FINAL TRANSCRIPT

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PRESENTATION

Operator

Good afternoon. My name is Alicia, and I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies Limited first 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 Cos. Ltd. - VP IR*

Thank you, Alicia. Good morning and welcome to the Loblaw Companies Limited first quarter 2011 conference call. A press release of our first quarter results was issued this morning. If you have not received a copy, it is posted along with the MD&A and financial statements and notes on our website at loblaw.ca. This call is also being webcast simultaneously on our website.

I'm joined here this morning by Galen G. Weston, Executive Chairman; Allan Leighton, President and Deputy Chairman; 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 2011 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 first quarter 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 first quarter report and other materials filed with the Canadian securities regulators from time to time for a reconciliation of each of these measures to the most directly comparable GAAP financial measures. An archive of this conference call will be available on our website.

So with that, I'll turn it over to Galen.

Galen G. Weston - *Loblaw Cos. Ltd. - Executive Chairman*

Good morning. Thank you for joining us. We continue to make progress with our renewal program as we begin to turn our attention to new opportunities for growth. While we expect an unpredictable and competitively intense market environment, we remain focused on executing the plan. As previously announced, we expect our investment in the information technology supply chain infrastructure to negatively impact 2011 operating income.

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

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

Thank you, Galen, and good morning. This is our first quarter reporting in IFRS. Some of the key highlights include the deconsolidated certain franchise stores that were previously consolidated under variable interest entities accounting. Our credit card receivables that previously qualified for off-balance-sheet treatment are now on balance sheet, and as a result, we now have two reportable segments -- retail and financial services.

You will note we did make some minor changes to our 2010 IFRS preliminary financial statements as we fine-tuned the results on adoption of IFRS. Details on the impact of our conversion to IFRS can be found in Note 16 of our first quarter financial statements, which includes a reconciliation of our 2010 first quarter comparative results between IFRS and Canadian GAAP. Overall, it's important to note that it's business as usual under IFRS.

In the retail segment, which consists primarily of food, but also includes drugstore, gas bars, apparel, and other general merchandise, sales decreased by 0.5% to CAD6.8 billion in the first quarter of 2011. Same-store sales decreased 5.1%.

In the first quarter of 2011, sales growth in food was flat. Sales in drugstore declined marginally, negatively impacted by deflation due to regulatory changes in Ontario and other provinces, and new generic versions of certain prescription drugs. Sales growth in apparel declined marginally, due in part to cooler weather and the timing of the Easter holiday, while sales of other general merchandise declined moderately due to continued reductions in square footage and optimization of range and assortments of products. And gas bar sales were strong as a result of higher retail gas prices and modest volume growth.

In Q1, our internal retail food price index experienced moderate inflation, but was lower than average CPI in the quarter of 2.5%. We saw marginal deflation in internal food price in Q1 of 2010.

The retail segment gross profit was CAD1.6 billion, or 23% of sales, compared to 22.7% of sales in the first quarter of last year. The improvement was primarily due to improved control label profitability, improved shrink, the shift of pharmaceutical professional allowances from SG&A expenses to gross profit, as legislated, and a stronger Canadian dollar, partially offset by increased transportation costs and timing of Easter vendor programs.

Operating income in the retail segment increased 7.5% to CAD285 million in the first quarter compared to CAD265 million in Q1 of 2010. Operating margin was 4.2% in the quarter, a 30-basis-point improvement over last year. This increase was due to increased gross profit, labor efficiencies, the improvement in the performance of our franchise businesses, a stronger Canadian dollar, and the impact of share-based compensation net of equity forward, partially offset by incremental costs of the investment in IT and supply chain and a charge related to the internal realignment of the business centered around the Company's two primary store formats, discount and conventional.

In the financial services segment, which includes credit card services, our retail loyalty program, insurance services, personal banking services provided by the direct banking division of a major Canadian chartered bank, and telecom, revenues decreased by 5.7% to CAD115 million from CAD122 million in Q1 of 2010. This decrease was primarily driven by improvements to customer payment practices, and therefore less interest revenue, as a result of more stringent credit risk policies which were implemented in 2009. Although these more stringent policies resulted in lower revenue, they have favorably impacted the annual credit loss rate.

Operating income in the financial services segment decreased 25% to CAD18 million in the first quarter of 2011 compared to CAD24 million in Q1 of 2010. The decrease was mainly due to the reduction in revenue, as mentioned before, and an increase in marketing costs due to the ramp-up of acquisition costs as part of our growth strategy. This investment in marketing will continue throughout 2011. This was partially offset by a lower allowance for credit card losses.

On a consolidated basis, operating income was CAD303 million in the first quarter compared to CAD289 million in Q1 of 2010. Operating margin was 4.4% in the quarter, a 20-basis-point improvement over last year. The improvement in operating income was primarily due to the improvement in gross profit, SG&A expenses, and CAD7 million of income related to stock-based compensation net of equity forward, an CAD8 million charge related to the internal realignment of the business, and CAD43 million in incremental costs related to the Company's investments in IT and supply chain.

With respect to our investments in IT and supply chain for the quarter, our incremental expenses for the quarter are CAD43 million, included CAD16 million related to the changes in the distribution network and CAD13 million related to depreciation and amortization. SG&A expenses in the quarter as a percent of revenue were 19.9%, which is flat with Q1 of 2010. Interest expense decreased to CAD73 million from CAD87 million last year due to a net decrease in long-term debt, an increase in net interest income on financial derivative instruments, and an increase in interest income as a result of higher short-term interest rates.

Our effective tax rate for the quarter was 29.6% versus 34.6% in Q1 of 2010. A tax rate of 29% to 30% is what we anticipate for the full year of 2011.

Loblaw realized first quarter basic net earnings per common share of CAD0.58 compared with CAD0.48 in the first quarter of 2010. Net debt at the end of the first quarter was CAD4.8 billion, down from CAD5 billion in Q1 of 2010. Capital expenditures in Q1 were CAD155 million. Our estimate for capital expenditures in 2011 continues to be approximately CAD1 billion. Approximately 50% of these funds are expected to be spent on upgrading IT and supply chain, with the remainder being spent on retail.

I would now like to turn it over to Allan Leighton, who will provide some context for the quarter and the year ahead.

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Thank you, Sarah, and good morning, everyone. Quarter 1 of '011 became our thirteenth successive quarter of EBITDA growth -- a quarter in a wonky market with little sales volume, plenty of aggressive promotional activity, and some modest, if peaky, inflation.

It was the first quarter of IFRS reporting, which has happened largely without a glitch, and the quarter where we set the organizational and operational platform for our two-division structure. So on the surface, business as usual, but underneath, some changes of real significance and executed well.

In supply chain, we continued to work towards finalizing major investments into our network. To date, we roughly have 60% of our distribution centers, which are about 77 on volume, on new systems. With our new transport management system complete, we'll work to roll out WMS, our warehouse management system, for the remainder of the year, which will put 90% of our network on the new WMS. In Q1 we rolled out our new warehouse management system to two more DCs.

Today we have 70% of our purchases on our new forecasting system, IPFR, improving ordering and replenishment in our DCs. For Q2 2011 we expect to have all of our grocery and general merchandise on the system and fully integrated with SAP. And in addition, we'll start our rollout for fresh products, to bring almost 100% of our purchases onto this new forecasting system.

Our flow pilot in our Ajax DC continues to make progress. Expanding on the program, we started to flow grocery in our Maple Grove DC in the quarter. And while both pilots are still in the early stages, we're seeing positive results in terms of labor productivity.

With respect to our SAP implementation, as we roll out to our merchandising organization, which is the big focus this year, our focus is on clean and accurate data with robust processes to maintain this data integrity. We've rolled out SAP into roughly a quarter of our merchandising categories to date.

In driving store productivity, the implementation of our store time and attendance system, STAS, has started to deliver, with improved schedule visibility and the benefit, reduce overtime and premium pay. For 2011, our goal is to complete our rollout of STAS to all corporate stores, with only Quebec now left to complete.

As for our store renewal program, we completed another 60 stores, including both major and minor renovations. And in 2011, our target is to renovate more than 100 of our stores.

Our Nofrills expansion in Atlantic continues. Recently we announced the opening of our first Nofrills in Prince Edward Island, Shores Nofrills in Stratford, bringing our total in Atlantic coming in to eight. While it's still early days, our Nofrills in Atlantic are being well received by our customers in that region, and we have plans for more this year.

In western Canada, we opened a new Nofrills in Vancouver in the quarter, bringing our total in the region to 29, with six more to come in 2011. We started on another four of our west Real Canadian superstores, and four more are already on the go for Q2, whilst in Ontario we continued to forge ahead with our investments in Zehrs and Fortinos. And in Quebec, work on Maxi and Maxi and Co. stores are beginning to make headway.

Recently we added two of the four new Joe standalone stores that we plan this year -- Heartland and Baramalea City Center. While it's only been a few weeks, we've received positive feedback from our customers.

Joe has also been busy with general merchandise and has launched the Everyday Living concept in 21 of what we call the right-hand side of the store pilot, a stylish new look, a revitalized offering, and new sub-brands like Jogi and J+/-. While we're still tweaking our range and assortments, so far we've seen promising results.

Looking forward, trading conditions continue to be tough. Consumer confidence is staid, disposable income is being spent on reducing household debt, and fuel costs are biting heavily. The balancing act between sales for vanity and profit for sanity is becoming more acute.

"Where goes inflation?" is the million-dollar question -- 3% on food is digestible; 5% or more would cause severe indigestion. Suffice it to say, with the unknowns growing, we remain cautious in our outlook, but determined to execute our investment programs for the long term.

With that, operator, I'd like to hand it over to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions.) Perry Caicco, CIBC World Markets.

Perry Caicco - *CIBC World Markets - Analyst*

I'd just start with a quick question on same-store sales. I wonder if you could quantify the impact of the generic drug price reductions, and I think general merchandise is down, and the increase on gas prices. I'm just wondering if they would offset.

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Roughly. There's a lot of deflation, as you know, Perry, in the pharmacy drugstore business, and that's still significant. There's a bit of inflation and sales growth in fuel, but not much more than we would normally expect. And general merchandise continues to be down, largely driven by market conditions. And as you saw, our food growth was pretty stagnant, actually, pretty flat.

Perry Caicco - *CIBC World Markets - Analyst*

Great. And then on the topic of food price inflation, I'm just wondering how the need to get prices up impacts your promotional strategy. How necessary is it to keep promoting heavily as prices rise?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

I'm not sure that it is that necessary, but it just happens to be a factor of the market and maybe something that changes. I think the real issue is that the promotion activity in the market is just becoming more acute. Let's be clear. If you look at all the performance of all of the retailers, they're all pretty much in the same place. And so we're all -- the market's much softer, and therefore people are looking at ways of which, one, they can get to incremental sales. But as you know, I think it's very important to balance that with just making sure you don't chase off the volume that's there.

So the promotional programs are getting a bit more acute and a bit more aggressive because I think people are just trying to find a different way to try and get some sales. But it's clear to me there is much more balancing going on than there has been in the past, because it needs to be.

Perry Caicco - *CIBC World Markets - Analyst*

And just lastly, I wonder about the timing and process for the new CEO coming onboard. And also, on that topic, I was wondering how you'd characterize the state of the Company he's taking over, what condition it's in. And what would you say his priority list should be over the first 12 months?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

I think it's in reverse order. Vicente will probably be around some time in the late summer. We've got directionally things to get towards, but (inaudible) moving house and family and things like that, so we're pretty flexible on that. It is for him to decide, when he understands the business and gets his feet onto the ground, where to next? Clearly, we have a strategy which he is very akin to and buys into, and therefore, the execution is absolutely paramount.

But the first year, really, of Vicente's life in Loblaw will be to really try and get to understand the business. And that's why we've made the organizational changes we have, to make sure we have the people in place to run the business.

Now, how would I characterize the business that he's taking over? I'd characterize it as being in a business that was in much better shape than it was four or five years ago. It's got a real platform to grow from, has an infrastructure which will have been built which will make it be able to compete in a way which it wouldn't have been able to compete for. And with some very exciting areas of our growth for the Company in ethnic and PCF and health and wellness and in Joe. So I think there's, as somebody described to me, a car is being built, and now the issue is what speed and what direction the car gets driven.

Perry Caicco - *CIBC World Markets - Analyst*

Okay, thank you.

Operator

Irene Nattel, RBC.

Irene Nattel - *RBC Capital Markets - Analyst*

Thanks and good morning. Just looking at the level of growth margin gains in the quarter, certainly on a sequential basis, it seemed to moderate a little, and recognizing that trees can't grow to heaven, but wondering about the impact of the shift in Easter and the vendor program, and whether we might see that come back in Q2.

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Irene, it's Allan. You saw, I think, Sarah replied that clearly there was some timing issues on some of the promo (inaudible) and vendors for Easter just because of the timing. These things sometimes come through, sometimes they don't. I guess you'll have to wait and see.

But the big thing on our margin, how we've been able to grow the margin, is really the thing to focus on, which is the fundamentals. And the fundamentals of being, one, really trying to improve the control around profitability, and that continues to happen. Clearly, that plays a big part in this. And secondly, you've seen our shrink, which has had a lot of folks in the business continue to edge forward on that. And thirdly, general merchandise in terms of contribution and in terms of gross margin is beginning to play the role that it should play in the business. And so I focus on the fundamentals rather than stuff that happens in terms of timing.

Irene Nattel - *RBC Capital Markets - Analyst*

It makes a lot of sense. And if we think about private label profitability and shrink, where are we on a scale of 1 to 10 with those two initiatives?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

You know I'm a low scorer. On control of our profitability, we're with probably a 6 now, and on shrink, in my view, we're probably a 5 or a 6.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. And if we could, for a moment, turn to the financial services area. Obviously, first time that we're getting more robust disclosure. And just wondering how we should think about the evolution of that segment as we go through the year. Presumably, you are targeting growth and not declines?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Oh, no, absolutely. It's a very good question, so I'd think about it. As you know, we believe this is one of the areas that we can grow in the business with some impact. It's one of those four or five areas which we can get behind. And we've spent a period of time, I think, as I said it before, where we've really consolidated that business. And I've made sure that we have a very high credit quality in the customer base that we've got. And now I think, having learned how to do that, we've now got the opportunity to really grow that. So a lot of the declining operating income is as we invest in this business. And you can expect, certainly for the next 12 months, that to continue to happen.

We've got 1.3 million credit card customers. We think that we can improve on that significantly and maintain the high credit quality that we've got. It's worth remembering that our customers on our credit cards spend twice what the average spends. And so it's a very important piece for us. We've got 1.3 million banking customers, which we think we can improve on. We've just started a big program of almost doubling up the number of interceptors in the stores, and that's been very successful.

Our new customer growth is up about 80% on a year ago. So we're beginning to lay a foundation here for something of some scale.

The other thing you'll see us doing is the pavilions in the stores, in the core stores. We've come up with a smaller version called Pavilion Light that will probably enable us to double the number of pavilions that we have in our store, and you'll see that come through.

And also a big part of this is our focus on mobile. As you know, I use Tesco as a model. Tesco, a very big mobile business in the UK. We think that we should be able to emulate that. And in the last quarter, we've put in 530 mobile end caps in our stores. So you should really start to see this business beginning to ramp up in terms of its activity, but it's a business that we're going to invest in, certainly in the next 12 months, to make sure that we get the ramp-up that we're looking for. So we're very excited about it.

Irene Nattel - *RBC Capital Markets - Analyst*

And just on that subject, Allan, a final question. I think that there is some skepticism, given how well developed the Canadian mobile offering is, as to the kind of traction that you're going to be able to get. So could you just talk a little bit about what happens when you put those 530 end caps in, and generally speaking, who is the customer base that you're attracting?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Well, two things. First of all, remember we know something about retail. We're retailers of this. It's a slightly different proposition. Generally, what happens, the customer base is our own customer base, that the great opportunity for this business is this conversion of this customer base to sell more products to the existing customer base. So that's very much where we are (inaudible) to date. And without giving too much away, because I wouldn't want to do that, you could imagine that the sales impact from these new mobile shops, with a much more enhanced range of product that's being sold, is very significant.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. Thank you.

Operator

Michael Van Aelst, TD Newcrest.

Unidentified Participant

Oh, good morning. It's [Dakshi Derk] standing in for Mike. Just wondering, is incremental IT spend front-end loaded, or are you going to be spending more than you planned?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

No, we'll spend what we planned within -- there's always a bit of space to move around. But generally, the direction is we'll spend what we said we would do. It is slightly front-end loaded, as you can see. It's to do with basically accruing for a couple of DCs that are going to be closed, which we've announced, sent the announcement out to crew. So you should assume that it was a bit lumpy in Q1 because of that. But if you look at the guidance we gave you for the year, that's pretty good guidance, and I'd spread it through the year. Clearly, a bit more in the second half, because Q3, I think, is a four-period quarter. So it's still a good number to work to.

Unidentified Participant

Okay, thanks. And is the rest of the new general merchandise offering in the stores, and how the new offering doing as a whole?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Still working its way through. As I say, the 21 right-hand side stores are the ones where most of the focus has been, where I'd guess that Joe would say probably 70% of the way where he needs to be in terms of range. You know, there's long lead times on these things. And as I said, the results that we've seen from those stores versus the non-right-hand-side stores, for want of a better way of thinking about it, are pretty promising.

Unidentified Participant

Okay, thanks, guys.

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Operator

Chris Li, Bank of America.

Chris Li - *BofA Merrill Lynch - Analyst*

Just on the IT spend, I just want to confirm your guidance for the year is CAD135 million, correct?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Yes.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. And just reading the MD&A, I think you'd provide some disclosure about the incremental expense of CAD43 million, and then I think CAD16 million is the distribution network and CAD13 million is D&A?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Yes.

Chris Li - *BofA Merrill Lynch - Analyst*

Where's the other CAD14 million?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

Okay, so the way, the balance of CAD43 million incremental costs in the quarter. CAD16 million was the DC network changes. CAD13 million was D&A, and the balance of CAD14 million, that's specifically cash expenses. So it's not -- that would be related to the systems and infrastructure expenses.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay, so with the exception of CAD13 million in D&A, the rest would have been in the operating expense line?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Yes, think about it --

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

That's right.

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Think about it as SAP.

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

That's right. CAD13 million in D&A and then the rest would be in operating expenses, yes.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay, great. And Allan, I was wondering if you can give us an update on the initiatives that you're doing to grow your pharmacy business.

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

They're much the same. Actually, there's quite a lot of systems work that's been taking place over the last six months, which enables us to be much more efficient in the way in which we dispense, basically. And it's allowed more time to be spent face to face with the customer as opposed to doing administration, which is where we were before. So there's been a lot of operational work behind the scenes that frees up people's time to go do that.

As you know, we've extended the opening hours of a large number of our pharmacies. A lot of the renovations have an impact on basically pharmacy space and drugstore space and layout. That's really beginning to make a bit of difference.

And we've been into trade in a slightly more different ring. The ring is slightly less promotional than it's been in the past, because sometimes it can be very, very busy. And actually, what people want is to make sure the products are there all of the time. So there are four of the things that we've really been focused on to do that, and are very pleased with what's been happening to our script performance, particularly, which is really the thing that we focus on there. It all, as you know, gets a bit disguised by the fact that we've got still a lot of deflation in the category, but Michael Lovsin has been running that business now for the last quarter and a bit, and we can see the impact that he's having on that business.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay, great. My last question is, I know you had to reclassify your D&A and interest expense because of IFRS for this year? Can you give us maybe some direction in terms of how much those items will be for the full year, just more for modeling purposes?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

I'm going to hand this to Sarah.

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

Okay, so I'm not going to give you a guidance on what the dollar amount will be for the year, but what I can say is there's nothing unusual in either one in Q1. So I think if you just use that as a proxy, I would say D&A might go up a bit, because we would have had ramped expenses in capital at the end of last year, but interest is pretty stable for the year, and Q1 is representative.

Chris Li - *BofA Merrill Lynch - Analyst*

Thank you very much.

Operator

Winston Lee, Credit Suisse.

Winston Lee - *Credit Suisse - Analyst*

Allan, you mentioned food sales growth as being relatively flat. I wondered, on the volume side, what's happened there and if there was any kind of regional issue there or if it was by format, more discount versus conventional, like how we might think of the volume growing or not growing between the regions or those two formats, if you will?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Well, let me give you a bit of color without being specific. I think that this trend towards our discount and superstore for the profession still exists. And so that's something that's very much there. I think the way, sort of about what's changed the most, actually, there's not a lot, in terms of volume, not a lot of change. The items are pretty much where they were. The basket sizes are actually up. And the interesting thing, which I think is driven by two things, actually, is what we've seen a minor change in is frequency of shop. And I think that is driven by two things. One is I think that -- this point I made about fuel costs -- it's biting. And it is having an impact on the people's frequency of, shopping frequency, I think quite a lot of things.

And then I think the second piece of that is if you read a lot of the research that's been done recently on consumer behavior -- and actually, I think I was reading a couple that came out in the last few days -- where clearly, as people are spending their money and taking the debt down and also trying to spend slightly less money, because fuel is taking up so much of an increment, that you can see that people are saying that they are shopping les frequently and spending a little less money on groceries. And I think that's really the thing to think about.

As I say, as always, we would like it if we had a bit more sales and a bit more volume, but not at any price and not an any cost. And the point I made about this balancing between, as I describe it, sales for vanity and profits for sanity getting more acute, it is. It's actually getting a bit more difficult to do. But you can start to see just some subtle changes in the way that consumers are behaving.

Winston Lee - *Credit Suisse - Analyst*

When you think about this move from discount, or I guess solidifying the discount/conventional, and you've had some charges this quarter on that, is there not enough discount, from your perspective, in certain regions of the country? You're rolling out Nofrills, generally, outside of Ontario, and I'm wondering, is that just because there aren't enough discounts (inaudible)?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

No, I'm biased, of course. I think Nofrills one of the best discount banners in the world, and certainly the best discount banner in Canada, and has the scale and everything that you need, really, to make those businesses pop. And so no, I don't think it's to do with -- I think, actually, the distribution is okay. And we're increasing that distribution.

You also think about it, with all our superstore plays, particularly in the west. So we will add to our distribution the network of our discount businesses. But I don't think that there's necessarily a spread issue, that we're not on and don't have plans to address in some way, shape or form.

Winston Lee - *Credit Suisse - Analyst*

Okay. And I just want to ask you about what your thoughts were about retail inflation and wholesale inflation. You know, when I look at the government data, it's indicating that there's a negative spread, there were wholesale prices have gone up faster than retail. And what we wonder is are you seeing that at times in your quarter? Do you think the industry is -- I know it looks like you're not seeing it for the quarter as a whole, because your gross margin expanded. But is it your sense that there are some in the industry that do feel and have experiences, and continue to experience, this negative spread?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

I think there's a bit of it. I've been thinking about this inflation, because it is the thing which is, in many ways, worries me the most. But it is very peaky. Actually, there isn't yet a passive. And so most of the inflation that we see is in fresh rather than ambient. And that is very peaky, because a couple of months back, we'd have had inflation in produce. Months later we'd have no inflation in produce. So it is more fresh-driven, and it is a bit -- you know, I described it as peaky, because sometimes it's there, sometimes it's not, depending on, again, where we're buying. And then there's been supply issues, too, on the back of that.

And so it's very difficult to tell. My sense is that there's a bit of pressure beginning to build on pricing in ambient and grocery, but nothing of any great significance. And we're still combating the thing which we said before, which is everyone will just put prices up and then promote it all back down again, because that isn't the way forward.

So I think we're trying to be very balanced. We're very aware. We hold a very good value position in the marketplace. Nofrills does have the lowest prices in the marketplace. Our superstore does have the lowest prices in the marketplace. And our other banners are very competitively priced. So the art here is to maintain the price position and not to let inflation get too far carried away. And I think we play a big role in that. I think we're playing that role well.

Winston Lee - *Credit Suisse - Analyst*

I agree. Just a last question on here for, if I could, towards Sarah. Things have changed, it seems, from the last time we had a session. And I guess we're going from a preliminarily, like a 2010 restated earnings reduction to not much, actually -- what's been the differences now that you've been able to finalize?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

Yes, there's only really in two areas where we've had, which were the two most complicated sections, which were related to impairment. So the impairment in Q4 of 2010, the original assessment, was higher than what we have now. And then a small adjustment related to the investments in franchisees. Those were the two pieces. And I think none of them, not much in Q1 of 2010, but more back end. So hopefully, the new information will be able to give you an idea of what's happening for the rest of the year.

Winston Lee - *Credit Suisse - Analyst*

And I remember EBITDA was unchanged before on a preliminary basis. Is that still the case here?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

The margin's actually higher under IFRS, so the EBITDA margin. So if you look at Q1 of last year, it was 5.9%. It's now moved to 6.2%. And so there is some, that you should expect that, that EBITDA margin will be slightly higher. EBITDA dollars are pretty equal.

Winston Lee - *Credit Suisse - Analyst*

Sorry, but EBITDA margin dollars for the whole year? I thought there was a Q1 spike up on the preliminary, but -- .

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

EBITDA margin is higher under IFRS.

Winston Lee - *Credit Suisse - Analyst*

It is higher, still, for EBITDA. Okay, I appreciate that. Thanks.

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

To make a change in IFRS is that we now send 90 pages out instead of 10, and Sarah gets to talk five minutes as opposed to one minute. These are the major changes.

Winston Lee - *Credit Suisse - Analyst*

Thanks. We appreciate that.

Operator

Peter Sklar, BMO Capital Markets.

Peter Sklar - *BMO Capital Markets - Analyst*

Just back to your inflation. You described the inflation you're experiencing at retail as modest, average, quarterly internal food price inflation. I'm just wondering if you could be a little more specific. Does that mean 1% inflation or 0.5%?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Good try, but you know we never give numbers.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. Next, on the incremental IT spend, make some comments on what the outlook is for 2012. I believe last quarter, Allan, your thought was that these costs would peak in 2012, implying that 2012 would exceed the cost level in 2011.

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

I think that's a good assumption.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And back to these inflation trends and what you're seeing from your suppliers, how do you think the strong Canadian dollar is impacting your cost of merchandise? Do you think that's having a favorable effect and it's shielding you somewhat from these cost pressures?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Yes, but I think it's worth pointing out, I think the Canadian dollar had less impact on our margin in Q1 of this year than it did Q1 a year ago. So it obviously helps, but on a year-on-year comparator, it's actually less this year than last.

Peter Sklar - *BMO Capital Markets - Analyst*

And Allan, when you talked about your cost of merchandise, you said while you're seeing some peaky cost pressures in fresh, you're not really seeing it in grocery. So what is happening there? Are your suppliers trying to pass, putting through price increases, or you're resisting?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

A bit of everything. It's all in the twirl and hurl of day-to-day trading. Our guys are very focused on the fact that what we don't want to do is create a lot of noise. And putting prices up and then promoting them down just creates work. And so we're trying to get a balance. Clearly, where there are cost pressures on vendors that are very clear, then we try and be helpful. But at the same time, we have to keep one of our eyes very much focused on the consumer proposition. And, as I say, we hold a very strong position in terms of value in Canada, and our intent is to continue to do that.

Peter Sklar - *BMO Capital Markets - Analyst*

Right, okay. And lastly, Sarah, in the MD&A when you were talking about the improvement in your operating margin, you talked about one of the contributing factors was the performance of the Company's franchise business. Is that because the franchisees are just benefiting from stronger operating results, or has there been a structural change in the way you deal with your franchisees?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

It's related to their operating results, the performance of the franchisees. Their own operating results were better.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. Thanks very much.

Operator

Keith Howlett, Desjardins Securities.

Keith Howlett - *Desjardins Securities - Analyst*

Yes, I had a question on the general merchandise program. The 21 stores that are a pilot test -- what is the number of stores that test would apply to, should it work?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Our scale, probably 150 to 160. We're looking at the largest stores, so probably a scale of 150 to 160. And then there will be light versions, for want of a better description, that probably go to another couple of hundred.

Keith Howlett - *Desjardins Securities - Analyst*

And will there be a different model in Ontario and Quebec than there is in western Canada in terms of that general merchandise assortment?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Maybe a different mix. I think that's the way to think about it. The idea is the same idea, but with slightly different focus on some different -- assortment may be marginally different, and probably promotional approach and frequency may be different.

Keith Howlett - *Desjardins Securities - Analyst*

Great, thanks. And on the food business, I don't know whether I'm imagining it, but it seems to me there's some SKU rationalization of national brands in your stores. I know you went through a process on private label SKU rationalization. Is there some similar program on now on national brands?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

No, that's not in the normal course of business. So there's not a major program that's taking the SKUs down. A lot of the (inaudible) are doing category reviews, which they do, and it may well be that a number of categories have been reviewed recently where that had the effect. I think we have too many SKUs by some way, but the category guys are there to manage that.

Keith Howlett - *Desjardins Securities - Analyst*

In terms of the supply chain, the general move to warehouse versus direct to store, can you update us where you are on that and whether that's complete?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Not complete yet, because clearly, we're still in the process of rationalizing and opening the DC structure. This year's a pretty big year of that, and then the following year. So it's probably going to be, because flow plays quite a big part in that as well, so it's probably another 18 months of program to go to get us to where we are. But I think, if you asked Peter Cantley, he would say that he thinks he's in pretty good shape in terms of where he needs to be.

Keith Howlett - *Desjardins Securities - Analyst*

And in terms of the transportation system and savings, do they tie to that flow, or are you getting a lot of benefit already on transportation?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

We get some benefit -- unfortunately, fuel is not very helpful at the moment, but actually, when you look at the real productivity that we're getting from the transport system, we get that today and have been getting it as we roll the thing out. That's the great thing about it. Our routing around trucks is much more efficient. The routing of picking up vendors that go through that is much more efficient, so we're traveling less miles. And obviously, the queues on our trucks, too. As you know, I'm a big believer that all the money in the food retail business is made in the supply chain, and that's why we're very focused on it. And we can see the benefits in terms of the transport and queue and miles, and we're really going to see the benefits in labor productivity, too. So, so far, that business and that supply chain program has delivered exactly what it said on the cam.

Keith Howlett - *Desjardins Securities - Analyst*

And then just on the SAP implementation, the terms "maximum risk" haven't been used in the last couple of quarters, but I know the merchandising implementation is ongoing. Can you just speak as to where we are on the risk level and then perhaps whether your successor is as versed in SAP as you are?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Well, first, thanks for reminding us. I should say we're in the period of maximum risk. So I've got through that part of it. The reason we don't mention it is it is becoming a bit of the way we have to do things around here, and touch wood, we are much better at implementing these things. The merchandising piece is the big piece. So far, it's been okay. The fundamental issue is this data. I've always said we have the world's worst data. We do, and cleaning it up is one thing, and then protecting the data integrity is the other thing. So that's what everybody is very focused on.

Vicente is clearly SAP aware and systems aware, but Peter McMahon and the team here really run all of that now. Peter's been doing it for five years, and the team we've got here have been doing it for the last 18 months. So we very much look to that team to be able to do this for us from a systems perspective. But importantly, the divisional heads -- Sarah, Brock, Calvin, Mark -- they are very responsible, too. It's their SAP programs which IT supports, not ITSE programs that they support.

So we're just in better shape, better structure, better focused to be able to do this.

Keith Howlett - *Desjardins Securities - Analyst*

Great. Thanks very much.

Operator

Irene Nattel, RBC.

Irene Nattel - *RBC Capital Markets - Analyst*

Allan, just coming back to this whole inflation issue, I think what everyone is really trying to get at is, are you absorbing price increases because you are unable to pass them on to the consumer?

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

No. You never do that. You never think about it that way around. But what we do is we have a price position that we like to deliver in each one of our businesses. And that is what drives what we do. And so we put price increases through generally because there's a reason that they should be put through. And so we're absorbing a bit, but when necessary, we put it through. And that's why I say it's very peaky. The question you're asking is the same question I'm trying to ask myself, which is, "Where do I think all this is going to end up?" Because if I'm you, then life would be a lot easier. And as I say, the way to think about it is fresh is where it's most volatile at the moment, and that generally comes from the cost phase, which to a degree you have to push through.

But as I say, the key thing here is 2% or 3% inflation in these businesses is generally a good thing, because it covers your cost premium. When it gets north of that, then it starts to make things difficult. And if you look at the markets around the world, that's what's started to happen. And that's something that we are very conscious of and have got to try and be part of preventing happening in Canada.

Irene Nattel - *RBC Capital Markets - Analyst*

Presumably, though, that the suppliers are also aware of the difference between 2% to 3% and 5% and are doing what they can, because they don't want to see volumes go down, either.

Allan Leighton - *Loblaw Cos. Ltd. - President, Deputy Chairman*

Yes, I think it's a bit easier. I've been on both sides of the fence. It's a bit easier, actually, from a vendor perspective, because you've just got that small group of products. Remember what we do is that our customer sees it across their whole basket. And that's the thing to really measure. And it is. We can all try and fly shy from it, but all of the consumer stuff that's been done and all the research says that people are tightening their belts, and this household debt thing has become an issue. People decide to pay that down. Fuel is biting everybody.

And so I think it's uncertain times. But it's been uncertain for a long period of time. We've lived with a period of deflation. You know, everybody talks about inflation in food. There's been deflation in our business for more than 12 months. And so now, the art is not to go from deflation to what I describe as high inflation; it's to find the happy balance. And it's that word "balance" that everybody keeps coming back to. And that's what all businesses are really focused on at the moment, is what is the right balance for that business in today's conditions?

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. Thank you.

Operator

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

Kim Lee - *Loblaw Cos. Ltd. - VP IR*

Thanks. That concludes our call. Our AGM is tomorrow. I look forward to seeing you all there. Thanks, and have a great day.

Operator

And this concludes today's conference call. You may now disconnect.