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PRESENTATION

Operator

Good morning. My name is Michelle and I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies Limited third-quarter 2014 results conference call.

(Operator Instructions)

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

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

Thanks, Michelle, and good morning, and welcome to Loblaw Companies Limited third-quarter 2014 results webcast and conference call. I'm joined this morning by Galen Weston, President and Executive Chairman; Richard Dufresne, Chief Financial Officer; and Dominic Pilla, President, 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 expectations regarding certain aspects of the financial performance in 2014 and future years. These statements are based on certain assumptions and reflect Management's current expectations and they are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from our 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 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 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 available on our website. We also have some support material in the form of a few slides that have been e-mailed to you and posted to our website. They do not directly support the speakers' remarks, so you do not need to follow them as we speak.

Now, I'll turn the call over to Galen.

Galen Weston *- Loblaw Companies Limited - President & Executive Chairman*

Good morning, everyone.

This morning we announced our financial and operating performance for the third quarter of 2014. Our continued progress gives us increased confidence. Our strategic framework is clear and the entire Organization is focused on delivering against it: best in food experience; best in health and beauty; operational excellence; and growth. This strategy is supported by our commitment to stable, consistent trading; realizing synergies and efficiencies in our Business; as well as deleveraging the balance sheet.

In the third quarter, on a consolidated basis, revenue is up 36%, adjusted EBITDA rose 57%, and adjusted operating income rose 74%. We saw solid contributions from President's Choice Financial and Choice Properties. We realized CAD44 million in net synergies, and generated CAD216 million in free cash flow, and our deleveraging plan is on track.

In our grocery retail business, we saw improved tonnage trends, traffic, and basket growth. In fact, while growing square footage at one-quarter the rate of the industry, we maintained tonnage share and market dollar share. At Shoppers Drug Mart, improving competitiveness and increased stability and predictability in pharmacy resulted in a solid quarter, led by strong momentum in script count growth.

A stable trading environment is a key driver in our financial plan, and we delivered steady, consistent sales and margin performance across each of our major divisions this quarter. We are well-positioned competitively and see compelling customer traction in our major consumer initiatives, ranging from PC Plus, now available in our discount stores; the continued roll-out of our Inspire model stores in the market division; and the sustained success of our expanded scope of practice services at our pharmacies, like flu shots. Our adjusted EBIT growth for the Company, excluding synergies, was flat, slightly lower than we would have liked.

Efficiencies, the second driver of our financial plan, continued steady, meaningful progress at Loblaw. Supply chain costs continue to come down, as do IT expenses. Administrative expenses also continue to decline. For example, headcount in the Corporate head office is down from 6,100 people two years ago to 4,900 today, a reduction of 1,200 positions over two years.

Part of surfacing efficiencies is the implementation of SAP. SAP is operating in substantially all of our Corporate stores now and we are at the inflection point where legacy is being displaced by a new system. This is a critical juncture and needs to be carefully managed.

The third driver is synergies, and we're happy with our progress here. We have nearly completed our cost of goods negotiations with national brand vendors and are shifting efforts to other areas identified in our plan. We remain confident in delivering our target. The final driver of our financial plan is deleveraging, and Richard will speak to that in his remarks.

Before closing, I do, however, want to mention that the third quarter also marked the launch of Crave More, the next phase in the evolution of the President's Choice brand. Over the last few years, it's become clear to us that customers are thinking, caring, and talking more than ever about food. They're seeking new exciting flavors; they're passionate about where their food comes from and how it's made; and they obsess over what is healthy and what is not.

In this era, President's Choice has an important role as a pioneer and leader. Crave More is an invitation for customers to expect more from their food and more from our President's Choice brand. This fall, we've extended that invitation through an innovative combination of television, print, and digital advertising.

As part of that effort, we've launched an online community of those who share our curiosity and enthusiasm for food at our website, pc.ca. Qualitative measures show that Crave More struck a cord with Canadians and quantitative measures are equally encouraging. The pc.ca website traffic has increased more than three-fold and our latest PC sales campaign charted strong sales lifts, coinciding with our TV and digital launches. This is an exciting beginning for what we expect to be a sustained campaign.

In closing, I'm pleased with our progress. While still intensely competitive, the market is stabilizing and our performance continues to improve. We remain committed to delivering on our strategic and financial plan, which we believe will result in superior long-term returns.

I'll now turn the call over to Richard.

Richard Dufresne - *Loblaw Companies Limited - CFO*

Thank you, Galen, and good morning, everyone.

Let me provide you with additional context regarding our quarterly results. It's now our second quarter following the closing of the Shoppers acquisition, and while still early days, we are making steady progress.

Our financial plan for the business is aligned with the business priorities that Galen outlined. To reiterate those, we strive to maintain a stable trading platform; deliver on our efficiencies target; deliver synergies associated with the Shoppers acquisition; and finally, delever our balance sheet. Our goal is to deliver positive same-store sales and earnings growth from our core businesses, excluding synergies.

Our food retail business delivered same-store sales of 2.6%, driven by Fresh, improved tonnage, and traffic trends. Internal inflation was in line with CPI of 2.8%, and resulted from inflation in Fresh categories. We saw positive comps across all our businesses; however, our wholesale business led comp sales with almost double-digit comps.

In our drug retail business, our front-of-store same-store sales were 1.6%, with growth in both traffic and basket. We added eight beautyBOUTIQUEs in the quarter, and now stand at 361. In pharmacy, same-store sales grew 3.5%. With strong script growth of 4.4% and a very slight decline in average script value, pharmacy has outgrown front-of-store again this quarter and continues to be strong. Programs like flu shots, the focus on seniors, and waiving of co-pay for ODB, all contributed to improved results.

Top line of the business was strong, with sales of CAD13.6 billion in the quarter, up 35.9% over last year. Adjusted gross margin of our retail businesses stood at 26% in the quarter, versus 21.5% last year. In our food retail business, we held adjusted gross margin flat at 21.5%. We did record some synergies in gross margin in the quarter; however, we have not been able to pass through all of the food inflation we experienced.

In our drug retail business, gross margin grew 80 basis points to 39.1%. If we look at the financial performance of each of our food and drug retail businesses, both delivered flat operating earnings, meaning EBIT, year-over-year, if we exclude synergies. We posted CAD44 million in net synergies in this quarter for a total of CAD52 million since closing. We are confident we will hit the CAD100 million net synergies by the end of the first quarter of 2015, as announced earlier this year.

On efficiencies, we are making progress, as we are seeing tangible benefits in support labor, supply chain, and admin. We are, however, seeing non-recurring costs hit the SG&A line and we need to increase our vigilance to minimize such costs going forward. You will see that we booked a restructuring charge this quarter of approximately CAD46 million tied to cost reduction initiatives that have been ongoing. About 200 jobs were eliminated. This charge is largely comprised of Corporate headcount reduction, executive departures, as well as some realignment and repositioning of roles. For example, we are consolidating Loblaw's payroll in our shared service center in Winnipeg.

Our interest expense for the quarter, adjusted for items not linked to our indebtedness, stood at CAD169 million, an increase of CAD63 million versus last year. Adjusted net earnings totaled CAD371 million in the quarter versus CAD205 million last year, an increase of CAD166 million. Finally, adjusted earnings per share stood at CAD0.90 versus CAD0.73 last year, an increase of 23.3%.

Free cash flow was CAD216 million, bringing us to close to CAD600 million year-to-date. We repaid CAD350 million of debt in the quarter, while Choice Properties added to its debt slightly. Therefore, we reduced consolidated indebtedness by about CAD300 million. So, since closing of the acquisition in March, we have reduced our debt by CAD650 million, and remain on track on our deleveraging plan.

Our capital expenditure this quarter totaled CAD300 million, and CAD630 million (sic -- CAD638 million) year-to-date. Our capital expenditures tend to be back-end loaded, but we believe there's a possibility that they will come in lower than plan. The largest portion of our CapEx is spent on retail stores; however, a good portion continues to be spent on infrastructure and this portion is falling and should continue to fall next year.

I have spoken previously about the opportunity to reduce CapEx, as well as deliver a better return on capital in the Business. As we move to 2016 and beyond, we believe there are opportunities to bring the number down as we look at both businesses together. Further, we are aligning the methodology by which we look at allocation of capital in both our food and drug retail business, and we've added a number of additional metrics to assess the returns of our projects.

Before closing, I wanted to touch on two more items. All of you have seen the announcement last week on changes to interchange fees that are charged to retailers for credit card transactions. As a retailer that owns a bank, we both pay interchange fees at the retail level and profit from them at the bank. The reduction in interchange fees will clearly improve profitability in our retail businesses. Lower interchange does affect PC Bank, but we are waiting for the details to come out to be able to assess the impact. In any event, we do not believe this is material to the Company.

On SAP, I'm pleased to say that we've made tremendous progress on the roll-out this year. We now have 440 stores converted and all of our DCs. More importantly, we've been able to do so without negatively impacting our financial performance and our customers' experience at store level.

The next phase of the SAP implementation is having the team truly engage with the new system. We're currently running our legacy and SAP system in parallel, but with SAP in the majority of our Corporate network stores and all of our DCs, change management becomes a focus. Our teams must now embrace SAP and all of the benefits and insight it will provide. This is ongoing and we need to help our colleagues move through the transition.

This concludes my comments. I will now open the call to questions. Thank you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Irene Nattel of RBC Capital Markets. Please go ahead.

Irene Nattel - *RBC Capital Markets - Analyst*

Thanks and good morning, everyone. I'm wondering if we could just focus for a minute on EBIT and efficiencies excluding synergies. We have had some nice top-line performance from both the food and drug segments and yet that's failed to translate to operating leverage to improve the EBIT. So just wondering what's going on there and what needs to happen in order for underlying earnings to improve?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

Yes, Irene, fair question. Let's start with the basic idea of what we call stable trading. Stable trading means consistent sales performance; it means consistent margin performance; and it means consistent market share performance. The trick, the key to delivering against that is actually not overreacting to any particular circumstance.

And if you look at Q3 this year versus Q3 last year, our view was that we need to maintain the level of competitiveness that we delivered in Q3 and, therefore, we decided that we would run it largely at the same margin. The sales performance was positive and we were able to make up that rate investment through incremental margin dollars and so net-net, we felt it was the right thing to do and is largely a good story.

The area that we're focused on is really efficiencies and making sure that we're actually delivering on the SG&A leverage and on the admin leverage. And here, I'd say we were reasonably happy in the quarter, with a 30 basis point improvement. What we didn't like was the fact that there were some other costs, one-time costs, transaction costs, and so on and so forth that obscured that number. So, yes, the efficiency program is working, but what we have to make sure is that it actually does drop to the bottom line.

The examples I'll give you are the implementation management office, which is responsible for delivering the synergies. That's a cost that we've carried in the Loblaw P&L that would negatively impact that retail EBIT leverage on sales. Then we also had a one-time payment to the Lee family associated with the T&T transaction that was part of the deal we struck with them five years ago. Those are the kind of things that are there, but it doesn't change the fact that ultimately we need to see the numbers show up in the bottom line and that is something that the Organization is very focused on.

Irene Nattel - *RBC Capital Markets - Analyst*

That's very helpful, Galen. Can I also ask the degree to which running the systems in parallel and the fact that you now have all 440 stores running in parallel might be a factor as well? And when do we get to that inflection point where we start to see some of those costs start to diminish?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

The system will run in parallel for, in our mind, at least through the end of 2015. So there is, what I describe as, friction associated with that, and costs that are embedded in the Business to run those two systems, that we're not really going to be able to get at until we decommission one. But it's still largely operating consistently with our plan. And to Richard's point, this kind of [inflection] point that exists today is one where it's a mental model.

For the most part, people have been looking at the legacy systems because that's where they're comfortable. Now the volume of sales is such that, in order to understand what's going on in the business, they actually have to focus with an additional intensity on the SAP system. I can describe that right now for a lot of folks as drinking from a fire hose.

The level of granularity associated with the data that comes through the SAP system is very good, very helpful; ultimately, it's going to deliver, we think, some significant benefits, but it is a mind shift to start to figure out how to manage the Business that way. So I'd say we feel good about where we are, but it is -- it does need to carefully managed as we move forward.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. Thank you very much.

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

Thanks, Irene. Next caller.

Operator

Thank you. The next question comes from Michael Van Aelst of TD Securities. Please go ahead.

Michael Van Aelst - *TD Securities - Analyst*

I just wanted to start up with a follow-up on Irene's question regarding some of these duplicate, or some of these one-time costs that are in your SG&A lines. When I look at the SG&A growth, excluding EBITDA, it was up almost 3% at Loblaw's and 4% at Shoppers. How much of this growth -- how much of the -- was the one-time items that you discussed, a factor in seeing growth of SG&A at that level?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Michael, there's -- I won't give you the details of how much it was, but I think the point that we're trying to make here is that we are seeing the benefits. If you look at labor, at admin, and IT, we're seeing those benefits trickle in, but there's one-time items that are coming. So we need to improve our vigilance to make sure that these costs don't hit us going forward. So that's where we're at.

Michael Van Aelst - *TD Securities - Analyst*

What's a time frame you think before you feel you have control of those one-off costs?

Richard Dufresne - *Loblaw Companies Limited - CFO*

I'd say the whole Organization is focused on it now. We need to make sure, as an Organization, when there are specific items that occur, we need to make sure that we weigh the pros and cons of making a decision and making sure it doesn't hit our SG&A on a one-time basis.

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

I'll add to that. We still have a few quarters of potential restructurings and things that are going to lead to one-time charges. What we're going to try and do for you guys is really illustrate to the best of our ability what the underlying trend is, so we'll have to get back to you on that. But the take-away is that we acknowledge that if it doesn't drop to the bottom line, it's not going to give you a lot of confidence. We feel good about the actions that are taking place, but we have to make sure it shows up there for you.

Richard Dufresne - *Loblaw Companies Limited - CFO*

And on the Shoppers side, there's SG&A growth driven by new stores, so that is going to continue to happen. We are divesting some stores, so there's noise associated with that also.

Michael Van Aelst - *TD Securities - Analyst*

Thank you. And then on the gross margin side, on the food business, as you mentioned, it didn't recover from the depressed levels in Q3. How much of that is related to just not being able to pass on the higher costs of things like meats that have been running up and where are you in that process of trying to pass that on?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

That's certainly a part of what's happening here. There's some price increases that we are able to push through to the consumer, but it's consistent with what we said in Q2, which is that we're not able to pass it all on. Given the competitiveness of the environment, we would expect that basic structure to continue moving forward. It really depends on how the inflation story unfolds in 2015, but we don't expect a big change. People are passing through increases, but we're also all trying to stay as competitive as possible.

Michael Van Aelst - *TD Securities - Analyst*

Right. So the SG&A in terms of where you could have been -- sorry, the gross margin as relative to where you could have been if you had rebounded a little bit from Q3 last year, like you did in Q4 last year, actually, you had a good Q4 relative to Q3. Is there other things in there in that gross margin that we shouldn't expect to continue, like higher costs rolling out from the loyalty program or anything like that?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

No, I don't think so. The judgment, when you go into a valley, like we did in Q3, is do you try and flip the top of that valley, and in doing so, resulting in a deterioration in your competitive position. And again, we felt that, that was pulling the -- that would be pulling the lever too hard the other way, and that we should maintain our position.

I think we were right in that judgment, because the rest of the market was pretty aggressive in Q3 and we were able to keep pace with them. So we're just going to keep managing the Business that way and we may be a little behind in certain quarters, we may be a little ahead in certain quarters, but we're not going to pull these levers to hit the -- to land it on a dime at the end of each period.

Michael Van Aelst - *TD Securities - Analyst*

All right. Thank you.

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

Thanks, Mike. Next caller, please.

Operator

Thank you. The next question comes from Jim Durran of Barclays. Please go ahead.

Jim Durran - *Barclays Capital - Analyst*

Thank you. Just looking at the food business, you indicated that traffic was up slightly. Can you just give us some idea of what you attribute about to that? Was that industry-wide and so nothing specific to your Business or something you guys have been doing holistically that's getting you to a better place?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

We'd like to attribute that to the actions that we're taking in terms of our customer offer. So some good examples, I touched on the investment that we've made in the Inspire stores. We see a very meaningful increase in traffic whenever we renovate one of those stores. The launch and the acceleration of PC Plus; that's driving incremental trips into our stores that we've talked about before, we think is a really positive sign around the effectiveness of PC Plus.

Imagine, what we think we're doing is we're taking a trip that was otherwise going to another store and that loyalty is bringing them back into our stores. Or in fact, that we're putting these personalized fliers out once a week, that it's driving that incremental trip because customers want to come in and get that added value. Those would be examples of the kinds of things we're doing that we'd like to believe are increasing customer traffic versus the competition.

Jim Durran - *Barclays Capital - Analyst*

And on drug reform drain, we saw a dramatic easing of that drain. Can you give us some idea, what your crystal ball is telling you in terms of what that trend might look like over the next year?

Dominic Pilla - *Loblaw Companies Limited - President of Shoppers Drug Mart*

Hi, it's Dominic Pilla. It's not so much a crystal ball. There's been quite a bit of communication by the Council of Federation and ratification by several provinces of that protocol, and so our current estimate would be that the Council of Federation recommendation will prevail, at least through 2015 and hopefully all through 2016. That does generate additional deflation; however, it is visible and predictable and the other benefit is that it is common across all provinces and that's our current view.

Jim Durran - *Barclays Capital - Analyst*

What's the patented drug expiry, moving into generics, outlook for the balance of this year and into 2015?

Dominic Pilla - *Loblaw Companies Limited - President of Shoppers Drug Mart*

It's more modest than it would have been over the last 18 months, but still there will be continue to be patent expiry and deflation on top line, related to substitution of generics to branded product, but it will be more modest than we would have experienced in the last 18 months.

Jim Durran - *Barclays Capital - Analyst*

Thank you.

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

Thanks, Jim. Next caller, please.

Operator

The next question comes from Kenric Tyghe of Raymond James. Please go ahead.

Kenric Tyghe - *Raymond James - Analyst*

With respect to the PC Plus program and the launch in hard discount, could you give us some color as to how much of the lift in members was driven by the hard discount launch versus [in conventional] and just other color as to specific initiatives that may have driven that membership lift as strongly as it was, or strong as it was in this quarter?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

I don't know the specific numbers, but let's say that the substantial portion of the increase that we're reporting in Q3 was driven by the expansion of the program into No Frills and we've been really pleased with the level of adoption. It became the single number one requested item in the customer call center where No Frills customers saying when can we get PC Plus into our stores.

The thing to remember about PC Plus is the unique economic design of the program allows us to bring PC Plus to No Frills and manage the cost in a way that we think is consistent with the economic model of hard discount. So we don't believe -- never say never here -- but we don't believe that other folks are able to do that because of the base program that they offer. We think this represents a meaningful, sustainable competitive advantage and the opportunity for us to deliver meaningful incremental value to those shoppers, so we're optimistic about the impact it's going to have on that business.

Kenric Tyghe - *Raymond James - Analyst*

Thank you, Galen. If I could just switch gears to Shoppers for a minute. The front-store performance in the quarter, how much of that reflected disruption from either pilot store initiatives or repositioning of the square footage in grocery and the like versus, perhaps, just a particularly competitive environment. How would you characterize the team's thinking or performance relative to expectations in the front-store in the quarter.

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

It would have been no impact from any of the work we're doing on piloting additional food at this stage. The pilot is quite modest and not material to the front-store results. In terms of performance, we actually have very good performance in terms of, we continue to grow share in every category [we're] participating, [leading] by beauty and cosmetics, as well as food, overall in our system, not just in the pilot stores, but overall in our system.

Really the front-store comp is more driven by some market events, a much slower cough and cold season, and delayed in fact, cough and cold season, that we're not seeing that really pick up in the fourth quarter, and then a very small and calm allergy season where we would have expected some increase. So this is not a performance issue, not a share relative to expectations. We continue to grow share. We're actually very pleased with our front-store results.

Kenric Tyghe - *Raymond James - Analyst*

Thank you. I'll leave it there.

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

Thanks, Kenric. Next caller, please.

Operator

Thank you. The next question comes from Perry Caicco of CIBC World Markets. Please go ahead.

Perry Caicco - *CIBC World Markets - Analyst*

Yes, thanks. I was wondering what the outlook is on getting SG&A costs out of the Business in 2015. You took some headcount out in Q3, so maybe we can start there. How much savings will that generate and will it go to the bottom line and how much more should we expect over the next year?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

What we'd rather do, Perry, is give you a sense of the outlook for 2015 when we come into Q4. There's really two forces at play. There's the store component of SG&A, and you know well that there's lots of inflationary pressure there, particularly when it comes to wages. We have a big labor negotiation coming up in Ontario next year that we're focused on.

The challenge for the retail organizations is to absorb any increases on that front and to do it in a way that delivers against the stable trading model that we've outlined for you. Where we're really focused on accelerating those efficiencies is actually in the head office -- the IT, the supply chain, the head office admin -- and that work continues. The momentum is satisfactory, although it will be lumpy.

It's lumpy because of restructuring charges that go with headcount reduction. Lumpy because of other decisions that we might make. So we're feeling good about it, but we have to manage it carefully, and as Richard said, we have an obligation to demonstrate to you that this is actually flowing to the bottom line, so more on that moving forward.

Perry Caicco - *CIBC World Markets - Analyst*

And then I know it's quite early to talk about 2015, but maybe you can help us by maybe framing some of the external factors we should be considering and perhaps some of the more important initiatives that you might be pursuing to help us begin to figure out what 2015 might look like?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

Yes. I tried to do that. On the negative side, what we're focused hard on is this labor deal in Ontario. We also have British Columbia. Then on the opportunity side, it really is in the areas that I described: continuing to drive down the cost on the IT side; continuing to leverage what has been three years of really terrific momentum on the supply chain side; and then of course, there will be some opportunity, as the Shoppers Drug Mart business and the Loblaw business start to figure out more efficient ways of working together and that's an area of focus for us as well.

Perry Caicco - *CIBC World Markets - Analyst*

If I could ask one more question. You've talked quite a lot in the past about improving execution and today you used the term stable trading, which I'm assuming is fairly similar. How would you rate yourself today on those kinds of items and what indicators should we look for, as investors or as consumers, to judge whether or not you're making progress?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

The usual: store conditions, in-stock, our overall competitiveness on the shelf, our overall competitiveness in our fliers. When we are investing new capital and you go into a store, do you see a compelling upgrade in the consumer offer or is it just an exercise in paint and paper? We are seeing steady improvements in NpS; we saw it again in Q3.

So these are the kinds of things that we watch for and it's about not just delivering on a theoretical basis, or on a one day a week basis, but delivering on that promise day in and day out. Again, we've seen a big improvement in our consistency, and we've also seen big step-ups in our capital investment and the impact that, that's actually having on the customer experience. So we're starting to build some momentum around those programs and you should expect to see more of that.

If you think about Shoppers, for example, one of the big areas of opportunity in 2015 is their version of a personalized Optimum program, load-to-card personalized offers; that's something that we launched in Q3 and continues in Q4 and we're going to ramp it up in meaningful way in 2015. That's all about being as efficient as possible, in terms of the promotional investment that you're making, so that you're giving customer value on the things that they value. We've got that with PC Plus today and are really pleased with the results, and as that migrates in its own way to Shoppers, we're expecting some good results there too.

Perry Caicco - *CIBC World Markets - Analyst*

Okay. Thank you.

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

Thanks, Perry. Next caller, please.

Operator

Thank you. The next question comes from David Hartley, Credit Suisse. Please go ahead.

David Hartley - *Credit Suisse - Analyst*

Thank you very much. It's great your market share is holding in, or perhaps even increasing when you consider your square footage growth versus that of the industry. What I'm curious about is, as we move forward, I can see all the initiatives you're pursuing that will allow you to improve your blocking and tackling in the business, et cetera. What is the event or initiative that will see Loblaws on the food side really engage the consumer and perhaps meaningfully grow market share?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

Again, to come back to this idea of stable trading, we're a big business. We have a lot of market share and the cost to grow market share at a disproportionately significant rate, really, in our judgment, may not be worth the squeeze. So our view is that we're going to continue to invest in our assets; we're going to continue to deliver leadership across each of the businesses, whether it's market, whether it's Shoppers, whether it's our discount division; but we really don't expect that to translate into a meaningful acceleration or pulling away from the rest of the pack.

Holding share, given a lower investment in new square footage than the market, is a good result. What we've tried to express in terms of the investment thesis for this Business is that we should be generating a lot of cash. We should be able to put enough into the business to maintain our competitive position, to maintain our market position, and then we have to determine what to do with that cash. Right now, it's going to go to paying down debt, ultimately to buying back shares, and then beyond that we'll ultimately have to see. That's a way to think about the business, not in terms of a step-change in market share performance.

David Hartley - *Credit Suisse - Analyst*

Okay. Is that a time frame over the next three to five years, then you relook at that idea of market share gains either through new initiatives like taking the loyalty program a step further, click and collect, how do you think about that?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

Look, all of these things are important and all of these things will help us seek out incremental sales, whether it's the enhanced food proposition at Shoppers, whether it's click and collect, whether it's our vision of bringing health and wellness and food together. All these things are really important. They're sources of differentiation. They're sources of increased customer loyalty.

The point that I'm making is that, on a business that has CAD45 billion worth of sales in one country, it's very hard to imagine that you can -- any one of those initiatives is going to deliver incremental chunks in the CAD2 billion, CAD3 billion, CAD4 billion range over the course of just a couple of years. I've articulated in a number of circumstances my view of how the market is going to unfold. There's a reasonable expectation of intense competition with rational stability for the next three years.

Anyone who is predicting the market structure beyond that would be taking a big risk. Never say never and our positions is that we will respond to whatever competitive forces come against us, but we don't see a lot of evidence at this point that it's going to deteriorate particularly badly, and we don't see an opportunity for us to significantly outstrip our competitors over the next couple of years either.

David Hartley - *Credit Suisse - Analyst*

That's helpful. Thank you. Last question, if I may. Maybe talk a little bit about risk with SAP. Previous iterations of Management would suggest period of maximum risk, those descriptors. How do you look at risk now with SAP, given that you are looking to shed the legacy system and move onto the new system with your people?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Hi, David. Let me take a stab at this one. I'll characterize it with a comment that one of our senior Management told me over the last few days. If you look at the store roll-out right now, they've become boring because it's actually going essentially without a glitch. Usually, when we were converting stores, people were getting calls at 3am in the morning to fix stuff. Right now the store roll-outs are going very well and we're coming at the end of our Corporate roll out.

Where we're at right now is, as Galen mentioned, is now people are forced to get to use the new system. And compare the new with the old one is that there is immense amount of data that becomes available and people are not used to look at that data. So now they need to get into the new tools, go dig in the data to find out answers to questions they have about the business, and that will take time.

Like I can tell you, I'm working with my finance team, and with the operators to deal with these issues, and that's a journey that we're essentially just embarking on and that will take time. But the good news is, is that the system is working. So now we just need to get all our teams aligned with the benefits that this system provides and that will help us to make better decisions going forward.

David Hartley - *Credit Suisse - Analyst*

Thank you.

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

Thanks, David. Next caller, please.

Operator

Thank you. The next question comes from Vishal Shreedhar of National Bank. Please go ahead.

Vishal Shreedhar - *National Bank Financial - Analyst*

Hi. Thanks for taking my questions. Just a few quick ones here. Where are the synergies recorded in SC or L and how did you make the decision on where to put the synergies?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Vishal, the synergies are booked where they originate. As you can imagine, most of them have been in cost of goods sold and we've harmonized the cost of goods sold between both businesses. The one who gets its cost down gets the benefit. There's no decision as to where it's being put; it just happens to go where it needs to be. So that's why we're not talking about where it's going because it's somewhat irrelevant. We're one Business now and we're looking at the absolute number and that's what counts.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. But the businesses were each flat before synergies, right?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Yes.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. In terms of the opportunity associated with SAP, just on the cost side, or rather IT, is that still 1.2% of sales?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Yes, that's still a target we're aiming for. But on IT, what I can tell you is costs are going down. We are monitoring that very carefully. They've been going down this year. They're going down again next year. So that will continue. We need to get to the metric that we've talked about and we're well on our way.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. So that 1.2% of sales, you could probably hit that quicker than originally anticipated?

Richard Dufresne - *Loblaw Companies Limited - CFO*

I don't know when we're going to hit it, but it's going down.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. In terms of the collective agreement costs, there was a charge of CAD7 million in the quarter. How long should we expect those to continue? At some point in the future do they stop or--?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

We'll get back to you on it. I think it's one more quarter, so through Q4 and then we're largely through that buy-down period, but we'll get back to you and make sure that, that's correct.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay, so potentially starting 2015, those collective agreement charges may stop, potentially?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

Yes. We're at the very tail end of it, just moving through the last wave of stores, and so it's just a question of whether it's in Q4 or Q1 and we'll confirm it.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. And just two more quick ones here. Drugstore was flat at Loblaw and up about 3.7% at SC. I know there's some square footage delta there, but I was just wondering what's your view on what's causing the delta?

Dominic Pilla - *Loblaw Companies Limited - President of Shoppers Drug Mart*

It's Dominic Pilla. There is a delta, but what we've done is we are aligning the team and are working very hard to get best practices shared, some talent sharing, and we're actually seeing some momentum on the Loblaw side in areas like expanded scope of practice and customer communication and so on. So I'm expecting that gap to narrow in the future.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. And the last one, there was a slight decline in Corporate square footage and a slight increase in franchise square footage growth. I'm looking at it quarter-over-quarter. Just wondering what the reason was for that and if we should expect that trend to continue?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

We believe in a balanced portfolio and that balanced portfolio includes a number of Corporate stores and franchise stores. Right now, my guess is that this is driven by a steady rate of conversion of Provigo Corporate stores in Quebec to Provigo franchise stores. We've been doing that steadily for the last three years and we are really pleased with the results, so we'll continue that until the small Provigo stores are basically all franchised.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. That's it from me. Thanks a lot.

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

Thanks, Vishal. Next caller, please.

Operator

Thank you. The next question comes from Patricia Baker of Scotiabank. Please go ahead.

Patricia Baker - *Scotiabank - Analyst*

Thank you very much for taking my questions. I actually have three. The first one is just a clarification. When I look at the quarter, it was pretty much an in-line quarter and it was pretty nice that there were no real surprises. This has already been addressed, but I'd like to give you an opportunity for you to talk about it a little bit more.

The one thing that was a surprise to me was the Shoppers Drug Mart front-store comp at 1.6%. Dominic, you did talk about a slow cough and flu season. When I looked at these numbers, I just wondered if there wasn't any other dynamic in here that you're doing something different to the business and maybe managing the margin differently than you might have done in the past?

Dominic Pilla - *Loblaw Companies Limited - President of Shoppers Drug Mart*

No, for sure these are much more market-related events than what we would have done. But I will tell you that we're very pleased and why I say the team has had good performance is the progress we've made on personalization, that Galen already alluded to. We're going to continue to see that. That allows us to really respond to a customer's needs in a way that's more efficient and costs us less to deliver those values. We are very pleased about the performance there, and in terms of the actual comp relative to market share gains, again, we are seeing the momentum come back in some of those markets, macro in fact, and so I wouldn't read anything into that.

Patricia Baker - *Scotiabank - Analyst*

Okay. That's very helpful. And then secondly, Richard, it was you, yourself, in your commentary, you talked about the comps and the fact that the wholesale division had double-digit comps. That's not a number that you've called out much before. Would there be any way that you would tell us what the two-year stacked trend would be or what that business looked like last year so we have a sense of what it's being compared to?

Richard Dufresne - *Loblaw Companies Limited - CFO*

It's a prelude because -- and I actually said close to double-digit. I didn't say double-digit.

Patricia Baker - *Scotiabank - Analyst*

Okay. Sorry. I missed a couple of words. Okay?

Richard Dufresne - *Loblaw Companies Limited - CFO*

So no, that business has been doing very strongly on certain categories, such as tobacco, and there's a change in the way one of our supplier is going to deal with that business that could change that trend dramatically going forward. If it does happen, we'll have to call it out. So it's a prelude to that.

Patricia Baker - *Scotiabank - Analyst*

Change it dramatically in a negative or a positive sense?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Negative.

Patricia Baker - *Scotiabank - Analyst*

Okay. That's what I thought. And then Richard, again for you, you talked about this before and I know it's something that you're working very hard on and that's the return on invested capital trends over time and certainly CapEx. When in 2015 do you think you'll give us a sense of what the CapEx plan will be for 2015?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Probably going to be able to talk to you about that when we announce our Q4 numbers next year.

Patricia Baker - *Scotiabank - Analyst*

Okay. Super. Thanks a lot.

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

Thanks, Patricia. Next caller, please.

Operator

Thank you. The next question comes from Chris Li of Bank of America. Please go ahead.

Chris Li - *BofA Merrill Lynch - Analyst*

Good morning. First question is just, given that everyone is investing to enhance their fresh offering, with the successes that you guys are having in terms of increasing your fresh penetration, do you get a sense that, is it because the overall demand from consumers is increasing or is it mostly because you're getting share at the expense of your competitors?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

Listen, as always in these circumstances it's probably a bit of both. Then there's also a third force out there, which is the inflation, which as you know is coming, has been running through most of the year, predominantly in fresh. So that's naturally going to drive the fresh penetration up. But what we are seeing is consumers making a very distinctive choice to buy fresh food.

The way we evaluate it is we've now, in our Inspire stores, as the easiest to see example, we've upgraded our investment in convenience prepared foods. The quality is higher. The price is a little bit higher. But what we're seeing is consumers making that choice because they're beginning to see it less against what they might spend in the grocery aisle or the frozen aisle and more versus what they might spend if they went out to a restaurant instead. And in that sense, they're seeing real value.

The other example I like to use is the juice bars. We've rolled 50 juice bars out across the country and customers of a certain kind, and it's a broad-based number, it's not just the people with high, high, disposable incomes, are making a choice to spend CAD7 or CAD8 on 1 liter of orange juice because it's fresh, than say, CAD2.49, which is what they might spend on a 2-liter Tropicana from the refrigerator.

These are the kinds of positive trends that are driving our enthusiasm for those fresh stores and I'm sure that our competitors are seeing some similar benefits. You have to ultimately be the judge of who is putting the best proposition in front of the customers. We have our view, but you're going to have to be the one to determine if we're winning or not.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. That's helpful. And perhaps Richard, given the CapEx is coming below your full year target for this year, can you just update us what you expect the CapEx to be for the full year for this year?

Richard Dufresne - *Loblaw Companies Limited - CFO*

No, it's too early. I'm seeing a trend where we're probably going to be a bit lower than plan, but I need to wait to see because our CapEx are very much back-end loaded so a lot of stuff happening as we speak, so I'll comment on that when we publish our year-end numbers.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. Then just in terms of your debt reduction target, am I correct to assume now it's down to about just over CAD1 billion of debt you'll pay down before you consider buying back shares?

Richard Dufresne - *Loblaw Companies Limited - CFO*

We've paid down CAD650 million so far, and as I've mentioned, our target is to pay down some CAD1.7 billion. So we have Q4 and next year and the first quarter of 2016 to get to our target and our plan remains on track.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. Great. Thank you.

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

Thanks, Chris. Next caller, please.

Operator

Thank you. The next question comes from Keith Howlett of Desjardins Securities. Please go ahead.

Keith Howlett - *Desjardins Securities - Analyst*

Yes, I wondered if you could just divide up in a rough way the CAD44 million of synergies between gross margin and SG&A lines?

Richard Dufresne - *Loblaw Companies Limited - CFO*

No, Keith, we won't split it, but it's fair to say that most of it is in COGS, so in gross margin.

Keith Howlett - *Desjardins Securities - Analyst*

And then just on the SAP, the target of 1.2% of spending on IT by 2016, does that number also apply to Shoppers Drug Mart or are they a lower number?

Richard Dufresne - *Loblaw Companies Limited - CFO*

This number is on Loblaws. We're going to look at Shoppers on a consolidated basis, as we move forward, but right now, that number is specifically related to Loblaw.

Keith Howlett - *Desjardins Securities - Analyst*

Then just finally on the competitive environment, there's been obviously a lot of worry in the UK about the very small hard discounters like Aldi and Lidl. Do you see any white space in Canada for that concept? I think investors are asking the question?

Galen Weston - *Loblaw Companies Limited - President & Executive Chairman*

You know that we've been working on a concept that we call the box. We have three box stores now and it really is designed to answer that question. And question number one is, is there a white space in that area that the customer will respond positively to in Canada? We think so, but we're not sure.

And then the second question is do we have a proposition, can we develop a proposition that is accretive to our Business and strategically complementary. We're working our way through that and there's quite a number of views at the table, as I'm sure there are around the investor tables that you participate in, and we'll just have to keep you posted.

Keith Howlett - *Desjardins Securities - Analyst*

Great. Thank you.

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

Thanks. We have time for two final questions -- or two final callers.

Operator

Thank you. The next question will come from Peter Sklar of BMO Capital Markets. Please go ahead.

Peter Sklar - *BMO Capital Markets - Analyst*

Thanks. Question on the pharmacy business. As you know, the Council of Federation has reduced the generic drug price to 18% of brand. I believe it's on a further eight generics, and the effective date is April 1. I'm just wondering how you're going to handle that from an accounting perspective. Have you taken a retroactive adjustment or will you be taking a retroactive adjustment?

Dominic Pilla - *Loblaw Companies Limited - President of Shoppers Drug Mart*

You're right that the Council of Federation has made some announcements. As I said in an earlier question, that we're supporting that view as to how generics will deflate going forward and certain molecules are going to 18%. Some have already happened in 2014. Some happened all the way back in 2013. From an accounting standpoint, I'll let Richard answer it. We take the price as it happens and the market gets adopted by the provinces, our reimbursed price.

Richard Dufresne - *Loblaw Companies Limited - CFO*

There is no retroactive adjustment. We take it when it comes in.

Peter Sklar - *BMO Capital Markets - Analyst*

It's a funny thing, if you look at the Council's press release, it's retroactive to April 1.

Dominic Pilla - *Loblaw Companies Limited - President of Shoppers Drug Mart*

Well, I'll have to relook at it. The event on April 1, 2014 happened. Molecules were deflated and were being reflected in our results and there's further deflation in April 1, 2015, so I have to reread it. I'm not familiar with that retroactivity provision.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. Just lastly, I just had a question about the guidance paragraph in the press release. This is something you've been saying, I believe, for a number of quarters now, that 2014 adjusted operating performance, excluding synergies, is expected to be, or the trends are expected to be in line with 2013. I'm not too sure what that means. Does that mean you're expecting the same level of operating profit, excluding synergies, or do you expect the trajectory of 2013 to continue through 2014?

Richard Dufresne - *Loblaw Companies Limited - CFO*

The trajectory.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. Thanks.

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

Great. Thanks, Peter. And one final -- we have time for one final caller.

Operator

Thank you. The last question will come from Michael Van Aelst of TD Securities. Please go ahead.

Michael Van Aelst - *TD Securities - Analyst*

Two smaller ones. First of all, the synergies of that CAD44 million, how much of that is retroactive based on procurement contracts being retroactive back to the beginning of the closing of the--?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Mike, they're mostly all rate, so they're all recurring, so there's no lumpiness to it.

Michael Van Aelst - *TD Securities - Analyst*

Because at CAD44 million, if you add that all in the quarter, that gets you over your CAD100 million run rate already, right? If you keep at that pace?

Richard Dufresne - *Loblaw Companies Limited - CFO*

I guess so.

Michael Van Aelst - *TD Securities - Analyst*

Okay. Then on the financial services, can you explain the trends there? Profit was down a touch. You had a few fewer weeks, but what's happening in -- what should we be thinking about when we're looking at the growth prospect of the financial services at this stage?

Richard Dufresne - *Loblaw Companies Limited - CFO*

Good question, Michael. Because we realigned the way we account for that division, we benefited from it in Q2 and we're paying for it in Q3. Fortunately, the financial services business is a business that keeps on growing. So despite the fact that they had less time in Q3 than in Q2, they delivered flat earnings, essentially. So you should expect the trend that we've been experiencing year-to-date to continue.

Michael Van Aelst - *TD Securities - Analyst*

All right. Thank you.

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

Great. Thanks, Mike.

Operator

Thank you. There are no further questions. Please continue.

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

Thanks, Michelle, and thanks everyone for joining us today. Please don't hesitate to contact us if you need anything else. Take care. Bye.

Operator

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