

FINAL TRANSCRIPT

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L.TO - Q3 2009 Loblaw Companies Earnings Conference Call

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Loblaw Companies Limited - Executive Chairman

Bob Vaux

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Perry Caicco

CIBC World Markets - Analyst

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RBC Capital Markets - Analyst

Jim Durham

National Bank Financial - Analyst

Michael Van Elst

TD Newcrest - Analyst

Keith Howlett

Desjardins Securities - Analyst

Winston Lee

Credit Suisse - Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Loblaw Companies Limited third quarter earnings conference call.

At this time, all participants are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions. (Operator Instructions). I would like to remind everyone that his call is being recorded today, Tuesday, November 17, 2009 at 11:00 AM Eastern Time.

I will now 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. Welcome to the Loblaw Companies Limited third quarter conference call. This call is also being webcast simultaneously on our website www.loblaw.ca.

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I am joined here this morning by Galen G. Weston, Executive Chairman; Allan 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 expectations. These risks and uncertainties are discussed in the Company's materials filed with the Canadian Securities regulators from time to time including the Company's annual report and third quarter report.

Any forward-looking statements speak only as of the date they are made, the Company disclaims any intention or obligation to update or revise any forward-looking statements whether as a result of new information, future events, or otherwise, other than as required by law. Certain non-GAAP financial measures may be discussed or referred to today. Please refer to our third quarter report and other materials filed with the Canadian Securities regulators from time to time for a reconciliation of each of these measures to the most directly comparable GAAP financial measures.

Our third 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.

As we progress through the third quarter our sales were increasingly impacted by the significant decline in inflation and the ramp up of our pricing investments. Earnings benefited from cost containment and supply chain efficiencies. We expect that sales and margins will be challenged due to decreasing inflation, competitive intensity and our ongoing renovation and infrastructure programs.

Lastly, this quarter we are delighted to finalize the acquisition of T&T Supermarkets Incorporated and we've welcomed T&T's talented management team and colleagues into our Loblaw family of Companies, and look forward to continue running what we believe are the best Asian supermarkets in Canada.

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

Bob Vaux - *Loblaw Companies Limited - CFO*

Good morning, and thank you for joining us today.

Sales in the third quarter decreased by 0.2% to CAD9.5 billion, while same-store sales decreased by 0.6%. Sales in same-store sales in the quarter were positively affected by about 0.5% as a result of the shift of the Thanksgiving holiday into the third quarter of 2009 from the fourth quarter of 2008. Sales were negatively impacted by 0.5% as a result of the sale of the Company's food service business in the fourth quarter of 2008, and positively impacted by 0.2% by the acquisition of T&T.

Excluding these items, sales and same-store sales declined by 0.4% and 1.1%, respectively. In the third quarter, sales growth in food and drugstore was modest, sales growth in apparel was moderate, while sales of other general merchandise declined significantly, and gas bar sales declined significantly 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 4.2% in the third quarter of 2009. Our internal retail food price inflation was below CPI for food and significantly lower than our internal retail

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food price inflation in the second quarter of 2009. In addition, I will remind you that we experienced moderate internal food price inflation in the third quarter of 2008.

Gross profit in the third quarter was CAD2.2 billion or 22.9% of sales versus CAD2.1 billion or 22.1% of sales in the third quarter of last year. The improvement was largely due to improved buying synergies, more disciplined vendor management, sales mix, lower fuel costs and the efficiency of transportation operations. Increased investments in pricing partially offset the improvement.

Operating income was CAD378 million in the third quarter compared to CAD312 million in Q3 2008. Operating margin was 4% compared to 3.3% last year, and operating income and operating margin were positively influenced by improved gross profit, lower labor and supply chain costs and a lower net stock-based compensation charge, partially offset by the previously announced incremental investment in information technology and supply chain.

The Company incurred an incremental cost of CAD25 million in the third quarter related to its previously announced investment in information technology and supply chain which negatively impacted earnings per share by roughly CAD0.06. Loblaw realized third quarter basic net earnings per common share of CAD0.69 compared with CAD0.57 for the same period of 2008.

Net debt at the end of Q3 was CAD2.7 billion compared to CAD3.5 billion at the end of Q3 2008. The improvement of about CAD800 million was primarily due to an improvement in working capital and the cash savings associated with the dividend reinvestment plan partially offset by the acquisition of T&T.

For the remainder of the year we are continuing our investment in renovations to our existing store base and in upgrading our information technology and supply chain infrastructure. The estimate for capital expenditures for 2009 remains at about CAD1 billion.

I will now turn it over to Allan Leighton who will provide some context for the remainder of the year.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Thank you, Bob.

When we spoke last quarter, we spoke of a year of two halves and a balancing act. And where the second half of the year would be focused on using our war chest to drive volumes into a flat to declining market. With inflation dropping off drastically and a ramp up in our own infrastructure and renovation programs that are all vital to our renewal. The third quarter has seen exactly this.

We entered the quarter with moderate inflation, volumes and volume share under a bit of pressure in a food market, with bumpy volumes. We exited the quarter with close to no inflation, and with sales volume and volume share on an upward path in a food market of still bumpy volumes. Over this four period quarter our internal inflation declined by 3.5%.

We have invested margin in our price position and launched significant price programs across the country. In the Atlantic through the "Just Lower Prices" campaign, in Zehrs with "3,000 prices reduced", in Ontario Superstores with "prices rounded down", in No Frills through "won't be beat", and in Maxi through "1,000 ways to save". And our ad match program in the West continues to offer our customers there with the lowest prices. We are encouraged with the early results of this activity.

We are on track to successfully complete our first release of our SAP program, which as you know is largely finance focused in January and in the planning of releases two and three, which are merchandising and operations, which are due in the second half of next year. The supply chain programs around the warehouse management system, WMS, transport management system, which is TMS, and physical infrastructure two are on track. We opened our new 0.5 million square foot DC in Vancouver two weeks ago, on time, on budget and it's the first of our DC's to go with all of the new systems at the same time.



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More than 200 store renovations and refreshes are on track for completion in the second half of this year. We managed to do close to 100 during this quarter. We believe that inflation or lack of it will be a factor for at least the next six months, restricting revenue growth and therefore, volume is the new imperative.

With that in mind we have invested in price in the quarter at a cost to gross margin. And it is worth remembering the large part of our investment didn't take place until the second half of what was a four period quarter. Our outlook for the rest of the year has not changed and we believe sales revenue and margins will be challenged. Inflation will disappear, competition will intensify and volume growth and volume market share will be (inaudible).

Operator, I would now like to open the call to questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Your first question comes from the line of Patricia Baker of Scotia capital. Please go ahead.

Patricia Baker - Scotia Capital - Analyst

Yes. Good morning, everyone. Just, Allan, that last point that you made, that you still expect that revenues will be challenged and now that volume will be the new imperative. You have been talking about volume a lot all through this year and had a lot of people focused on volume.

If volume is a new imperative, can you share with us perhaps some quantitative indication of where volumes actually were in the third quarter? Because I think in your opening remarks, you made it sound as if the pricing strategy actually was successful and had helped you raise volume. And perhaps what kind of volume targets would you be looking for and exactly what, what metric will you be looking at to determine that these price investments are actually successful?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Thanks, Patricia, let me start with the end of that. The metrics that we are looking at really are; what is happening to our item growth, what is happening to our volume growth, and what's happening to our volume market share. So they are the metrics that we are looking at. Because clearly with little to no inflation in the market place, then clearly that's where you tend to focus on volume.

Our programs, as I said, really didn't get going until the second half of this quarter. That means two things, first of all I think when people look at the gross profit that we achieved in the quarter then clearly that's the blended average of that quarter. And would not be a good proxy for where we exited that particular quarter.

The programs as I say are in early days. We are seeing an improvement in performance off the back of that. And that's really what we will be focused on as we go into the Christmas period which we believe will be two things. First of all very competitive, and secondly, the real cycling of inflation will become much tougher in Q4 even than it has been in Q3.

Patricia Baker - Scotia Capital - Analyst

Just to clarify that, okay. I am going to ask you to really spell this out for the people don't interpret - - trying to interpret what you are saying. Your indication that we should not assume the gross profit that you had in the quarter was blended, you didn't

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end the quarter -- you didn't exit the quarter with that gross profit improvement and clearly what you are implying there, but I want you to say it, is that the gross profit in the last half of the quarter was lower than that blended rate?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes, but we don't talk about it. We only talk about it in a blended way.

Patricia Baker - Scotia Capital - Analyst

I understand that. But I think it is important because of the fact there has been a lot of different interpretations of lots of things that you have been saying through the year that we get a little bit of clarification. The answer you just gave me is a pretty good clarification.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

And I think, Patricia, our view is we are pretty consistent with what we have been saying, which is that revenues will be challenged, inflation would come off, gross margins would come down, and the industry would be competitive, and markets would be bumpy. And I think that's still very much our line.

Patricia Baker - Scotia Capital - Analyst

Absolutely. Now, in your opening remarks, did you indicate that you are starting to see a volume pick up and your volume share is growing?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

No, what I said is that, I was very specific on it is that we entered the quarter with both our margin -- both our volume and our volume shares under pressure. And that we exited the quarter with an improvement both in our volume and our volume market shares.

Patricia Baker - Scotia Capital - Analyst

Okay. Last question, I apologize for asking another one. But your discussion of volume being the new imperative and the implication that we are not going to see revenue growth. When are we going to see the revenue line move at Loblaw or in the industry? And do we absolutely need inflation before we get there because this -- I would have thought that a big machine like Loblaw, you would be very, very focused on trying to get that top line, despite inflation.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes. We were -- inflation is partially in our control, partially out of our control. So, what is clearly in our control is what we do with our volumes. If you have got negative inflation or if you have got pretty flat inflation for a period of time that does have an impact on top line revenue growth.

And as I said, when you look at our performance in this quarter, the inflation rate changed inside the business by 3.5% over that period of time. Now, that is a pretty significant number.

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Patricia Baker - Scotia Capital - Analyst

That's pretty dramatic. Okay. Thank you. I will let someone else get in the queue and I will get back in the queue.

Operator

Your next question comings from the line of Perry Caicco of CIBC World Markets. Please go ahead.

Perry Caicco - CIBC World Markets - Analyst

Yes, good morning. I just want to start with a couple of questions around the same-store sales number. The sales of non-apparel general merchandise declined significantly. Is there any way you can quantify the impact of that on same-store sales in the quarter?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes, Perry, I will give you a bit of a head line on the sales, generally it might help actually. I described it as a (inaudible) egg, slightly lumpy in parts.

So the bits to strip down to really understand what's going on is gas, probably had about a 1.4% impact on our comp sales number. So we got some volume growth there but clearly we are recycling the big inflation on gas over a year ago.

The core GM business, which is business if you take [haber] out and you take apparel out, which was actually worse in Q3 than it was in Q2. And that's for a number of reasons really. One is that (inaudible) the market, that market is still not particularly strong. But secondly, in a large number of our renovations and refresh work that we are doing, and as you know, we are reducing the amount of space that we are giving to that core GM, probably by around 10% to 15%. So that's also an impact on that.

So gas a pretty big impact, 1.4, GM much worse than it was in Q2. We also we renovated about 100 stores during this quarter, which is a big number of stores. And clearly when you do that, there's a bit of friction that it causes in terms of the sales performance. If you strip all of that stuff out and you look at the core underlying volume and item performance of the business, it is roughly much as it has been all year. The big difference is as I say inflation, our own internal inflation, dropped by 3.5% over this quarter. That's basically the make up of the sales.

Perry Caicco - CIBC World Markets - Analyst

Okay. And Allan, I understand that you executed a fairly large SKU reduction across a range of stores in the quarter. Obviously, that has some positives on your business in terms of operating costs, et cetera. But would that have had any impact on sales?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes, it would while we're going through the friction of doing it, Perry. As you know, it is not so much when you take them out, it is the process of taking them out and changing the planograms and the layouts as you are going through the renovations. So as we ramp up, as we have been doing this sort of whole renovation and refresh program in the business, on the scale that we are doing it, in the short term it adds some friction costs which we are prepared to take. Because our idea is to build the business for the long term not just the short term.

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Perry Caicco - CIBC World Markets - Analyst

And that is what you refer to when you refer to the challenges caused by the ongoing renovation and infrastructure program?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes. And a good way to think about it, Perry, we have got, we trying to get close to another 100 in this quarter. So even for a machine as big as ours, they are big programs.

Perry Caicco - CIBC World Markets - Analyst

Just again related to that, the ongoing renovation-infrastructure programs, the infrastructure side of that program. Has that had any impact on your business -- on your sales so far or should it have any impact on your sales?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

No, the reverse, it's only a positive. Our supply chain particularly is performing incredibly well.

Perry Caicco - CIBC World Markets - Analyst

Okay. That's good for now. Thank you.

Operator

Your next question comes from the line of Irene Nattel of RBC Capital Markets.

Irene Nattel - RBC Capital Markets - Analyst

Thanks and good morning, everyone. Would you be able to give us an indication of where you feel you stand at this point in terms of investment in price? In other words, did you take pretty much what you thought you needed to take later on in the quarter, or should we be looking for a fair degree of intensity there?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

I think we are in a much better place than we were. I think we are in a pretty good price position around the country. My view is that there will be some more because we will probably invest some price into some of the other banners.

And Irene, as you know, what's happening in the market is very competitive. If you look at most flyers most weeks, once upon a time you may get a couple of new lows in any one month. Most of the time now you are getting two or three new lows every week. So I think that this Christmas period will be pretty fierce in terms of competition.

So that's absolutely what I would describe as our strategic pricing, which is to just make sure that we are in the right place on a banner perspective. But I think the tactical piece of pricing will also increase because the market's just going to be more competitive.

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Irene Nattel - RBC Capital Markets - Analyst

That's great. Can you talk a little bit about your plans for PC around as we get into the holiday period which obviously is a very important driver of traffic for you?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes, Irene, I will get someone to talk a bit about PC for Christmas. Dalton?

Dalton Philips - Loblaw Companies Limited - COO

Yes, Irene, it's basically the culmination of our 25 years of Presidents Choice. We have gone out with a strong program. We have the Holidays too. We are on track with all our repackaging in that brand. So we will have nearly 2,000 items repackaged for the end of this year. So we are very encouraged by it.

Irene Nattel - RBC Capital Markets - Analyst

And are we going to see some special pricing around that 25th anniversary?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

We have to wait and see.

Irene Nattel - RBC Capital Markets - Analyst

Okay. Thank you very much.

Operator

Your next question comes from the line of Jim Durham of National Bank Financial. Please go ahead, sir.

Jim Durham - National Bank Financial - Analyst

Yes. Just wanted to focus on Quebec, can you give us an update on where you are at on that process?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Jim are you referring to some of the store change activities, is that what you're thinking about?

Jim Durham - National Bank Financial - Analyst

Yes, unless you want to tell us something else.

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Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

No, no, no, no. But you knew something that you didn't now anyway. So in Quebec, there are a couple of things really. As you know we have taken three stores and we have put Great Food program into that. That was initiated in Ontario but has been done with a very significant Quebec twist. In Angus Kirkland and the Cavendish and they still look very good. And the customer reaction has been very good. So we think that we have a pretty good model there for the Loblaw stores which are in the good sites for Loblaws.

We've converted one -- we are in the process of -- we've nearly finished actually converting a second Loblaw to Maxi & Co. And again, they tend to be in the sites that are not so strong from a Loblaw banner perspective. And again, those have been encouraging. And then thirdly, we have taken one of our urban Provigo stores, and we have made that really into an urban food store. And that too, although early days, we are pretty encouraged with.

So we have put a lot of work in terms of what those formats may look like. And we have also done a lot of work on meat in Quebec. And I think that we have now got a meat offer in Quebec which is absolutely right for the Quebec consumer. That has taken a bit of time to get to but we have worked with Cargill on that plant in Chambly. So there has been a lot of activity in Quebec, and we hold out a lot of hope for that market. Because our ability then to roll these programs is something we will talk to you about for something we may do next year.

Jim Durham - National Bank Financial - Analyst

Can you give us some ideas how many Loblaws stores you expect to have in Quebec at the end of the process?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

It is a bit early to tell yet. It is -- you can certainly have a Loblaw chain of some size there, but it is going to be really stores that are great food stores and in locations that are locations where you can have a great food store as opposed to some of the secondary locations and the more ethnic locations that some of the stores are in today.

Jim Durham - National Bank Financial - Analyst

Just looking at your SG&A in the quarter. Would you classify that as your new run rate? It was flat including the CAD25 million of IT supply chain spend? And as a second point to that question are you still intending to spend the full amount of CAD70 million in the back half of the year, which you only spent CAD25 million of on those initiatives?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes, we are. We are going to spend the CAD70 million, not just spend it for the sake of spending it. There's always a bit of flex in the IT projects because we tend to move them around by a week or two depending on where we are at any one time. I am very pleased with how we are managing that because as you know, it will be a huge program. But I think we are in pretty good shape. But there's a bit of flexibility sometimes around when we start stuff and sometimes we move things around. But our intention is to still spend that money. Frankly, what we don't spend we will just roll into next year. But that's a good number to be working on the back of.

As far as SG&A, the only thing I would say rather than comment on whether that's the run rate that's going to be there forever because (inaudible) that's the forecast is that there are -- clearly, we are pleased with what we have been able to do on the cost base.

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There are two big drivers of our cost performance. One is just our central cost, our general SG&A is being well controlled for a period of time. But also, our supply chain and the money we have invested in supply chain in terms of physical infrastructure, and the benefits of some of these new systems, TMS and WMS really started to kick in.

So certainly the supply chain piece of that is something that I would see as not just sustain but build on the rest of it is for you to forecast I guess, Jim.

Jim Durham - National Bank Financial - Analyst

Thank you for that.

Operator

Your next question comes from the line of Michael Van Elst of TD Newcrest. Please go ahead.

Michael Van Elst - TD Newcrest - Analyst

Thank you. Just a follow-up quickly on the Provigo. Are you planning on exiting any of the smaller underperforming markets in Quebec?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Not at the moment, no.

Michael Van Elst - TD Newcrest - Analyst

All right. Shifting to your working capital, I noticed a big shift there, you seem to be collecting a little faster but paying a lot slower. Is this something that is sustainable going forward or is this a temporary deviation.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

We think it is working capital as you know, it is up and down by CAD150 million at any one time. But, we think that the majority is sustainable. And as you know we had a very complex set of payment terms. I think we had 60 of them. We have simplified that down to a half a dozen. So -- and something we have been working on for a long period of time.

We are very cash conscious. We launched a program nearly nine, 12 months ago and that was called the Cash Marathon, which was making sure that we utilize our cash and that cash as our cash was utilized by us. You can see in our inventory, our inventory levels are way down below last year, and our payables are a much more simplified from where they have been. So there's always a bit of volatility in those numbers, but it's a pretty good proxy for what we expect going forward.

Michael Van Elst - TD Newcrest - Analyst

And just finally, can you give us an update on what the performance of the No Frills are like in Western Canada?

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Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Very strong.

Michael Van Elst - TD Newcrest - Analyst

All right, that's fair.

Operator

Your next question comes from the line of Keith Howlett of Desjardins Securities. Please go ahead.

Keith Howlett - Desjardins Securities - Analyst

Yes, on the store rationalization or SKU rationalization, is that exclusively in general merchandise or is there some reduction in the food side?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Well two things, Keith. Number one thing is, SKU rationalization to me is something that you do everyday. There's an oxymoron that says retail ranges only go one way, which is they increase. And the best way to manage retail ranges is you edit them. So for me this whole thing about SKU rationalization and how we manage SKUs is something that the business has to learn to do on a day-to-day basis.

To the second point, is in some of the I think what we have really tried to do is tailor the right range and the right SKUs for the right banners. And you will see more of the tailoring and less of the sort of general all of these SKUs go in all of these banners. And that is something that we will sort of continue to build on.

Keith Howlett - Desjardins Securities - Analyst

And on the general merchandise side of the business. How are you pretty much where you want to be, or how far along in the process are you?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

I don't think we are half way yet, and that's not just the SKU rationalization. It is a -- in all of the stores that we touch, we basically reduce what I describe the core GM space. We're giving slightly more space to grocery, we're giving more space to Joe, which is doing well. And we are also giving more space to haber and pharmacy within all of that.

So I think that you really are talking about 500 stores where it really will make a difference, and we are probably less than one-third of the way through those.

Keith Howlett - Desjardins Securities - Analyst

Recently I have noticed that some of the real Canadian Superstores that you have reduced the sort of staff levels in floral and I think removed cosmeticians out of the beauty area. Are these tests or is this a broad sort of modification of the service level at those stores?

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Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

No, it is not. In some stores we will test them and test them out. I think the thing about the Superstore businesses and the hard discount business is clearly that cost basis is part of that competitive edge. And it is very easy to label costs into those stores for sometimes which are peripheral product groups in terms of sales, in terms of real sales.

Actually in recent weeks, recent months we have been adding, we've been actually putting ads into the stores. Because we think it is really important as part of the build-up to Christmas to make sure that the store conditions are even better than they were last year and that we've got plenty of people to get people through what we think will be a pretty busy time.

Keith Howlett - Desjardins Securities - Analyst

Thank you.

Operator

Your next question comes from the line of Winston Lee from Credit Suisse. Please go ahead.

Winston Lee - Credit Suisse - Analyst

Hi. Thanks. I just wanted to talk about the gross margin expansion a little bit more. I know that it is coming down in the quarter and you guys have indicated basically inflation is really accelerated downwards. And so what I am wondering is how much of the gross margin benefit do you think is sustainable, excluding inflation? If there's a way to sort of help us to think about it?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

The way to think about it this way. First on inflation, this is really important. It is sort of disappeared, I think is the way I would describe it. So, and if anything it is going to stay that way for a period of time is our view of it. And that is an important thing just to get in your head.

In terms of the gross profit which is the -- just remember in that calculation, it isn't just the gross margin but it has shrink and it has the transport piece of our supply chain cost in it. That's just the way the calculation is.

If you look at our gross margin, it is up 0.8 year-on-year, but if you look at the quarter it is actually down about 0.3. And as I say, just to give you some direction, I will repeat it for that point is that that is a blended number over four periods and wouldn't be a proxy for where we ended up. So it would be part of the gross profit improvement is clearly benefits of our centralized buying and our vendor management but also the success in the supply chain of transport which is two elements to it.

One is there is a fuel piece of that, which will either depends on what happens to fuel, it will either stay or go away. But the more concrete part of that is just that we have become much more efficient in managing our 30,000 trucks that we have on the road everyday. So it is a big cost and therefore a big benefit.

So some of that gross profit will go because it will get invested into price. Clearly we try to make up some of that, and clearly, the transportation piece which is to do with the supply chain, which as I say, I am very confident we will not just sustain but grow. But any element of that has to do with fuel is as volatile as all commodities are.



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Winston Lee - *Credit Suisse - Analyst*

When you look at the programs that really kind of took off in the second half of the quarter, can you talk about if there was a notable volume difference for you?

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

Again, without being specific because we never are, I think I indicated in my opening remarks that the performance as we exited the quarter in terms of both volume and our volume market share was better than it was that when we entered it.

Winston Lee - *Credit Suisse - Analyst*

And the SG&A, again ex the incremental IT costs, it looks like as it was pointed out earlier, it was flat as a ratio of sales. I wondered if there was kind of some upside from or sorry, if there was further upside to that? Or should we expect that you're going to have increasing labor costs into the next year that will kind of keep that relatively flat, or how should we think about that?

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

My sense of it is that clearly as you enter next year you will get some wage inflation, which you always get and no inflation to compensate for the wage inflation, which is why inflation is always the retailer's friend.

So I think there are in the costs that are to do with the supply chain and our admin costs as I said I think we are in a good place. And there is certainly opportunity for some improvement as and when the system comes in. But I wouldn't want to give you any other steerage apart from that.

Winston Lee - *Credit Suisse - Analyst*

Okay. That's great. Thank you very much.

Operator

Your next question is a follow-up question from the line of Perry Caicco of CIBC World Markets. Please go ahead.

Perry Caicco - *CIBC World Markets - Analyst*

Just want to delve a little bit more into store labor if I could. As your revenues suffered a bit over the last quarter, I am assuming you've had to make some ongoing decisions about some variable costs in the business. I guess most notably would be store labor. So I guess sort of understanding that the impact, the changes in labor levels have on things like customer service. How do you over the fourth quarter (inaudible) balance between sort of a pessimistic sales outlook and the need to really service the business coming into Christmas?

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

Okay, so I'll have Dalton talk to the first part of that, Perry. Okay.

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Dalton Philips - Loblaw Companies Limited - COO

Well, Perry, we have been at this now for a while in terms of putting in processes into the business that can improve the productivity. So in the quarter to give you an idea, our store productivity was up 2.5%. That's what is really helping and you can see that in the front end where our items are scanning right now is up to 3.5% on last year, so that's a strong improvement.

And in grocery, our productivity is up nearly, what 5.5% up on last year. And what that really means is that with a more efficient supply chain that Allan talked about. You have trucks coming in on time. You've got teams there when they need to be there to unload the trucks. We've got [pallets] that are configured. We can get at that freight up onto the shelf more effectively than we did last year. So you have 2.5% productivity improvement, which is obviously helping our business.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Perry, I'll just finish it off. So I think the answer is that's why productivity and that's why the linkage in the improvement in the supply chain and the linkage -- how we have managed the prices through the stores is a big part of that. Because as you know, we are still relatively inefficient in that because we don't really -- it's not an end-to-end process.

The second thing to your wider point though is that we will not allow, we won't bring down our wages to make sure that we -- as a cost of service. And you are right to raise that point because that does put a bit of pressure on the business. So we will get -- productivity will go a long way but it may not be sufficient to cover everything that we need because as you know if you have got a bit of inflation on the top line, and do not help that particular metric.

Perry Caicco - CIBC World Markets - Analyst

Okay and just an unrelated question. You have launched No Frills in Atlantic Canada now. Just wondering what your plans are for No Frills in that market? And similar to the west, will No Frills be a replacement program for existing stores, or do you plan to build out some new units.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Well we Shediac as you know which has been very good and turned around pretty quickly. We want to have a look-see what that does. But if we do, I think you will just have to wait and see what happens. But it is not just a one off just let's stick one in the ground for the hell of it. It is to see how these things work. And if they work then we may get behind it aggressively, if they don't, we won't.

Perry Caicco - CIBC World Markets - Analyst

In the west No Frills was obviously a sort of a replacement program for extra food. I'm just wondering if you are looking at the east in the same vein.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Not necessarily. And remember, Perry, as you know, in the west it is a conversion program. But our intention is to build ten new ones and I think we have done two already. And the plan is to finish the rest off probably by quarter three of next year.

The most interesting thing for us in the west about No Frills is one, how well it's been received. And secondly, how many real estate people are contacting us about sites for No Frills in urban areas, which is something that is really come out of the success of that.

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We have opened one in downtown Vancouver, which people have seen and quite like the idea of. So we see the opportunity of No Frills in the west to be a bigger one that we initially thought.

Perry Caicco - CIBC World Markets - Analyst

Okay. Thank you.

Operator

Your next question is a follow-up question from the line of Patricia Baker of Scotia Capital. Please go ahead.

Patricia Baker - Scotia Capital - Analyst

Hi there. Two things we haven't talked about, Allan, are traffic and the consumer. Can you talk to us about what traffic trends were like through the quarter and maybe even exiting the quarter? And also with respect to the consumer, are we still seeing some trade down behavior, are they changing the way they shop, what they shop for? What's your read on the consumer going forward?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

On the latter part, Patricia, consumer behavior as much as they have been now. It is pretty shackled into where it has been probably for the last quarter and a bit. As far as our item count, actually our custom numbers would be up year-on-year, on the quarter. Our basket size is actually up year-on-year on the quarter. And our customer count, item count, where it was before, only down a tad.

Patricia Baker - Scotia Capital - Analyst

Down a tad. So you are not going to be like Dalton and give us little percent numbers, right?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

No.

Patricia Baker - Scotia Capital - Analyst

Okay. Okay, just go back -- going back on the related to that but going back to what you said earlier about exiting the quarter with volume increasing and your volume market share up. So that would be indicative of Loblaw actually gaining share in the market because there's a lot of chatter about Loblaw actually losing market share.

And then secondly, with respect to that volume improvement and market share improvement, looking sort of at attribution, how would you assign cause and effect with respect to the [Renos] and the pricing in delivering that result for you.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

The cause and effect is always a combination of the two and, because we've done some [Renos] where there's been no pricing, so it is a combination of the two things.

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Patricia Baker - Scotia Capital - Analyst

I understand that's a combination, but you probably have some sense of which is the greater contributor. Is it the pricing?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Not necessarily. Past example, we've renovated Bayview & Moore in Toronto and not adjusted the price in any way, shape or form. And it has been a tremendous performer. It is very much depending on both banner and site. The idea is that both of them to have an impact. And it's the combination of the two that are more potent than one in isolation.

As far as the market share is concerned, the direction we have given I think is all of the direction that we can give. We don't talk about market share. I have tried to give everybody a bit more indication than normal because of the contrast between the beginning and the end. Not just on market share but also in terms of inflation and other things in the quarter. So, I'm afraid you will have to work with what we have said so far.

Patricia Baker - Scotia Capital - Analyst

No, I certainly understand that. But maybe I am completely missing something because it seems pretty simplistic to me that if you say your volume market share is up then you are likely gaining share.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

No. What I said is was actually that when we entered the quarter our volumes were under pressure.

Patricia Baker - Scotia Capital - Analyst

Yes.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

I said when we exited the quarter that our volumes were on the upward trend and our volume market share was on the upward trend.

Patricia Baker - Scotia Capital - Analyst

Okay. Perfect. Thanks for the clarification.

Operator

Your next question is a follow-up question from the line of Jim Durham of National Bank Financial. Please go ahead, sir.

Jim Durham - National Bank Financial - Analyst

My question has been asked. Thank you.

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Operator

There are currently no further questions on the phone lines. Please continue.

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

Okay. Well this is Inge van den Berg just wrapping up the call. Thanks very much for your interest in Loblaw Companies. We will speak to you on our fourth quarter call in February.

Operator

Ladies and gentlemen, this concludes the conference call for today. Thanks for participating. Please disconnect your lines.

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