic. And our average basket is up. That translates to dollars, right?

Peter Sklar - *BMO Capital Markets - Analyst*

So tonnage is flat, traffic is up?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. Customer count is up and average basket is up.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay.

Sarah Davis - *Loblaw Companies Ltd - CFO*

And there's a change in mix, would be the other piece to it.

Peter Sklar - *BMO Capital Markets - Analyst*

And the mix has a positive effect or a negative effect?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Positive effect on sales.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. I have it. Thank you.

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thank you.

Operator

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

Janet Craig - *Loblaw Companies Ltd - Senior VP, IR*

Thanks, Tracy. Thanks, everyone, for joining us today. And if you have any follow-up questions, please don't hesitate to call me or Jonathan Ross and we'll be here to answer your questions. Thank you. Bye.

Operator

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



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