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Kenric Tyghe *Raymond James - Analyst*

PRESENTATION

Operator

Good morning. My name is Denise and I'll be your conference operator today. At this time, I would like to welcome everyone to the Loblaw's third-quarter results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session.

(Operator Instructions)

Thank you. Kim Lee, Vice President of Investor Relations, please go ahead.

Kim Lee - *Loblaw Companies Ltd - VP, IR*

Thanks, Denise. Good morning, and welcome to the Loblaw Companies Limited third-quarter 2012 conference call. This call is also being webcast simultaneously on our website at loblaw.ca. I am joined here this morning by Galen G Weston, Executive Chairman; Vicente Trius, President; and Sarah Davis, Chief Financial Officer. Before we begin today's call, I want to remind you that the discussions will include forward-looking statements, such as the Company's beliefs and expectations regarding certain aspects of its financial performance in 2012 and future years. These statements are based on certain assumptions and reflect management's current expectations. And they are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations.

These risks and uncertainties are discussed in the Company's materials, filed with the Canadian Securities regulators from time to time, including the Company's annual report and third-quarter 2012 report. Any forward-looking statements speak only as of the date they are made. The Company



disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by law. Certain non-GAAP financial measures may be discussed or referred to today. Please refer to our third-quarter report and other materials filed with the Canadian Securities regulators from time to time for reconciliation of each of these measures to the most directly comparable GAAP financial measure. An archive of this conference call will be available on our website.

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

Galen Weston - *Loblaw Companies Ltd - Executive Chairman*

Good morning, and thank you for joining us. In the third quarter, the team executed the plan. Targeted investments in the customer proposition are delivering clear results. The infrastructure program remains on track. And planned efficiencies are beginning to come through. We are pleased with the fundamental progress to-date. The dividend increase announced this morning reflects the Board's confidence that management's long-term strategy will build shareholder value over time.

Now I'll turn the call over to Sarah to walk us through the results.

Sarah Davis - *Loblaw Companies Ltd - CFO*

Thank you, Galen, and good morning. Let me start with the performance in our Retail segment. Retail sales increased by 0.7% to CAD9.6 billion in the third quarter of 2012. Same-store sales decreased by 0.2%. Modest growth in our food, drug and gas bar businesses was offset by a decline in general merchandise. Apparel sales were flat. During the quarter, our average quarterly internal food price index experienced modest inflation, which was lower than that in Q3 of 2011, and lower than average CPI in the quarter of 1.8%. In the Retail segment, we reported gross profit of CAD2.1 billion, up CAD33 million and 20 basis points on rates year-over-year. This increase was primarily driven by improved buying synergies and vendor management and decreased transportation costs, partially offset by increases in promotional pricing programs and shrink. Increased shrink in the quarter included an estimated CAD5 million investment in our customer proposition, related to improving assortment in our stores. For the Retail segment, operating income was CAD373 million, down CAD24 million or 6% year-over-year. This decrease was mainly driven by increases in our notables and labor and other operating costs, partially offset by gross profit and foreign exchange gains.

Increases in labor costs included an estimated CAD10 million incremental investment in our customer proposition, related to improving service in our stores. Notable items for the quarter included CAD29 million in incremental cost related to the IT and supply chain projects; a CAD6 million decrease in stock-based compensation expense; a CAD4 million decrease in costs related to the transition of certain Ontario labor agreements; and no notable fixed asset gains compared to the CAD14 million gain reported last year for the sale of a portion of a property in North Vancouver, BC. In Q3, our incremental investment in our customer proposition totaled CAD15 million, which included the CAD10 million in labor and CAD5 million in shrink that I mentioned before. Year-to-date, we have invested an incremental CAD40 million in our customer proposition. Of that, we invested CAD20 million in value, CAD5 million in shrink -- both of which impact gross profit -- and CAD15 million in labor, which impacts SG&A.

Now turning to our Financial Services segment. Revenue in the segment increased by 22% to CAD200 million, compared to CAD164 million in the third quarter of 2011. The increase was primarily driven by higher PC Telecom revenues resulting from the launch of the Mobile Shop kiosk business in Q4 of 2011. And higher interest and interchange fee income from increased credit card transaction values and increased receivable balances. Operating income in the Financial Services segment was CAD32 million in the third quarter of 2012, up from CAD24 million in the same quarter last year. Increased revenue, partially offset by investments in the launch of the Mobile Shop kiosks and higher credit card losses, drove the improvement in operating income. On a consolidated basis, operating income was CAD405 million in the third quarter of 2012, compared to CAD421 million in 2011.

Operating margin was 4.1% compared to 4.3% in Q3 of last year. Interest expense was CAD100 million, up CAD5 million compared to Q3 of 2011. Our effective tax rate for the quarter decreased to 27.2% year-over-year. The decrease was due primarily to further reductions in the federal and Ontario statutory income tax rate. For the quarter, Loblaw realized basic net earnings per common share of CAD0.79, compared with CAD0.84 in the third quarter of 2011. Free cash flow was CAD216 million versus CAD307 million last year. The decrease in free cash flow was primarily due to



the change in non-cash working capital, partially offset by a decrease in fixed asset purchases. During the third quarter, our capital expenditures totaled CAD289 million. We continue to expect to invest approximately CAD1.1 billion in capital this year.

We have updated our full-year 2012 outlook. For the year, we expect costs associated with the transition of certain Ontario labor agreements to be approximately CAD40 million. Incremental expenses related to our investments in IT and supply chain projects to be roughly CAD65 million, down from our previously anticipated CAD70 million. Incremental investments to strengthen our customer proposition to be approximately CAD50 million, up from our previously anticipated CAD40 million. And full-year net earnings are expected to be down year-over-year, with Q4 earnings -- excluding the CAD60 million in restructuring -- to be generally in line with Q4 of last year. As Galen mentioned, this morning we announced that we increased our quarterly dividend payout by CAD0.01, or 4.8%, to CAD0.22 per common share. Looking ahead, we still have a lot to do to complete our SAP store and DC rollout through 2014, and to further strengthen our customer proposition. We are making progress and remain confident in our position in an increasingly competitive environment.

I would now like to turn it over to Vicente, who will provide some context for the quarter and the balance of the year.

Vicente Trius - *Loblaw Companies Ltd - President*

Thank you, Sarah. Good morning, everyone, and thank you for joining us. First, let me talk to you about the trading environment. In Q3, competition remained intense, as promotional penetration continued to rise, combined with significant square footage activity. While there was an increase in consumer confidence, the quarter saw rising unemployment and low retail food price inflation, which put pressure on the top-line. In this environment we have stayed focused on the customer and made important progress in strengthening our customer proposition. Our initiatives, which are designed to offer our customer better service, selection and value, are working well in the areas where we have targeted our investments. As a result, Q3 delivered improving trends in key metrics for prioritized regions, banners in our fresh-led initiatives. Our category strategy continues to expand and edge forward on driving sales and margin. We are also seeing good signs with our health and wellness program. Our drugstore is delivering good sales growth in both organic and acquired script counts.

With our eye always on our customers, our customer satisfaction and feedback scores continue to exceed our targets. While customer count was relatively flat this quarter, a positive basket in customer analytics indicate that our programs, designed to build a more loyal, higher-value customer, are paying off. It takes time. But as we continue to focus on strengthening our customer proposition, it will translate into an even greater understanding among customers that we're here to provide value, assortment and service that they can trust every day. Our initiatives are focused on driving loyalty and repeat business into our stores. As we continue to consistently execute, our efforts will help to manage our reliance on promotional activity and build further momentum in the core. On the expense side, we're managing costs and driving efficiencies to support our investments and strengthen our competitive position. Last month we accelerated our cost reduction plan, impacting approximately 700 positions.

Now let me give you an update on our SAP implementation. Most recently we hit a key milestone in our SAP implementation. In conjunction with our first DC go-live, supply chain buyers of our first DC are now replenishing this warehouse on new and fully integrated systems. Although it's still early-days, the teams executed a smooth transition and integration with the new systems. This DC is a key warehouse that touches each of our stores in the region. And we'll service our first store pilot, which is set to go live in the coming weeks. In preparation for our store roll-out in 2013, all our corporate stores have completed our readiness program. Training of store colleagues has begun. As colleague engagement is critical to adopting a new system, I am pleased with the positive feedback that we have received from store colleagues, trained on new hand-held devices. With our SAP plans on track, we continue to believe that we will largely complete our store roll-out by the end of 2014.

2012 is proving to be exactly what we thought it would be. However, we have a lot of work ahead of us. 2013 will bring another year of heavy square-footage activity to the industry, and is another big SAP year for us. Today we're looking at one store and one DC. We still have a whole network of DCs and stores to complete before we start to realize the benefits of our renewed infrastructure in 2014.

In closing, the Board is happy with the results thus far. I am pleased with where we are. Our investments are delivering, and we are confident in our plans for building the business the right way for the long-term. We are on the right track and remain steadfast. We will continue to invest in our customer proposition, while aggressively managing costs and driving efficiencies to improve our competitive position.



With that, let's open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Perry Caicco with CIBC World Market.

Perry Caicco - CIBC World Markets - Analyst

On the same store sales, the trends and the tonnage trends are obviously not behaving the way you'd exactly like. I'm just wondering if there's anything inside those numbers that gives you, you know, any feeling that anything you've been working on is having a positive impact. I mean, perhaps you can give us some, some actual examples of things you've done and of some numbers that you've been able to produce.

Vicente Trius - Loblaw Companies Ltd - President

Well, good morning, Perry. We believe that our sales actually can't be better. If we look at the market from a tonnage perspective, the market was flat or down. And we think the market -- actually our tonnage trends are improving. Now, what I want to tell you is that we see a lot of solid traction in different areas. And one example that I want to give you is, for example, our category strategy. We have rolled out thus far about 10 categories. In those 10 categories, we see our sales improving, we see our mix improving, we see our share improving, we see us improving competitiveness and it makes us feel good on the traction that we're getting with our customers.

Perry Caicco - CIBC World Markets - Analyst

And how many categories do you have to go?

Vicente Trius - Loblaw Companies Ltd - President

We have about, I would say, 60 categories. It will depend on the banners. As you know, we have different formats. And as we said all along, we see this as a 2 to 2.5-year process. And it is an ongoing process after that as well.

Perry Caicco - CIBC World Markets - Analyst

Okay. Your gross margins were up substantially over last year. I wonder if that suggests that, you know, that perhaps you haven't been investing as much as you would like in price or that you've been perhaps working closer with your suppliers. I'm just wondering if there's any relationship between the gross margin performance and the sort of relatively weak same-store sales.

Vicente Trius - Loblaw Companies Ltd - President

Actually, I feel our gross margin has been pretty much in line over the last few quarters. And what I can tell you is that any future investments in the customer proposition, we believe that we can leverage them through the top-line, and expenses into the bottom line.



Perry Caicco - *CIBC World Markets - Analyst*

And on that customer proposition spending. What's your outlook for that next year? I mean, is there a continual push on that? And perhaps related to that, have you seen any specific returns from that specific investment?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, I'm not going to share any sort of future outlook investments with you. What I can say is that we will continue our path to improve our customer proposition and to drive efficiencies through the business. And we feel confident on the areas that we're getting traction. I can give you another example. Like, for example, in our Fresh departments, we're seeing good comp growth and this is coming across different departments. We have departments, for example, where we have had deflation, like produce, and we see good performance in produce. And this is about all our initiatives that we have in service on the breadth of the assortment, on the quality of the products, and the value that we offer for our customers.

Perry Caicco - *CIBC World Markets - Analyst*

Okay, that's good for now, thank you.

Operator

Irene Nattel with RBC Capital Market.

Irene Nattel - *RBC Capital Markets - Analyst*

Thanks. I'd like to continue along the same-store outline. I think clearly what we're all trying to understand is, what is really responsible for the sequential deterioration in same-store sales? You were up about 20 BPs in Q2. Now you're down about 20 BPs. You know, you've said that you're stepping up your investment in the customer proposition. Is it market-wide projects deflation? Is it that you have chosen to invest more? Could you please, you know, give us a little bit more color there?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes. We've seen actually our sales have stayed positive in the areas of food and drug. And what keeps us actually encouraged as we roll out some of these initiatives -- and in many cases we have accelerated some of the initiatives in different banners. And in those different banners we see improvement in sales and we see improvement in shares. So at the end of the day, what I feel is that our strategy is working. And this is a good sense, it's a good sense in my stomach.

Irene Nattel - *RBC Capital Markets - Analyst*

Okay. Can we talk a little bit about general merchandise? It feels like at some point, the declines in sales from general merchandise have to stop. Like, how close are we to that point?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, I'll tell you, one thing is, let's take it step-by-step. If you look at apparel, the whole market has been flat. And we've been in line with the market. When we look at the general merchandise out of the store, we're in the process of, as you know, rolling out what we call the right-hand side. I would encourage you to see some of the stores. I believe it has a very well-defined layout for our customers. And we've completed thus far 75 stores. We have another 10 to go this year. And we believe we will have another 40 next year. Now as part of this right hand side, we down-sized some of the departments like, for example, electronics -- we took the square footage down and we're seeing good positive trends in beauty and in home.



Irene Nattel - RBC Capital Markets - Analyst

Okay. So what you're suggesting is that we should expect this [executive] pressure at least through 2013?

Vicente Trius - Loblaw Companies Ltd - President

I feel good about what we have in the right-hand side, you know? I feel good about the remodels, how they're coming. And I see a little bit more of down-sizing some of those departments. But overall, I feel good about the trends going forward.

Irene Nattel - RBC Capital Markets - Analyst

Right. No, I understand that you're making progress in key categories. It's just, you've got that offsetting from eliminating higher ticket items like electronics. One other question, if I might. On the CapEx, if we look at where you are year-to-date and that CAD1.1 billion target for the full year, it seems like you're going to be spending an awful lot of money in Q4. Could you give us an idea of exactly where that money is being spent in Q4?

Sarah Davis - Loblaw Companies Ltd - CFO

Okay, I'll take that one. Good morning. So we are generally back-end loaded. So we often have our Q4 as our heaviest spend on CapEx in any year and this year is really no different. When we look at what we've got left, the total year of the CAD1.1 billion, we've always said that 60% of that would be spent on retail and 40% on infrastructure and that will continue, we still expect it to be that way. When we look specifically to Q4, we're still planning to open about 10 more stores, and we've got 40 renovations to complete. So that's where a lot of the money will go, as well as we still have spending to do on our IT infrastructure in Q4.

Irene Nattel - RBC Capital Markets - Analyst

That's great, thank you, Sarah.

Operator

Patricia Baker with Scotiabank.

Patricia Baker - Scotiabank - Analyst

Actually have three questions, Vicente. First, coming back to the customer proposition, and you did indicate that you've upped that to CAD50 million. What prompted you to increase that? Since at the beginning of the quarter you were quite confident that CAD40 million would do the trick for you this year.

Vicente Trius - Loblaw Companies Ltd - President

If we look at our sales -- I'm not going to give you all of the investments -- but if we look at our sales, our trends are good, and especially our trends are good in specific areas that we see traction in. And where we see the success, we are continuing, let's say, to leverage it better. So for example, I gave a few examples in the categories. I gave a few examples on share -- I mean on Fresh. Other areas that are working well are, for example, our drug categories. We see our drug categories improving. We see our scripts coming up. We had about a 9.6% increase in scripts. And we see our health departments increasing. Another area that makes us feel strong is what our customer are telling us. Like, for example, our net promoter



score continues to improve. And within that, even though we've had a flat customer count, we see our higher-value customer -- which is the one that buys more items, larger baskets -- improving. And we see a better composition of that customer count.

Patricia Baker - Scotiabank - Analyst

Okay. So at some point, Vicente, this spend on labor and gross profit or pricing, and what you refer to as a focus on value and service. At some point, does this just not become an ongoing spend that you shouldn't be calling out? Because essentially, it's a reflection of a new reality in the market in Canada. And that you've got to, which you've already started to do, change your model to adapt to that new reality?

Vicente Trius - Loblaw Companies Ltd - President

Yes, we are changing the model to adapt to this new reality. I think we're very well-positioned for this new environment. And as I said before, any future investments, we believe that we can cover them through the top-line in leveraging expenses.

Patricia Baker - Scotiabank - Analyst

Okay, and on that 9.6% script count growth that you talked about. What would that be X the Zellers files?

Vicente Trius - Loblaw Companies Ltd - President

So it was about 8.3% Zellers, and you would have about a 1.3% organic growth. So we saw growth from both ends, organic and through the Zellers scripts.

Patricia Baker - Scotiabank - Analyst

Okay. Are you able to tell us what the retention rate has been with the Zellers scripts?

Vicente Trius - Loblaw Companies Ltd - President

I'm not going to tell you the retention rate. But I can tell you that it far exceeded our expectations in our evaluation model.

Patricia Baker - Scotiabank - Analyst

Okay, that's good. And then just following up on the discussion from one of Perry's questions. And you referenced the fact that where you are seeing positive trends is in the categories, you're getting some traction in the 10 categories that you've done. I think you said you have either 60 in total or 60 more to go. And given that you've got data with the first 10 categories, sort of within that 2 to 2.5-year process to get the rest of them done, at what point in that 2 to 2.5-year, based on what you've seen from the first 10, will you get the traction so that that top-line will be above the zero?

Vicente Trius - Loblaw Companies Ltd - President

(laughter) Sorry, I'm smiling a little bit, but --



Patricia Baker - Scotiabank - Analyst

(laughter) I'm glad I could make you smile.

Vicente Trius - Loblaw Companies Ltd - President

(laughter) I'm not going to give you that data. What I can tell you is that we feel very good about how the categories are working, and this is a journey. And also look at it as one that you can accelerate as much as you can -- of accelerated. That you can accelerate it if you feel so, and that's what I said, that when we look at some specific banners and areas we have accelerated, and we've seen a very, very good traction.

Patricia Baker - Scotiabank - Analyst

Okay, thank you.

Operator

Peter Sklar with BMO Capital Market.

Peter Sklar - BMO Capital Markets - Analyst

(technical difficulty) at this point improvement in gross margin year over year. When I look at your write-up, like you talk about buying synergies, and vendor management to decrease transportation cost, I'm surprised that you don't reference to your merchandising strategies or the category management activities that you just outlined. So can you talk a little bit about that? I was really surprised you didn't attribute it to any of your merchandising strategies.

Vicente Trius - Loblaw Companies Ltd - President

Well, I mean, our merchandising strategies are there. We're rolling out the categories, and you're getting a better mix on those categories. So part of it is leveraging through that. But having said that, we've only rolled out 10 categories. It's early-stages, you know? Real early-stages.

Peter Sklar - BMO Capital Markets - Analyst

Okay. On the -- Sarah, on the 700 -- sorry, the 700 headcount reduction. Have you disclosed what you expect the anticipated annual savings to be and when you expect to capture that from an accounting perspective?

Sarah Davis - Loblaw Companies Ltd - CFO

Well, we haven't specifically given a number. But it will cost us about CAD60 million in severance. So using about one times severance is a pretty good guess on an annualized basis. And most of the people have left the business. There are still some that are on transition that will take them through until the end of this year, and a couple, but not very many, would go into 2013. But most of it's already there. So we should start to see the savings in 2013. The back -- the balance, back of this year, and then in 2013, as well.

Peter Sklar - BMO Capital Markets - Analyst

Okay. And do other costs come in, because as these people are removed, there's other costs you have to pick up elsewhere, consultants or contracting?



Sarah Davis - *Loblaw Companies Ltd - CFO*

No, our plan is not to pick -- increase our consulting or contract spend.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And lastly, Sarah, a couple of times in the write-up you refer to foreign exchange gains in the quarter. Could you reference as to where those gains are and what the magnitude is?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Sure. So in -- I'm not going to tell you the magnitude. But I will say it's big enough that we talk about it. But generally, we wouldn't talk about something if it didn't have a meaningful impact on the quarter. Where they show up is generally in the conversion of our accounts payable at the end of the quarter. So it would be -- to the foreign exchange. So on any of our US purchases, it would be -- so it shows up in SG&A.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay, thank you.

Operator

David Hartley with Credit Suisse.

David Hartley - *Credit Suisse - Analyst*

Thank you, and good morning. Just want to ask you a little bit about the closure of the Zellers stores. I mean, I know they had a small food business, and a more meaningful pharmacy business applies to you. But are you seeing any increased traffic due to Zellers closing down? Or has that actually maybe hurt some of your stores, given proximity, et cetera?

Vicente Trius - *Loblaw Companies Ltd - President*

No, actually -- well, as you know, we bought the scripts, and this has added obviously additional customers into our stores. But we see us -- we actually haven't seen that much of a change since the Zellers stores closed, to be honest. And the one thing I want to reference to, which is also important, is a lot of those stores have reopened. We have a very detailed plan on each store when it reopens. As you know, it's been reopened by one of our competitors. And actually some of our best performance happened during the month of September, they had one of the highest reopening of those stores.

David Hartley - *Credit Suisse - Analyst*

Okay, interesting. Just want to talk about remodels. I'm starting to see some remodels in the markets, notably Fortinos stands out. It seems that you're long past the days of tinkering with your in-store for the most part, other than the category things you're mentioning. But -- and you're ready to kind of roll those out. And we're seeing that. Are we expecting a lot of this perhaps in 2013?



Vicente Trius - *Loblaw Companies Ltd - President*

We will -- I mean, if I understood your question correctly. I mean, we will continue in our strategy, and our strategy is to improve the customer proposition and drive efficiencies. Within that category, we'll continue to roll out and accelerate across 2013. Our Fresh initiatives, which we started, which is about quality, assortment and service, will continue, and they're getting traction. Our initiatives in drug, which we see very good improvements, whether it's with the pharmacist, with dietitians, with the service, the area of health and wellness. And the whole right-hand side, which positions our right-hand side in the right spot, will continue. We are transferring -- we have transferred a lot of the Maple Leaf Gardens initiatives in a lot of our conventional stores. And this will continue across the system. And that's what makes us feel good when we listen to the customers, that we're getting tractions and things are happening.

David Hartley - *Credit Suisse - Analyst*

I guess what I'm trying to figure out is, is there going to be stepping up of these initiatives coming to stores relative to this year, in a big way in 2013?

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, that's what I said. I mean, in 2012 we did 10 categories. I'm not going to give you now all of the categories for 2013. But let's say we'll do substantially more than those 10 categories, for example. Indeed.

David Hartley - *Credit Suisse - Analyst*

Okay, that's too bad. I had my pen ready to write them all down.

Vicente Trius - *Loblaw Companies Ltd - President*

(laughter)

David Hartley - *Credit Suisse - Analyst*

Just a last question. There's a lot of -- especially ahead of this SAP deployment, where I guess you kind of have to wait for that to go into play before you can kind of really put the finishing touches on some of these initiatives. But a lot of upfront investment here. You're starting to talk about some of these investments now will be fully paying for themselves, whether it be through the top-line or leverage of expenses. When we think into 2013, is this also -- you think about CAD60 million in cost-savings on the labor side, and you think about these investments paying for themselves. I mean, are we expecting -- obviously I guess we're expecting not a lot more cost investments next year over and above -- a called-out number that you have to reference every quarter. So should we expect a big jump in profit margins as we look into 2013?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay, I'll take that one. So I would say first of all, we're not going to give a lot of guidance on 2013 on today's call. But I'll give you a little bit of flavor on some of the things that we're looking at. So we've already mentioned that our IT and supply chain costs are in their peak in 2012, and they will basically be flat with 2013. So you won't hear us talking about our incremental costs associated with IT and supply chain. And if anything, the cash expense is actually going down a little bit next year, with depreciation being higher. So you should expect that.

When you look at some of the savings that we talked about for the 700 positions -- yes, that will go into our earnings, and it will be -- but I wouldn't count on 100% of it. Some of it will be going to some of the -- to offset the customer proposition. Some will be into continued investments that we have there. So when you think about how to look at 2013, I wouldn't expect huge earnings growth in 2013. It's going to be one of the biggest



competitive years for us, with a lot of square-footage coming in, as well as the year that we're going to be rolling out to every one of our -- to a majority of our stores from an SAP perspective. So I wouldn't look for large increase in earnings. But you can expect not to have a decrease.

David Hartley - *Credit Suisse - Analyst*

I tried, and that was great. Thank you.

Operator

Michael Van Aelst with TD Securities.

Michael Van Aelst - *TD Securities - Analyst*

The tonnage question, actually, Vicente. I think you said that tonnage was flat or down for the industry. I'm wondering, does that include general merchandise in those comments?

Vicente Trius - *Loblaw Companies Ltd - President*

No, that would include drug and food.

Michael Van Aelst - *TD Securities - Analyst*

So we know that drug is growing overall. But are people eating less, or do we have a population drop? I'm not quite sure I understand why tonnage is going down in food. Because it certainly doesn't seem like it's going into the quick-service restaurants or anything like that. And we're seeing, you know, Metro's numbers, same-store numbers up, Empire's up, Walmart's adding square footage, so I would assume their total sales are up.

Vicente Trius - *Loblaw Companies Ltd - President*

Well, that's the data that I have, you know? So tonnage is actually in the whole industry flat or down. And within that, actually, we're getting good trends in tonnage.

Michael Van Aelst - *TD Securities - Analyst*

And when you say good trends in tonnage, you're saying just --

Vicente Trius - *Loblaw Companies Ltd - President*

Good trends in tonnage. That's what I mean.

Michael Van Aelst - *TD Securities - Analyst*

And the SAP roll-out. You also mentioned that you expect them in the stores largely by 2014. And, correct me if I'm wrong, but I thought last comments you had said most of it would get done in '13 and you'd finish it up in '14. Has the roll-out been pushed back at all?



Vicente Trius - *Loblaw Companies Ltd - President*

No, not at all. I mean, I always said by the end of 2014. Actually, you know, we already have one DC up and running, which is pretty good. And replenishing stores and SAP. So to us it was a very important milestone. And with no distraction to the business in the next couple weeks, we'll have a store being rolled out, which is what we told you all along, and on-plan. And we expect our rollover stores to be on-plan through 2013 and 2014.

Michael Van Aelst - *TD Securities - Analyst*

Okay, so when you said largely by 2014, it was just kind of a -- I guess a wrong use of words maybe.

Vicente Trius - *Loblaw Companies Ltd - President*

Well, no, it's just basically by 2014, that's what it is.

Sarah Davis - *Loblaw Companies Ltd - CFO*

And also I'll just add that what we are doing is planning to go to some of the bigger stores in 2013. So we will have proportionately more of the revenue done in the earlier part, and then it will be some of the smaller stores that we do in 2014.

Michael Van Aelst - *TD Securities - Analyst*

Okay. And on the input cost inflation. Others seem to be suggesting they're not seeing much down the pipeline, although it seems like there could be some protein increases next year and bakery increases next year. Is there -- what are you seeing as far as cost inflation coming into the market for next year?

Vicente Trius - *Loblaw Companies Ltd - President*

I think if you look at the competitiveness of the environment and you see maybe -- you know, you might have some movement in some categories, but other categories, like I said before, are deflating. So I would see it actually contained at about the same level that we have right now. And I'm not a guru or a forecaster of inflation.

Michael Van Aelst - *TD Securities - Analyst*

Alright, thank you.

Operator

Jim Durran with Barclays.

Jim Durran - *Barclays Capital - Analyst*

Just, you were talking about the customer experience being improved, and you've done consumer research to confirm that. When you do that research, do you compare the Loblaw's experience with other competitors' experiences to get a gauge of how you're doing on an index basis, versus your competition?



Vicente Trius - *Loblaw Companies Ltd - President*

Absolutely. I compare the net promoter score of every one of my banners against every one of our competitors'. I'm not going to tell you the data. But we feel good, definitely, about how we're trading and about our trends in the net promoter score.

Jim Durran - *Barclays Capital - Analyst*

And you referred to a number of the initiatives that you, you know, incubated at the Maple Leaf Garden store that you're, you know, deploying into the other conventional stores. How far along is that project?

Vicente Trius - *Loblaw Companies Ltd - President*

We have divided our conventional banners in two sets of stores. So we have what we call the Inspired, and we have what we call our Nava. And I would say in the Inspired stores is where you would see most of the initiatives. And the first set of initiatives that cut across mainly all of our Fresh departments have been rolled out at this stage. So you'll see improvements if you go to the bakery, you'll see improvements in assortment, from artesian breads to cupcakes, to even macaroons, to smaller cakes, to many different types of products. You'll see that in the produce, with not only improvement in quality, but practical assortment behind ethnic products, as well as organic, as well as better sourcing behind the quality. And I could go category by category. But those are -- we feel pretty good. And again, getting traction on those categories, like I said before.

Jim Durran - *Barclays Capital - Analyst*

So if you were to sort of find a time frame that you'd say the majority of stores you want to impact by those initiatives are in place, are we there yet? Or we're sometime later in 2013?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, this is a good question. Because it's actually -- in my mind, it's not a project that has a full stop. It's a project that's ongoing. I mean, we use Maple Leaf Gardens a lot as an R&D. So there is a pipeline, as well at the same time of new initiatives, that all the time on how can we improve better and better our offer to our customers with a stronger focus in the Fresh departments.

Jim Durran - *Barclays Capital - Analyst*

Gross margin, as everybody's pointed out, was up in the quarter. I guess there's some hesitancy on some of our parts to assume that gross margin-up is a new trend. Was there anything unique about the quarter in terms of initiatives that assisted the gross margin at this point?

Vicente Trius - *Loblaw Companies Ltd - President*

No. Actually, what I said before, I feel like gross margin is fairly in line with the way we have traded over the last few quarters. And we feel comfortable with the level of gross margin. And I would re-emphasize what I said before -- any future investments, we believe that we can leverage them through sales and through the expenses.

Jim Durran - *Barclays Capital - Analyst*

And do you feel that promotional intensity, as we're now in the fourth quarter, is up year over year in any way, shape or form?



Vicente Trius - *Loblaw Companies Ltd - President*

Well, it's been up year over year in every quarter. It's consistently on that trend, you know? So it is true. And we think that environment in this quarter, we've been pretty much in line. But we continue our strategy to invest more behind the categories and the breadth of our assortment and our shelf price. Which we believe strongly that that's what builds the trust with our customers.

Jim Durran - *Barclays Capital - Analyst*

Okay. And then, my last question. A number of retailers, as we've gone through the third quarter release period, have suggested that perhaps there's been a further belt-tightening by the consumer within this quarter. Have you noticed any changes in terms of cadence on traffic, private label penetration, et cetera, that would be indicative of that type of further ratcheting down?

Vicente Trius - *Loblaw Companies Ltd - President*

No. I would not say that this trend has been during the quarter. And, again, I go back to where the areas that we focus on, the areas that we have invested in, we see traction. So I wouldn't have any indication of that sort at this stage.

Jim Durran - *Barclays Capital - Analyst*

Okay, great, thank you.

Operator

Vishal Shreedhar with National Bank.

Vishal Shreedhar - *National Bank Financial - Analyst*

Thanks a lot. Just on the SAP implementation at the store level. Sarah, when will you get a sense of if that's proceeding as anticipated? And when will you be able to update the street and investors on the progress and the synergies that you're able to capture from these implementations?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay, well, that's a good question. So I would say we're going with one store this year. So we will learn something from that, but I don't think it will give us a very good sense of all the synergies we're going to have. And then earlier -- depending on how that goes -- in early 2013, we'll have a few more. But I really anticipate it won't be until after Q2 of next year, when we've done a few more stores, that we'll be able to come back and tell everybody where we think the synergies are going to come out. Directionally, we've done it. But we won't really be able to quantify it until then. That's my estimate at the moment.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay, so around Q2 you should get a sense of what kind of synergies are manifesting and you'll be able to potentially update us.

Sarah Davis - *Loblaw Companies Ltd - CFO*

That's right.



Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. On Joe Fresh and the initiative with JCPenney, can you just update us? Is there anything new that we should know there?

Vicente Trius - *Loblaw Companies Ltd - President*

The only thing new is that we have already placed our first orders, and that we're on target on rolling out the stores, starting in April of next year.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. Now, in terms of the profitability and the sales lift that Loblaw could get from that. Is there any new information that you could disclose with us? Or is it -- are you staying mum on that at the moment?

Vicente Trius - *Loblaw Companies Ltd - President*

No. No new information beyond what we told you in the last quarter.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. In terms of the credit card division, Sarah, I saw a nice uptick in the earnings -- or the PC financial division, I saw a nice uptick in the earnings this quarter. How should we look at kind of the trajectory of those earnings for the balance of this year? I know you gave us full-year guidance for that. And also heading into 2013, when you implement the loyalty initiative. Is there any thoughts you can give us?

Sarah Davis - *Loblaw Companies Ltd - CFO*

So for Q4, I would -- I mean, we made the investment that we did back, and we're starting to see basically the benefits of that investment that we did make, so we have seen an uptick in earnings, which is what we had said. So I would say I would look for an increase in earnings in Q4 as well, without quantifying exactly what it's going to be. And then for 2013, we should -- we are looking for earnings growth in the PC financial division. So you should look forward to that as well.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. And Vicente, you might have said this on the call and I might have missed it. But food growth, excluding drug, excluding gas, as is indicated in the press release, was that positive? I'm talking sales.

Vicente Trius - *Loblaw Companies Ltd - President*

Yes.

Vishal Shreedhar - *National Bank Financial - Analyst*

That's it from me, thanks a lot.



Operator

Keith Howlett with Desjardins Securities.

Keith Howlett - *Desjardins Securities - Analyst*

Yes, I wondered if you could narrow a little bit what food inflation was for you in the quarter. Was it sort of under 0.5% or?

Vicente Trius - *Loblaw Companies Ltd - President*

All I will tell you is that our inflation has been below the CPI. And we've been consistently like that, below the CPI.

Sarah Davis - *Loblaw Companies Ltd - CFO*

And CPI was 1.8%, so it's less than that, and it would be down from Q2 and down from last year.

Keith Howlett - *Desjardins Securities - Analyst*

Okay. And just on the general merchandise repositionings. You'll have 85 stores done by the end of this year, and another 40 next year. What is the total number of stores that need to get repositioned on the right-hand side?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, we will be completed by next year, so 85. We also had already 50 major renovations that had been done before. And with the additional 40, the total is about 140, which is the network of large stores that we have with a right-hand side. So we should be done next year.

Keith Howlett - *Desjardins Securities - Analyst*

By next year, great. And just on the Joe Fresh, the flat apparel sales. What would its year over year increase in square-footage be? In other words, I presume sales per foot of Joe are quite a bit lower, if the sales are flat. Is that correct or wrong or?

Vicente Trius - *Loblaw Companies Ltd - President*

You would have a very much like-for-like from a standpoint of square-footage in Joe Fresh, versus last year. So there's no additional. So it's basically a market that's flat, and we think that market -- we're flat and holding our share, actually.

Keith Howlett - *Desjardins Securities - Analyst*

And then just in terms of preparation for Target. Is there anything specifically you're doing at Joe Fresh, given the price point is somewhat in the same range as Target?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, we have a very detailed plan by store that goes beyond Joe Fresh. And we know exactly when the stores will open, and we have a detailed plan planned for those open sort of Target stores. In reference to Joe Fresh, I think we have a very, very strong brand, very good quality, very good

design and great price points. And let's see what price points they bring here. But as I visit the stores in the US, and I visited them several times, let's say -- I would say that we're well-positioned.

Keith Howlett - *Desjardins Securities - Analyst*

And just finally, on private label in the balance of the store. I know you did a lot of culling of under -- you know, ones that didn't generate sufficient margin, et cetera. Where is the private label repositioning program? And how is private label penetration level at the moment?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, private label continues to perform well. Penetration is around 30%. And margin is accretive, and is accretive in line with what we told you last year.

Keith Howlett - *Desjardins Securities - Analyst*

Great, thanks very much.

Operator

Chris Li with Bank of America.

Chris Li - *BofA Merrill Lynch - Analyst*

Good morning. First on the Financial Services division, the operating expenses in that segment are trending up fairly significantly year-to-date as you kind of invest to drive sales growth. Can we expect a similar type of investment in 2013? Or do we expect operating expenses to kind of moderate next year?

Sarah Davis - *Loblaw Companies Ltd - CFO*

No, we're going to continue to invest. And you should expect the same level of expenses in 2013.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. And then with respect to the dividend increase, just maybe curious to hear more comments about -- with respect to the timing of the increase. And also is it sort of a one time? Or can we expect it's going to be more of a recurring annual event going forward?

Sarah Davis - *Loblaw Companies Ltd - CFO*

Okay. So, I mean, I think when we look at the dividend, I think we all knew better -- I actually did say, when I've been asked a few times, when would we do a dividend, consider doing a dividend increase. And management believed that we would do it when we were pretty comfortable with our position, and confident in the strategy that we had. And so that's why we raised the dividend at this point in time. We are confident in our strategy and in some of the work that we have done. And the fact that the Board supported our recommendation, that shows their confidence in the strategy as well. So as far as it being -- I think our wording was carefully chosen. So we have updated our policy. And I think the last -- of course, it's going to be subject to the earnings of the business and the cash flow of the business, and other growth opportunities. But I think the last sentence that we have put in there represents what we believe. Which is over the long-term, it is the Company's intention to increase the amount of the dividend



while retaining appropriate free cash flow to finance future growth. So we do intend to grow the dividend, without giving a specific amount of how much on an annual basis.

Chris Li - BofA Merrill Lynch - Analyst

Okay. And last question, just with respect to your EPS guidance for Q4. When you say flat compared to a year ago, I just want to make sure I'm comparing to the right EPS for Q4 last year. Is that the reported EPS of about CAD0.62 that you're referring to?

Sarah Davis - Loblaw Companies Ltd - CFO

Well, I would actually start with operating income. So last Q4 in 2011, we had operating income of about CAD315 million. And we've given you -- so I'd start at that as the base. But obviously this is just -- it's going to be a range. I'm not guaranteeing an exact dollar value, but it will be in that range. And it will also -- once you factor in the interest, which is pretty stable, and you look at our tax rate, which we also gave you some updated guidance on, to be for the full-year in the 25% to 26% range, you'll get pretty close to where we think we'll be at this point in time.

Chris Li - BofA Merrill Lynch - Analyst

Thank you.

Operator

Patricia Baker with Scotiabank.

Patricia Baker - Scotiabank - Analyst

Yes, sorry, Vicente, I forgot to ask one question. And it's probably an area where you can educate me. On the customer proposition, can you explain to me how the investment of CAD5 million in shrink speaks to the customer proposition and the assortment? I'm a little confused there.

Vicente Trius - Loblaw Companies Ltd - President

Yes, sure. So what it means is, as we reposition the Fresh departments, we expanded the breadth of assortment in Fresh. We have executed better, and executing better is also creating theater into the stores. When you create theater, it means in some items you can invest a little bit more on inventory. And that naturally will have a little bit more shrink on some of those products. But at the same time, you build on the sales, right? It's the right way. It's the right way of managing a good-looking Fresh department.

Patricia Baker - Scotiabank - Analyst

Okay, I think I get what you mean by that. Thanks a lot.

Operator

Kenric Tyghe with Raymond James.

Kenric Tyghe - *Raymond James - Analyst*

Good morning. Vicente, if I could just follow up on the private label discussion. Could you perhaps provide some color on Black Label, you know, the number of SKUs in the quarter? How that is tracking specifically against your expectations versus the broader private label portfolio? And whether at some point you see an opportunity to start breaking out, providing a little more color on your private label around, you know, Black, President's Choice and the No Name portfolio.

Vicente Trius - *Loblaw Companies Ltd - President*

Well, we launched about 300 items, as you know, on Black private label. It's trending well, and with a very good consumer appeal. We're planning to launch an additional 100 items. And as we look at President's Choice and No Name -- but more so President's Choice -- we're looking at categories where we believe strongly that we have the opportunity to drive innovation and customer loyalty for the product, you know? And we have several initiatives across many categories.

Kenric Tyghe - *Raymond James - Analyst*

Fair enough. And if I could just switch gears back to just the competition and market share. We've focused, I think -- we've focused more specifically on your competition versus your more traditional competitors. Why don't you just break out or provide some color on impact to share and -- or even more specifically -- the margin profile that the drug retailers and the like are taking with their accelerated push, not just into food, but into your higher margin convenience food items?

Vicente Trius - *Loblaw Companies Ltd - President*

Well, if I understood your question correctly, one was about share. So I am going to talk about the share. When we look at the market share in the market, I mean, there's no secret that there has been an increase in square-footage. We think that environment -- what we believe is important is the market share per square foot. And within that, we're holding our own as it refers to that. I didn't catch the second piece of the question. So could you go back to this?

Kenric Tyghe - *Raymond James - Analyst*

Actually, the second piece of the question was just, you know, looking at the -- not just the impact on share, but on your margin profile, given that the drug retailers' and convenience store operators' push into food is in more convenience food items, and not necessarily or traditionally more a higher-margin profile to that business.

Vicente Trius - *Loblaw Companies Ltd - President*

Yes, the drugstores actually in the market have showed growth in food over the last 12 months. I've seen that from Shoppers Drug Mart a little bit. So you see a convenience offer there. But I mean, our banners, as a market, we don't see that as an important trend that is actually impacting us.

Kenric Tyghe - *Raymond James - Analyst*

Great, thanks so much. I'll leave it there.

Operator

Okay, there are no further questions at this time. I'll turn the call back over to Kim Lee.



Kim Lee - *Loblaw Companies Ltd - VP, IR*

Thank you, everyone, for joining us this morning. We'll look forward to speaking with you on our Q4 call. Have a great day.

Operator

This concludes today's conference call. You may now disconnect.

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