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PRESENTATION

Operator

Good Morning, my name is Michelle. I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies Limited first quarter 2014 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. I will now turn the call over to Janet Craig. You may begin your conference.

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

Thanks, Michelle and good morning, everyone. And welcome to the Loblaw Companies Limited first quarter results conference call. During this call we will also be providing some key metrics on the first quarter of Shoppers Drug Mart. I'm joined this morning by Galen Weston Executive Chairman, Vicente Trius, President and Sarah Davis Chief Financial Officer. We will also have with us Domenic Pilla, President of Shoppers Drug Mart.

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 expeditions regarding certain aspects of the financial performance in 2014 and future years and the Company's plans and projections with respect to Shoppers Drug Mart Corporation, which the Company has acquired. 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. Any forward-looking statements speak only as of the date they are made. The Company disclaims any intention or obligation to update any -- update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by law.

Certain non-GAAP financial measures may be discussed or referred to today. Please refer to our annual report or other materials filed with the Canadian Securities Regulators from time to time for a reconciliation of each of these measures to the most directly comparable GAAP financial measures. An archive of this conference call will be available on our website. Also, as we committed last quarter, we have e-mailed to members of our distributor list a copy of the scripts to be used in today's call. Please check against delivery.

We've also uploaded on our website or you may contact Colton Davis at Colton.Davis at Loblaw.ca if you require a copy. We also have support material in the form of a few slides that we've also e-mailed to you today and posted to our website. They do not directly support the speakers' remarks so you do not need to follow them as we speak. I'll now turn the call over to Galen.

Galen Weston - *Loblaw Companies Ltd - Executive Chairman*

Good morning, everyone. We began 2014 by making steady progress in all areas of our business. Our core grocery operations, President's Choice Financial and Choice Properties. As we exited the first quarter, we marked a seminal moment in our Company with the close of the acquisition of Shoppers Drug Mart. This will be the last quarter of our Company that does not include results from Shoppers Drug Mart. Domenic Pilla is here to provide some color on its performance in the first 12 weeks of this year. Welcome, Dominic.

Turning to our operational and financial performance for the quarter, in our grocery business, we stayed on strategy of improving our competitiveness against growing retail square footage and intense competition and a very tough comp. We grew same-store sales while investing in the customer proposition and achieving incremental synergies in our business.

We also made good strides in our implementation of SAP after reaching a scalable model earlier this year. SAP, when fully implemented, will increase our operating effectiveness as well as allow us to unlock further efficiencies in our business. President's Choice Financial had strong growth due to improvements in our credit card business and opportunities in insurance and mobility. For the balance of 2014, in our grocery business, we will continue to execute our proven strategy. We will keep investing to improve our customer proposition. This should deliver slight revenue growth, and we will also keep up our efforts to become leaner and more responsive and a more efficient Company.

As Shoppers Drug Mart joins the family, 2014 is going to be a big year. Plans are in place, and we remain optimistic about our ability to surface synergies between the two companies. Looking forward, I'm confident as we build out our portfolio of independent, complementary businesses, along with a balanced capital return, that we will accrue long-term value for shareholders. In keeping with our long-term outlook, I'm pleased to report a dividend increase of 2.1%. Now, I will turn over the call to Sarah for more details on our financial performance.

Sarah Davis - *Loblaw Companies Ltd - CFO*

Thank you, Galen and good morning, everyone. As morning I'm going to cover our results, our near-term expectations, and outline some of the expected accounting policy and purchase price allocation impacts from the Shoppers Drug Mart transaction. With the Shoppers Drug Mart acquisition closing post quarter end, Shoppers financial results are not included in Loblaw's first quarter results.

Turning to Loblaw's first quarter results, we reported strong consolidated revenue of $7.3 billion, which is an increase of 1.2% over last year, driven by positive contributions from each of our reporting segments. Retail, financial services, and Choice Properties. In retail, same-store sales grew by 0.9%, growth was approximately 1.1% when adjusted for the shift in the timing of the Easter holiday. Inflation was also a factor in our growth with internal inflation slightly higher than CPI of 1.2%. We believe our internal inflation was ahead of CPI despite deflation in grocery due to our continued shift in mix towards fresh. While sales in apparel and general merchandise were flat, we made strides in key areas such as home, and we continue to exit the low-margin non-core electronics and leisure category.

Sales in drugstore declined marginally, primarily due to deflationary pressure from drug reform. Retail gross profit of $1.58 billion in the quarter, a slight increase over 2013. Rate declined 10 basis points to 22.3%, primarily due to higher shrink and transportation costs. Shrink was 8 basis points higher, mainly due to increasing the fresh mix in discount as well as some impact from opening Inspire stores, which offer a greater fresh assortment. Transportation cost increases of 5 basis points were a result of higher fuel prices.

We continue to focus on balancing investments in price with our ability to achieve efficiencies. Core operating expenses were well-controlled in Q1. These core expenses were $6 million higher than last year, but achieved an 8 basis point improvement as a percentage of sales. This was despite upward pressure due to FX translation and depreciation and amortization of approximately 10 basis points each.

Retail SG&A was also $8 million higher in the quarter due to the loss of ancillary property operating income, which is now reflected in the REIT. While we made steady progress in our retail business, our adjusted operating income decreased by $2 million, or 0.9%, to $226 million. Two factors in the decline were the depreciation and amortization expense of $10 million and FX losses of $6 million. Adjusted EBITDA grew by $8 million, or 2%, to $416 million, achieving an adjusted EBITDA margin of 5.9%, up 10 basis points.

Now, turning to our PC Financial Services. This segment continued to perform well. It increased revenue by 9.1% due to higher interest income which resulted from higher credit card receivables, a higher yield on those receivables, as well as growth in other service fee related income. Earnings before income tax grew 21.1% in the quarter to $23 million.

At Choice Properties REIT, first quarter results were slightly better than its IPO forecast. It generated revenue of $167 million and AFFO of $69 million. Choice is also executing on its growth strategy acquiring an additional property in the first quarter and bringing the total increase in square footage since the IPO to approximately 1 million square feet, or an increase of 3%.

On a consolidated basis, we increased adjusted operating income to $268 million, an improvement of 3.9%. Adjusted EBITDA rose by 5% to $463 million, and we grew adjusted net earnings by 3.7% to $139 million, or to $0.49 per share. Now, looking forward to the impact of the Shoppers Drug Mart acquisition. As mentioned earlier, Shoppers financial results are not included in Loblaw's first quarter results; however, we will include full pro forma financials for fiscal 2013 and the first quarter of 2014 in our business acquisition report which will be filed by June 10.

Starting in the second quarter, Shoppers Drug Mart will be consolidated into our retail segment. In the near term, we plan to disclose same-store sales figures, as well as revenue gross profit EBIT and EBITDA. Our goal is to continue to provide you with transparency into our key business drivers which we expect to evolve as our business evolves. For synergies, we plan to provide you with updates on what we have achieved and how we are tracking against targets on a quarterly basis.

2014 will be a complicated year from a financial reporting perspective. We would like to start to prepare you for what you can expect to see when we report Q2. And note that we will also bridge the accounting policy changes on Shoppers' prior periods so that year-over-year comparisons can be made. We still have a lot of work to do, and there could be other adjustments we need to make, but we have already identified several accounting and modeling considerations that have occurred as a result of the transaction. We expect to recognize approximately $2.2 billion of goodwill and approximately $9.5 billion of intangible assets, mainly related to prescription files and Shoppers Drug Mart brands. You'll find further details in our news release.

In terms of the P&L, the key to items be excluded from adjusted operating income are a writeup of Shoppers inventory of approximately $800 million, which will be recognized in cost of goods sold having the effect of reducing our gross profit. We expect this to be largely completed over the next three quarters. An increase in amortization of intangibles. The amortization of intangibles are expected to be approximately $550 million on an annualized basis. One-time transaction costs that will also be excluded. In Q2, we expect to record $30 million to $40 million in combined Company transaction costs.

A number of key items that will be included in our adjusted operating incomes and earnings are as follows. An increase in Shoppers Drug Mart's rent expense due to the rate reset of straight-line rent on acquisition. We expect that will increase rent expense by approximately $40 million on an annual basis. Reclassification of certain Shoppers Drug Mart costs from COGS to SG&A as a result of aligning various accounting policies between the two companies. There's no impact on operating income.

We'll see increased depreciation expense on the fair value of fixed assets. We expect that will increase our depreciation expense by approximately $10 million annually. Total interest expense for the combined company, excluding the fair value of the trust unit, will be approximately $587 million in 2014. Q1 interest expense was $103 million. It is expected to be approximately $145 million for the second quarter, $184 million for the third and $155 million for the fourth quarter.

And finally, unrelated to the Shoppers Drug Mart acquisition, as noted in our MD&A, we are implementing a new perpetual inventory management system as part of SAP. We expect to have visibility by the end of Q2 as to whether the implementation will require an adjustment to the carrying amount of our inventory. Any charges required will be adjusted in our non-GAAP results.

Now, let's turn to our outlook for the business. Longer term on a combined company basis, we believe our grocery business has opportunities to leverage further efficiencies including an incremental benefit from the completed deployment of SAP. The acquisition of Shoppers Drug Mart will allow us to drive annualized synergies of $300 million by the end of the third year, and we are committed to delivering these to the bottom line. The acquisition also provides further revenue synergies that are not factored into this target. As we continue to build our portfolio of independent but complementary businesses including Choice Properties and PC Financial Services, in addition to delivering the efficiencies and synergies I described, the free cash flow generation potential of this business is compelling.

Turning to our near-term outlook, we do intend on updating our expectations when we report our second quarter to reflect the accounting policy alignment and purchase price allocation impacts with respect to the Shoppers Drug Mart acquisition, as well as synergies expected to be achieved in 2014. The Company's synergy targets remain unchanged. We expect the competitive environment and industry square footage to remain at historically high levels and we expect deflationary pressure from regulatory drug reform in the second quarter. The impacts of both are expected to moderate in the second half of the year.

During the second quarter, we expect to be negatively impacted by the timing of charges related to the transition of certain stores to a more cost effective and efficient operating terms under collective agreements. This charge is anticipated to be approximately $25 million. Expectations for the full year with respect to these agreements are approximately $36 million, including a $5 million charge in Q1. In 2013, the charges were $8 million and $24 million for the second quarter and full-year respectively.

I also wanted to touch on CapEx. We expect total Company CapEx to be between $1.2 billion and $1.3 billion for 2014, excluding the $51 million in CapEx already spent by shoppers in the first quarter. We seek to have a balanced capital return through growing our business with prudent investments, buying back shares and increasing our dividend. While we do not expect to buy back shares in the near future as we are committed to the reduction of our leverage to 3 times adjusted debt to adjusted EBITDA within 24 months, we did feel that we were in a position to slightly increase our dividend to $0.245, an increase of 2.1%, roughly in line with our adjusted earnings growth in 2013. With that, I would like to hand the call over to Vicente.

Vicente Trius - *Loblaw Companies Ltd - President*

Thank you, Sarah, and good morning, everybody. At Loblaw, we have been on a focused and steady course to reposition ourselves in the Canadian retail landscape and to create a leaner, more agile and more competitive organization. We continue to invest in our customer proposition to drive the top line while consistently achieving efficiencies. We continue to focus on fresh as a differentiator; and our broad portfolio of banners is well positioned to trade to the customer across formats, price point, and location.

In the first quarter, we achieved positive same-store sales growth in a challenging environment against a difficult comp. We invested 10 basis points in the customer proposition, which we were able to offset by efficiencies led by supply chain and labor. Adjusted EBIT and adjusted EBITDA grew year-over-year. SAP is on track, and as of yesterday, we had rolled out to 17 DCs and approximately 200 stores. Our strong same-store sales were led by fresh with our basket size growing again.

Inflation was also a factor in our growth with our internal inflation being slightly higher than CPI. While grocery continues to deflate, we do see significant inflation in areas of fresh. Both traffic and tonnage continue to be impacted by the unprecedented growth in square footage, but we continue to perform better than the market here with our tonnage volume and dollar market share declining less than our decline in share of overall total supermarket square footage.

Our PC Plus loyalty program is exceeding our expectations. We introduced it a year ago as a pilot in Ontario Loblaw stores and in November, launched it across the country with the exception of No Frills, Maxi, Maxi and Cie and Wholesale Club. By any measure, this program has been successful. We now have more than 5 million members, about half of which are registered. More importantly, we're seeing a positive income on sales, especially in Ontario where PC Plus has had more time to get established. Almost 40% of our sales in participating banners are now accompanied by the scan of a PC Plus card. Our PC Plus members make more trips, buy bigger baskets, and show more categories.

Turning to other areas of our business. Pharmacy continues to be under pressure from the impact of regulatory drug reform and increased competition. The right-hand side reset continues with nine additional stores planned. We expect to have close to our entire network completed by year-end. These resets continue to yield results including positive comps in home, but we still see slightly negative comps as we continue to cycle through the changes.

Though comps are negative, contribution dollars are up. The apparel business has had a tough winter and with the delay in spring buying as well. We have seen very positive traction in our Joe Fresh e-commerce platform, which is growing period over period with an average order double the in-store. Our emerging business, which we don't speak to enough, continues to progress. Wholesale Club continues to grow double-digits, and T&T and Fortinos continue to advance their businesses.

Turning to operational efficiencies and strategy, we continue to consistently invest in the customer proposition. In the first quarter, we did invest in price, but we also experienced upwards pricing pressure due to foreign exchange which impacts produce as well as price impacts due to shortages in beef and pork. Affecting gross profit, we also had negative efficiencies in transportation due to higher fuel costs and shrink combined 13 basis points. We were more than able to make this up through efficiencies in SG&A and achieved 17 basis points of efficiencies in supply chain and 15 basis points in labor. With the drive for efficiencies, we do expect some headwinds on efficiencies as we move through 2014 due to increased fuel costs, foreign exchange, and the increase in the minimum wage in Ontario. However, we're still committed to achieving the efficiency targets that exceed our investments in our customer proposition in the grocery business.

Turning to SAP, we're very pleased with how the SAP rollout is currently progressing. We are on track to complete the corporate network rollout this year and the DCs rollout completed by midyear. It is early still, but we're encouraged by what we see. Longer term, SAP is expected to have a positive impact on availability, perpetual inventory, productivity, shrink, and overall customer experience.

Looking ahead, in our core grocery operations, we see very little relief from the intensely competitive environment in which we operate, although there may be some easing in the unprecedented growth in retail square footage in the second half of this year. We will have to remain extremely vigilant and on strategy to continue to deliver improved year-over-year comps, but we are comfortable we can do this with our balanced energy.

We're well-positioned in three strategic pillars, the best in food experience; efficiency and growth in our core business and complementary business platforms. Now we're adding a critical fourth pillar; best in health and beauty through Shoppers Drug Mart. We have all had time to consider the potential of these acquisitions, the ability to meet customer demands, the product set, the store networks, the leading brands and loyalty programs. As exciting as that is, there is real work that needs to be done to capture the potential of the combined companies and deliver the synergies we outlined, which we expect to start surfacing in the third quarter.

Before I pass the call over to Domenic, I wanted to take this opportunity to welcome him and the entire Shoppers Drug Mart team to Loblaw. In the past several months, we have had a chance to work and interact with Shoppers Drug Mart team. We have been extremely pleased with how well the two teams are working together to drive our business forward. And for me personally, it was pretty exciting to walk into Shoppers Drug Mart stores and see what we call Hero Items of PC products including PC Decadent Cookies and PC Organics for Baby, as well as Life brand products in the Loblaw's stores, right after we closed the transaction. This is obviously just a taste of what is yet to come.

In closing, I am pleased with the results of our first quarter. We continue to look at the first half of the year with caution due to be competitive intensity, the impact of drug reform, and tough comps relative to last year. But I am truly enthusiastic about the prospects for the future as we unlock the value of the combined companies. And now to Domenic.

Domenic Pilla - *Loblaw Companies Ltd - President, Shoppers Drug Mart*

Thank you, Vicente, and good morning, everyone. I'm delighted to be here this morning to provide a little color on the first quarter operating and financial results of Shoppers Drug Mart. Before doing so, however, I want to echo the sentiments already expressed by Galen and Vicente and tell you how excited all of us at Shoppers Drug Mart are to be part of the Loblaw family. The strategic rationale for this combination is clear, and the opportunities for our business have been well articulated. But what I am most excited about is the degree to which this transaction has been embraced and the level of engagement that exists among our people including our associate owners and their teams at store level as we work together to better serve our patients and customers and ultimately, help Canadians live life well.

Turning to the quarter, let me start by saying that we are pleased with our first quarter results. Looking at the top line, Shoppers' total sales were $2.5 billion in Q 1, an increase of 1.3% over the same period last year, driven by strong volume growth in pharmacy and continued sales gains in the front of store. On a same-store basis, sales increased 1.4% during the quarter. Pharmacy sales which accounted for 48.2% of Shoppers' sales mix in Q1 were $1.2 billion, an increase of 0.5% compared to the same period last year as strong growth in the number of prescriptions filled at retail was partially offset by a further reduction in average prescription volumes. On a same-store basis, pharmacy sales increased 0.4% during the quarter.

During Q1, the number of prescriptions dispensed at retail increased 4.1% compared to the same period last year and was up 4% on a same-store basis. Consistent with recent quarterly trends, pharmacy volume growth was evident in all regions of the country and remains particularly strong in Ontario. Year-over-year, average prescription value at retail declined a further 3% during Q1, largely the result of further reductions in generic prescription reimbursement rates due to recently implemented and ongoing drug reform initiatives in most provincial jurisdictions, along with increasing generic prescription utilization rates.

In the first quarter of 2014, generic molecules comprised 62.5% of prescriptions dispensed compared to 60.7% in the same period last year. In the front of store, first quarter sales were $1.3 billion, an increase of 2.1% compared to the same period last year, led by strong growth in cosmetics, food and confection, and other convenience categories. This is a strong result in what remains a very competitive and highly promotional marketplace, as well, after giving consideration to the impact of the calendar shift -- of the Easter calendar shift.

The Company's store network development program, which resulted in a 2.1% increase in drug store selling space compared to a year ago, continues to have a positive impact on sales growth, particularly in the front of store. On a same-store basis, front store sales increased 2.1 per -- 2.2% during the quarter. Year-over-year, gross margin -- gross profit margin declined slightly in Q1, reflecting the heightened level of promotional intensity in the marketplace, particularly in the front of store. However, effective marketing and promotional campaigns proved to be impactful, driving year-over-year growth in transaction counts and average basket size, resulting in an increase in gross profit dollars of 0.9% during the first quarter of 2014.

First quarter operating income, adjusted to exclude the impact of transaction related costs of $7 million pretax, were $177 million compared to $175 million in the same period last year as of the benefits of cost reduction, productivity and efficiency initiatives and comparable stores were mostly offset by higher operating expense at store level tied largely to the Company's network growth and expansion initiatives. I will now pass things back to Janet.

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

Thanks, Domenic. And Michelle, we're actually ready to take questions at this time.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Irene Nattel, RBC Capital Markets.

Irene Nattel - *RBC Capital Markets - Analyst*

Now that the Shoppers acquisition has closed and we're, what, 32, 33 days into the process, just wondering what incremental information you may be able to provide to us around synergies,, integration plans, integration costs. And also I noted that you said that we should start seeing the synergies in the third quarter of this year, so just wondering what the implication is on the annualized run rate target.

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. Good morning, Irene. This is Vicente. Good question. We have been working very well between the two companies and obviously, within the competition raw constraints we started working well before the closure of the 21st of March. We have cross-functional teams across both organizations, and we're mainly working in two major areas. One I would say synergies, which is related to COGS, efficiencies and revenues, and the other one would be related to people, talent, organizational design and bringing the two cultures together. We are making good progress. We are committed to the $300 million and we're committed to the $100 million on our first year analyzed, which means for March to March, and we should be able to give you some color behind the progress during our Q3 call.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. Thank you very much. And then if I could, just moving on to the whole balance of competitive intensity, investment in top line to drive market share, inflation, and how we should expect all of this to play through in 2014?

Vicente Trius - *Loblaw Companies Ltd - President*

So, let me give you some color. First of all, as a Company, we have continued to invest in our customer propositions. So, if you look at Q1 we did deflate in grocery. And we compensate our investments by driving efficiencies. Having said that, we did experience in the market some inflation in fresh, and I want to maybe spend a minute or two on giving you more detail behind that inflation.

It's been mainly driven by foreign exchange, but also driven by some impacts in the mid-category. So, foreign exchange has impacted mainly produce. In meat, you have a shortage of the beef cattle herd in North America which has impacted beef prices. You have a disease which is called PED in pork which impacts suckling pigs where they need to be slaughtered after five years of -- after five days, sorry, of birth, which impacts inflation in pork. And that has had a cascade effect into other protein like chicken because of higher demand as well as into derivatives like deli. Combined to that, there's been some inflation as well in salmon and shrimp due to some challenges in the fisheries. But we see the whole process that has gone well in the market and has been well-managed in the market overall. As far as the way we would see the remaining of the year, I would say that we're starting to see a stabilization in reference to inflation.

Irene Nattel - *RBC Capital Markets - Analyst*

Okay. That's great. Thank you. Just thinking about the overall tone of the release this quarter, which seemed slightly more cautious than the prior couple of quarters, just wondering, is it what you're seeing out there that's causing you to be more cautious than you were, say, at the end of Q4?

Vicente Trius - *Loblaw Companies Ltd - President*

I think, actually, that we've been quite consistent. We said that we had second half a little bit more challenging than the second half. We believe that we continue to make solid advances in our combined business as a Company which should reflect both financially and operationally. And we feel good about our prospects as a combined business.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. Thank you.

Operator

Vishal Shreedhar, National Bank.

Vishal Shreedhar - *National Bank Financial - Analyst*

My first question is with respect to capital return and the balanced program that was noted in the prepared remarks. That's nice to hear. How large should we think of this buyback program to be in particular when you get to it? Is there any color you can give us now, or is it too early?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Hello, Vishal, it's Sarah. Right now, I think our biggest piece is focusing on delevering, so we really are focused on that over the next few years, so we're not anticipating doing any share buybacks during the next 24 months. And after that, I think we'll just be in a different place. We'll have a lot of the cash flow coming in from the business, and so I wouldn't want to give you an estimate at this time. We have to wait until we are a little further along with that.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. And with respect to internal inflation, that was higher than CPI typically, correct me if I'm wrong, that's not the case? I'm wondering why internal inflation was higher than stats can CPI.

Vicente Trius - *Loblaw Companies Ltd - President*

Mainly, in many ways, driven by mix. We let lead with fresh. Fresh is increasing penetration which drove a higher average basket. We also had some comparisons against last year where water and pop had, let's say, a higher participation in units, which drives, let's say, more tonnage, but less average transactions. What we have experienced is a much better performance of our loyal customers with a higher average transaction.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. If I could sneak one last one in there, with respect to the rent expense, the additional rent expense at Shoppers, that $40 million that you noted, should I take my old Shoppers EBITDA number and step down by $40 million, or is that covered in the synergies number that you have? Is that synergies number a net number that covers that?

Sarah Davis - *Loblaw Companies Ltd - CFO*

You should take your old Shoppers numbers and step it down by the $40 million on an annualized basis. It is non-cash because it is just the accounting treatment of the rent, but it will be $40 million incremental expense on Shoppers. We are going to restate 2013 for Shoppers as well to align it, so you will actually be able to see the operating performance on an apples to apples basis as well.

Vishal Shreedhar - *National Bank Financial - Analyst*

Thanks very much.

Operator

Jim Durran, Barclays.

Jim Durran - *Barclays Capital - Analyst*

Just wanted to go back to the inflation discussion. Vicente, you were saying that you see the future quarters being normalized now. Is that suggesting that this 1%, 1.5%, 2% inflation is going to be the new norm for the rest of the year?

Vicente Trius - *Loblaw Companies Ltd - President*

No. I am suggesting that it's normalizing the fresh categories. I am not going to make an opinion how the CPI will land because you have other variables that build the overall basket. But as we reflect to Q1 where we experienced inflation was in the fresh categories.

Jim Durran - *Barclays Capital - Analyst*

Okay. As of the Shoppers integration, aside from the fact that we have seen some seen some PC products show up in the Shoppers stores already, what other things should we be looking for in 2014 that as a consumer we'll actually see a difference?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, you should see a higher, let's say participation of control brands along all of 2014. And you should see some of the complementary knowledge being applied into pilot stores at the end of this year where there's an enhanced food offering in Shoppers Drug Mart, as well as an enhanced (inaudible) offer in the grocery side of the business in Loblaw.

Jim Durran - *Barclays Capital - Analyst*

Okay.

Vicente Trius - *Loblaw Companies Ltd - President*

As it relates to the consumer, okay?

Jim Durran - *Barclays Capital - Analyst*

Yes, exactly. That's certainly a high important focus at this point. And then with respect to SAP, good progress obviously over the past quarter. Any change to how many stores and DCs you expect to have online by the end of the year, or are we just on plan at this juncture?

Vicente Trius - *Loblaw Companies Ltd - President*

We are right on plan at this juncture. We rolled out approximately 200 stores, 17 DCs. Just to give that in context, we do have 21 DCs. We should complete those DCs in June, and it's quite encouraging because it's going smooth. But there is a maximum pace that you can rollout stores, and it ranges anywhere between 10 to 20 stores on a weekly basis. So, that would get at the end of the year all-purpose stores and solid piloting across all franchise banners to accelerate the rollout across all franchise banners in 2015.

Jim Durran - *Barclays Capital - Analyst*

Okay. And then as far as when you would expect to actually gain benefits from the SAP program, are we into a situation that once all the stores are tacked on, that we'll still be waiting another year before you start to lap proper history with SAP before we are only one system and standalone SAP and then trying able to leverage the SAP benefits?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, this is a good question. We are already obviously in the process of monitoring progress in the 200 SAP stores. Keep in mind that only a small portion of the stores have cycled the year, and I do believe that you need a full year and an inventory to really get the full perspective. The areas that we see, let's see, efficiencies to SAP would be on the end-to-end which impacts availability, impacts solid disciplines on planograms, better inventory management, which should translate into shrink, and all those variables should translate into better productivity, more hours that are invested face-to-face to the customer and improvement of the overall experience of the store. We're starting as a Company to -- in a detailed manner, measure all those variables and in the future, we will be sharing some color behind the benefits.

Jim Durran - *Barclays Capital - Analyst*

Great. Thank you.

Operator

Peter Sklar, BMO Capital Markets.

Peter Sklar - *BMO Capital Markets - Analyst*

Your retail pricing at was in excess of 1.2% CPI, slightly in excess of that, which is more than other grocers seem to be reporting in the industry in Canada. Can you talk about the context of this? You're passing this through, it's something -- you're passing -- sounds like your foreign exchange related costs as well as your beef and pork costs, you're passing that through at retail, something other grocers have not done or they're slow in doing. Can you talk a little bit about the context about -- you seem to be showing pricing leadership and what the dynamics of that are?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, even though I do not want to make comments on other competitors, there are differences, let's say, on the quarters that the different retailers report on. And there is an inflation that, let's say, took hold maybe a little bit higher at the end of the quarter than at the beginning of the quarter.

And that's the inflation in the market. When we look at our competitiveness, it's solid. Based on our strategy across all of the banners, whether it's market or discount division versus the competitors.

Peter Sklar - *BMO Capital Markets - Analyst*

Right. But this inflation that you're passing through at retail, do you feel it's negatively impact you from a tonnage perspective?

Vicente Trius - *Loblaw Companies Ltd - President*

No. Actually, when I look at the tonnage, you got to live with comparisons. That's part of the business. But when we look at the tonnage, last year we had one of our highest comps, right? And it was, a lot of it could have been driven by smaller transactions and driven by water and pop. There is a little bit also obviously of impact due to the increasing square footage in the grocery sector. But mainly in our case would be driven by the pop and water comparisons versus last year.

Peter Sklar - *BMO Capital Markets - Analyst*

So, are you saying that the tonnage was higher for water and pop last year?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. It brings smaller transactions. It's less than $1, right? Transaction in many cases, right? Not the transaction, but the item. Right? So it does drive some additional tonnage in those categories, but it doesn't mean that it's 100% healthy tonnage.

Peter Sklar - *BMO Capital Markets - Analyst*

Right. Okay. And then just one other question, if you look at your overall grocery retail business, your operating profit or EBIT was essentially flat year-over-year. Which is generally a good result in the context of what other people in the industry or other grocers in the industry are reporting. Where do you think you're getting that relative outperformance from? Is it passing through some of these wholesale procurement costs? Or is it block and tackling efficiencies? Are you beginning to see some SAP benefits? Where do you think you're getting some traction in the business?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, where I believe we're getting traction, we are consistent on our customer proposition. On investing on the customer and being more competitive and a better experience. But where we see that traction is leveraging our efficiencies. When we talk about a supply chain that had a 17 basis point efficient gain, this is substantial. When you talk at a labor productivity of 15 basis points in this business, this is substantial. So, yes, we're getting efficiencies. Some of that in some parts of business could be related to technology. Others through improvement in processes across the whole Company.

Peter Sklar - *BMO Capital Markets - Analyst*

Right. Okay. Thank you.

Operator

Chris Li, Bank of America.

Chris Li - *BofA Merrill Lynch - Analyst*

Just a quick follow-up on SAP, Vicente. Just wondering if you can tell us, what gives you the confidence that you'll be able to implement SAP at all the corporate stores by the end of the year? Are there any guideposts or any stats that you're monitoring that gives you that confidence?

Vicente Trius - *Loblaw Companies Ltd - President*

The heart of the confidence is adoption, right? So, it's about people and users and adopting the system. The other one is obviously no impact to the customer and no impact financially. When you combine all of that together and having a sample that is close to 30% of our sales, we feel actually -- if you look really add any company that implemented SAP and they're at 30% of the sales and 200 stores and almost the whole distribution network done, it gives you a sense of confidence because most of the time, any skeletons would have appeared way before.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. That's great. And one for Sarah. You mentioned earlier that you won't be buying back shares or not planning to do it for the next 24 months. Could that timeframe be shortened, let's say if you're able to deliver faster than expected? Or is that 24 months a hard period that you won't be buying back shares?

Sarah Davis - *Loblaw Companies Ltd - CFO*

I think it's fair to say if we delivered quicker, it would be -- we would you potentially look at buying back shares. But at this moment, based on the plans that we have for the combined companies, we don't see it happening quicker. But there's always the potential that we could.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. Thank you.

Operator

Patricia Baker, Scotiabank.

Patricia Baker - *Scotiabank - Analyst*

My first question is for you, Vicente, just on the core grocery retail business. I know you don't like to give much distinct information between the discount banners and the conventional, but you do run two distinct businesses, and you referenced both in the slides and in the remarks. The exceptional increase in square footage that's been put in the marketplace and the bulk of that is happening on the discount side. Can you get share with us whatever colors or metrics you want about what the distinct performance might've been in the quarter with discount relative to conventional? Are you seeing potential particular pressures there, what's happening, how happy are you with discount business in this context?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. We've seen a stable performance as a real business, that's a period on period so across the three periods of the quarter. When I refer to some of the water and pop comparisons there would be more influencing the discount business, but not necessarily the market business. And so we're encouraged on both divisions, but let's say that market could have a slightly better performance in the quarter than discount.

Patricia Baker - *Scotiabank - Analyst*

Okay. That's very helpful. My second question is for you, Sarah. It's just a simple clarification. In your remarks, you talked about what you will be disclosing with respect to Shoppers Drug Mart and referenced in the near term you plan to disclose same-store sales figures, revenue, gross profit, EBIT and EBITDA, and the goal is to continue to provide transparency. Can you share with us what you mean by near term and what you really mean when you talk about the key business drivers which will evolve? Are you really saying that that's what you're going to provide with us now and maybe in the second quarter, but really you can't guarantee that we'll see that on a longer term basis?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay. The financial metrics that you would see in the slides that we sent out with the call would be what you should expect for the next year. So we are --until we lap, the acquisition, we do expect to provide this information in order for people to understand the performance of the business. After that and after we have put the businesses together and evolved a little bit more, we just -- we don't know yet. We're going to determine it as we go through. And so we may continue to provide that information or it may be that the businesses are integrated that that's not the most valuable information, but we will work with you to make sure that we are giving you what you need to understand our businesses as well.

Patricia Baker - *Scotiabank - Analyst*

Okay. That's very helpful and clears that up. Another clarification might be simply something that I'm missing, but also, the referenced that in the next 24 months you are going to work to delever the balance sheet and get to, I think you said 3 times leverage?

Sarah Davis - *Loblaw Companies Ltd - CFO*

2.0 times.

Patricia Baker - *Scotiabank - Analyst*

Okay. Sorry.

Sarah Davis - *Loblaw Companies Ltd - CFO*

3 times, sorry. We're at 3.2 today as of the acquisition -- the close of the acquisition, and we'll go to 3.0. And it's worth about $1.5 billion of debt reduction.

Patricia Baker - *Scotiabank - Analyst*

Okay. The reason I'm asking that is I think I've made, and maybe I'm just confused on some definitions here, but I think you guys had indicated earlier in previous statements that you'll get to 2.5 times.

Sarah Davis - *Loblaw Companies Ltd - CFO*

Yes. So, I think the difference is that there has been a change in S&P's methodology, so we've adjusted to their new revised methodology. So, it is 3.2 down to 3, but I can provide you -- maybe after the call we can provide you the exact calculations.

Patricia Baker - *Scotiabank - Analyst*

Okay. That would be excellent. Thanks a lot.

Operator

Derek Lessard, TD Securities.

Derek Lessard - *TD Securities - Analyst*

I'm actually just standing in for Michael Van Aelst. Just a quick question on, switch gears to the financial services. Revenue growth was still healthy and margin expansion as well. But it is slowing. Are we at a point now where we're going to be seeing single-digit growth?

Sarah Davis - *Loblaw Companies Ltd - CFO*

So, the growth in the quarter for earnings before taxes is about 20%. I would say that that's fair to say that that's not representative for the full year, but I think it will still be double-digit by the end of the year, but it will be low. So, high single and low double-digit for the full year.

Derek Lessard - *TD Securities - Analyst*

Okay. Thanks. And the revenue and on the retail side, again, revenues were up and gross margin was down just a touch, despite all the pressures we're talking about. Maybe if you can just talk about some of the offsets that helped you to minimize the gross margin compression.

Vicente Trius - *Loblaw Companies Ltd - President*

Well, the offset -- the number one offset would have been the higher penetration in participation of fresh. Right? So, our participation in fresh has consistently grown over the last couple of years. And so that creates a higher margin of fresh and it creates a better mix, which compensates for the deflation that we experienced in grocery.

Derek Lessard - *TD Securities - Analyst*

Okay. Thanks.

Operator

Perry Caicco, CIBC World Markets.

Perry Caicco - *CIBC World Markets - Analyst*

Just a quick question on inflation. Were there any notable geographical differences in your internal inflation rate?

Vicente Trius - *Loblaw Companies Ltd - President*

No, Perry. Good question. No. Actually, it would have been experienced across Canada because foreign exchange impacts across Canada. And then what I mentioned, the cattle herd in beef and pork would have experienced across the country as well, so it's pretty consistent.

Perry Caicco - *CIBC World Markets - Analyst*

Okay. Do you -- the same-store tonnage decline, do you think that that's the cost of maintaining margins at a reasonable level in the near term, or do you expect to be able to drive that back in a positive territory with selected investments in either gross margins or labor?

Vicente Trius - *Loblaw Companies Ltd - President*

No. The impact is mainly what I said, the comparisons on water and pop. And then obviously these high square footage that we have. We should not underestimate the 3.6 increase in square footage that we have across the country. And that is this is playing in different manners, depending on the region as you start to maybe cycle some of growth but other provinces accelerating.

Perry Caicco - *CIBC World Markets - Analyst*

Okay. And can you tell us how you've reorganized the senior management team after the closing of the Shoppers deal? Who does Loblaw pharmacy report to, who does Domenic report to, who at Shoppers reports to Loblaw?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. We're very pleased, first of all, to have the whole Shoppers Drug Mart team and their capabilities. Domenic reports to me, and I like to say that he works very closely with me. And we just announced, in reference to pharmacy, for example, we just announced an individual from Shoppers which would lead pharmacy in Loblaw. And that is being led by Domenic across obviously both combined organizations.

As far as the overall structure, we did announce a structure way back, even before the closing, which supports a shared service structure across support divisions. And then it has distinct divisions across the Company, and that's a management board level.

Perry Caicco - *CIBC World Markets - Analyst*

Are there senior executives at Shoppers who have dual reporting?

Vicente Trius - *Loblaw Companies Ltd - President*

I don't know what you mean.

Perry Caicco - *CIBC World Markets - Analyst*

Reporting to Domenic and then reporting functionally within Loblaw.

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, it is a make matrix organization, yes. And as part of the management board, there are four senior executives from Shoppers today in the management board.

Perry Caicco - *CIBC World Markets - Analyst*

Okay. One last question specific to the synergies. On the one hand, you need suppliers to cooperate for you to meet your synergy targets at the Shoppers, especially in year one. On the other hand, the weak dollars put many of those suppliers in a tough position. How do you expect to balance between the two situations?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, we see these as a parting with suppliers, we have a very solid joint business in process. We think the joint business process, we look at plans that are three years out, and we base that on accurate data and good planning across both companies. And we see it as a very good and solid approach.

Perry Caicco - *CIBC World Markets - Analyst*

Okay. Thanks.

Operator

Kenric Tyghe, Raymond James.

Kenric Tyghe - *Raymond James - Analyst*

Vicente, with respect to your growth in fresh penetration, how much of that growth is just about improved merchandising within fresh versus better insight into the consumer, given that 40%, as you described of your sales, are now attached to your PC Plus slide? I'm just curious as to how much of this is driven by greater insight into fresh and what matters for consumers versus perhaps, just on the storefront level, the merchandising decisions you're making?

Vicente Trius - *Loblaw Companies Ltd - President*

I wouldn't have a concrete measure that would single out one or the other. But I would say it's a combined effort. So, there's no doubt that we have improved, and I'm going to use the word tremendously. Our assortments and presentation in fresh, and this takes different elements, whether you look at an inspired format in market or whether you look at a No Frills. And this has translated in better mix and better transitional fresh. But at the same time, the fact that we are penetrating through PC Plus, 40% of our scan sales does help as well drive the fresh. And it does help us target on a one-to-one basis those customers on the fresh needs.

Kenric Tyghe - *Raymond James - Analyst*

Thank you. And then just switching gears to SAP again very quickly, 72 stores in the first quarter, just over 50 stores in the first month of this quarter implies a fairly marked acceleration. How much of that is an actual acceleration in terms of your confidence capabilities or other impacts? How much of that is just a timing? Essentially, should we be looking at this as a run rate on the quarter of somewhere north of 150 stores? Or is that a bit of a false read?

Vicente Trius - *Loblaw Companies Ltd - President*

If you take -- that's a good question. If you take the quarter on its own calendar-wise, you're looking at about 100 stores that we delivered in Q1. Right? If you take the next approximately next four weeks to do that, the total, counting what we had last year, would be at about 200 stores. There's a little bit of an acceleration as we look at the year, but not significant.

Kenric Tyghe - *Raymond James - Analyst*

Thank you. I'll leave it there.

Operator

Keith Howlett, Desjardins Securities.

Keith Howlett - *Desjardins Securities - Analyst*

Yes, I had a question on the SAP. The goal was to move eventually, I think by 2016, the IT spending at Loblaw down to 1.2% of revenue from 1.8%. I'm wondering where we would be at at this point in time.

Sarah Davis - *Loblaw Companies Ltd - CFO*

It's Sarah. We are at about -- in 2014, we will be at about 1.5% -- 1.55%. So, between 1.6% and 1.5% for -- as a percent of sales, and we're on track to get to 1.2% for -- by 2016.

Keith Howlett - *Desjardins Securities - Analyst*

And in the future, does Shoppers Drug Mart need to go to SAP or not?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, we have a robust infrastructure in platform and I would say best in class today in Loblaw. And as we look at the future, we'll look at ways that we can complement the Shoppers business, but we shouldn't underestimate either what they have done and the robust platform that they have, for example, behind Rx and initiatives that they have. I would say it's compliment to their business, but we're in the process to analyzing where we will add, let's say more value with SAP.

Keith Howlett - *Desjardins Securities - Analyst*

And just on the Loblaw business, in terms of the emerging businesses that you highlighted Fortinos, T&T, and you mentioned the wholesale club, which has not really had a lot of profile maybe outside the Company recently. Can you speak to what your plans on the Wholesale Club are?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, Wholesale Club is -- we think within the context maybe is not as large as the other divisions, but it's an interesting division and a division that we are repositioning with a very strong focus through the food service and convenience stores. We embarked in a low capital remodel plan. We remodeled a couple stores that had huge, huge results, very good. And that means on the top line and the overall performance of those clubs, so we're encouraged. And we see good potential in that division.

Keith Howlett - *Desjardins Securities - Analyst*

Can you explain -- I wonder if you could comment on your other formats that you're testing like the No Frills box or the new -- more than a test, but the new prodigal stores, et cetera?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. The inspire stores were very -- we're pleased with what we're seeing, and it's mainly driven by solid, solid sales increases. Higher penetration of fresh that allows you to improve, let's say, the overall experience in service in the stores. So, we see that as a good model and a model that can have growth across, let's say, more of our stores in the market division. As I look at the box, we are just about to cycle a year, and we're seeing good signs. And the good signs means being able to hit a sales target and being able to hit a EBIT target that we have targeted for the first year. So, we're encouraged, but early stages because we basically have only two stores operating.

Keith Howlett - *Desjardins Securities - Analyst*

Thank you.

Operator

David Hartley, Credit Suisse.

David Hartley - *BMO Capital Markets - Analyst*

Your predecessor, Vicente, would talk about a period of maximum risk when talking about some of the early days of SAP, and I was just wondering if maybe you could characterize a period of maximum risk in terms of the integration of Shoppers and your ongoing turnaround initiatives and SAP initiatives. Is it -- is there a period of maximum risk that exist in year one, year two, year three of that integration?

Vicente Trius - *Loblaw Companies Ltd - President*

I would like to see it like understanding the risks and at the same time, having very good planning behind it, right? I would say that a successful integration is when you have a company that, in my mind, comes together from a people, talent, organizational, design and culture. So yes, the synergies are important, and we will deliver on the synergies. But the most important, as we look long term, is really bringing those two companies together, right? And this includes processes, this includes people. So, it's about the sensitivity behind people on all of us in management of understanding the change that you are driving among both organizations. And that's always a risk, but we're very conscious about it. We're driving many leadership programs across the organization to understand change management of how we can bring those two companies closer and closer.

David Hartley - *BMO Capital Markets - Analyst*

So, it sounds to me like you're comfortable, confident, you seem to have a platform in place that leads me to believe that perhaps this is not -- this is a different Loblaw's today than it was three years ago where you're now building. And not on your back heels, on your front feet with in pursuing this process. Is that the way to think about it?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. And this is definitely a different Loblaw's.

David Hartley - *BMO Capital Markets - Analyst*

Okay. And let me ask you a little bit about initiatives around, we'll call it growth. Renos and relos, how do you see that progressing? Obviously throughout the year, but into the next couple years? You do have a lot of balls in the air here with integration with SAP, et cetera. But how do you think about those renos and relos and growth? And then, of course, my favorite topic of click and collect and your pilot there, could you maybe give some color around that and the cadence of all that?

Vicente Trius - *Loblaw Companies Ltd - President*

So, we have a target this year. I think we're planning on about 22 new stores and about 150 stores between renovations and relocations. We always said that our target was about 1% in additional square footage, and it would be within that target, I believe. And as we look at 2015 it should be pretty stable with those numbers. You should add to that, obviously, what we're doing at Shoppers as well, which they have a plan on new stores and remodels and relocations.

David Hartley - *BMO Capital Markets - Analyst*

Okay, great. I'll --

Vicente Trius - *Loblaw Companies Ltd - President*

Let me get back to your second question, sorry to interrupt you. As far as click and collect, we're progressing well. And we are on target to have about three pilot stores in the greater Toronto area by Q3, Q4 this year.

David Hartley - *BMO Capital Markets - Analyst*

And is that -- do you visit that for a year, see how it goes and then maybe think about if it hits the targets? Or do you think about rolling that out a little further?

Vicente Trius - *Loblaw Companies Ltd - President*

We see it as an intrinsical piece of our omni channel strategy. We've done extensive research. We believe that it's a model that you get it to profitability in the fair amount of time. So obviously, it's that we have a, I would say a much more aggressive plan to roll it out across our networks.

David Hartley - *BMO Capital Markets - Analyst*

Great. Thank you very much.

Operator

Jim Durran. Barclays.

Jim Durran - *Barclays Capital - Analyst*

Just wanted to go back to the tonnage conversation. So, Vicente, I don't want to put words in your mouth, but if we exclude pop and water from the equation, would you say that you held tonnage share in the quarter versus the previous year? And maybe perhaps versus previous quarter?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. I would say maybe a slight, slight decline in tonnage but when you compare to square footage, it would have been very, very solid. Square footage growth of the market.

Jim Durran - *Barclays Capital - Analyst*

And when you are track your tonnage share these days, I understand part of the challenge now is as you continue to grow fresh and some of it's no UPC code, that AC Nielsen as a reference struggles to represent the entire pie. Do you adjust your numbers in some way, shape, or form to keep an eye on that, or are you still relying mostly on Nielsen?

Vicente Trius - *Loblaw Companies Ltd - President*

We're still relying on Nielson. It's a very good question. You're making me think, so it's a good question. But we rely on Nielsen.

Jim Durran - *Barclays Capital - Analyst*

How relevant is this issue? Because is the amount of fresh that's not being tracked by Nielsen becoming increasingly material?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, could be. So, I'm not ready to give you an answer, but I'll definitely do some research.

Jim Durran - *Barclays Capital - Analyst*

Okay. And last question is just on your review of categories, how far along are you now, and do you continue to embrace the lower shelf price strategy and reduced promo price?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. The categories is an ongoing process. We should be basically close to completion by the end of this year. It's part of the process, it's the proper strategies, the proper planning, the proper assortment and the positioning in pricing as well. And that position takes a different color, whether it's the market division or the discount division.

Operator

Great. Thank you.

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

Thanks, Jim. And our call has come to an end. Thanks, everybody for joining.

Operator

Ladies and gentlemen, this does conclude the conference call for today. You may now disconnect your line, and have a great day.