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PRESENTATION

Operator

Good morning. My name is Melissa and I will be your conference operator today. At this time I would like to welcome everyone to the Loblaw Companies Limited fourth-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. Ms. Kim Lee, Vice President of Investor Relations, you may begin your conference.

Kim Lee - Loblaw Companies Limited - VP of IR

Thank you, Melissa. Good morning, and welcome to the Loblaw Companies Limited fourth-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 discussion will include forward-looking statements, such as the Company's beliefs and expectations regarding certain aspects of its financial performance in 2013 and future years. These statements are based on certain assumptions, and reflect management's current expectations. And they are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from current expectations. These risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulators from time to time, including the Company's annual report. Any forward-looking statements speak only as of the date they are



made. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, other than as required by law.

Today, certain non-GAAP financial measures may be discussed or referred to. Please refer to our annual report or other materials filed with the Canadian securities regulators from time to time for a reconciliation of each of these measures to the most directly comparable GAAP financial measures. An archive of this conference call will be available on our website.

I will now turn the call over to Galen Weston.

Galen Weston - *Loblaw Companies Limited - Executive Chairman*

Good morning, and thank you for joining us. Before I turn the call over to Vicente, I wanted to share with you my enthusiasm about the progress the team is making. It's very nice to see that the hard work of the last few years, whether it be investments in supply chain, IT, or the focus on the customer, is beginning to bear fruit. In 2012, we achieved this by focusing on our strategic priorities, which has driven measurable results. Through the year, we have seen positive trends in key areas of our business that accelerated during the last quarter of 2012 and through the first seven weeks of 2013. These results are giving us the confidence to have an outlook of both revenue and earnings growth for this year. Despite new entrants in the market and a continued increase in square footage.

I look forward at this business with a sustained confidence that our customer offer is improving steadily, the team is driving efficiencies appropriately, and that we have a disciplined approach to growth. I will now turn the call over to Vicente to share the specifics on the business performance.

Vicente Trius - *Loblaw Companies Limited - President*

Good morning, everyone. Thank you for joining us. 2012 marks my first full fiscal year at Loblaw. While we faced a number of challenges and difficult decisions, the team delivered significant achievements throughout the year. It was a year where we invested to strengthen our businesses, and improve our competitive position. I am pleased with the progress that we have accomplished. We closed the year on plan, and made headway with improving our customer proposition on all three fronts -- service, assortment and price. While we would like to see sales momentum accelerate faster, we are encouraged by improving performance across the country. With some markets performing better than others.

Overall share trends continued to improve, with tonnage up in the quarter. For example, in Q4, in a couple of regions, we delivered nearly 100 points improvement in tonnage share. This is reflected in positive comps for food and drug combined of more than 0.4%. Despite flat internal inflation. We continue to focus on consistently building a loyal customer base. And we saw the number of high-volume transactions increase over the course of the year.

Our comprehensive category strategy reviews continue to deliver better sales, share, and mixed performance. To provide some context, one particular category, in the three short months since we launched this new strategy, has delivered sales increases of more than 4%. Improved margin and tonnage growth of roughly 180 basis points. Looking ahead, we will accelerate our category strategies to ensure we have customized assortments, compelling displays, and are delivering competitive volume throughout our store network.

For the fourth quarter, certificate growth was up 8.4%, driven by our ongoing business and our successful transition of prescriptions files acquired earlier in 2012. While general merchandise sales declined, our new assortment layouts in merchandising delivered approximately a 1 point improvement in contribution margin for our GM offer in 2012. And as for PC Financial, our investments to grow this business are paying off. The segment delivered solid growth in the quarter and for the year. On the expense side, we drove costs out at a significant pace, with little impact to operations. Given the magnitude and impact of the organization, I am pleased with the organization's capacity to drive efficiencies and adapt to change.

A key enabler to drive further efficiencies is SAP. In Q4, we delivered on key milestones in our implementation program with our first [DC] and first store pilot go-lives. Today we have three stores up and running. Considering the complexity involved in implementing SAP, we have had challenges,



although none was customer facing. We are now gearing up to start rolling out to stores, as planned. We continue to believe that we will largely complete our store rollout by the end of 2014.

Looking ahead for 2013, I see continued competitive intensity, with more competitive square footage being added. Compounded by a customer that is squarely focused on volume. In this environment, I remain focused on improving our customer proposition, strengthening our competitive position through investment in price, assortment and labor to be offset by managing costs. In 2013 I will maintain our focus on these fundamental priorities -- improving our competitiveness, implementing SAP, and driving efficiencies.

I will now turn the call over to Sarah to walk us through the results.

Sarah Davis - Loblaw Companies Limited - CFO

Thank you, Vicente, and good morning. Let me start with the performance in our Retail segment. Retail sales increased by 0.9% to CAD7.3 billion in the fourth quarter of 2012. Same-store sales were flat. Modest growth in both our food and drug businesses, and moderate growth in Gas Bar was offset by a decline in general merchandise. Apparel sales were flat. During the quarter, our average quarterly internal food price Index was flat, which was lower than average CPI in the quarter of 1.5%.

In the Retail segment, we reported gross profit of CAD1.6 billion, up CAD6 million, and down 10 basis points on a rate year over year. That decline on a rate basis was primarily driven by investments in food margins, and an increase in fresh food shrink. Partially offset by margin improvements in drug and general merchandise, and lower transportation costs. Increased fresh shrink in the quarter included an estimated CAD10 million investment in our customer proposition related to improving assortment in our stores.

For the Retail segment, operating income was CAD228 million, down CAD69 million, or 23.2% year over year. Operating income included the following notable items. A CAD61 million restructuring charge related to the reduction in head office administrative positions. CAD19 million in incremental costs related to the IT and supply chain projects. A CAD17 million charge for fixed asset impairments net of recoveries. A CAD5 million charge for costs related to the transition of certain non-charter labor agreements. And a CAD2 million charge for stock-based compensation expense. In addition, operating income was negatively impacted by foreign exchange losses and increased labor costs, which were partially offset by other operating cost efficiencies and a small increase in gross profit.

Increased labor costs included a CAD5 million investment in our customer proposition related to improving service in our stores. In Q4, our incremental investment in our customer proposition totaled CAD15 million, which included the CAD10 million in shrink, and CAD5 million in labor, that I mentioned before. For the full year in 2012, we invested and incremental CAD55 million in our customer proposition -- CAD20 million in price, CAD15 million in shrink, both of which impact gross profit, and CAD20 million in labor which impacts SG&A.

Now turning to our Financial Services segment. Revenue in this segment increased by 19.7%, to CAD176 million, compared to CAD147 million in the fourth quarter of 2011. The increase was primarily driven by higher PC Telecom revenues resulting from the launch of the Mobile Shop kiosk business in 2011. As well as increased credit card receivable balances and credit card transaction volumes, resulting in higher interest and interchange fee income. Operating income in the Financial Services segment was CAD34 million in the fourth quarter of 2012, up from CAD18 million in the same quarter last year. The increase is primarily due to increased revenue year over year, as well as lower costs related to the renegotiation of vendor contracts. These factors were partially offset by investments in the launch of PC Telecom's Mobile Shop kiosks. And an increase in the allowance for credit card receivables due to quarterly growth in the credit card receivable program.

On a consolidated basis, operating income was CAD262 million in the fourth quarter of 2012, compared to CAD315 million in 2011. Operating margin was 3.5% compared to 4.3% in Q4 of last year. Excluding the restructuring charge, operating income in Q4 2012 was CAD323 million. And operating margin was 4.3%. Both in line with last year and our expectations. Interest expense was CAD80 million, down CAD1 million compared to Q4 of 2011. Our effective tax rate during the fourth quarter was 21.4%, compared to 25.6% in 2011. The year over year decrease was due primarily to reductions in the federal and Ontario statutory income tax rates. And a change in the proportion of taxable income earned across different tax jurisdictions.



For the quarter, Loblaw realized basic net earnings per common share of CAD0.51, which includes a CAD0.16 charge related to restructuring, compared to CAD0.62 in the fourth quarter of 2011. Free cash flow in Q4 was CAD476 million, very CAD463 million last year. The increase was driven by the change in non-cash working capital, partially offset by a decrease in EBITDA and increased capital expenditures. Our capital expenditures totaled CAD1 billion for the year. For the full year 2012, we reported consolidated revenue growth of 1.1%. EBITDA of CAD2 billion, down 5.3%. And net earnings per common share of CAD2.31, including restructuring, down 15.4% from the prior year.

Looking out to 2013, sales growth will be moderated by an environment characterized by ongoing square footage expansion, a new competitor's entry into the market, and generic drug deflation. We will continue to invest in our customer proposition. But expect those investments to be offset by operating cost efficiencies. In addition, investment in our infrastructure program will continue, with associated costs anticipated to be flat to 2012. As a result, we expect operating income growth in 2013 to be modest. Excluding the impact of the CAD61 million restructuring charge recorded in the fourth quarter of 2012. And the impact of the previously announced plan to launch an IPO of a new REIT.

The adoption of amendments to the accounting standard related to employee benefits in 2013 will require a restatement of our 2012 consolidated financial statements. This will reflect a reduction in net earnings by approximately CAD16 million, or CAD0.06 per share. In 2013, we expect an effective tax rate in the range of 26% to 27%, higher than the rate in 2012. And capital expenditures of approximately CAD1 billion with net new retail square footage growth of approximately 1%.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Irene Nattel from RBC Capital Markets.

Irene Nattel - RBC Capital Markets - Analyst

The first question is, what is your definition of modest?

Sarah Davis - Loblaw Companies Limited - CFO

My definition of modest is low-single digits growth.

Irene Nattel - RBC Capital Markets - Analyst

Okay, that's very helpful, Sarah. Thank you. I think that will probably be most people's definition of modest. I want to come back to the SAP rollout, please. If I understood correctly, you have three stores that are live now. And I believe that Vicente said that you now expect a majority of the stores to be completed by the end of 2014, which seems to me is later than the last time we talked about it. So I was wondering if you could, in fact, confirm that? And if you could give us some more color on where you saw the glitches in the early going, and what changes you might have made?

Vicente Trius - Loblaw Companies Limited - President

Good morning, Irene. As I recall, I'd been 1.5 years in the business the first time that I talked on SAP, I always talked about 2014, as being part of the full rollout of the stores. So we have not changed that target and we are on plan to achieve that target. We have thus far rolled out three stores



into SAP. We feel, in my experience, implementation of systems is a good start of a rollout, but obviously in any rollout and in a pilot test of three stores, you have some issues that you need to fine tune to build a model that is scalable for the rollout of the rest of the stores. And we believe that starting in Q2 we should start rolling out at a faster pace.

Irene Nattel - RBC Capital Markets - Analyst

Okay. So you haven't had to make any significant adjustments?

Vicente Trius - Loblaw Companies Limited - President

No. Some of the adjustments in an implementation of technology is a little bit around data cleansing. There's 100's and 100's of 1,000's of items sometimes. So it's always fine-tuning the data cleansing so we have smooth rollout when you start scaling up.

Irene Nattel - RBC Capital Markets - Analyst

That's great. Thank you. And on the general merchandise side, when are we going to stop hearing about general merchandise being down? It seems like this has been going on for a very long time.

Vicente Trius - Loblaw Companies Limited - President

The answer is, I would say, by 2014. Now, having said that, let's balance a little bit what happened this year. We did many renovations, on the right-hand side, about 78 renovations. And I wanted to recall that part of renovation is downsizing the space on general merchandise. When you have areas like home downsize by 23%, electronics by 36%. Whereas you have other parts of the store, like beauty, increasing by 33%. So when you look at all of that, we have been able to manage well the inventories. We have been able to manage markdowns very well. And we've been able to increase profitability. When I look at the sales performance, if you look at relationship to square footage, it's pretty good and strong. So we feel good about it. And this year, by the way, just let me add, this year we will roll out an additional 30 to 40 stores. That's why I say that my full expectation is by 2014 we will see improvement in the GM side of the business.

Irene Nattel - RBC Capital Markets - Analyst

That's great, thank you. And one final question, if I may. Can you make any comment about whether you are still on track in terms of working towards a mid-year target for the REIT IPO?

Sarah Davis - Loblaw Companies Limited - CFO

I will take that. Yes, we are on track. We said mid 2013, and everything is going according to schedule. So we are feeling pretty confident with that deadline.

Irene Nattel - RBC Capital Markets - Analyst

That's great. Thank you.

Operator

Peter Sklar from BMO Capital Markets.



Peter Sklar - *BMO Capital Markets - Analyst*

In terms of the benefit that you'll be seeing in your financial results from the reduction in the headcount, I believe it was 700 people, what is the affected period when you start to see that benefit? How much of a benefit did you get in the quarter? And will you get a full benefit in the first quarter of 2013?

Sarah Davis - *Loblaw Companies Limited - CFO*

Most of it would have affected part way through the quarter. So we would have had probably two-thirds of a quarter affected, because the people would have left during the quarter of Q4, so it would have been in there. So I wouldn't take -- divide by four for the annual impact. But definitely -- and there were a few people who stayed until year end. So I would say -- but in Q1 of 2013, yes, the majority of the people will have left and we would see the full impact of the savings.

Peter Sklar - *BMO Capital Markets - Analyst*

Sarah, have you articulated what the dollar amount of the savings is going to be? I know that is something you did not disclose in the past.

Sarah Davis - *Loblaw Companies Limited - CFO*

Basically we said if you take the restructuring charge of CAD61 million, it's about equal to the annual savings coming from it.

Peter Sklar - *BMO Capital Markets - Analyst*

Right. Okay. The next thing is, the investment in price that you've talked last year and you're continuing to take, you mentioned you're continuing to take in '13, can you talk a little bit about where that investment is focused? Is it more focused on discount as opposed to conventional? Are there any regional discrepancies?

Vicente Trius - *Loblaw Companies Limited - President*

These are focused across all divisions. And it's mainly through our category reviews and rollout of the categories. I referred to one category, but we have done 12 categories thus far. For the most part, with good performance on increase in sales and better mix and tonnage share, whilst becoming more competitive and improving our pricing. Our intention is to continue to do that throughout 2013. We will roll out an additional 25 categories. And I see that as a process that's about 2 to 2.5 years, like I said before. It's an ongoing process. And we feel very confident on the performance we're getting.

Peter Sklar - *BMO Capital Markets - Analyst*

Right. And Vicente, more of a strategic question. Loblaw has a large number of banners across the spectrum of your business. Have you given any thought to consolidating the number of banners that you have?

Vicente Trius - *Loblaw Companies Limited - President*

Yes, we have given a lot of thought about the amount of banners. But banners have a lot of strong equity with the customers, so you need to be careful when you try to rationalize banners. But we believe that there's some opportunities and maybe some rationalization on banners.



Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And, lastly, Sarah, on the REIT IPO, can you give us a timing of when you expect to issue the circular?

Sarah Davis - *Loblaw Companies Limited - CFO*

We are not being really any more specific than saying Q2 of 2013. As we get closer, we will be able to fine-tune that a little. But right now we don't have a specific date.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay, that's all I have. Thank you.

Operator

Patricia Baker from Scotiabank.

Patricia Baker - *Scotiabank - Analyst*

Good morning, everyone. In the press release, you referenced the good performance metrics and how that's validating the management strategy. And, Galen, you talked about the measurable results. And thank you very much, Vicente, for providing us with some hints of exactly what those -- some of those good performance metrics might be. I think you gave us three little examples. One of which would have been the rollout of the revamping of the categories. And I think you just said you have got 12 done so far. Are there any others that you can share? Secondly, what should we look for in 2013 with respect to how those performance metrics should accelerate. You'll be doing a lot more categories. Are those performance metrics going to get to the point where we will actually see it more measurable on the top line and in the actual results? Really what I'm saying is, I was really pleased to see discussion of some evidence, but I would love if you would share a bit more and tell us what we can look for in 2013.

Vicente Trius - *Loblaw Companies Limited - President*

We are really encouraged on the performance of the categories that we've rolled out thus far. And we will continue to accelerate that, like I said, in 2013. We should not underestimate the dynamics of 2013 with increased square footage and the rollout of a competitor with, potentially -- depends who you talk to -- but potentially an additional 130 stores. Now, we believe we are very well placed. We believe our strategy is working. And we believe that we can see improved sales in 2013.

Galen Weston - *Loblaw Companies Limited - Executive Chairman*

Patricia, it's Galen. I might just add to that. Because I really love this particular statistic. So we have seen 52 weeks of tonnage share growth in two regions. That's a meaningful trend. And really gives me an enormous amount of confidence in Vicente's strategy and how he's moving the business forward.



Patricia Baker - Scotiabank - Analyst

Okay, that's an excellent point. And would I be right in assuming that there are specific things you did in those two regions that delivered that tonnage growth? And as you apply whatever that is to additional regions, you're hoping to see some tonnage growth? Or you should see tonnage growth -- forget the hope.

Vicente Trius - Loblaw Companies Limited - President

Yes, we should see tonnage growth. And just to add to Galen's comment, it's not limited to two regions. We have seen tonnage growth in other banners, in other regions, as well. And improved trends across the country. So we feel good about the category strategy process. And as we are rolling it out, if we can give you more information, we will.

Patricia Baker - Scotiabank - Analyst

Excellent. And maybe one last question. On the CapEx -- and forgive me if this was discussed earlier and I missed it -- can you break down how it is going to be spent? Is there any regional allocation that's disproportionate?

Sarah Davis - Loblaw Companies Limited - CFO

Okay, I will take that. Basically in 2012 we spent about CAD1 billion dollars. And in 2013 we are highlighting that we'll spend about the same. But in 2012 we spent about 50% of it on retail. And in 2013 we are anticipating spending about 65% on retail. So as the supply chain and IT projects finish, we do have more capital available to spend on retail. So that's definitely good news for the retail business. Within that, we do expect to increase the number of renovations between 2012 and 2013. It will be fairly equal. But where we will be increasing the capital spend is on new stores. So we opened 16 stores in 2012, and we anticipate doubling that in 2013. As far as regionally, it's actually pretty well spread. We have plans across all the regions to open stores in every region.

Patricia Baker - Scotiabank - Analyst

Okay, thank you. And, actually, I'm going to be very selfish and ask one more. I noticed that you've rolled out all the T&T product into the conventional stores. Is it still too early to talk about how that's going?

Vicente Trius - Loblaw Companies Limited - President

We rolled it out approximately four weeks ago during the month of January.

Patricia Baker - Scotiabank - Analyst

Then it's early.

Vicente Trius - Loblaw Companies Limited - President

Yes. But it was in preparation for Chinese New Year's, which we had a very good implementation across all of our banners. And initial reaction from the consumers is very good. Initial performance is ahead of expectations. And we anticipate during the second half to roll out an additional 20 T&T products across all of our network, and across all of our banners.

Patricia Baker - Scotiabank - Analyst

Okay, thank you very much, Vicente.

Operator

Perry Caicco from CIBC.

Perry Caicco - CIBC World Markets - Analyst

I just want to dive in to same-store sales a little bit in the quarter. I'm just wondering how it trended over the quarter, and if there's been any change to the trend in Q1. And can you comment about basket size versus same-store traffic in that number?

Vicente Trius - Loblaw Companies Limited - President

Yes. The trend was pretty consistent across the quarter. We are encouraged on the trends going forward. As we look, our customer count was slightly down, but we should filter into that the fact they have a little bit of switch of new years. So you have a Sunday and a Monday prior to New Year's. And we have seen good conversion of our medium and low consumers into more high-volume transaction customers. So we see positive.

Perry Caicco - CIBC World Markets - Analyst

Would it be fair to say that your discount divisions outperformed the conventional?

Vicente Trius - Loblaw Companies Limited - President

We see good trends across both divisions, with discount maybe a little bit better.

Perry Caicco - CIBC World Markets - Analyst

And you talked a little bit about some of the underlying good performance metrics. Can you just detail those for us? What are some of the performance metrics that you're seeing that are encouraging?

Vicente Trius - Loblaw Companies Limited - President

The performance metrics, in my mind, is there's a leading indicator, which is tonnage share. That, to me, is a big one because it means that we are selling more products in the stores. The other one would be comp sales, obviously, in food and drug. A big one for me would be net promoter score, which I referred to a few times. But we improved by three points. So we are pretty close to what we call performance zone. So you have many indicators that are actually telling, our customer telling us that they like what they see. They like what they see, they like to shop in our stores.

Perry Caicco - CIBC World Markets - Analyst

All right. And just a question on the outlook for 2013. You mentioned that investments in price, assortments, and labor should be offset by operating efficiencies. What exactly are these operating efficiencies? And where will they turn up in the P&L?



Vicente Trius - *Loblaw Companies Limited - President*

We see opportunity to leverage efficiencies across the network. And I would see it in areas like supply chain. I would see it in areas like shrink. I would see it in areas like flow of the product in the stores -- product in the stores as well as in administration costs.

Perry Caicco - *CIBC World Markets - Analyst*

And I know you've mentioned that infrastructure and IT spending is predicted flat in 2013 versus '12. Are you willing to comment a bit on 2014? Do you see these rolling off materially? Can you help us quantify that?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes. Our expectation is that 2014 will be down for the IT costs, for sure. We don't have a number yet. But I think it's a fairly material number. Yes. The other thing to point about 2013, although the total expenses in 2013 are flat, what we will see is an increase in depreciation. So if you use Q4 as a run rate on depreciation, you'll get a pretty good number. But what we will see is a compensating reduction in cash expenses. So the EBITDA will be improved as a result of that. So, higher depreciation but lower cash costs.

Perry Caicco - *CIBC World Markets - Analyst*

All right. And just one last question. What will be the impact in your sales and operating income of the Joe Fresh openings at JCPenney?

Vicente Trius - *Loblaw Companies Limited - President*

We are on track with JCPenney. We are going to roll out 700 stores starting in April. Actually we have a pop-up store that is going to roll out in a couple weeks in Los Angeles. And obviously, effective to sales. We see more sales coming out of those JCPenney stores.

Perry Caicco - *CIBC World Markets - Analyst*

Will that have an immediate positive impact on your operating income?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes.

Perry Caicco - *CIBC World Markets - Analyst*

Okay, thank you.

Operator

Michael Van Aelst from TD Securities.



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

Most of my questions have been answered, but I wanted to touch on a few things. On the SG&A side, if you back out the IT and the supply chain costs, it seems the growth in that line seems to have slowed quite a bit in Q4. Is this a timing issue at all? Or does it just reflect sustainable efficiencies that are starting to surface, including those labor cuts and things like that?

Sarah Davis - *Loblaw Companies Limited - CFO*

I think it's pretty sustainable. There's a little bit of timing between the costs as we go through the quarter, but I think it's pretty sustainable.

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

Okay. Great. And when you talked about the guidance and not adjusting or not reflecting the higher REIT costs, is that a one-time cost to take it public? Or is that higher operating costs to keep it as a public company?

Sarah Davis - *Loblaw Companies Limited - CFO*

It's both. So I'm excluding from our outlook and our forecast any impact related to the REIT. But there would be two types of costs that you highlighted. So, yes, there is a cost of doing the IPO and the REIT, setting it up. And there will be an ongoing cost of having the REIT, that we did mention in the original press release, because there will be some incremental SG&A. There will be a new -- there's public company costs of having the REIT. There will also be some incremental positions and people working in the REIT. So there is a bit of cost there, as well. Although, obviously, we are trying to minimize that.

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

Are you able to quantify it at all?

Sarah Davis - *Loblaw Companies Limited - CFO*

Not at this time. When we get closer we will.

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

Okay. And just finally, can you discuss how the competitive environment may have changed in the recent months after Walmart opened the 39 Zeller stores, or converted the 39 Zeller stores? And as we are approaching the imminent openings of the Target, have you seen a change in the way the market is competing or preparing?

Vicente Trius - *Loblaw Companies Limited - President*

We see the same sort of trends, with promotional activity penetrating more, and we're penetrating less than our competitors because we are basically investing more across the breadth of the assortment. But beyond that, no other fundamental changes. And we have a very good plan, a very good strategy that rolls out across all of the banners and by store on any Walmart or any Target that opens. And we feel pretty good thus far they way we've performed.



Michael Van Aelst - TD Newcrest/Waterhouse Securities - Analyst

All right, thank you.

Operator

David Hartley from Credit Suisse.

David Hartley - Credit Suisse - Analyst

Just want to ask you a little bit about the shrink and new products assortment. I suspect that's a lot around food service. Can you talk a little bit about that program or home meal replacements? And what the plans are for 2013 in expanding that offering?

Vicente Trius - Loblaw Companies Limited - President

Yes. The shrink mainly, one of the increases in shrink is mainly around fresh. This was about a requisitioning of fresh. Which is about increased breadth of assortment, and increased presentation levels. And we feel that we have a rebasing, that we like the way we're treating for 2013. We are looking at new lines of home meal replacement for 2013 that we will see launching across some of our banners around Q2.

David Hartley - Credit Suisse - Analyst

And should I be thinking along the lines of what we see in the revamped Fortinos stores?

Vicente Trius - Loblaw Companies Limited - President

Fortinos and MLG actually is a very good best practice because what we are doing is, as you know, in Maple Leaf Gardens, we have an R&D. And we are developing recipes. And it's basically replicating these recipes through a very efficient supply chain, to have those home meal replacements in all of our stores actually. We are encouraged. We tasted it and it's very good.

David Hartley - Credit Suisse - Analyst

When you think about your Burlington Fortinos and other stores that are modeled after that, could you give us an initial take of how well they have done? Are they meeting your expectations? Or will it take some time?

Vicente Trius - Loblaw Companies Limited - President

No, they are exceeding our expectations. So Pane Fresco is a real success. And you should see that being rolled out in our Fortinos stores, as well.

David Hartley - Credit Suisse - Analyst

Okay. And just a question around loyalty program. I think this year -- and maybe you can correct me if I'm wrong -- but I think this year you are planning to roll out a highly customized loyalty program that we hear is going to be mobile-enabled, and a whole bunch of other bells and whistles. Can you talk a little bit more about that, what it means for you, and the timing?



Vicente Trius - *Loblaw Companies Limited - President*

Yes, we are looking at rolling out loyalty doing the course of Q2. And completing all of the rollout by Q4. We see that as a great enabler for us to trade better to the customer needs, specific customer needs. And we believe that's a great enabler with our partnership with suppliers, to actually deliver the products the customers want. So we're looking forward to it.

David Hartley - *Credit Suisse - Analyst*

Do you expect it to be profitable upon roll out?

Vicente Trius - *Loblaw Companies Limited - President*

Yes, we expect it to be neutrally funded. That's what we said all along. But it does have the capacity to be additive.

David Hartley - *Credit Suisse - Analyst*

Okay. And just on that, could you give us a little color on how that program will manifest itself. Will it be built around your existing points program with the MasterCard? Or are you looking to expand into a regular points card or something to that effect?

Vicente Trius - *Loblaw Companies Limited - President*

I would prefer to give the information, if you will allow me, once we launch it, which we could give you much more information on Q1 release.

David Hartley - *Credit Suisse - Analyst*

Okay, great. And if I could squeeze in one more question. Just around the, we'll call it, CAD60 million of savings from headcount reduction, is this really representing the efficiencies you expect to gain in 2013 that will offset more customer proposition spending? And is it more than offsetting it? Or is some of that going to drop to the bottom line? Could you maybe flush that out a bit, Sarah?

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. I would say, yes, that's part of it. So definitely when we say that we'll cover any investments with efficiencies, that would be part of it. The other efficiencies that Vicente mentioned is we are looking for some efficiencies in our supply chain. Part of that goes through gross profit, part of it goes through SG&A. We're looking for some efficiencies in dry shrink. So grocery and [ha-bats] will be another one. And if we can be more productive from a labor perspective in our stores, we are always looking for productivity improvements in that way, as well. And so, to say in the whole bundle, some of it drops to the bottom line because we end up with earnings growth. But that's how it also washes out.

David Hartley - *Credit Suisse - Analyst*

Thank you very much.

Operator

Kenric Tyghe from Raymond James.

Kenric Tyghe - *Raymond James - Analyst*

I want to follow-up on the loyalty-related question. The posits that you're setting, or your expectations you have necessarily are going to require a very analytics-rich loyalty offering. Could you speak to what your intentions are with whether or not you will be doing those analytics using your internal resources for the analytics, or will be going externally, as a number of other leading global grocers have done?

Vicente Trius - *Loblaw Companies Limited - President*

Analytics around the loyalty care? Is that correct? I missed a little bit the beginning of your question.

Kenric Tyghe - *Raymond James - Analyst*

Yes, Vicente. The analytics as it relates to your loyalty initiative.

Vicente Trius - *Loblaw Companies Limited - President*

The analytics will be done in-house.

Kenric Tyghe - *Raymond James - Analyst*

On that, could you just walk through what your rationale would be, given what one could loosely say is it's something of a precedent, with the number of global grocers who have elected to rather have that performed by specialists in the area?

Vicente Trius - *Loblaw Companies Limited - President*

I would prefer a loyalty -- I would go back to what I said before -- I would prefer to maybe at the end of Q1 to give you more information on it. Okay, fair enough. I'll leave it there. Thanks, Vicente.

Operator

Jim Durran, Barclays.

Jim Durran - *Barclays Capital - Analyst*

Back to SAP for a second. On the DC side of the equation, how quickly do you expect to have the DCs integrated into SAP?

Vicente Trius - *Loblaw Companies Limited - President*

We have one DC integrated, obviously, on SAP. And we expect full roll out of all DCs in the calendar year of 2013.

Jim Durran - *Barclays Capital - Analyst*

And when we look at the stores, as they get rolled on, can you give us an inflection point, assuming that there's an 80/20 rule in terms of number of stores versus amount of revenue as a percent of your total, as to when you would feel like the majority of revenue has been covered off by integration on the stores?



Vicente Trius - *Loblaw Companies Limited - President*

Yes, I would say that this would happen, depending on how fast we roll out this year, this would happen by early 2014.

Jim Durran - *Barclays Capital - Analyst*

Okay. And with respect to inflation, you kindly provided us with your measured number, thank you. Can you give us some ideas -- like, that zero inflation level, how much cost of goods sold inflation was there versus how much price pressure brought it back down to zero?

Vicente Trius - *Loblaw Companies Limited - President*

I would say most of it would be a lot more on the pricing side to the consumer.

Jim Durran - *Barclays Capital - Analyst*

And what is your sense of what inflation is going to be like in 2013?

Vicente Trius - *Loblaw Companies Limited - President*

I'm not good at forecasting inflation, but I would see stability in 2013.

Jim Durran - *Barclays Capital - Analyst*

Okay, great. Thank you.

Operator

Vishal Shreedhar from National Bank.

Vishal Shreedhar - *National Bank - Analyst*

On the customer proposition costs, I was wondering if you could give us a more clear breakdown in terms of how you expect that to be split in 2013, and maybe even the dollar value?

Vicente Trius - *Loblaw Companies Limited - President*

I missed your question. The split of what in 2013?

Vishal Shreedhar - *National Bank - Analyst*

The customer value costs. The same cost.

Vicente Trius - *Loblaw Companies Limited - President*

You mean between divisions, you're saying?

Vishal Shreedhar - *National Bank - Analyst*

Between SG&A and gross margin.

Vicente Trius - *Loblaw Companies Limited - President*

What we said all along is that we will continue to invest in the customer proposition, and we would leverage that through efficiencies.

Vishal Shreedhar - *National Bank - Analyst*

Do you have a dollar value that you intend to spend in the upcoming year?

Sarah Davis - *Loblaw Companies Limited - CFO*

I will try a little bit on the line item, but I'm not going to give you a dollar amount. I think what we would say is, from a fresh shrink perspective, we are actually pretty happy with where we are today. So it's basically 2012 position, and in 2013 we don't expect a large investment in shrink. We do still, depending on the competitive nature of 2013, we do expect to have some in price, which would affect gross profit. And we do expect to have some investment, I think, in labor. But the biggest piece will be in price in 2013.

Vishal Shreedhar - *National Bank - Analyst*

Okay, understood. And in terms of the way to think about your outlook when you said moderate growth for 2013 in operating income, should we think of the main drivers for the growth being PC Financial, the workforce reductions, and the efficiencies? And perhaps slight benefit from Joe Fresh and SAP? And that would be offset by price? Is that the way to think about it?

Sarah Davis - *Loblaw Companies Limited - CFO*

That's a good way to think about it. But I wouldn't see -- SAP is not helping us in 2013. It's flat. The rest of it's all correct, though.

Vishal Shreedhar - *National Bank - Analyst*

Okay, so SAP would be flat. And in terms of the outlook that you've baked into your sales guidance in terms of inflation, I understood from other grocers that the outlook is fairly tepid. Is that what you baked in you outlook, as well?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes, we don't have a high inflation assumption. It would be pretty low.

Vishal Shreedhar - *National Bank - Analyst*

Okay, got it. Thank you. And in terms of your drugstore business, I was hoping you could give us the script count?



Vicente Trius - *Loblaw Companies Limited - President*

8.4% increase in script account.

Vishal Shreedhar - *National Bank - Analyst*

Okay, great. That's it. I appreciate your time.

Operator

Keith Howlett with Desjardins Capital.

Keith Howlett - *Desjardins Securities - Analyst*

Just on the labor agreement, are we finished with that now, the incremental costs? Or is there more to come?

Sarah Davis - *Loblaw Companies Limited - CFO*

There's more to come. We have about CAD20 million to CAD30 million that we expect to spend in 2013. So down from the 2102 level of CAD35 million. But we still have it, and we will have it in 2014, as well.

Keith Howlett - *Desjardins Securities - Analyst*

And then, just on the Atlantic Superstores, forgive me, I have forgotten, are they considered discount or conventional?

Sarah Davis - *Loblaw Companies Limited - CFO*

Conventional.

Keith Howlett - *Desjardins Securities - Analyst*

Conventional. So is there some adjustment in their pricing platform given expansion of discount competition in that market, or not?

Vicente Trius - *Loblaw Companies Limited - President*

We have invested in pricing across all banners and regions. And in the Atlantic, definitely we're doing that, as well.

Keith Howlett - *Desjardins Securities - Analyst*

And just on the announcement that an executive from Quebec was leaving, can you just indicate how you are filling the gap, or what you're doing with Quebec? I guess he was partly Ontario, partly Quebec.



Vicente Trius - *Loblaw Companies Limited - President*

Yes. You are referring to Sylvain Prud'homme.

Keith Howlett - *Desjardins Securities - Analyst*

Right.

Vicente Trius - *Loblaw Companies Limited - President*

Who is President of Lowes. We thank him for the contributions over the last three years. A good colleague. We wish him the best. Having said that, we have already filled his position with Shaun Halstead, which is the leader, was leading all of our health and beauty in our business. We feel confident on his capabilities on driving conventional business going forward with grocery.

Sarah Davis - *Loblaw Companies Limited - CFO*

And I'd just mention, Sylvain actually lives in Ontario. He wasn't a Quebec colleague. And he wasn't responsible for Quebec, other than he did have the grocery portfolio, the conventional business. So it wasn't a Quebec-specific job.

Keith Howlett - *Desjardins Securities - Analyst*

And just on the home meal replacement business, is that going to be prepared in-store, or is there going to be a centralized facility?

Vicente Trius - *Loblaw Companies Limited - President*

There's going to be a centralized facility through a third party.

Keith Howlett - *Desjardins Securities - Analyst*

And just on the Joe business, are you doing anything in particular to prepare that business for the entry of Target? Or is it pretty much set as it is?

Vicente Trius - *Loblaw Companies Limited - President*

We have a very strong brand in Joe Fresh. Great fashion, great basics and great volume. I'm going to go out on a limb, but when I visit the Target stores, I do believe that we have a very strong brand to compete with Target in Canada.

Keith Howlett - *Desjardins Securities - Analyst*

And then, just finally, so that I understand the guidance. There seems to be a lot of positives here. Am I to take it that when you talk about the price investment under that general improve the customer proposition, on top of that you're expecting some price pressure in the market more broadly, that leads the guidance to be -- I might want to make sure I get the right word -- modest operating income growth?

Vicente Trius - *Loblaw Companies Limited - President*

Yes. Again, you have a new entry in the market, which is Target, with 130 stores. So you should plan accordingly, and don't underestimate the impact when you have a new competitor.

Keith Howlett - *Desjardins Securities - Analyst*

Great. Thanks very much.

Operator

Chris Li, Bank of America.

Christopher Li - *BofA Merrill Lynch - Analyst*

With respect to the retail gross margin improvement that was due to the drugstore business, can you share with us a little bit what was done to improve that, despite the drug reform pressures?

Sarah Davis - *Loblaw Companies Limited - CFO*

In Q4, we had a good Q4 in drugs. So, a couple things happened there, so the comps in drug were positive. And from a margin perspective, we had additional pharmacy. We had strong growth in pharmacy scripts, which has a higher margin, so that improved the margin. And we had a good flu season from the sense of having a lot of people with the flu, so that helped, as well. So those are higher margins. So the combination of those would be the major drug, the improved margin in Q4.

Christopher Li - *BofA Merrill Lynch - Analyst*

Okay. Do you have a same-store script count growth, as well?

Vicente Trius - *Loblaw Companies Limited - President*

8.4.

Christopher Li - *BofA Merrill Lynch - Analyst*

That is on the same-store basis?

Vicente Trius - *Loblaw Companies Limited - President*

Yes.

Christopher Li - *BofA Merrill Lynch - Analyst*

Okay. And then just on the transportation costs that drove the margin improvement, was that mostly because of lower fuel prices?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes, that would be definitely part of it. And just the efficiency of the supply chain as we've rolled out the new system has helped us in the management of transport. So having a better queued load and things like that have helped us improve the efficiencies of each of the truck runs, as well.



Christopher Li - *BofA Merrill Lynch - Analyst*

Okay. And in your outlook section, you also mentioned, with respect to the IT system, that it's going to be rolled out to a significant number of corporate stores in 2013. Is the way to think about it is that your plan is to finish the corporate stores mostly in 2013, and then move on to the franchise stores in 2014?

Vicente Trius - *Loblaw Companies Limited - President*

Yes.

Christopher Li - *BofA Merrill Lynch - Analyst*

Okay. And just lastly, with respect to your control label business, are you right now pretty satisfied with just the overall level of the profitability? Or is there much more room for improvement?

Vicente Trius - *Loblaw Companies Limited - President*

We are pleased with the level of profitability and the strength of the brand. It is accretive as far as to the categories. And it's an intrinsic part of our category review. And we will continue to drive innovation. I mentioned the T&T products. We will have more black label products, we will have more gluten-free products, and we will have more blue menu products. All very strong for us.

Christopher Li - *BofA Merrill Lynch - Analyst*

Thank you.

Operator

Keith Howlett from Desjardins Capital.

Keith Howlett - *Desjardins Securities - Analyst*

Just had a question on the new stores. You indicated there might be as many as, say, 32 new stores. How many closures would you be anticipating in 2013?

Sarah Davis - *Loblaw Companies Limited - CFO*

That's a good question. I don't know if we've got them all. I would say in the five to six range, would be my estimate. We're looking for about 1% of net additional square footage.

Keith Howlett - *Desjardins Securities - Analyst*

And then just in terms, I know there was the talk about banners, but what about new formats? Do you think that you would be experimenting with any new formats?



Vicente Trius - *Loblaw Companies Limited - President*

We are looking, obviously, at consumer trends. And we believe that there's a trend for small stores. And we have developed plans behind that. And that is as far as we would go at this stage.

Keith Howlett - *Desjardins Securities - Analyst*

Thank you.

Operator

There are no further questions at this time. Ms. Lee, I turn the call back over to you.

Kim Lee - *Loblaw Companies Limited - VP of IR*

Thank you. Thank you for dialing today. We are looking forward to speaking to you on our Q1 call in May. Thanks again and have a great day.

Operator

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

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