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PRESENTATION

Operator

Good morning. My name is Simon, and I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies Limited third-quarter results conference call.

(Operator Instructions)

Thank you. Ms. Janet Craig, you may begin your conference.

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

Thanks, Simon, and good morning. Welcome to the Loblaw Companies Limited third-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 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, and the Company's plans and projections with respect to Shoppers Drug Mart Corporation, which the Company recently entered into 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 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 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.

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

And with that, I'll turn the call over to Galen.

Galen Weston - *Loblaw Companies Ltd - Executive Chairman*

Good morning, everyone. Over the past year, we've continued to execute on our strategy of improving our customer proposition, while at the same time creating a more responsive and lean organization. This strategy has increased our competitiveness and yielded measurable results, including three quarters of basket, traffic and same-store sales growth.

As expected, in the third quarter the competitive environment intensified significantly. Increases in square footage from incumbents and new entrants reached critical mass. This, combined with a shift in consumer expectations, put significant pressure on our Business.

Balancing sales and margin in such a dynamic market is not easy. In the third quarter, we made significant incremental investments in the customer proposition. In most areas of our Business, this drove sales and tonnage; however, some targeted investments in our conventional business did not.

We have rebalanced, and brought the Business back in line without compromising our market position. However, the combination of the incremental margin investment in Q3, and some continued margin pressure in Q4, results in us lowering our expectations for earnings growth this year. Despite this disappointment, as we move into 2014, we remain dedicated to our strategy. We will carefully balance our commitment to competitiveness and earnings performance, while maintaining the flexibility to respond in this volatile market.

In addition to the strides we have made in our customer proposition this year, we have accomplished much that positions us extremely well for the future. We have continued to gain efficiencies in our Business, and over the last 12 months have taken out over CAD100 million of annual expense, and see the opportunity to continue this trend. Albeit slower than we anticipated, we have carefully managed our SAP rollout to successfully scale up at store level. We are positioned to deliver an accelerated rollout in 2014.

The launch of Choice Properties REIT unlocked the value of our property, while at the same time creating an additional growth channel within the Loblaw portfolio. And the announcement of Shoppers Drug Mart, the acquisition which will drive synergies in both the top and bottom line, as well as position us as the leader in the two most compelling trends in retail -- health and urbanization.

Looking forward, our Company will be more powerfully positioned than ever before to meet the evolving needs of the Canadian consumers, with the right infrastructure, cost structure, asset mix, and formats to deliver long-term earnings growth.

I'll now turn the call over to Sarah.

Sarah Davis - *Loblaw Companies Ltd - CFO*

Thank you, Galen, and good morning, everyone. Before I turn to the discussion of our third-quarter results, I would like to highlight that we will be presenting adjusted numbers along with our quarterly financials going forward. Prior to this quarter, we chose to highlight certain notable items on a quarterly basis that helped to explain changes in our financial performance. However, as a result of the creation and consolidation of Choice

Properties, the pending Shoppers Drug Mart acquisition, and certain other items, there is more volatility in our earnings. By presenting adjusted numbers, we hope to make it easier for investors to obtain a view of our underlying operating performance.

I should highlight that as part of the adjusted amounts, we will only be adjusting for the SG&A costs related to Choice Properties until Q3 of 2014, when we will have comparable results. In addition, when the Shoppers Drug Mart acquisition closes, we will adjust for intangible amortization and other purchase price valuations.

Now, let's go to the quarter. As we continue to execute against our strategy, we have two primary levers we are balancing to drive performance. The first lever is our customer proposition investments. These are investments in price, service and assortment, and they are aimed at driving the top line. Specifically, it is our goal to drive same-store sales at a rate greater than our internal rate of inflation. We have succeeded at doing this for the first three quarters of this year.

The second lever is efficiencies. We need efficiencies to offset our investments in food margin and service, as well as to drive long-term earnings performance. We have delivered on targeted efficiencies in a few areas. We have taken over CAD100 million of annualized expense out of the Business since Q4 of last year, and we will continue to drive further efficiencies in 2014. In Q3, we hit our targets on sales and efficiencies, but it cost us more than we had projected in margin.

Let's look at sales in our retail business. Same-store sales grew 0.4% in Q3, or 0.1% excluding the gas bar. While we had the same number of shopping days year over year, Q3 2013 lost one week of pre-Thanksgiving shopping that we estimated impacted our comps by approximately 50 to 70 basis points.

So, we are looking at an adjusted-comp number of approximately 1 percentage point, just using the midpoint. We are happy with that result, given the intensity of the environment, and the fact that our internal food basket continued to deflate in the quarter. Same-store sales were driven by continued positive comps in Fresh, a differentiator and an area we continue to focus on.

Most of the deflation in the quarter was driven by grocery, which is the center of competitive intensity. Drug store sales declined marginally, as a result of reform-induced deflationary pressures. Apparel sales were strong, driven by both our Canadian retail and US wholesale businesses. Excluding apparel, sales in our general merchandise business declined marginally versus Q3 of last year. Declines were primarily related to categories we are exiting or downsizing, such as electronics and leisure.

Now turning to gross profit. Gross profit in Q3 was CAD2.1 billion, flat to last year, while gross margin was down 40 basis points to 21.5% from last year's 21.9%. Consistent with our strategy, in Q3 we continued to make investments in our customer proposition. During the quarter, we decided to accelerate our planned investment by CAD25 million across select categories within our conventional business, based on the opportunities we saw in the market.

While the investments translated into sales and tonnage, they did not result in the volume we had targeted. By the end of Q3, we had retracted to our base investment plan, and we will continue to execute on that trajectory as we move forward.

We also benefited from improved shrink during the quarter, which was a result of lapping some of the investments we made last year, as well as improved practices on the part of the Business. We have targeted areas such as dry shrink for focused improvement going forward. Higher margins in our general merchandise and apparel businesses provided a partial offset to the gross margin decline during the quarter.

We maintained good cost control in the quarter. On an adjusted basis, retail operating expenses as a percent of sales were 17.9%, roughly flat with the third quarter of last year. Excluding depreciation and amortization, cash operating expenses were 15.3%, a 10-basis-point improvement over last year. The higher depreciation year over year was primarily related to our IT investments.

Gross profit dollars were flat year over year. Adjusted retail operating income declined, driven primarily by lower foreign exchange gains recorded in SG&A, higher depreciation and amortization, and changes in the value of our investment in our franchise business. Supply chain and labor efficiencies provided partial offsets to the decline.

On the financial services side, revenue grew by 11%, driven by higher interest and interchange income from increased receivable balances in our PC MasterCard business, as well as higher revenue from the growth of our mobile shop business. PC financial earnings before tax grew by CAD8 million, or 42.1% year over year.

Q3 marks the first quarter where the results of Choice Properties REIT have been included in our consolidated financials. Revenue at Choice Properties was CAD154 million for the quarter, of which CAD107 million of rental revenue and CAD32 million of cost recovery came from Loblaw's retail segment. Net operating income for Choice Properties was CAD108 million, in line with our IPO forecast.

In addition, the presentation of our results this quarter matches closely to what we shared with you as part of the REIT accounting teach-in we did back in June. As a result of the consolidation of Choice Properties, consolidated revenue in the quarter increased by approximately CAD15 million, and SG&A increased by roughly CAD21 million. The CAD15-million increase in revenue, as well as CAD15 million of the CAD21-million increase in SG&A, represents a reclassification of base rent, operating costs and property tax recoveries on ancillary properties, which were previously netted out of SG&A. The remaining CAD6-million increase in SG&A is related to CAD3 million in start-up costs and CAD3 million in net Choice Properties' SG&A.

Turning back to our consolidated results, adjusted basic net earnings per share of CAD0.78 were 3.7% lower in Q3 compared to the prior year. The intensity of the competitive environment in Q3 put pressure on our gross margin as we continue to invest. I am disappointed that, based on our performance in Q3 and the environment we foresee for the remainder of the year, we will not be able to deliver on the expectations we set last quarter for full-year operating income growth.

When we raised our outlook in Q2, we foresaw a competitive back half; however, the actual intensity we experienced in Q3 was greater than projected, and caused actual performance to be below our expectations. We anticipate that Q4 will be comparable to Q3 from a competitive standpoint, and we plan to continue to invest in food margin. We have adjusted our full-year expectations to call for flat adjusted operating income and flat operating income growth for the full year.

Before I close, I'd like to turn to SAP. We continue to take a measured approach to our SAP rollout. We have not reached as many stores as we had expected to this year, but it's critical that we get it right. Our confidence from an operational perspective increases every day, as our colleagues in the stores work with the system. We now have stores live in every province except Quebec. We have successfully rolled out 10 stores in a weekend. We still need to optimize the model prior to scaling up at a more rapid pace.

As we continue our rollout, we expect to see lower IT spending. We still project that our total IT and supply chain expense at stand-alone Loblaw will be 60 basis points lower than the peak of approximately 1.8% of revenue in 2012. We expect capital expenditures on IT to be 50% lower in 2014 compared to 2012, and we see cash costs continuing to decline. Over time, as we optimize our live locations and continue the rollout, we expect to see benefits in areas such as productivity, inventory management, pricing and shrink.

As we continue to drive efficiencies in our Business to become a more agile organization, we implemented a restructuring in October. This restructuring was the result of detailed work by colleagues across the Business to improve on our processes. We expect this measure will save us roughly CAD30 million on an annualized basis, which is approximately equal to the restructuring charge we will take in Q4. We will continue to use these savings to invest in the Business and drive competitive advantage.

With that, I'll pass the call over to Vicente.

Vicente Trius - *Loblaw Companies Ltd - President*

Thank you, Sarah, and good morning, everyone. While I am disappointed that our earnings growth for the year will not come in where we expected, I am pleased with the same-store sales results we drove in the quarter, where our internal food price index continued to deflate. This growth is a result of our continued focus on the customer proposition. We are focused on how we trade to the customer across banners, formats and regions. I firmly believe that we are following the correct strategy to position our Business to deliver long-term earnings growth.

The current competitive environment is intense, but certainly not unprecedented. We're investing in our customer proposition to drive the top line, while consistently driving efficiencies. We expect the combination of these strategic initiatives to result in earnings growth over the long term.

In Q3, results were led by Fresh. Fresh is a competitive differentiator, and drives traffic. We continue to work to increase Fresh that is key to delivering on our customer proposition. During the quarter, both traffic and basket were up, and we performed better than the market on tonnage. We continued to work through our category strategies during Q3. We are happy with the assortments we have rolled out, our competitiveness, as well as the tonnage strengths we're seeing in the categories we have reset.

This is a dynamic process. We have 50 to 60 categories across our network; and by the end of 2013, we expect to have implemented approximately half of our targeted category plans. This initiative is about giving our customers more of what they're looking for in each category, optimizing assortment, getting price right, and looking at control brand, as well as other areas, such as ethnic and natural value within the context of each category. We expect to be complete over the next year to year and a half, at which point we will enter a regular cycle of updates.

As a Company, we have made calculated efforts to ensure our banners are positioned correctly from a price and experience standpoint, but there is more work to do. In our discount division, our target is to be the lowest-cost operator delivering the lowest prices in the market in differentiating with Fresh. Most of the adjustments we have made in the discount area of the Business over the past two years have been around price, while also improving our Fresh sourcing and narrowing assortment. We are happy with our results in this division, with solid performance on the metrics we're targeting -- sales, share and tonnage.

On the conventional side of the Business, our strategy is to lead in Fresh with the right assortment. We focus on providing a consistent in-store experience, as well as sustainable and competitive pricing for our customers. Last year, we made a number of target investments in labor to ensure service standards were higher. We also invested in shrink to broaden our assortment and offer the customer a better selection of high-quality fresh food. We're getting the formula right and are gaining traction, but there is room for conventional to be a larger contributer to our Business as we continue to optimize the offering.

Across our Business, we have driven solid performance over the past three quarters, but we still have room to grow. One of the leading indicators of sales we track is the net promoter score. The net promoter score is a third-party survey that tells us what proportion of our customer base will go out of their way to not only shop at our store, but to recommend it to others. Both divisions have shown an improvement since the beginning of the year. Our conventional division has made particularly impressive strides, and is now in a zone where we would expect to see these scores translate into further improvements in operating performance.

As the market environment intensifies, our goal is to continue to execute our strategy of investing in our customer proposition to drive the top line, while consistently levering efficiencies to largely offset this investment. We are targeting slight adjusted operating income and operating income growth for 2014 for stand-alone Loblaw. We need to retain the flexibility to respond to the market as it evolves, but our goal is to balance the speed at which we deliver the strategy.

We took further steps to drive efficiencies in October, and we will remain focused on the opportunities we see to get more competitive going forward. Beyond our recent restructuring, we also expect to continue to drive efficiencies in supply chain, in-store productivity, and shrink.

A strong driver of our Business going forward is our loyalty program, PC Plus, which is looking to be a real game changer. PC Plus is performing beyond our expectations. It plays right the trends we're targeting, interacting with customers across multiple channels, talking to them one on one in a personalized way, and levering the technology they carry with them every day to do that. In fact, based on the experience we have had with over 300,000 registered digital members to this point, we see PC Plus having the potential to be a meaningful, positive addition to our sales line at a national level.

In our 44 Loblaw's Ontario stores, customers have demonstrated a high level of engagement. Over a third of all sales in that banner are now accompanied by the scan of a PC Plus card. Customers that are engaged with PC Plus make more trips to our stores, shop a larger average basket, and they also shop more categories. We believe PC Plus has driven a low single-digit sales lift in our Loblaw's banner in Ontario since we launched in early May. We are launching nationally over the next few days.

During the quarter, we did a soft eCommerce launch with our Joe Fresh brand, reaching out to our core customers to build a base, and scale our operations. So far, we're happy with sales and margins, and we have seen a higher average ticket than we had projected. PC Plus and eCommerce are part of a broader omni-channel strategy. It is all about meeting the evolving needs of our customers, who are more digitally connected than ever, with new digital channels where they can be served.

Before closing, I wanted to touch on Shoppers Drug Mart transaction. As we work together, my confidence increases about the opportunities that this will drive. Following the completion of the transaction, Mark Butler, a seasoned Loblaw executive, will be charged with delivering the CAD300 million in synergies we have outlined to you. We plan to realize those synergies over a three-year period, and intend to be transparent about our progress and results.

The office that has been set up to accomplish this task has been staffed with some of the best and brightest talent from both Loblaw and Shoppers Drug Mart. These individuals are extremely busy planning for the running start on day one, as well as taking care of the planning necessary to achieve our short- and long-term business objectives. We continue to believe the transaction will close by the end of the first quarter of 2014.

In conclusion, what is important is to keep focused on our strategy. We remain focused on the initiatives that will drive the critical strategic pillars in our Business -- best-in-food experience, driving efficiencies, and driving growth.

And we'll now pass the call back to Janet for questions and answers.

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

Thanks, Vicente. And before I turn the call over for your questions, I would request that you limit your questions to two. After your second question, you will be placed on mute. We appreciate your cooperation.

And now, I'll turn the call over to questions. Simon?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question comes from the line of Irene Nattel with RBC Capital Markets. Your line is open.

Irene Nattel - *RBC Capital Markets - Analyst*

Thanks and good morning. Clearly, with the market competitive intensity out there, to some degree you've been faced with a choice between volume and margin. Your competitor that reported this morning chose margin over volume. It seems that Loblaw's is looking to drive volume and is willing to sacrifice margin in the near-term. But is this -- do we face this choice forever? Is it a temporary issue?

Vicente Trius - *Loblaw Companies Ltd - President*

Good morning, Irene. Let me first talk a little bit briefly on the market environment. We see a market environment that has increased in square footage at twice the pace of any other year; and basically, we are at its peak. But we see this peak mainly over next quarter, and more challenging next quarter and maybe the first half of next year, less on the second half. Now this competitive environment has translated mainly, in my mind, through a higher promotional activity, and with penetrations, let's say, higher than last year. Like last quarter, I penetrated the market at about

40% on promotions. Now we're building the business on what we strongly believe is the right strategy that will deliver over the medium and long-term growth in sales and earnings.

As you look at our strategy, at the heart of it, it's always been a strong focus on the customer and driving our business on what the customer wants and needs, but also leveraging the efficiencies to drive just that. And if you look at the last few quarters and last quarter, our same-store sales consistently have been up, let's say net of Thanksgiving, 1%, and with a good performance of Thanksgiving, by the way, when you look at apples-to-apples, and consider that we had a food deflation of negative 0.3% on that. Our customer count is up. Our customers are visiting our stores and converting their sales and purchases into larger baskets; and our tonnage is better in the market, in the market that is down. We have also delivered efficiencies, 19 basis points, for example, in supply chain in the last quarter, 16 basis points in [label]. Having said that, I do believe that we can be better on how we balance the speed of our investment, especially more so in one of our divisions, which would be our Conventional division. We see Q4 in line with Q3 and, as Sarah said, flat earnings for the year. We see 2014 with a modest increase in sales and earnings.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. And I guess the related question then, Vicente, becomes at what point does the business really start to surface enough efficiencies that you can really do both? You said starting in 2014, but presumably at some point we should see an acceleration, particularly given all the heavy lifting you guys have done.

Vicente Trius - *Loblaw Companies Ltd - President*

Well, we are driving our efficiencies. And if you look at Q3, really, at the end of the day, in my mind is the speed that we drove our strategy. And remember, our strategy is about one, mix, which to me is led by Fresh and led by areas like Apparel and General Merchandise; the other one is about the category reviews. And embedded in the category reviews, we put a pricing strategy that's customized to each banner and division. As we look at that, to be honest, we accelerated versus our strategy. And what we're looking at is balancing the speed. And we understand how to balance the speed as we look at the categories, whether it's through more categories or not as aggressive competitiveness or by division. Overall, we feel very good that we know where we are going and how we are driving the business.

Operator

Your next question comes from the line of Jim Durran with Barclays. Your line is open.

Jim Durran - *Barclays Capital - Analyst*

How long do you think it's going to be before you do get to a critical mass of rollout on the SAP? You're at 10 now. I think that we've been suggesting 50 is the intended goal?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, that's a great question, by the way. Remember, we always said we will rollout SAP in the right manner. And in the right manner is not losing versus the customer, as we interface with the customer and driving efficiencies. As of today, we have rolled out 72 stores. This includes two banners, 100%. This includes three provinces where we are 100% or close to it. We have done, over the last few weeks, about 10 stores. And the good side is that we have made considerable improvements on data quality and on our operational confidence to really roll out without impacting the business. We've taken a little bit of a break, because of Christmas. And we believe that is a very important time of the year, so we shouldn't be rolling out stores over the next seven weeks. Having said that, we will resume that starting mid-January. And we see ourselves rolling out the bulk of our business throughout 2014.

Jim Durran - *Barclays Capital - Analyst*

And how linked is the reduction in IT spend as a percent of sales, from 1.8% downward, to the completion of the rollout?

Sarah Davis - *Loblaw Companies Ltd - CFO*

I would say -- it's Sarah. Good morning. I would say, so 1.8% was our peak in 2012. We're at about 1.6% this year, and really we're aiming to be at 1.2% by 2016. And what we are confident in is that the cash spend is starting to decrease and our capital spend that we would have spent back in 2012, at about CAD400 million, is going to be about CAD200 million in 2014. And so we've got a 50% reduction there. So we're pretty confident we're going to be able to get to the 1.2% by 2016.

Operator

Your next question comes to the next question of Kenric Tyghe with Raymond James. Your line is open.

Kenric Tyghe - *Raymond James - Analyst*

Thank you. Good morning. Vicente, the traction that you're seeing on PC Plus in the trial is very encouraging. How would you characterize your loyalty analytics capabilities today, and perhaps more importantly, the analytics opportunity as it relates to both share of wallets and promotional efficiency going forward? Essentially, I'm trying to understand how much runway you think you have on the analytics front and how confident you are on your ability to capture the opportunity.

Vicente Trius - *Loblaw Companies Ltd - President*

Let me understand the first part of the question, how confident on the analytics, in what sense? How we drive the analytics within the loyalty card?

Kenric Tyghe - *Raymond James - Analyst*

The effectiveness of how you apply the analytics to the loyalty card in driving promotional efficiency and wallet.

Vicente Trius - *Loblaw Companies Ltd - President*

We feel very good about that. We have had the PC Plus at the Loblaw banner in Ontario now since May. We have seen very good penetration of the digital customers. It amounts to about a third of our sales, with much larger baskets. And that's driven, obviously, by the data intelligence that we have and how we customize the offers to them. As we look towards the future, we're rolling out loyalty across all of the rest of the banners, starting the next few days, excluding No Frills and Maxi. We feel very good about the performance of the loyalty card going forward. I think I missed one of these last questions. Repeat the last portion of your question?

Kenric Tyghe - *Raymond James - Analyst*

Sure. It was really just on your

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. So yes, sorry. I guess I answered it, but I thought since you did it two-fold. We feel very confident that we see that as actually critical for us going forward. And I think you asked me something a little bit on the promotion and balance of investment, at one point; and we see a balancing between promotional activity and obviously how we customize the offers to our customers through the loyalty card. But all in all, we see that as upside.

Kenric Tyghe - *Raymond James - Analyst*

Great. Thank you. And then just switching gears, the commentary with respect to your General Merchandise and Apparel margin improvements in the quarter, is this just a function of the competitive intensity being more narrowly focused on Food in the most recent quarter, or rather through the year, and having some room to move by way of pricing in these categories, or does it reflect improved merchandising and mix within those categories?

Vicente Trius - *Loblaw Companies Ltd - President*

I wouldn't say that that's just because there's more focus on Food, because I believe, as you look at the square footage that has gone in the market, it's gone in as well in Apparel, right? And I think what this reflects is the strength of our Apparel brand. And we're driving more better value than last year in price points and we're able to deliver better margins. And it shows that, regardless of the competitive environment, we are able to increase our sales. So I think that's a real strength in our portfolio.

Operator

Your next question comes from the line of Patricia Baker with Scotiabank. Your line is open.

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

Patricia?

Operator

Patricia Baker with Scotiabank, your line is now open.

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

Okay. Well, I guess we'll go on to the next caller. Patricia, if you're there, if you can come back into the queue, please?

Operator

Your next question comes from the line of Chris Li with Bank of America. Go ahead, your line is open.

Chris Li - *BofA Merrill Lynch - Analyst*

Hello. Good morning. Given your revised full year outlook for operating income, can you maybe please provide us with a bit more commentary on what you're expecting for Q4 in terms of same-store sales growth and for retail EBITDA margins? Do you expect them to be similar to what you achieved in Q3?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Yes. I think that's what we're looking for. So we are looking for some positive comp, marginal positive comp sales, and we're looking for about the same performance from an EBITDA perspective as what we've seen in Q3, as well as a similar margin investment, as well.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. And the second question, just with respect to the cost reduction you mentioned in the opening remarks that you've taken out, about CAD100 million in expenses in the last 12 months. Can you give us a sense of how much you're planning to take out in the next 12 months on a stand-alone basis for Loblaw by itself, without Shoppers?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, you know what we've done with the restructure that happened in October, and I think we quoted about CAD30 million. And then we believe strongly that we have capabilities of driving additional efficiencies in supply chain, productivity at store level, as well as shrink. That's as far as I'm going to tell you, but we feel good about that, that we do have capabilities to do that.

Operator

Your next question comes from the line of Patricia Baker with Scotiabank. Go ahead, your line is open. (Audio Difficulties)

Your next question comes from the line of Perry Caicco with CIBC World Markets. Your line is open.

Perry Caicco - *CIBC World Markets - Analyst*

Yes. Vicente, it's probably too early to give formal guidance for 2014, but you did say that you plan to grow sales and operating income next year. And in the release, it says that over the next three quarters you're going to try to balance your commitment to competitiveness and financial performance. So does that suggest that the first half of 2014 is going to be pretty tough and then things should kind of bounce back in the second half?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, that's saying that we see a first half more challenged, and we see a second half less challenged. That doesn't mean that we will drive strongly the business every quarter, to drive the sales and earnings. But we see the first half a little bit more challenged than the second half. And that's what it is, and it's directly linked to the fact that you're peaking on square footage, as we speak. And you're not cycling that square footage until -- starting to cycle that square footage -- until the second half.

Perry Caicco - *CIBC World Markets - Analyst*

And when you think about all the challenges for next year, integrating Shoppers Drug Mart, maximizing SAP, the tough first half, the organizational change, how do you think about your priorities for next year? Is it sales maintenance or earnings delivery, or is it somewhat of a transition year?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, we see our priorities, what I said is on driving growth from sales and driving efficiencies and modest growth in sales and earnings. We see our priorities as really rolling out SAP in a robust manner, as I said, and we see our priorities on driving the synergies between the two businesses. And I think that's great, because by doing that, I believe it gives us solid upside.

Operator

Your next question comes from the line of Michael Van Aelst with TD Securities. Your line is open.

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

Can you review the same-store sales numbers again and just give us an idea of the mix between tonnage, price, product mix and traffic? And how that -- how same-store sales as a whole trended during the quarter, did it finish stronger than it started or the opposite?

Vicente Trius - *Loblaw Companies Ltd - President*

I would say our sales -- I'm going to start with the latter statement -- so I would say our sales have been pretty steady, that means consistent. And as I said, we're pleased with an apples-to-apples comparison on Thanksgiving. Of our sales, if you adjust Thanksgiving as it falls into Q3, we said is about 1%; and that's taking around the midpoint, led by Fresh. Food, decent; but remember, deflation, about 0.3%, and with a good performance in Apparel.

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

Okay. And sounds like tonnage was a little negative, along with the industry?

Vicente Trius - *Loblaw Companies Ltd - President*

Our tonnage was flat in a market that was 0.7% down, according to our internal data.

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

Okay. And with the PC Plus rolling out nationwide soon, what percentage of your revenues will be captured by stores that are going to be on that card?

Vicente Trius - *Loblaw Companies Ltd - President*

We need to see, obviously, how it rolls out. All we have is the data on the 44 stores. And as we said, on the digital customers, which is really what we're focusing on the most, on all of them, but the digital is the most important for the future, we're getting today about a third of our sales through PC Plus. So I'm not saying I believe it. We can do better than that, actually. As we roll it out, I think we'll get more and more customers on the PC card, and we can do better. But that's what I have today, so I would hate to extrapolate it. But that's really a test over the last four or five months.

Sarah Davis - *Loblaw Companies Ltd - CFO*

If I could just add, Michael, was your question, though, what percent of total sales are on -- will be on PC Plus? No, but it's every banner, except for --

Vicente Trius - *Loblaw Companies Ltd - President*

Correct. In Loblaw's, I said a third. That's Loblaw's Ontario. Now you could extrapolate that out and you need to exclude -- you're right, Sarah, Maxi and No Frills. You're absolutely right, because we're going to roll out in Maxi and No Frills, not at this stage.

Operator

Your next question comes from the line of Peter Sklar with BMO Capital Markets. Your line is open.

Peter Sklar - *BMO Capital Markets - Analyst*

Thanks. In terms of your strategy of investing in customer proposition and specifically price, there seems to be a change in your philosophy. Before, you invested as you -- you seemed to invest in prices, you realize savings from SAP, category reuse, et cetera. And now you seem to be investing ahead of your ability to offset. So I'm just wondering, is this a permanent change in philosophy or is this just a temporary reaction to the competitive intensity?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, I see that this is not a perfect world, where things mathematically work perfectly. So this is about having a strategy that at times you feel actually very good, and you feel I will accelerate, because I feel what I'm getting. And then at times, it doesn't translate 100% the way you are, and then you sort of retract yourself. But a strategy is not perfect. The most important thing is to stay on course in the strategy, which is exactly what we're doing and knowing that the strategy works.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And then just on Galen's comment, and you've hinted to it, as well. It sounded like there was some promotional activity that you undertook in your conventional banners that you didn't get the returns you were anticipating. Can you talk a little more specifically what happened? Was that your flyer activity, and what lessons were learned from that?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, really to be honest, I wouldn't see that as much on the promotional activity. I would see that more on accelerating a shelf pricing investment that maybe we went a little bit much further than what our strategy was, in some categories. And that's what it was. And then you deflate yourself in dollars, and sometimes you don't get the return short-term that you're expecting to. So it's about measuring a little bit at the right pace, as you do that. That's all. And that's why I answered, we have a category process, we know how to position ourselves, and it's managing that process. That's the balance.

Operator

Your next question comes from the line of Patricia Baker with Scotiabank. (Audio Difficulty)

Vicente Trius - *Loblaw Companies Ltd - President*

Honest to God.

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

Okay. Sorry about that. I think Patricia has a new phone system, so we thought we'd try a third time. But I think we're going to have to give that one up for now. I'm sorry, Patricia. Next caller?

Operator

Yes. The next caller -- your next question comes from the line of David Hartley with Credit Suisse. Your line is open.

David Hartley - *BMO Capital Markets - Analyst*

Hello, and good morning. Thanks for taking the call. Just around the CAD25 million you talked a bit about, Sarah, could you clarify how that was deployed and how you pulled back? Was that an annual number, a quarter number? Can you give me some color around that?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay. So it's basically, just to reiterate what Vicente would have said, that it's a Q3 number. So CAD25 million related to the conventional business investment. We were feeling very confident in the response we were getting to the margin investment we were doing. We went a little bit -- we decided to accelerate that. But in the short-term, during the quarter, we weren't able to get the return that we were looking for.

David Hartley - *BMO Capital Markets - Analyst*

So did you pull back completely on that, meaning that if we isolate it to those shelf prices, that you brought those prices back up?

Sarah Davis - *Loblaw Companies Ltd - CFO*

No, we basically went to the strategy that we were on. We just basically -- we didn't pull them back up. We went to the strategy of investing, just not at the same level as we were doing with the CAD25 million.

David Hartley - *BMO Capital Markets - Analyst*

Okay. But you're still hopeful, though, you'll get returns on that down the road, just a tough environment to get them, isn't it?

Sarah Davis - *Loblaw Companies Ltd - CFO*

That's right. Just can't get it in the short-term.

Vicente Trius - *Loblaw Companies Ltd - President*

Absolutely. And we're very certain, as well, on our capacity to deliver efficiencies. And the two go together at the speed that you want to drive it.

Operator

Your next question comes from the line of Vishal Shreedhar with National Bank. Your line is open.

Vishal Shreedhar - *National Bank Financial - Analyst*

Thank you very much. Just wondering about the capital return to shareholders philosophy over the next several years. Given the road map that you gave us a while ago, where you noted expansion in Loblaw's margins over the next several years, declining CapEx, and when you add synergies and SC on top, it seems like the Company has substantial potential to generate cash flow. I'm just wondering how shareholders should think about balancing the need to repay down debt and also to participate in the cash flow, perhaps with dividends or share repurchase programs, if you could just provide some context on that.

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay. So what we would -- with the Shoppers acquisition and when that does go through, we do have a tremendous amount of cash flow, in the billion dollar range on an annual basis. But our first priority with that cash flow is to reduce our debt, and we have committed to the debt rating agencies that we will reduce that over the first two years by about CAD1.5 billion. So that's our first priority. After that, we would look for ways to return to shareholders, either through dividend increases or through share buybacks, as well.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. And then I guess my next question would be in Q4, the cadence of operating income growth, the actual growth year-over-year seems to be deteriorating at a very quick rate, if I just back out from your guidance, relative to Q3. So I was hoping you could give me some color there. Is there something that you perceive to deteriorate further in Q4, or is there some new investments, or any context that would help me to understand that better?

Vicente Trius - *Loblaw Companies Ltd - President*

Nothing special, just the context of the challenging operating environment and what we're doing with our strategies. But nothing different. And we will drive our business, obviously, to do better, but we felt that calling flat for the whole year is the right thing to do at this stage.

Operator

Your next question comes from the line of Keith Howlett with Desjardins Capital Markets. Your line is open.

Keith Howlett - *Desjardins Securities - Analyst*

Yes, I just had some questions around your credit card strategy. Is the key here to try and get as many cards out to get PC Plus membership up? And I'm also wondering whether your intention is to maintain an on balance sheet credit card business?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay. So basically yes, our strategy is to get as many credit cards, worthy credit card holders. We do have a risk profile that we are conscious of, as well. But yes, we are trying to drive the receivables, as well as the number of credit cards, in order to increase the earnings in the bank, as well as to help with the loyalty program. As far as the credit card receivables, they are on balance sheet as a result of IFRS, but they are actually securitized. So under Canadian GAAP, a few years ago, they would have been off balance sheet, but it's the accounting that puts them back on balance sheet.

Keith Howlett - *Desjardins Securities - Analyst*

And are you happy -- would you look at any sort of alternative like Target undertook in the United States to get them off balance sheet, or you don't really care either way?

Sarah Davis - *Loblaw Companies Ltd - CFO*

We aren't looking at any other alternative.

Operator

Your next question comes from the line of Jim Durran with Barclays. Your line is open.

Jim Durran - *Barclays Capital - Analyst*

I just want to go back to the IT expense. Once you're no longer running dual systems, have you identified how much cost savings there will be?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. We said all along that the IT expense would come down from a 1.8 peak of 2012 to about 1.2, which will leave us the right running rate of IT expense.

Jim Durran - *Barclays Capital - Analyst*

Okay. So that's inclusive in that number then?

Sarah Davis - *Loblaw Companies Ltd - CFO*

That's right. It would be the total cost of IT that we're talking about.

Jim Durran - *Barclays Capital - Analyst*

Okay. Great. Thank you.

Operator

(Operator Instructions)

And your next question comes from the line of David Hartley with Credit Suisse. Your line is open.

David Hartley - *BMO Capital Markets - Analyst*

Yes, thanks. I just want to follow-up on my last question, just around the whole cost. When you're looking at your -- two things -- when you look at your PC points and launching it across nationally, is there a substantial cost you're expecting to incur and for how long? And then when you look at your base EBIT, adjusted EBIT number from 2012, what number should we be using to think about flat EBIT in 2013?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, I'm going to ask you to repeat the last part of the question. Go ahead and answer it.

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay. So the second part, on the EBIT. So for 2012 to 2013 takes the operating income in 2012 and we're saying 2013 will be flat to that number.

David Hartley - *BMO Capital Markets - Analyst*

So it's the reported operating income or the adjusted operating income?

Sarah Davis - *Loblaw Companies Ltd - CFO*

They both end up being flat, essentially close to each other, just because of adjustments that are both positive and negative. So they both end up relatively flat, is what we're saying.

David Hartley - *BMO Capital Markets - Analyst*

Okay. Thank you. And just on--

Vicente Trius - *Loblaw Companies Ltd - President*

The loyalty card, it does have some added cost. Nothing out of this world, by any means, but it does have some added cost. And a lot of it is on call center and data mining, but the benefits from it far, by far, far exceed whatever cost we put up front into it.

David Hartley - *BMO Capital Markets - Analyst*

But that's on the launch itself?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, I'm talking on expenses going forward, yes.

David Hartley - *BMO Capital Markets - Analyst*

What about the --

Operator

Janet, do you have any follow-up? I understand you wanted to ask a question on behalf of Ms. Baker?

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

Yes, actually, I'm channeling Patricia at the moment. So hopefully, Patricia doesn't mind. Patricia's question, actually, Vicente, for you, is that you indicated your goal for Discount is to become the low cost operator. So how far away are you from being in that position, where are the levers, labor or elsewhere, and when can we look to that being the case?

Vicente Trius - *Loblaw Companies Ltd - President*

I thought that we said the lowest cost operator and the lowest prices, I think that's what I said. And I believe we have definitely the lowest prices. And as I look at benchmarks and I look at transparency of other discounters, we have a low cost of operation.

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

So you believe at this moment, we are where we need to be in Discount?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. It doesn't mean that we can improve. But as I compare to the market, yes.

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

Thanks, Vicente. Sorry, Patricia. Thanks, Simon. Do we have any other questions?

Operator

Yes. Your next question comes from the line of Keith Howlett with Desjardins Capital Markets. Your line is open.

Keith Howlett - *Desjardins Securities - Analyst*

Yes. I wondered what your thinking was on the Provigo bannering in Quebec and how the conversions from Loblaw's to Provigo have done in the marketplace?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, we're really pleased with the conversions. This means from a customer view, the traction that we're getting, the additional customers that we're getting in the stores and is translating into better sales, I'd say in better margins, in better margins overall. So we're quite pleased with what's happening in Quebec on the Provigo banner and the conversion of those banners, as well as in our Discount sector. Actually Quebec overall, we're pretty pleased.

Keith Howlett - *Desjardins Securities - Analyst*

And just one final question, on the General Merchandise business, which I think you've completed repositioning, but I just wanted to confirm that the large surface --

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Vicente Trius - *Loblaw Companies Ltd - President*

Yes, we're basically about 90% there at the end of Q3 on the stores on the right hand side. So I would say from a remodeling standpoint, we're there. From Electronics, even though we're repositioned, there might be still a little bit of a downsizing that we might want to do in the future by maybe exiting altogether Electronics. And if you go to the stores, you have some today. That's how it would be left.

Operator

Ladies and gentlemen, at this time, I will turn the call back over to Janet Craig for any closing remarks.

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

Thanks, Simon, and we really appreciate your time today on a very busy day. And we appreciate you working through our new system with us, in terms of going on mute. I think there were a couple of misfires during the call, but we'll get it right. And you can always call IR if you have any further questions. Thank you very much.

Operator

Ladies and gentlemen, this concludes today's conference call. You may now disconnect.
