

FINAL TRANSCRIPT

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L.TO - Q2 2009 Loblaw Companies Earnings Conference Call

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Loblaw Companies Limited - Executive Chairman

Bob Vaux

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Michael Van Aelst

TD Newcrest - Analyst

Patricia Baker

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Jim Durran

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Keith Howlett

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PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Loblaw Companies Limited second-quarter results conference call. (Operator Instructions). I would like to remind everyone that this conference call is being recorded today, Friday, July 24, 2009, at 11AM Eastern Time.

And I would now like to turn the conference over to Inge van den Berg, Senior Vice President, Corporate Affairs. Please go ahead.

Inge van den Berg - *Loblaw Companies Limited - SVP, Corporate Affairs*

Good morning and welcome to the Loblaw Companies Limited second-quarter conference call. This call is also being webcast simultaneously on our website, www.loblaw.ca. I'm joined here this morning by Galen G. Weston, Executive Chairman; Allan

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Leighton, President and Deputy Chairman; Dalton Philips, Chief Operating 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 expectation. 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 second-quarter earnings release.

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 statement, 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 second-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. Our second-quarter report, 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.

Galen G. Weston - Loblaw Companies Limited - Executive Chairman

Good morning. Thank you for joining us. Let me begin by speaking briefly about T&T. Earlier this morning, we were delighted to announce our intended acquisition of T&T Supermarket Inc. T&T's talented management team and colleagues have developed what we believe are the best Asian stores in Canada. From our perspective, this is a strategic acquisition, which will help us extend our ethnic offering to better serve Canada's fastest-growing customer segment, while at the same time, T&T will leverage Loblaw's access to capital and real estate expertise to further its growth opportunities.

The transaction is expected to close prior to our fiscal year end, and we expect it to be accretive to Loblaw earnings in year one. T&T will operate as a separate division of Loblaw, allowing our management to remain focused on its current turnaround efforts.

I would now like to turn my attention to our second-quarter performance. Our results in the quarter indicate progress. However, it is important to note that the earnings improvements were largely cost and gross margin driven. Consistent with our comments during our first-quarter call, we still believe the second half of the year will be the toughest. With market volumes in decline, inflation dropping off, intensified competitive activity and a substantial ramp-up in our infrastructure and renovation programs, we expect a significant challenge to sales and margin for the remainder of the year.

I will now turn the call over to Bob Vaux to review our financial performance.

Bob Vaux - Loblaw Companies Limited - CFO

Good morning. Total sales in the second quarter of '09 increased by 2.8% to CAD7.2 billion, while same-store sales increased by 2.5%. Same-store sales and same-store sales growth were affected positively by approximately 0.8% as a result of the shift of the Easter holiday into the second quarter of '09. Sales growth was negatively impacted by 0.5% due to the sale of the Company's foodservice business in the fourth quarter of '08. Excluding these items, sales growth and same-store sales growth were 2.5% and 1.7%, respectively.



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In Q2 of '09, sales growth in both food and drug store was strong. Apparel sales growth was modest, while sales of other general merchandise continued to decline, and gas bar sales declined as a result of lower retail gas prices, despite moderate volume growth.

National food price inflation, as measured by the Consumer Price Index for food purchased from stores, was 7.4% in the second 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 first quarter of '09. In addition, I will remind you that we experienced modest internal retail food price deflation in the second quarter of '08.

Gross profit in the second quarter was CAD1.7 billion or 23.4% of sales versus CAD1.6 billion or 22.5% of sales in the second quarter of '08. The improvement was largely due to our focus on improved buying synergies, more disciplined vendor management, and transportation logistics efficiencies. Also contributing to the improvement were sales mix, successful promotional campaigns and inflation.

Operating income was CAD324 million for the second quarter compared with CAD264 million in Q2 of '08. Operating margin was 4.5% in the quarter compared to 3.8% in Q2 last year. Operating income and operating margin were positively influenced by improved gross profit and lower labor and warehousing costs, partially offset by the previously announced incremental investment in information technology and supply chain, and lower net stock-based compensation income.

Loblaw realized second-quarter basic net earnings per common share of CAD0.70 compared to CAD0.51 for the same period of '08. Net debt at the end of Q2 '09 was about CAD3 billion compared to about CAD4 billion at the end of Q2 '08. The CAD1 billion decrease was primarily due to the issuance of capital securities of CAD218 million in Q3 of '08; the securitization of PC bank receivables of about CAD300 million, again in Q3 of '08; and an improvement year over year in working capital.

For the remainder of the year, we are increasing our investment in renovations to our existing store base, as well as our investment in upgrading our information technology and supply chain infrastructure. The estimate of capital expenditures for 2009 has risen to about CAD1 billion.

I would now like to turn it over to Allan Leighton, who will provide some further context.

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Thanks, Bob. We've always seen this year as both a year of two halves and a balancing act. As a year of two halves, we planned the first half where we felt inflation would help both topline sales and gross margins; where we would build a base from which we would feel confident to ramp up our infrastructure programs; and where we'd be very focused on a cash and cost marathon to remove bad costs from the business and create more liquidity and a stronger balance sheet.

This has largely been achieved. This would enable us to create a war chest from which we could compete aggressively in the second half, where we felt market volumes would be in decline, inflation driving off, and therefore sales and margins challenged. Against this market backdrop, we would both have the capability and confidence to ramp up our infrastructure and renovation programs that are so vital to our renewal.

Let me just elaborate on these. Firstly, the market -- we see the food market volumes softening. And in a number of recent weeks, market volumes have been negative. We believe this trend may continue. And when you combine this with inflation falling off, as it will, delivering topline sales both to cover fixed costs and to drive market share in a negative volume market will require aggressive programs and margin investment.



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Secondly, infrastructure ramp-up -- two-thirds of our IT roadmap costs will occur in the second half at a cost of around CAD70 million as we complete Release 1, which is our financial systems, which will be in by the end of the year, and the design of our Releases 2 and 3, which are our ordering and merchandising systems.

As Bob has said, we are increasing our capital spend to CAD1 billion for this year. More capital will go into our supply chain infrastructure as we bring the Regina DC construction forward. TMS, which is our Transport Management System, will be in all depots by the end of this year. And WMS, which is our Warehouse Management System, will be in half of the DCs by the year end. In addition, there are more than 200 stores that will be renovated and refreshed in the second half, including more capital into the West Superstore renovations and more capital into Loblaw to Maxi & Co. conversions in the West -- sorry, in Quebec.

This is what our second-half outlook is based upon, hence the balancing act -- our constant requirement to both trade for today and build for tomorrow in tandem to both run and renew the business. Today's announcement of the acquisition of T&T is a classic example of this. The ethnic market opportunity in Canada is vast. Today, we have a relatively small share. Our objective is to be the number one player. And T&T gives us the platform to build to this objective, both to run for today and to build for tomorrow.

Operator, at this stage I would like to open the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Irene Nattel, RBC Capital Markets.

Irene Nattel - RBC Capital Markets - Analyst

In light of your comments around the increasingly competitive market and volumes going negative, could you walk us through your thinking about why at this particular time you would want to ramp up your CapEx so dramatically?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Irene, it's Allan. Actually, for the reasons I just stated. We are doing two things. We have to compete in a market which is the marketplace of today, which is changing. But at the second term, we have a renewal plan, which is about renewing the business over a period of time. And therefore, we feel good about the work that we've done in the first half in terms of what we've been able to do and the success we've had, both in our infrastructure and our renovations. And therefore, we believe that it's the right thing to do for the business long term to ramp up that investment in the second half. And that's why we're doing it.

Irene Nattel - RBC Capital Markets - Analyst

So is it at all related to your perception of your market positioning in Western Canada and Quebec in particular relative to the competitive set?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

No. We, as you know, we've spread our capital around. I think I alluded to at the last call that the West, particularly some of our real estate out there is pretty old and has not been touched for a period of time. We've been doing pilot work in terms of



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renovations in our RCSS stores in the West. We are pleased with that. And therefore, we feel confident to invest more money in that part of the country, which has been very successful for us for a period of time.

And as far as Quebec, at exactly the same time, I think I mentioned last time we've run a pilot of converting one of our Loblaw stores to Maxi & Co. in Quebec. That pilot, too, we're pleased with the performance and feel, again, that therefore we can invest some more capital and do that to more stores.

It really is this whole balancing act which I refer to, which is very much the theme of the business, is that we have a business that we need to run and trade for today in conditions that change frequently, but we also have a bigger picture, which is the renewal plan of the business, which, as I say, we feel is going well. And therefore, we should continue to invest in it and ramp up and speed it up where we think that that is the right thing to do.

Irene Nattel - RBC Capital Markets - Analyst

That's great. And one more question, if I might, around the gross margin. If we look at the 84-basis-point or 90-basis-point expansion in gross margin in the quarter, clearly inflation is a help. But wondering if you could just talk a little bit around some of the other initiatives, better sourcing, lower shrink, the progress you are making there and the contribution those would have made to the gross margin improvement.

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Well, two things, really, to think about, Irene. First of all, if you look quarter on quarter, actually the gross profit number went down. Secondly, in terms of the year-on-year comparison, there are really three elements that are making a difference. First of all, clearly our cost of goods have improved. Secondly, we are getting transport efficiencies, which is a combination of fuel efficiency and some of the work that's being done now in the supply chain. And thirdly, there is an element of mix that is sort of working for us. But they are the three ingredients that are driving our gross profit.

Irene Nattel - RBC Capital Markets - Analyst

That's great. Thank you.

Operator

Perry Caicco, CIBC World Markets.

Perry Caicco - CIBC World Markets - Analyst

I just wanted to spend a few minutes on your same-store sales number, the 2.5%. Just I guess sort of three questions around it. Not sure you are willing to tell us this, but was it higher or lower than your measurement of internal inflation? I'm also interested in, was same store traffic up? And then, inside the basket, I was wondering if item count was up or down.

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Perry, it's Allan. A couple of things, really. First of all, both frequency was up, basket size was up. And as you know, we never talk specifically about volume or inflation apart from to say that, as we said, our inflation was lower than it was in the previous quarter.



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I think if I make a couple of other observations about our sales, there are sort of three or four distinct pieces to it. Clearly, gas has an impact. And although our gas volumes were good, having a negative impact on our comp sales, this quarter it was about 1.3%. So it's increased quarter on quarter, which is a negative impact of gas.

Our general merchandise business, particularly our core general merchandise business as you would understand it, continues to perform poorly, which is reflective of what's happening in the marketplace. However, our food and HABA sales and comps we were relatively pleased with and certainly would be comparative with what anybody else has announced recently in the marketplace.

Perry Caicco - CIBC World Markets - Analyst

And, Allan, further on the general merchandise, it's down, and part of that is the market. Part of that I think is a bit of a managed decline on your part. When do you expect the kind of managed decline of general merchandise to stop or slow down? And have you given much thought to the sort of excess or unproductive space in the general merchandise sections of your larger stores?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Yes. Two things, Perry. You're absolutely right. We are continuing to manage general merchandise down. I think the reality of that, that is another six or nine months of work, because part of the way we are managing down is not just in terms of the ranges that we are buying, but also, clearly, a lot of the renovations that we are doing are dealing in that space issue, which is the issue that you refer to.

A lot of the space that is excess in general merchandise is really going to two areas, or three areas, really. One is clearly Joe, which is still something which is working particularly well for us. Joe is both getting more space, but actually getting space in stores that it hadn't had space before. Quebec is a very good example of that.

Secondly, HABA is an area where we continue to expand space. We still think we've been pretty tight in the space. And as I said before, generally our grocery space is light in a number of our stores. So that space where it's being managed is being managed into those three parts of the business. And as I say, it's a bit of an extended process because it's as much a physical change as it is a ranging change.

Perry Caicco - CIBC World Markets - Analyst

One last question, if I could. Do you have any speculation as to why you are seeing and therefore predicting that market volume is negative?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Yes. I have a very clear view on it, is that my experience on these things, in recessions, food tends to do well at the beginning because there's inflation there. The second thing is that as that recession tails down a bit, food tends to struggle, particularly when inflation falls off.

And I think the other big driver for me is unemployment. People say that the good thing about unemployment, it seems to -- it sort of peaked off, but it's peaked off at 9.5%. We've got 500,000 people in this country who are unemployed who were working a year ago. And that has an impact.

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And I think what we are beginning to see is that people are buying less. And the combination to me, and this is very important that people get this, is a combination effect, is, one, that you've got volume starting to decline in the marketplace. But at the same time, you've got inflation coming down. And it's that combination which is the issue, because clearly it's the topline sales in cash terms that both drive your market share and, importantly, cover your fixed costs

Operator

Michael Van Aelst, TD Newcrest.

Michael Van Aelst - TD Newcrest - Analyst

A few questions. First of all, on the buying synergies that you've talked about the last couple of quarters, when do you expect to cycle through the improved buying synergies? I know it's a recurring exercise, but it seems to have picked up the last two quarters. Was there any of that in the second half last year, or is it--?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

It's Allan again. I think if you're talking about cost of goods, then no, it is a continuation of a trend, which is clearly how we manage our cost of goods is very important to us. We've got some mix impact in that, which is also clearly key, but nothing significantly changed from where we've been.

Michael Van Aelst - TD Newcrest - Analyst

Okay. And you also talked again about disciplined vendor management, which, I think in Q1, related to a higher level of eventing. Was that the case in Q2? And can this pace keep up?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

It's probably the same amount. It doesn't sort of -- doesn't oscillate much quarter by quarter. So, no, we've got event programs. They seem to be working relatively well, slightly different to what other people do, but it's pretty consistent.

Michael Van Aelst - TD Newcrest - Analyst

Okay, so same amount going forward as well, then.

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Probably, yes.

Michael Van Aelst - TD Newcrest - Analyst

Okay. And then, can you talk a little bit more about the labor and warehousing cost efficiencies that you've had?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Well, I'll get Dalton to talk a bit about where we are in labor. Dalton?

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Dalton Philips - Loblaw Companies Limited - COO

Yes. Michael, we've had productivity gains in the quarter. It's been a big focus. Obviously, labor rates are increasing at a faster rate than sales, so it all comes down to productivity. And we've just been doing some really basic stuff of scanning rates at the front end. We're scanning people through the registers 4% faster than we were last year, which is positive for our P&L and it's positive for the customer experience.

Allan will talk about the warehousing, but stocking, goods in grocery now, we're about 12% quicker stocking at night because our pallets are coming in better configured from our warehouses, [more friendly]. So it's initiatives like that.

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

And from the supply chain perspective, as I said to you before, I think we're in the process of building probably the best physical infrastructure in North America. The money that we spent on our physical infrastructure is making a big difference in terms of productivity in the distribution centers. As is, although early days, clearly the reason we are putting these systems in, both transport management systems and the warehouse management systems, is to improve productivity. And certainly, from what we've seen in the early days, that productivity is coming through.

Michael Van Aelst - TD Newcrest - Analyst

Okay. And a couple of housekeeping items here. The CapEx of CAD1 billion, does that include the T&T acquisition?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

No. The T&T acquisition is outside of that.

Michael Van Aelst - TD Newcrest - Analyst

Okay, and the tax rate, are you still expecting 31% for the year?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

I'm looking at Bob, and he's nodding his head.

Bob Vaux - Loblaw Companies Limited - CFO

Order of magnitude, yes.

Operator

Patricia Baker, Scotia Capital.

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Patricia Baker - Scotia Capital - Analyst

I want to go back to the outlook that was in the press release, Galen's opening remarks, and also your discussion at the beginning, Allan. And you've certainly telegraphed to us that you're going to be much more aggressive both on the capital spending front and the operating front in the second half.

And I want to know whether or not what you are saying now, particularly for the outlook, is a lot more forceful than the message that you've been giving us, which was quite consistent in the first and second quarter. But is there something that happened in the second quarter per se that caused you to push this plan forward? Or had this always been the plan, that in the second half of this year you were going to be more aggressive on both those fronts?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

It's Allan, Patricia. You are right; it is slightly more forceful. Two answers, really. It's always been part of the plan. Clearly, the way, particularly in terms of if you think about ramping up the infrastructure and renovations, which is it's always been part of the plan, but I think we wanted to feel confident that the organization could execute it.

And in the first half, on the infrastructure work and the renovation work we've done, we've improved greatly. So it was always part of the plan. It would have not been part of the plan if I guess we didn't think that we would execute it well or that we hadn't got some positive results. And we've had both, and so therefore, that's why the ramp-up is there. So that's always been part of the plan.

Clearly, changes in the marketplace determine, then, what we do from a program prospective. And I think the point that we're flagging is quite a unique one, which is where you've got a market where there is a volume decline, and where topline sales cash are so important, and a large part of that topline sales growth in the past has been inflation driven, when that inflation drops off, as it is, as it will, then two things happen. First of all, really the only way you can get market share is being more aggressive in your programs. And secondly, generally that tends to impact in terms of margins.

Patricia Baker - Scotia Capital - Analyst

No, I understand that, and I really appreciate the answer. Has that program commenced? Are we seeing it in the stores now?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

I wouldn't want to talk about either the contents of the program or the timing of the program. But I thought it was very important that we flagged to everybody that that was a very -- a big likelihood.

Patricia Baker - Scotia Capital - Analyst

Okay. And just back to something you mentioned in answer to one of Perry's questions, and that is that you say you don't really comment on volumes. Occasionally, you do actually comment a little bit on volumes. Last quarter, you mentioned that your volumes were actually off a tad. Can you, in that context, give us any more color on what it was like this quarter?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Yes, I think I actually said that our items were off a tad, and that's still the case.

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Patricia Baker - Scotia Capital - Analyst

Okay. And just on a slightly different topic, previously you've talked about something that you refer to as smart sales. Can you update us on what your thinking is there and whether you've made any progress?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Yes. I think we have made some progress on smart sales. It's still very much around our thinking, because my whole thing is, don't just drive sales for the short term. And so, I don't think we'd be investing in anything that we thought would give us a short-term gain, because when you've got some market volatility, sometimes you can chase volume that isn't there. But I think we are much better at that. And I think you will see probably a bit more of that going forward in the business.

Operator

David Hartley, BMO Capital Markets.

David Hartley - BMO Capital Markets - Analyst

One of the initiatives I think you've spoken about in the past is improving profitability in private label and also lowering shrink. Could you give us some color on the progress you're making in those two areas?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

David, I'll get Dalton to do that.

Dalton Philips - Loblaw Companies Limited - COO

On private label, as we talked about before, this is the 25th anniversary of President's Choice. We're very focused on that. We talked about 500 new products this year and 1000 redesigned and improved products, and we are on track with that. And clearly, it's a very, very important part of our business. And we're comfortable with the progress so far.

Shrink, shrink is a -- it's a big, bad cost in the business, and it's something that you continually have to focus on. We talked a lot last year about some of the initiatives that we put in place to get that shrink to more manageable levels, and we were happy with those programs and we continue to manage it. But it's something you've got to manage every day, and we still feel there's a long way to go in improving that, David.

David Hartley - BMO Capital Markets - Analyst

Okay. And some of the initiatives -- am I to understand, then, the profitability of private label has gone up for you?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

We wouldn't, David, comment on the profitability of different parts of the business. I think what we've said consistently, David, is that our profitability of our control label isn't where we would want it to be, and that's something we're working on.

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David Hartley - *BMO Capital Markets - Analyst*

Okay. Could you talk a little bit about -- so some of the initiatives you've had in place [or of] the system, how lumpy has it been over the past four quarters, and what do you see in the next four? I guess people are trying to get an understanding of how sustainable going forward some of the growth in your profitability has been from that perspective before you start talking about some of your price investments, etc.

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

Well, we're then into forecasting, which we don't do. Clearly, the thing the business has to strive to do is be consistent in terms of its delivery. I think we, I've said this before, I think we're better -- we're much better today than we were three months ago and certainly better than we were a year ago.

There are elements of the business where I think we've gotten much better at identifying and tackling what we call bad costs. There are good costs in a business. There are bad costs in a business. We've got plenty of bad costs, and I think we are much better at tackling them.

I think the supply chain team, as I say, are building a very good infrastructure. And I think that we will continue to see benefits from that. And clearly, the ramping up of the systems support in that area and building out of infrastructure will make a big difference.

Store labor is all about productivity. Again, one of the issues you have, as I refer to, if your topline sales, which are all cash driven, start to come down, then you've got fixed costs. And the only way that you can deal with store labor, which generally always rises with a higher rate of sales, is you have to get real productivity. I think we're getting better at getting productivity.

But to a degree, all these things are only as lumpy as your dedication to try and deal with them every day. In my view, in retail, you never really fix them unless you are on them every day. And that's what the operators have to do, and that's why execution is so important.

David Hartley - *BMO Capital Markets - Analyst*

And just a few other quick questions here. The income tax benefit relating to prior year's income tax matters, what was that?

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

Bob?

Bob Vaux - *Loblaw Companies Limited - CFO*

It's primarily the treatment of the gain on the sale of the MasterCard shares.

David Hartley - *BMO Capital Markets - Analyst*

Okay, fair enough. And the CAD100 million guidance relating to IT and supply chain initiatives in fiscal '09, is that still in place? I know that this quarter it was CAD13 million in costs. I think it was CAD20 million or so last quarter. Are we still on course for that CAD100 million?

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Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Yes, David. That's why I flagged the second half as there's CAD70 million of costs that will hit the P&L on those programs.

David Hartley - BMO Capital Markets - Analyst

Okay, I figured as much. And just about the participation rate in the DRIP, where are we at with that?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Bob?

Bob Vaux - Loblaw Companies Limited - CFO

Well, George Weston Limited obviously participated. And in terms of the float, it's between 20% to 25%.

David Hartley - BMO Capital Markets - Analyst

Okay. And would you expect that level to be sustained or move higher?

Bob Vaux - Loblaw Companies Limited - CFO

Well, if you look at all the DRIPs that are out in the market, the participation rate is anywhere from 5% to 40%. So it's really got to be a call of the minority. But we expected it to be in 20% to 25%, and that's generally where it is today.

Operator

Jim Durran, National Bank Financial.

Jim Durran - National Bank Financial - Analyst

Just a couple of questions. First of all, in terms of tracking what the consumer is seeing in terms of the improvements you are putting into the stores, can you give us any metrics as to things that are going to demonstrate the consumer is embracing an improved Loblaw?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Jim, it's Allan. Yes, clearly, sales is -- that's the absolute measure of whether these things work or they don't on a store-by-store basis. But we do do -- we are very strong in our consumer research. We have 30,000 customers who feed back to us every month on our performance, our stores, our banners, our pricing, our ranges and how we compare with our competitive set.

Jim Durran - National Bank Financial - Analyst

Have you seen any noted increase in volume performance in your private label as you've been working on the 25th anniversary?



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Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

The control label participation of sales is higher than national brand.

Jim Durran - National Bank Financial - Analyst

And would you have seen that as a trend improvement, though, from where you were?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

I think it's a trend. The issue I have with everybody here is it should be stronger than it is.

Jim Durran - National Bank Financial - Analyst

And then in Quebec, so we've got the Loblaw conversion to the Maxi banner. Can you give us any idea what your plans are for the Provigo banner in Quebec?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

We will -- we are working on our Provigo banner. It's a very important banner for us. We are just in the process of doing some renovation in a couple of Provigo stores in the urban centers, which will serve as pilots for what we do with the Provigo banner.

Jim Durran - National Bank Financial - Analyst

And the last question, on the CapEx side, you've given us a piece of the puzzle in terms of the incremental spend. Can you give us what the breakdown is of the additional dollars you are going to be spending?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Probably 50-50 between supply chain and store renovations.

Operator

Winston Lee, Credit Suisse.

Winston Lee - Credit Suisse - Analyst

I just wanted to see if you could provide us with more color on the market volume declines, if you can give us an idea of whether it's more precipitated in conventional versus discount, or if it happens to be more in one area of the country versus another, and if that happens to be tied to unemployment, because you have mentioned unemployment.

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

This is Allan. Without giving all the detail, because clearly this is something we track, it's pretty general. And some parts of the country slightly worse than others, but not of any great significance. It is just a general softening. And as I say, in a strange way, in my mind, it's always been very expected. It's not unexpected in any way. And as I say, I think the watchout for everybody is

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not just the fact that the volume is softening, but when you get a combination of softening volume and inflation falling off, that is the combined impact of which I have been pretty wary from the beginning of the year.

Winston Lee - *Credit Suisse - Analyst*

Okay. And would you say you've seen a change in the consumer behavior in terms of what they're purchasing, given that the volume has been declining in the last few weeks?

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

We've said in a number of the recent weeks, so, yes, it's just -- the big issue I think is that people are just buying slightly less product. And you can also see there is a bit more shift to our discount. There is a slightly more shift to control label. But the real difference is there's just a step-down in volume purchased.

Winston Lee - *Credit Suisse - Analyst*

Okay, that's helpful. Thank you. And in terms of Calgary, I understand there's an LDC out there as well. You mentioned Regina. Are there plans on updating that this year or next?

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

Regina we're going to bring forward to this year. We've already done some work in Calgary. And clearly, as we continue to build out the infrastructure, most of the DCs will have been touched in some way, shape or form.

Winston Lee - *Credit Suisse - Analyst*

Back to best, and I'm not sure what you think about that and to what degree some of that is passe. But if we were to think about back to best, what does that mean in terms of the outlook going forward when you think it might be achievable as being back to best? Are you getting your infrastructure up to speed to where you think it should be? Are we looking out for two years, three years, or is it too hard to say at this point?

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

On terms of our -- are you talking about our supply chain infrastructure?

Winston Lee - *Credit Suisse - Analyst*

Yes, and what you mean by -- maybe refresh us on what you mean by back to best at this stage.

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

Well, two -- there's three things. Back to best was and is a program that we run in our Great Food stores in Ontario, which has been pretty successful. So it was a very specific conventional largely Loblaw program, AS I say, which has worked particularly well.

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If you think -- if you are talking about renovating our store base and building the rest of our infrastructure out of the supply chain, I think the supply chain is another year away from being complete from the physical infrastructure standpoint -- as I say, I think will stand us as good as anywhere in North America.

Our store base still requires a huge amount of work. And there are large parts of it not been touched for a period of time. And so just on catch-up, we've probably got 12 or 15 months' worth of work. And then the art is something you have to sit on top of every year. In my view, every four or five years, you have to make some adjustment in some way, shape or form for the customers in your stores. And if you don't do that, it catches up with you.

Winston Lee - *Credit Suisse - Analyst*

And on CapEx, are we to understand that you are putting a greater CapEx effort of investing in Western Canada and Quebec than, say, a quarter ago?

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

Yes, than, a quarter ago, absolutely.

Operator

(Operator Instructions). Keith Howlett, Desjardins Securities.

Keith Howlett - *Desjardins Securities - Analyst*

Yes. I would like to just go back to the volume point, not to beat the horse dead, but just a couple points. One, how do you measure volume? Is it by item count or pounds, is the first question. The second question I guess is more philosophical. I would have thought as prices come down, volume goes up. At least that's what I used to be taught, I think, somewhere. So I'm wondering why you think volume would go down as prices go down.

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

Jim, two things, really. It is because we are in a slightly different position. This is not a normal market. And generally, you are right. But what we've got is the consumer basically buying less product. And therefore, that's a subtle change, which we are not being very good at communicating, but that is the subtle change.

And that's why I think there is an issue. And remember also, there's been pretty -- there's been a lot of inflation in the marketplace. And it is the combination of the two things, and I sound like I'm stressing it. It's a combination of less volume in the marketplace, volume decline and inflation falling off that becomes the issue. So I think that's the way I would answer your question.

So what was the second part? I missed that.

Keith Howlett - *Desjardins Securities - Analyst*

I'm just wondering, do you measure sort of by department, like in grocery it's number of items sold? In meat, it's number of pounds?



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Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

We measure it by department, but we also look at the market in tons, too. So we have an absolute volume measure in whatever is the relevant measure.

Keith Howlett - Desjardins Securities - Analyst

And then just in terms of the renovations, am I to read or are we to read that there could be some disruption to the sales in the store? Or is it merely that you are stepping up the renovations? Or are you flagging that there will be some disruption in same-store sales because of renovation activity?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Well, a bit of both. There's always a bit of disruption in same-store sales in the store that you change the -- make the renovation in. And clearly, that has an impact, because a number of these stores we close for a day or two. And we try and spread the volume around, but of course you don't get it all back.

But that's because we have a long-term view. And I think we prefer to be in a situation of getting them done faster, of which you may take a little pain in the short term rather than spread them out over a long period of time, which tends to really irritate customers. And that's something the team here have done really well in the first half of the year, really learned how to do these things faster than we were doing them before and, therefore, causing much less disruption from a customer perspective.

Keith Howlett - Desjardins Securities - Analyst

And just on the general merchandise, if I look at a store where you have already done the physical renovation, a large-surface store, is the range of general merchandise in those stores now the way you would like it?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

No, not yet, because as you know, some of these -- there are quite long lead times on some of this product, particularly the seasonal product. And therefore, you work with much longer lead times than you do in food. So I guess that we're probably 50% of the way there in terms of where we want to be in range.

Keith Howlett - Desjardins Securities - Analyst

And then, just I know it was a -- well, I think it was a difficult spring for almost all general merchandise retailers. Can you just speak to how your inventory position or your clearance inventory is relatively to last year?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Yes. We've got slightly more inventory, but we are not concerned about it. We've, as everybody else has, we've been sort of trying to mark down stuff to clear. But there were a number of issues. One is, clearly, big-ticket items have been under pressure for a period of time. And secondly, the seasonality, the seasonal relevant products have been under a lot of pressure because the season hasn't been here. So it's been -- it almost has been a perfect storm for general merchandise. But from an inventory perspective, we're in not bad shape.

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Keith Howlett - *Desjardins Securities - Analyst*

And then just a couple questions on the banners. The Maxi & Cie. pilot that you tried in Quebec, how many -- do you have a sense of how many Loblaw stores would fit that in terms of their area, or is that too early to know?

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

Well, we do, but we are not going to share it.

Keith Howlett - *Desjardins Securities - Analyst*

Okay. And then if you could just speak on the No Frills program in Western Canada.

Allan Leighton - *Loblaw Companies Limited - President and Deputy Chairman*

Again, Dalton, do you want to just update on where we are (multiple speakers)?

Dalton Philips - *Loblaw Companies Limited - COO*

Yes. Going strong, Keith. We've got 12 at the moment, and we continue to roll them out. They are all franchised now. We talked about that being a franchise program. That's been implemented. And we're on track for our 20 that we talked about. And they're doing very well, actually.

Keith Howlett - *Desjardins Securities - Analyst*

And just finally on the shopkeeping initiative, where we are on that?

Dalton Philips - *Loblaw Companies Limited - COO*

I think the availability is obviously improving significantly over where it had been. The strong supply chain support is really helping. So you are seeing hole count, which is the key thing there, dropping. And in any given week, we're 25% to 30% fewer holes than we would have had this time last year. So that's encouraging. Shrink we continue to work on. Label we continue to work on. And then the key thing is our whole customer service focus and looking after our customers. And as Allan said earlier, we measure this in depth, and progress is being made.

Operator

David Hartley, BMO Capital Markets.

David Hartley - *BMO Capital Markets - Analyst*

I'm fine, thanks.

Operator

Jim Durran, National Bank Financial.

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Jim Durran - National Bank Financial - Analyst

I'm almost fine. How's that? In terms of the renovations that you are doing, and I guess really the resets that are being done, can you give us some idea, are those included in your back-half plans? And will you be done all of the intended ones by the year end?

And then second part of the question is, how long does it take for the sales to ramp back up once you've done those relines?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

The answers are yes, and yes, and about two weeks.

Jim Durran - National Bank Financial - Analyst

Great. Thanks, Allan.

Operator

Patricia Baker, Scotia Capital.

Patricia Baker - Scotia Capital - Analyst

I apologize for getting back on, but Allan, I was quite intrigued and thought it was important that you mentioned that this is not a normal environment. The consumer has changed. One of the things we haven't talked about today is trading down. And I don't mean just trading down from national brands to private label. But what else have you seen across categories? I know yesterday, Steve Burd mentioned that at Safeway they've seen evidence of trading down in just about every single category across the entire business. So I would be very curious to see what you guys are seeing here.

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

We do see a bit of trading down. The biggest category, it seems to me, is HMR, home meal replacement, which is, if you look at the market performance and you look at our performance, it's pretty poor. And that's a very good illustration, because I think what people are doing is moving away from convenience and [inverting commerce], i.e. are moving much more to ingredients-based purchases.

So what we're seeing is all the products where people buy products to create a meal are growing, and all of the product groups where you are paying a premium to take a product home or something like that are in decline. The HMR thing is pretty staggering, actually.

And then, I guess across the page, you see a bit of trading down. In fact, the only place you don't see it is in pet food, for whatever reason. (multiple speakers) their pet better than they are themselves, which is a sign of the times, no doubt.

Patricia Baker - Scotia Capital - Analyst

That's interesting. The HMR anecdote is really interesting. At the beginning of the recession, where people were, say, supposed to be trading down from eating out in restaurants into more eating at home and more -- and you guys should have gotten a little boost from that. Did you see there anecdotally any pickup in HMR just at the beginning of the recession?



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Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Yes, there was a bit. It's very interesting, because it started out with people not eating out and then taking product home that they usually eat in. And now it's moving much more to taking product home that we can cook. And remember, I think I read somewhere, I don't think -- the restaurant business in Canada has not been hit as badly as it has been in the US. But thirdly, that is a trend that we have seen in recent weeks, is this HMR thing, which has seemed to have been pretty significant.

Patricia Baker - Scotia Capital - Analyst

Thank you. I'm glad I asked the question.

Operator

Keith Howlett, Desjardins Securities.

Keith Howlett - Desjardins Securities - Analyst

I won't apologize for asking any questions. Just on the T&T, can you speak to your plans to bring their assortments into your stores or how you are planning to go forward on that?

Allan Leighton - Loblaw Companies Limited - President and Deputy Chairman

Well, first of all, the T&T acquisition we feel really good about. It's a great business. Cindy has done a fabulous job in what she's done with that business. And frankly, we've got much more to learn from them than they have from us. And that's the way that we think about it.

It will be run independent of the rest of the business. Clearly, they've got a successful business. We're going to let them continue to run it as it is. We don't want to change any of their systems or any of that stuff and for a long period of time.

The other thing is, I want to make it very clear -- any synergies that we have in this business will not be to do with closing offices, DCs, or getting rid of people. It's a great business. We want it as it is, working as it is. And we are very pleased about that.

As I say, I think that there is -- we can help them in terms of sites and in terms of capital. And both Cindy and we believe that there's a great opportunity to expand that business into significantly more outlets than there are today. And that will drive that business, and that will be very good for them and us.

And I think we see a big opportunity in -- we've got a lot of stores. We've got some ethnic business. And we've done okay at it. But there's a huge amount of learning we can get from them in terms of ranges, in terms of sourcing, which I think will have a very positive impact on our core stores, too.

So we are very pleased with this. Strategically it's absolutely the right thing to do. And I think both businesses in partnership will look pretty good down the track.

Operator

Ms. van den Berg, there are no further questions at this time. Please continue.



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Inge van den Berg - Loblaw Companies Limited - SVP, Corporate Affairs

Thank you very much, everyone, for joining us today. And we appreciate your continued interest in Loblaw. Bye-bye.

Operator

Ladies and gentlemen, this concludes the conference call for today. Thank you for your participation, and you may now disconnect your line.

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