

# FINAL TRANSCRIPT

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## **L.TO - Q1 2009 Loblaw Companies Earnings Conference Call**

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May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

## CORPORATE PARTICIPANTS

**Inge van den Berg**

*Loblaw Companies - VP, Public Affairs & Investor Relations*

**Galen Weston**

*Loblaw Companies - Executive Chairman*

**Bob Vaux**

*Loblaw Companies - CFO*

**Allan Leighton**

*Loblaw Companies - President & Deputy Chairman*

**Frank Rochetti**

*Loblaw Companies - CMO*

**Dalton Philips**

*Loblaw Companies - COO*

**Sarah Davis**

*Loblaw Companies - EVP, Finance*

## CONFERENCE CALL PARTICIPANTS

**Perry Caicco**

*CIBC World Markets - Analyst*

**Irene Nattel**

*RBC Capital Markets - Analyst*

**Michael Van Aelst**

*TD Newcrest - Analyst*

**Jim Durran**

*National Bank Financial - Analyst*

**Patricia Baker**

*Scotia Capital - Analyst*

**Winston Lee**

*Credit Suisse - Analyst*

**David Hartley**

*BMO Capital Markets - Analyst*

**Keith Howlett**

*Desjardins Securities - Analyst*

## PRESENTATION

**Operator**

Good morning, ladies and gentlemen and thank you for standing by. Welcome to the Loblaw Companies Limited first-quarter results conference call. At this time all, participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at the time for you to queue up for questions. (Operator Instructions). I would like to remind everyone that this conference call is being recorded on Tuesday, May 5, 2009 at 11 a.m. Eastern time and will now turn the conference over to Inge van den Berg, Vice President, Public Affairs and Investor Relations. Please go ahead.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Inge van den Berg** - Loblaw Companies - VP, Public Affairs & Investor Relations

Good morning and welcome to the Loblaw Companies Limited first-quarter conference call. This call is also being webcast simultaneously on our website, [www.loblaw.ca](http://www.loblaw.ca). I am joined here this morning by Galen G. Weston, Executive Chairman; Allan Leighton, President and Deputy Chairman; Dalton Philips, Chief Operating Officer; Frank Rochetti, Chief Merchandising Officer; Bob Vaux, Chief Financial Officer and Sarah Davis, Executive Vice President, Finance.

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 2009 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 reports. Any forward-looking statements speak only as of the day they are made. The Company disclaims any intentions 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 measure. Our first-quarter reports, as well as the archive of this conference call, will be available on our website. I will now turn the call over to Galen Weston.

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**Galen Weston** - Loblaw Companies - Executive Chairman

Good morning. Thank you for joining us today. We are pleased with our Q1 performance. Along with the rest of the food industry, our results have benefited from food price inflation. Our focus remains on consistent execution while undertaking aggressive store renovation and infrastructure programs. The remainder of 2009 could see inflation unwind and more volatility in the economy; therefore, we've remained cautious and prepared for continuing challenges. Now I will turn the call over to Bob Vaux to discuss our financial performance.

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**Bob Vaux** - Loblaw Companies - CFO

Good morning. Total sales in the first quarter of 2009 increased by 2.9% to C\$6.7 billion while same-store sales increased 2.1%. A number of factors are highlighted in the Q1 release, which affected sales growth comparables relative to Q1 of last year. These included the sale of the Company's food service business late last year, the timing of the New Year's and Easter holidays and the strike at certain Maxi stores in Quebec. Excluding these items, sales growth and same-store sales growth were 4.5% and 3.2% respectively.

Sales growth was strong in both food and drug store. Apparel sales growth was moderate while sales of other general merchandise declined significantly, primarily due to reductions in consumer spending, the timing of Easter and the continued reduction in assortment and square footage. Gas bar sales declined as a result of lower fuel prices despite moderate volume growth.

National food price inflation, as measured by the consumer price index for food purchased from stores, was 9% in the first quarter of '09. Our internal retail food price inflation was lower than CPI for food and lower than our internal retail food price inflation in the fourth quarter of 2008. In addition, I will remind you that we experienced food price deflation in the first quarter of last year.

Gross profit in the first quarter was C\$1.6 billion, or 24% of sales, versus C\$1.5 billion, or 22.8% of sales in the first quarter of last year. The improvement was largely due to our focus on cost reduction, including initiatives to reduce shrink, buying synergies

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

and more disciplined vendor management. Sales mix, successful promotional campaigns and inflation also contributed to the improvements.

Operating income was C\$226 million for the first quarter compared to the C\$156 million in Q1 '08. Operating margin was 3.4% compared to 2.4% in Q1 last year. The increase in operating income was mainly due to improved gross profit and lower net stock-based compensation costs, partially offset by the incremental investment in supply chain and information technology.

Loblaw realized first-quarter basic net earnings per common share of C\$0.40 compared with C\$0.23 for the same period last year. The Company discontinued its use of the non-GAAP measure of free cash flow in the first quarter and going forward will address the change in net debt.

Unlike free cash flow, the change in net debt includes all factors impacting cash flow and we believe it is a better reflection of cash flow performance. We also changed the definition of net debt to include the fair value of financial derivative assets and liabilities, which we believe reflects more accurately the economic net debt of the business.

Net debt at the end of Q1 2009 was about C\$3.6 billion compared to 4.1 billion at the end of Q1 '08, a decrease of about C\$500 million, in part due to the preferred share equity issue we did last year. Net debt increased C\$293 million in the first quarter of 2009 relative to year-end 2008. The increase is attributable to changes in working capital requirements and is directionally comparable to Q1 2008.

We are continuing to invest in renovations to our existing store base and in upgrading our information technology and supply chain infrastructure. During the quarter, we invested C\$123 million in capital. Operator, we would now like to open the call to questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions). Perry Caicco, CIBC.

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### Perry Caicco - CIBC World Markets - Analyst

Thanks, good morning. A couple of questions. First of all, I'm wondering if there is any way to help us quantify the impact on your same-store sales from the decline in general merchandise sales. I mean a significant portion of that is probably planned decline, so it would just help if we could get a handle on the impact now and how you see that decline being managed over the next few quarters.

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### Allan Leighton - Loblaw Companies - President & Deputy Chairman

Yes, Perry. It's Allan. Good morning to you. Two things I think to think about. First of all, the general merchandise sales growth or decline was sort of accelerated in this quarter for a couple of reasons. One, which -- the sort of general economic conditions, as you know, are not helping general merchandise. If you look at all the general merchandise retailers in Canada and around the world, they are all having a pretty difficult time. And therefore, that reflects back to us too in our general merchandise business.

As you know, we are scaling back that business and making it much more focused business than it has been in the past. So there is an element of that, but that is really a continuation of where we have been. The biggest change I think was primarily driven by the change in economic conditions.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

And the other thing worth thinking about Perry, which I will put on is, of course, gas, which I guess you can sort of put into that sort of category. Our gas volumes are okay, but our cash sales are down very significantly, probably close to 0.8% impact on our comp sales versus a year ago.

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**Perry Caicco** - CIBC World Markets - Analyst

And Allan, how long do you think the managed decline in general merchandise will impact your same-store sales?

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**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Probably right through to Q4 of this year.

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**Perry Caicco** - CIBC World Markets - Analyst

Okay. And then my second question is around gross margins. They improved significantly in the quarter and you mentioned several factors. Just want you to expand a bit on those -- what do you mean by buying synergies and disciplined better management and then how exactly did inflation contribute to the improvement in gross margin?

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**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Well, a couple of points really. First of all, I think we have made the comment our food and drug sales were pretty strong actually and we are pretty pleased with those. So clearly, that makes a big impact in terms of our gross margin.

The second thing, clearly, the fact that our gas sales go down has an impact too in terms of gross margin. Shrink is also in that number. So as you know, the way that that number is defined and our shrink performance was also very good. Inflation does play a role. As you know, inflation is the retailer's friend. I think I have said to you before, food inflation in Canada is as high as it has been for 27 years. Most of the food retailers in Canada and around the world are showing pretty good quarter ones and that is not a coincidence because clearly prices are being passed through more so than probably in the past.

And then there is a benefit for us. We have been a year and a bit at a sort of centralized structure in terms of buying and merchandising and we are beginning to get some real efficiencies from that. So it is sort of a combination of all of those things, but I wouldn't underplay inflation. Inflation always plays a big role. My experience of these things is when inflation is high, then gross margins improve. When inflation falls away, often the reverse is the case.

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**Perry Caicco** - CIBC World Markets - Analyst

That's good for now. Thank you.

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**Operator**

Irene Nattel, RBC Capital Markets.

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**Irene Nattel** - RBC Capital Markets - Analyst

Thank you. Allan, as you were going through the things that had contributed to the improvement in gross margins, one of the things that you didn't mention was change in your stance around promotional activities. Could you talk a little bit about where you sit with that right now?

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

I have not changed very -- compared to where we were a year ago, we are in a very different place versus Q1 a year ago, but our stance has always been the same. We have got -- we have a price position, which we feel pretty comfortable about and is exactly where we need it to be. Our promotional activity is clearly less intense than it was a year ago from a pricing perspective, but actually it is still pretty aggressive. And as you know, we have moved much more to event-type programs, which tend to have generally a relatively positive effect on gross margin because it enhances the mix, volume and all that. So I think it plays a part, but as I say, the bigger part I think has come from the things that I mentioned earlier on.

**Irene Nattel** - RBC Capital Markets - Analyst

That's very helpful. If we could just take a step back, a number of retailers are talking about changes that they are seeing in terms of consumer spending patterns. Could you talk, other than the shift away from general merchandise, could you talk a little bit about what you are seeing in terms of private label, any shift from traditional to discount and any other category changes that you are seeing?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Well, I think the general merchandise one and the euro, I mean I think that is a big deal. And you can see in (inaudible) and everybody else's numbers that that is now pretty significant. The rest of it has been trending where it has been, Irene. There is a bit more trading into the discount -- into the discount banners. There is a bit more trading into control label. PC, in our business, is doing better than the national brands.

And then you can see -- so you take some product -- water is a classic where that has become very discretionary, bottled water and therefore, you have got quite significant volume declines in that type of product. Some of the deli area, some of the added value produce areas. And then there is a bit -- across Canada, it is pretty similar. Southern Ontario I think is probably more -- there is more of a trend of trading down I think in southern Ontario where the economic situation is pretty bad. So continuation of where we have been I think.

**Irene Nattel** - RBC Capital Markets - Analyst

That's great. Thank you.

**Operator**

Michael Van Aelst, TD Newcrest.

**Michael Van Aelst** - TD Newcrest - Analyst

Hi, good morning. Good numbers. I just wanted to get back on the gross margin a little bit more. And if I look at Q4 versus Q1, you had similar inflation rates, so that really shouldn't have had a big impact. But your margins were substantially higher in Q1 and you are kind of at that 6% level almost if you fully adjust for all the items that might not be here in a few years. And that is kind of the level that you are hoping to be at at the end of your three to five-year restructuring. So I guess the question is how should we look at this from a sustainability standpoint? Do you think that the Q1 run rate is reasonable or were there some other items from Q4 to Q1 that might not be recurring?

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Well, I mean my number one thing (inaudible) anybody want to get ahead of themselves. This is an okay period, which is a continuation of where we have been, i.e., more of the basics are getting right. But it is flat by inflation. And I guess that there is sort of -- the way to think about it, the way I think about it is you have to really decide what you think is going to happen in the second half of the year. And I am a hawk on two fronts. I am a hawk on inflation because I think it unwinds. And in the same way that inflation is the retailer's friend, deflation is not the retailer's friend.

And then secondly, I think it all depends on how you feel about the economy and although there is some noise around things being more encouraging, I am not sure that that is really going to translate its way through. And I think the consumer behavior actually lags that data and I just feel that the economy could still be more volatile.

So the way we think about these numbers is that they are okay and they are a continuation of where we have been and a number of the basics that we have been working on are continuing to progress in a steady way, not in any significant way, but we are very cautious about what happens when inflation unwinds in the second half.

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**Michael Van Aelst** - TD Newcrest - Analyst

I understand what you're saying, but it just seems that usually Q4 historically, other than maybe the last couple of years, has been a stronger margin period and the inflation was similar in Q4 and Q1. So when you look at that, why would you see such a big increase from Q4 to Q1?

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**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Again, I think going back to the same things, it is a -- we have got clearly a stronger food and drug business in Q1 than we did have in Q4 and you have to remember those two businesses are the engine that drives our sales. Our shrink performance also was pretty good in P1 and where I have been before, we are beginning -- it's another quarter further on of the central merchandising group and they are becoming much smarter and much better in the way we execute things.

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**Michael Van Aelst** - TD Newcrest - Analyst

Okay. And just on the shrink, that is an area where it seems like it was pretty good in Q3 and then maybe not as good in Q4 and now looks quite strong in Q1. Are there processes in place right now where you think the shrink might -- performance might stabilize or are we going to continue to see some volatility there?

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**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

I think you've always got a bit of volatility and shrink, but Dalton and the team have a very clear plan to bring it down. As you know, we also have very high shrink. We are now getting our shrink down to levels which are more the norm. We think there is still some way to go, but you always, to a degree, get a bit of volatility in it.

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**Michael Van Aelst** - TD Newcrest - Analyst

Thank you.

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**Operator**

Jim Durran, National Bank Financial.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Jim Durran** - National Bank Financial - Analyst

Yes, just go back up to the [concert] sales number for the quarter. So last quarter, you sort of gave us an idea about how basket and traffic, etc. were performing. Wonder if you could give us an update on how it behaved this quarter. And last quarter, I think your commentary was that you were pleased with your, we will call it volume as a proxy performance versus the inflation driver to comps. How did you feel about this quarter?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Well, as you know, we don't give inflation numbers, but let me tell you our sort of -- our customer count is up and our baskets are up. I would think if you look at our volume, the best way to look at it if you look at item count, is probably down a tad. So that is the sort of context. It has sort of not very much changed, except for, as I say, (inaudible) count is up, basket size is up and item count down a tad.

**Jim Durran** - National Bank Financial - Analyst

Okay. And you are indicating that your measured inflation was lower in Q1 than it was in Q4. That is different than what we have seen from Sobeys and Metro, although the timeframes aren't exactly the same. Would we be wrong in interpreting that as you having lowered prices quarter over quarter? Or is there some other factor that would have contributed to your inflation dropping quarter over quarter?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Well, two things. I mean clearly inflation has got many (inaudible), but you are really comparing that's where you were the year before. I think the whole -- the one thing we understand is our own inflation. We see the other numbers that people use on their inflation. As you know, the CPI number is nine. So there is a huge gap somewhere, which no doubt somebody in some stage will be able to explain. My view, for what it is worth, is basically the inflation in all of the food retailers is roughly the same because generally it is. So that hopefully gives you a bit of context.

**Jim Durran** - National Bank Financial - Analyst

That's great. Thank you.

**Operator**

Patricia Baker, Scotia Capital.

**Patricia Baker** - Scotia Capital - Analyst

Good morning. Allan, I just want to follow up a little bit on the discussion that Michael had started in your answer to his question. You referenced that this quarter to you guys was an okay quarter. I think there is probably nobody on the conference call that doesn't see this quarter as a pretty big surprise quarter. It was quite robust, very good performance. What was there in the quarter for you guys that might have surprised you? Was it really just as you would have expected as you moved through the quarter?

Did the pace quicken towards the end of the quarter because there seems to be a little bit of a disconnect between what the expectations were and maybe some of the cautionary messages we were getting earlier directed at not extrapolating from the

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

fourth quarter? So if you could just tell us a little bit more about how the quarter progressed and anything that happened in the quarter that surprised you when you came out of it.

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Yes, thanks, Patricia. I mean it is a -- the word sandbagging has been used on a number of occasions. We don't do that. We sort of talk it through as we see it and I actually only do see it as an okay quarter because I keep going back to the same thing. I have been around in these businesses for a long time. And when you have got high inflation, generally all the food retailers perform well.

And it is because, if you have got high inflation, you have generally got good sales numbers and if you have got good sales numbers, they are going to run ahead of where your costs are running. When that flips around, that is a different thing and therefore the real measure for me is what is happening to your volume because that is the only thing that you know is a constant because inflation will come and go and be what it is. So I really do only see it as an okay quarter and it is flattered by inflation and I have always said, we have been edging forward and I still believe that is what we are doing. We are much better than we were a year ago, but we have still got a long way to go in terms of our consistency.

**Patricia Baker** - Scotia Capital - Analyst

Are you a little disappointed by the volume performance in the quarter?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Good question. I think the volume is where I would expect it to be and I think that is the way I would describe it. The volume is a bit where I would expect it to be. I think that, in the marketplace today, perhaps the volume isn't as strong as it would have been six months ago.

**Patricia Baker** - Scotia Capital - Analyst

Okay, that's fair enough. Now, when you talk about --.

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

That is a market point, not a Loblaw point.

**Patricia Baker** - Scotia Capital - Analyst

And back to the discussion on the gross margin because that was the huge driver in the quarter and you called out four or five different contributors to that. And I know you are not going to quantify for us how flattered by inflation the gross profit was, but if we rank ordered them with the shrink improvement, a bigger contribution than the flattered inflation or vice versa?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

I think that you could say the flattered inflation could be 30% of it.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Patricia Baker** - Scotia Capital - Analyst

Okay, good.

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

And then the rest I think is as we talked about before.

**Patricia Baker** - Scotia Capital - Analyst

Okay. Thanks.

**Operator**

Winston Lee, Credit Suisse.

**Winston Lee** - Credit Suisse - Analyst

Thanks. Allan, I just wondered -- you guys used to talk about being six to nine months behind as an effective selling organization and maybe that is rather old now, but I just wondered where you think you are if you can provide us an update. I think you just said you are just kind of moving forward a bit, but is the economy pushing you back given where you thought you would be if the macro picture had been the same over the last year? Or is it more that there are more things to do still just in your organization than you had initially anticipated?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

No, Winston, I think we are exactly where we said we would be. We were about six or nine months behind. We are still that six or nine months behind. We are not going to catch it up. We always said that this was three to five years and it is more likely to be five than it is three. And as I say, the most important thing for me is our consistency and we are still -- we are much more consistent than we were, but we are still pretty inconsistent. We make a lot of progress on a number of areas. Sometimes we are slightly ahead, sometimes we are slightly behind, but nothing has changed in my mind. We are at about the place where I would expect it to be and the most important thing is for us to become more consistent, which we are, but we still have a degree of inconsistency.

**Winston Lee** - Credit Suisse - Analyst

Thank you. And on the Canadian dollar, I know it created a level of double-digit inflation in produce and now we're looking at it and we're wondering where it is going to go. What do you feel about the Canadian dollar? And I know -- if you can remind us how you manage that. Let's see if the Canadian dollar goes back up to parity, I don't think it is going to do it very quickly, but let's say it does. Does that create further pressure for you than just staying at constant level?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Well, two things. First of all, we can't -- I haven't got -- if I knew what was going to happen to the currency, I wouldn't be sitting here having this conversation. I would be baking on a boat in Monte Carlo. So I can't really comment on that. I guess Frank might just talk a little bit about the sort of impact it has. Frank?

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Frank Rochetti** - Loblaw Companies - CMO

Yes, I think you hit it on the head. Produce and obviously general merchandise are most impacted, but we trade daily, particularly in produce, which is much bigger than our GM business. So with the movement into local here, combined with California being a little lighter, to be honest with you, it is a day by day. If it increases, it'll likely diminish some of the inflation in produce would be the impact.

**Winston Lee** - Credit Suisse - Analyst

Could you just remind us or give us some idea of how much your purchasing is done in US dollars? I would've thought GM would have been more the mix in there, but maybe I am wrong.

**Frank Rochetti** - Loblaw Companies - CMO

No, I think the point on GM is when you buy overseas, you trade in US dollars. I would say use a number like 20%.

**Winston Lee** - Credit Suisse - Analyst

Okay, great. Thank you. And just one question, Bob, on net debt sort of being a greater focus rather than free cash flow. Do you have some objective for net debt or will you be able to provide one at a later date in terms of where you would like to be?

**Bob Vaux** - Loblaw Companies - CFO

Well, clearly our view is net debt will come down over time. I mean it is really -- the movement in net debt is a function of the operating performance, which I think we've talked to many times that coming out of the work we are doing, we would expect operating performance to be somewhat stronger. And if you take operating performance somewhat stronger than what it is today, take capital at what we see it running forward and the dividend rate, we see ourselves, at some point in time in the future, generating C\$250 million of cash flow, which could, all things being equal, be a reduction in net debt. But that is not this year; that is sometime in the future.

**Winston Lee** - Credit Suisse - Analyst

Okay, that's great. Thanks very much.

**Operator**

David Hartley, BMO Capital Markets.

**David Hartley** - BMO Capital Markets - Analyst

Good morning and thanks for taking my call. Just for clarity sake, when you talk about basket size and unit count, etc., are you talking right across the business or just on the food side?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

I could talk all across the business, but it is roughly the same food as anywhere else.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**David Hartley** - *BMO Capital Markets - Analyst*

Okay. Just in terms of the merchandise business, the decline you saw to your top line from the declines you saw in that section of the business, I mean what was the impact on the profit line? Was it relatively the same, more or less? We will talk about EBITDA margins.

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Well, that is a leading question. And I think you can -- as you know, those businesses, the general merchandise businesses tend to have high gross margins, high costs, low contribution, so depending on which element it is. So I think they are due to work out, but there is a bit of steerage for you.

**David Hartley** - *BMO Capital Markets - Analyst*

Okay, got you. The systems that you are putting in place -- supply chain, IT -- how comfortable are you now with, I guess, your fallback -- parallel systems, etc. -- if you should have some, say, hiccups in the implementation, whether it be this year or next year that you can kind of catch the fall, if you will, with kind of some fail-safe mechanisms, parallel systems, etc.?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Well, comfortable is not a word ever to use in these situations, but we pretty thoroughly planned this. And therefore, if anything like that happened, then I think we'd feel pretty good about our ability to manage it. As you know, we are going with people who have done this before. We are going with pretty plain vanilla and proven systems. And we have sort of got the business owners really driving it and engaging it. So I think the planning behind this has been pretty good and should enable us to move through it as it needs to be done. You always get a couple hiccups on these things, but I think we are feeling pretty confident that we have got a good plan in place.

**David Hartley** - *BMO Capital Markets - Analyst*

Okay and just a few more. Trying to get the volume side of things again, how would you characterize your marketshare gains across, say, food, drug, apparel and merchandise? Or marketshare, maybe not gains?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

I think we would say that we are comfortable with our marketshares, that we have been pretty good in a couple of the regions where we will have gained share. One of the reasons being pretty flat and of course, in Quebec, we would have lost a bit of share because of the strike stores.

**David Hartley** - *BMO Capital Markets - Analyst*

Okay, but other than that, would you say you are holding your own on the food side in terms of marketshare if you took out that impact across Canada?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Well, again, what's the definition of holding your own, as you say?

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**David Hartley** - *BMO Capital Markets - Analyst*

Holding it flat then?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

I think we feel reasonably good with our marketshares.

**David Hartley** - *BMO Capital Markets - Analyst*

Okay. And just last question would be I guess really on management incentives and bonuses. Could you maybe spell out how management will be incented or is incented through this turnaround I guess over the next couple of years? What goals that you are supposed to achieve and how you get paid for those goals?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Well, a good question to ask (inaudible) at the AGM tomorrow, but I mean it is the same way we have always done it. We link -- the management is linked to their individual performances in a year because clearly performance in any one year is important and then they are also linked to a period of time, i.e. the recovery program both in terms of (inaudible) terms of either share options or RSUs. So it is a pretty normal, plain vanilla approach.

**David Hartley** - *BMO Capital Markets - Analyst*

Okay, great. Thanks a lot.

**Operator**

Keith Howlett, Desjardins Securities.

**Keith Howlett** - *Desjardins Securities - Analyst*

Yes, I wondered if you could update us on your in-stock and shopkeeping initiatives.

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Yes, Dalton will do that.

**Dalton Philips** - *Loblaw Companies - COO*

Yes, Keith, we embarked on this two years ago. We have been rolling out this always-available program to the stores, have got about 400 stores now fully on the program. And we are seeing stock improvement in those stores somewhere between 30% and 50% over last year. So massive reduction in hold counts. However, at the same time, our supply chain has made strong improvements in their service levels and we are seeing some of the best service levels that we have witnessed in a long time. So the two of those coming together definitely improving on-shelf availability.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Keith Howlett** - *Desjardins Securities - Analyst*

And in terms of the Joe Fresh square footage additions, where would you be in terms of the number of stores where you have it versus the number where you would like to put it sort of thing?

**Frank Rochetti** - *Loblaw Companies - CMO*

It's Frank. We keep rolling it out across our chain. We fit all our superstores and a bunch of the Great Food stores. So our response to it has been quite good, so we don't really have a net gain in terms of number of stores. But we're fortunate the response has been very strong and so we kind of tailor the assortment to the market and the store size. We are into the hundreds of stores now and it is growing.

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

It's Allan again. We are very -- Joe, we still are very pleased with. We describe the sales as moderate, which they were in the quarter. But compared to everybody else in this industry, they are gaining marketshare and that is very important.

**Keith Howlett** - *Desjardins Securities - Analyst*

And then just in terms of deflation, are you seeing deflation in any category or is there any signs of it starting anywhere?

**Bob Vaux** - *Loblaw Companies - CFO*

I mean with the exception of gas at the moment, obviously it is down considerably. But the year you can think of as kind of two halves and the back half of this year, that is where the risk really resides.

**Keith Howlett** - *Desjardins Securities - Analyst*

Great. And then just in terms of the credit card, are you seeing any big change in net write-off rates or any signs of consumer stress on your cards?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Bob?

**Bob Vaux** - *Loblaw Companies - CFO*

Bankruptcies are up across the board on all credit cards in Canada and ours are basically in line with that and our loan losses are basically in line with what we expected given the current economic environment.

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

But again, we are pleased with the performance of the bank.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Keith Howlett** - *Desjardins Securities - Analyst*

And then just if you could update us on your western Canadian nofrills initiative.

**Dalton Philips** - *Loblaw Companies - COO*

That is absolutely on track. We've got [Bob] on the ground at the moment and doing well and hope we can get another 12 through till the end of this year and making steady progress. And in Q2, as we said at the AGM last year, we will be opening our -- because at the moment, there have been conversions from Extra Foods to nofrills. We will be opening our first greenfield standalone store.

**Keith Howlett** - *Desjardins Securities - Analyst*

And then on the renewal of the traditional conventional store based in Ontario, how is that tracking?

**Unidentified Company Representative**

Very good. Actually we have got a major renovation program going on right across the country and we will be touching up to 300 stores. The genesis of that was our Back to Best program that we talked about and many of those programs, what you will have seen on fish for example or in our service meat cases, many of those programs are rolling out right across the network. It depends on the store obviously.

**Keith Howlett** - *Desjardins Securities - Analyst*

Great. Thanks very much.

**Operator**

Irene Nattel, RBC Capital Markets.

**Irene Nattel** - *RBC Capital Markets - Analyst*

Thanks. You guys have been working very hard for the last couple of years on things like in-store service, on sort of the display in store, particularly in the Great Food stores, the relaunch of PC and really more focused on event-driven promotions. And I am wondering what your consumer perception surveys are telling you. Are consumers noticing? Is there -- are they sort of seeing Loblaw coming back to a destination for Great Food?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

I mean the answer to the question is yes. All our consumer perceptions are, which we track regularly, are moving in the right direction. We hold leadership category with most consumers in most of the banners on most of the things that really count for customer service and they have been improving.

**Irene Nattel** - *RBC Capital Markets - Analyst*

That's great. I would assume that that is not necessarily the case in Quebec?

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Even in Quebec actually. The Maxi banner particularly is, as you know, very strong and Quebec is an interesting market for us because we have had many false starts there. But we have got good programs in Quebec at this moment in time. Sometimes we have to remember, we get too defensive about Quebec. We are the number one retailer in Quebec by some way and we have to remember that and that is an important thing for us to build on.

**Irene Nattel** - RBC Capital Markets - Analyst

That's great. And one just follow-up if I may, Bob or Sarah. If you could just talk a little bit about how the cash management initiative is coming along.

**Sarah Davis** - Loblaw Companies - EVP, Finance

Okay. Good morning, everyone. The cash marathon initiative is coming along quite well. The issue -- the only concern we have got right now is just a higher level of inventory that you would have seen in our Q1. It is higher than it was last year. A lot of that is related to the timing of Easter. It's the big brand event, but that is part of the initiative than we expected to take in Q2 and Q3. Other than that, the rest of the initiatives are pretty much on track.

**Irene Nattel** - RBC Capital Markets - Analyst

That's great. Thank you very much.

**Operator**

Michael Van Aelst, TD Newcrest.

**Michael Van Aelst** - TD Newcrest - Analyst

Just a small one I guess on your equity forward contracts. It looks like you ended up exiting about -- or you will be exiting about a third of them. Can you explain why you're doing that at this time I guess with the price of your stock now increasing?

**Bob Vaux** - Loblaw Companies - CFO

Well, the counterparty on the other side of the equity forwards wanted to lessen their exposure based upon their own situation. And as we looked at them, we could either have them unwind or we could move into another counterparty. And all things considered, we figured that with the two of the things aligning, that we would just lower our exposure to equity forwards and likely, we will move out of them over time. It is not a call on the share price.

**Operator**

David Hartley, BMO Capital Markets.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**David Hartley** - BMO Capital Markets - Analyst

Hi. New store or the new renovations, 300 that you referenced the last couple of quarters, where are they going to be concentrated and is it spread across the country or should I look at it based on your store concentration today?

**Dalton Philips** - Loblaw Companies - COO

David, this is Dalton. It affects our largest stores. So basically 300 of our 400 largest stores in terms of sales are getting some sort of work done on them this year. So it is really right across the country.

**David Hartley** - BMO Capital Markets - Analyst

Okay, great. Also just, Bob or Sarah, if you will, on the tax rate, what are you expecting for the rest of the year and how should we look at it on a quarterly basis?

**Bob Vaux** - Loblaw Companies - CFO

Well, it is difficult to do on a quarterly basis. As you can see, it does tend to move around, but order of magnitude, a 32% tax rate on average for the year is probably pretty good.

**David Hartley** - BMO Capital Markets - Analyst

Okay. And I am just curious about the organization itself. There has been a lot of changes both inside and customer-facing-wise. I am just curious about the engagement of your employees across the organization, morale, that kind of thing. It has come from a pretty bad spot we understand. Where are we today and what is going on within the organization to make changes in that regard?

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

I think we are in a better place today than we were. We have still got a long way to go. This is something that we measure every period and I think it sort of moves around depending on where you are in the organization. But I think we are in much better shape than we were and probably in no different shape to most other companies. Clearly as the business gets better, that makes people feel better.

The biggest thing that we will be able to do, which I think will have the biggest impact on the organization, is the work that we are doing on IT. It is still pretty difficult to get things done because of the archaic nature of our IT and as that improves, I think that will have a significant effect on people in terms of just loosening them up to be able to do many more things. But I think at the moment, people are in pretty good shape.

**David Hartley** - BMO Capital Markets - Analyst

Okay. And just on two more questions. On the IT, you had C\$23 million of costs this quarter. How should I look at the timing of your costs, I guess it is C\$100 million this year, throughout the rest of the year, Bob.

**Bob Vaux** - Loblaw Companies - CFO

It's spread equally.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**David Hartley** - *BMO Capital Markets - Analyst*

Okay. And in terms of your flyer program, there has been a lot of changes. You obviously have a lot of different programs going on week to week, but your flyers have changed a lot. It may even indicate that you are testing things out or trying different things. Could you maybe talk to that a little bit and give us a better understanding, to the extent you can, what you are trying to do there?

**Unidentified Company Representative**

I think there is always work going on with the (inaudible) of the player. Really one of the primary things we're trying to do is to separate our formats to the extent that they are unique. Lots of customers like to shop across all three and there is customers that obviously are a bit more loyal to one and just making sure that our value proposition in each of them is clear. And we have done a bunch of focus groups with our customers to tell us a bit more how to lay them out to make them easier to read and respond to. So that is kind of never-ending work and I think we are making some progress.

**David Hartley** - *BMO Capital Markets - Analyst*

But to the extent you actually have a structure in place as opposed to everything else, is that in place or how far away are you from that and not just with your flyers, but just with store aesthetics, store differentiation, etc.?

**Unidentified Company Representative**

That is all a bit bigger question than the flyer, but I would say that our discount, we have done some good work. nofrills is pretty well-defined. I think we have done a decent job in Great Food and we are still doing some work within our superstore format. Pretty solid out west, play with it. But to be honest with you, creating those three distinct formats is a work in progress and Dalton and I continually are tweaking it.

**David Hartley** - *BMO Capital Markets - Analyst*

Okay, that's helpful. Thank you.

**Operator**

Keith Howlett, Desjardins Securities.

**Keith Howlett** - *Desjardins Securities - Analyst*

Yes, I had a question on the inventory. Is it on your plan and did I understand it is mostly up due to Easter and a great brands program? Was that what I heard?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Yes, that is what you heard. Inventory is up a bit, largely because of timing of Easter, a bit of where we are on general merchandise, but it is not something we are particularly concerned about. What you see is an upside basically.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

**Keith Howlett** - *Desjardins Securities - Analyst*

Sorry, an upside?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Yes, just in terms of -- as our supply chain becomes more efficient, the next phase for us is to take inventory out and therefore, there is a huge upside in that.

**Keith Howlett** - *Desjardins Securities - Analyst*

And on the -- just a couple questions on the formats. How did the converted Loblaws to Maxi and Cie, how is that going on in Montreal?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

We are very encouraged by the progress.

**Keith Howlett** - *Desjardins Securities - Analyst*

And then on the nofrills -- large-format nofrills that you've tried in a few locations here in Toronto, what is your experience with that?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Very encouraged with the progress.

**Keith Howlett** - *Desjardins Securities - Analyst*

Great. Thanks very much.

**Operator**

(Operator Instructions). Michael Van Aelst, TD Newcrest.

**Michael Van Aelst** - *TD Newcrest - Analyst*

Thank you. You talked last quarter about having private label profitability as a focus with new programs or new initiatives to try and improve -- I guess reduce the blurring between the two brands. Is it too early to have seen any of that benefit in this quarter?

**Allan Leighton** - *Loblaw Companies - President & Deputy Chairman*

Probably, yes. The packaging is coming on nicely, but it is probably still three, four months away from actually hitting the stores. We've probably got about 25% to 30% of No Name out there and probably 10% of PC as it works its way through the system.

May. 05. 2009 / 11:00AM, L.TO - Q1 2009 Loblaw Companies Earnings Conference Call

And Frank and Michael and the team are very focused on the profitability because we, again, believe that is something that is an opportunity for us.

**Michael Van Aelst** - TD Newcrest - Analyst

All right. Thank you.

**Operator**

We have no further questions at this time. Please continue.

**Allan Leighton** - Loblaw Companies - President & Deputy Chairman

Yes, just by way of wrap so that people are clear on our view of the performance really. It was an okay quarter, perhaps okay plus. It is flattered by inflation as every food retailer in the world's numbers are flattered by inflation at the moment. We are no different to that. I see a continuation of where we have been. I think it is a year of two halves and I think we have to think about it that way around and we are pretty cautious about inflation unwinding in the second half of the year and the impacts if that happens that would have on the industry and the businesses. So as I say, I think we are okay plus and making progress in the basics, but still cautious for the right reasons. Okay.

**Inge van den Berg** - Loblaw Companies - VP, Public Affairs & Investor Relations

Great. So thanks, everyone, for your time and interest in Loblaw Companies. We'll look forward to speaking with you again on our second-quarter call.

**Operator**

Ladies and gentlemen, this concludes the conference call for today. Thank you for participating and please disconnect your line.

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