

FINAL TRANSCRIPT

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Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

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PRESENTATION

Operator

Good morning, my name is Sarah and I will be your conference operator today. At this time I would like to welcome everyone to the Loblaw Companies Limited third-quarter results conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question-and-answer session. (Operator Instructions). Thank you. I would now like to turn the call over to Ms. Kim Lee, Vice President Investor Relations. Ms. Lee, you may begin your conference.

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

Thanks, Sarah. Good morning, everyone, and welcome to the Loblaw Companies Limited third-quarter conference call. This call is also being webcast simultaneously on our website at Loblaw.ca. I'm joined here this morning by Galen G. Weston, Executive Chairman; Allan Leighton, President and deputy Chairman; and Sarah Davis, Chief Financial Officer.

Nov. 17, 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

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 2010 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. And with that I'll turn it over to Galen Weston.

Galen G. Weston - Loblaw Companies Limited - Executive Chairman

Good morning and thank you for joining us. We continue to make progress towards the final stages of our renewal program in a market that remains highly competitive and under deflationary pressures. These factors combined with the significant risks and costs associated with our major systems and infrastructure programs will continue to put future sales and margins under increasing pressure. I'll now turn the call over to Sarah to walk us through the results.

Sarah Davis - Loblaw Companies Limited - CFO

Thank you, Galen, and good morning. Sales in the third quarter of 2010 increased by 1.3% to CAD9.6 billion. The acquisition of T&T, which was completed in the third quarter of last year, positively impacted sales by 1.7%. Same-store sales decreased by 0.4%.

In the third quarter of 2010 sales in food were flat, sales in drugstore declined marginally impacted by deflation due to regulatory changes in Ontario and certain prescription drugs becoming generic. Sales growth in apparel was strong while sales of other general merchandise declined significantly. And gas bar sales increased significantly as a result of higher retail gas prices and strong volume growth.

In Q3 our internal retail food price index was flat whereas we saw internal food price inflation in Q3 of 2009. Gross profit in the quarter was CAD2.3 billion or 24.2% of sales versus CAD2.2 billion or 22.9% of sales in the third quarter of last year. The improvement was primarily due to continued buying synergies, disciplined vendor management, improved control label profitability and inventory management and a stronger Canadian dollar. This was partially offset by increased transportation costs.

Operating income was CAD390 million in the third quarter compared to CAD378 million in Q3 of 2009. Operating margin was 4.1% in the quarter, a 10 basis point improvement over last year. The improvement in operating income was primarily due to the increase in gross profit that I mentioned earlier. This was partially offset by a CAD10 million charge related to stock-based compensation net of the equity forward, a CAD17 million charge related to the ratification of labor agreements, and CAD46 million in incremental costs related to the Company's investment in IT and supply chain.

SG&A expenses in the quarter as a percent of sales were 18%, slightly lower than our year-to-date trend of 18.2%, but higher than Q3 2009's rate of 17%. The year-over-year increase in SG&A is primarily driven by stock based compensation, the onetime labor charge, a portion of the incremental IT expense and investments in labor during the quarter. Q3 2010 SG&A includes T&T

Nov. 17, 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

for the entire quarter whereas Q3 2009 includes only 12 days. Adjusting for these items SG&A expenses in the quarter were up approximately 1.6% year over year.

As a result of buying efficiencies and the timing of certain phases of our IT projects we now expect our full-year incremental spend to be in the range of CAD140 million to CAD145 million, down from our previous estimate of CAD185 million. Loblaw realized third-quarter basic net earnings per common share of CAD0.77 compared with CAD0.69 in the third quarter of 2009.

Net debt at the end of the third quarter was CAD2.5 billion compared to CAD2.8 billion at year end and CAD2.7 billion at the end of Q3 2009. The year-to-date decrease in net debt was primarily due to cash flow from operating activities and a decrease in credit card receivables after securitization partially offset by fixed asset purchases.

Capital expenditures in Q3 were CAD479 million and CAD863 million year to date. As the performance of stores renovated to date has exceeded our expectations we have increased the number of planned renovations this year and our estimate for capital expenditures in 2010 is now approximately CAD1.3 billion, up from our previous estimate of CAD1 billion. I would now like to turn it over to Allan Leighton who will provide some context for the quarter and the balance of the year.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Thank you, Sarah, and good morning, everyone. Performance in the third quarter continued to show that we are making solid progress towards our renewal plan. The marketplace and the economy continue to present more headwinds than tailwinds. Unemployment still remains high with long-term unemployment, the real killer, continuing to rise. Household debt is at an all-time high and there is the ever lingering menace of rising interest rates. This combination of economic factors continues to drive consumer confidence down.

In Q3 we had zero food inflation and deflation in drugstore. We exited the quarter with 0.1% inflation in food -- 0.1% inflation in food, but drugstore was significantly deflated. It's difficult to predict where inflation will go, but with the market still spotty and very promotionally intense we remain focused on volume and item growth.

Our infrastructure programs remain a key priority for us. As we mentioned on our last call, we went live with our second SAP deployment integrating our general ledger and related financial reporting across the business on SAP. This is our first quarter close and release without financials rolled up on SAP. Also in Q3 we launched a baby SAP pilot in merchandising and we'll move to a super pilot in merchandising in this current quarter.

Our work on supply chain proceeds on track. We're on plan to complete the first phase of our Regina DC by year-end and opening in Q1 2011 and with that the physical infrastructure of our supply chain will largely be built out.

On supply chain systems we now have a large number of users on what we call IP at IPFR, a new forecasting system to improve ordering and replenishment. Also in Q3 we rolled out our warehouse management system to our St. John's [NHF] DCs and by year-end we'll have 50% of our DCs on the new system. And with six more transport management system go lives in Q3 we now have all of our transport operations on the new TMS system.

To further improve our supply chain efficiency there were 12 category go lives of retail ready packaging. Our total to date is 17 categories and we now deliver well over 1 million grocery retail ready cases to our stores each week. We will have 70% of all our control brand products in retail ready packaging by year end and all of our control brand will be open date coded.

Our store renovation program continues at pace. In Q3 we had by far our biggest quarter ever. We took 70 stores including some of our largest turnover stores, bringing our year-to-date total to 161 stores and we will deliver 200 by year end as planned.

Nov. 17, 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

During the quarter, as previously announced, we opened five more Nofrills in the Atlantic with a sixth to open soon. The five new Atlantic Nofrills have been very well received; each week we continue to see new customers shopping our stores to benefit from our discount offering and we're still on track for 20 Nofrills in that region.

In the West we continue to convert Extra Foods to Nofrills and now have 23 stores under that banner. We plan to convert another six Extra Foods in this quarter to have 29 West Nofrills by year end.

We continue with our investment with Zehrs with eight more renovations this quarter and are halfway through the renovation of seven Fortinos. We plan to build one or two new Fortinos in 2011.

We also opened our first City Market, (inaudible) Street Market, which is a smaller urban store. We're encouraged by its performance and plan to introduce a number of small and large urban stores into our portfolio over the next few years.

In Quebec we converted another five Provigos to franchise operations. Our new franchise has been well received and we're pleased with the results thus far.

On the Joe front, we opened two new Joe standalone stores, one in the historic Jean-Talon train station in Montreal and the other on Granville Street in the heart of the Vancouver shopping district. We are still targeting 20 such standalone stores.

It's been a year since we acquired T&T and today we opened a new T&T store, Park Royal in West Vancouver and we have plans to open four new T&Ts next year. We've been able to take a lot of learning from T&T and put it into our core business. We believe that the asset market is a key area of future growth and our objective is to be the number one player in Canada.

In the quarter five year collective agreements were ratified with our key Ontario union locals. Negotiations were tough but met our twin objectives of remaining the highest paid in our industry, but now with the flexibility that will allow us to have the right people at the right time in the right place to serve our customers.

This agreement, now dovetailed with our new store timed attendant system, STAS, gives us the management tools and information to execute this opportunity effectively. We currently have 250 stores on STAS, we'll be at 300 by year end and all corporate stores will be on the system by mid-2011.

So in summary, economic conditions are a headwind, inflation is unpredictable at worst or [matt sized] at best. The market is tough and promotionally intense and we still hover on the darker side of the moon. In these conditions we continue the tricky balancing act of trading for today whilst building for tomorrow.

We are making real headway on building the strong foundation the business requires to build out from. A strong balance sheet, state of the art supply chain systems and infrastructure, finance systems, a renovated core store base and with labor flexibility now as good as our competitors the opportunity to serve our customers even more effectively. With that, Operator, I'd like to over for questions.

QUESTIONS AND ANSWERS

Operator

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



Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Michael Van Aelst - TD Newcrest - Analyst

Good morning. Just to start off on the IT costs for the quarter being lower. You mentioned that some was timing, some was better buying. Are you able to split that up at all?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Michael, the best way to think about it I think is -- I sort of think about it one-third, one-third, one-third. We are buying more efficiently and frankly I'd expect us to. We are still running the biggest IT projects on earth in terms of retail. And those -- that market is still a tough market for all the IT suppliers. So clearly I'd expect us to buy more efficiently. So that's a chunk of it.

A second chunk of it is, again I'd expect us to be more effective in how we deploy our resources on this. We've been a year going at this and we are getting much better at deploying the resources at the right time. You know a lot of this is people and, like anything else, you deploy the people correctly you can do it efficiently or you can do it inefficiently. And I think we're certainly becoming much more effective at that.

The third thing is the program will adjust. We're at that phase with SAP where there will be adjustments in the program and some things will pull forward and some things will push back. And in that there are two things. The big issue really is one of risk management. We're doing this program very quickly and that's the intent. But at the same time we don't want to put any elements of the business at risk while we do that.

And data is a big issue for us, it always has been a big issue for us, and as some of these projects require more data cleansing, then I think you will see some oscillation in terms of some will be put back and some will be brought forward. So, I sort of think about it on those three ways. There's some time adjustment, there's some much more effective working and there's -- we're just buying more efficiently.

Michael Van Aelst - TD Newcrest - Analyst

Are you able to give us the timing I guess of the major remaining stages?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

I think that's really for the next meeting and that's not passing on it. Clearly the next stage is all what we do around merchandising. As I said in my notes, that we are in the process, we've done what I call a baby pilot and we're just about to move into a super pilot with a large number of categories. And depending on how that goes -- and again, for me the issue will be around data -- will then determine at what pace we go at the next phase on merchandising.

So that probably will be determined over the next couple of months. And when we talk at the year end, our year end, we're going to give you hopefully a better idea about what the next phases are and also some idea about where the costs will go. But I think everybody should prepare themselves at this time. When you get into this stage of SAP you start to move the programs around, and I'm very keen to do that because I want to make sure we moved at pace but we manage the risk.

Michael Van Aelst - TD Newcrest - Analyst

And then just finally on that topic, the -- did you encounter any inefficiencies in the quarter that wouldn't necessarily have been captured in that CAD46 million?

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

What do you mean by inefficiencies?

Michael Van Aelst - TD Newcrest - Analyst

I'm sorry, related to the IT and the deployment and whatnot?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Not really, no.

Michael Van Aelst - TD Newcrest - Analyst

Thank you.

Operator

Irene Nattel, RBC Capital Markets.

Irene Nattel - RBC Capital Markets - Analyst

Thanks and good morning, everyone. Allan, we've all just come off the Metro call and certainly they were talking about a more intense competitive environment. Can you -- particularly in Ontario. Can you give us your thoughts around that?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

(inaudible). I mean, is it helpful -- would it be helpful if we got Sotheby's also to announce today so you could do all these back-to-back? Would that be something we could arrange or --?

Irene Nattel - RBC Capital Markets - Analyst

That would be perfect actually.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

We'll work on that; we always want to try and be helpful. I think the competitive environment, as I describe it, is tough. The market is -- is not particularly strong, there's no inflation that sort of helps everybody along. And I've always said to you inflation is the friend of the retailer and that means that everybody would be pretty aggressive to try and get some volume.

And certainly most of that is through promotions. If you look at the flyer programs they're pretty intense. And we're still in a position where literally every week a new market low appears for something. So, I think it's just the way the market is.

If you've got very little market growth, if any, and you've got no inflation, then people are trying to drive some volume and that tends to be a bit short-term and tactical. And so as I said to you, we very much are in the balancing act which is -- one, we want to stay competitive and certainly hold our position in the marketplace. But at the same time I'm not going to be deterred from getting these basics right for the business. And we're focused on both of those things.

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Irene Nattel - RBC Capital Markets - Analyst

That's great, thank you. And on the subject of doing what's right for the business, you mentioned, or Sarah mentioned that the early results from the renovated scores was better than expected. Could you add a little color around in what way is it better than expected?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Well, I mean there are -- I mean, I think there are only three ways that you ever see the performance. One is clearly what happens to the sales trends. Two, what happens to the profitability. And three which is most importantly the sort of customer reaction to it. And a large number of our reno's have done well on all three counts.

And also as I say, we've done one or two different things in the quarter. So it's a combination of those things. I'm very keen -- I'm not a great opener of stores, I don't think it's a particularly good thing to be doing in a market like this. You can seduce yourself to drive sales, but there's a long history of you drive sales in the short term it causes you profitability problems in the long-term.

And we've been very focused on getting our core store base up to date and we're well down the track of doing that. We've learned to do it in half the time and we're getting much better results, so that's why we're going to increase our capital and probably when we talk to you next year you can imagine that we'll have the same confidence and that will probably reflect in the capital number for next year too.

Irene Nattel - RBC Capital Markets - Analyst

That's great. Thank you.

Operator

Peter Sklar, BMO Capital Markets.

Peter Sklar - BMO Capital Markets - Analyst

Good morning. Just back on the reduction in the IT spend from CAD185 million to that range you provided, CAD140 million to CAD145 million. Allan, one of the reasons you attributed to was buying efficiencies. Wasn't too sure what you meant by that. Does that mean that in terms of that one-third the gross amount of the spend hasn't been reduced, it's just rather you're starting to see some of the benefits so you're netting it off (multiple speakers)?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

No, what we thought we may have to pay for it we're paying less, it's as simple as that.

Peter Sklar - BMO Capital Markets - Analyst

You mean in terms of your procurement you're seeing the benefits already?

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Absolutely. It's a sort of -- it's a procurement issue. So, clearly when we started out, when it was -- 15 months ago we tried to put a budget together what we thought this would be and give you some guidance on it. As I'd expect us to we bought better than that. And so that's a combination of it. It's basically the price that we paid for the service is less than the price that we thought we'd pay for the service.

Peter Sklar - BMO Capital Markets - Analyst

Okay. And looking out beyond -- into 2011, do you have any feel yet for how -- sorry, into 2011 do you have any feel yet how these costs are going to continue? Are they going to continue at about the same level as 2010 or are we going to see some reduction?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Well, I think there are two ways to think about it. One is that will be dependent on what programs and what pace we go at. And as I just said, this next phase, which is a merchandise program, is a big test for me in terms of how that runs. If that runs well and I think that we've got dates, we're in good shape, then I think we'll press ahead aggressively. If it doesn't run well I think we've still got more work to do on data then we'll slow it down and move on another piece of the program and work on that.

So, I think if you were thinking around the same number, it's probably not a bad place to start. It may be higher. And -- but I think that I'd rather deal that when we meet next time because it will be a more thoughtful -- it will be a more fact-based answer, put it that way.

Peter Sklar - BMO Capital Markets - Analyst

Okay. And when it's all said and done I presume sometime in 2012, will there be some tail of expense that will continue?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes, I mean -- not a tail -- I wouldn't look at it as a tail expense. But clearly the running costs of our IT with the base cost will be higher than where we started, it's just the way that it goes. But clearly we would still expect further cost to come down significantly. We haven't put all this in to put all our costs up, so it's [better to have some] cost reduction off the back of that. But remember the real benefits in these systems come from how they're applied and they'll come in margin and shrink and things like that.

Peter Sklar - BMO Capital Markets - Analyst

Right. On a different topic, as you know commodity prices -- wheat, flour, sugar, etc. -- have risen quite substantially. How do you see this unfolding as it flows through into wholesale food deflation? I assume you haven't seen anything yet, but you assume you might see some of it in the future.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes. No, I think there's a couple of things. Clearly because of the market where it is, where it is then and everybody pretty aggressive in their position, including the manufacturers. Remember the manufacturers also see a market that isn't doing very much. So, at the moment there's a bit of price movement in fresh, there's very little price movement in grocery. And frankly I expect it to seem like that for a period of time.

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

I think that there's got to be a pretty big justification for price increases in a market in the condition that this market is in today. So, the new year is always a new year, that generally is the time when everybody comes knocking on the door to put prices up, so accept their pricing for the year and, again, I think we'll have a better view on it then. But I don't see any great change in the position certainly in the short term.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And just lastly, the CAD17 million of costs related to the contract ratification, is that just a settlement bonus for employees or what is that?

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

Yes, it's a signing bonus, think about it that way around.

Peter Sklar - *BMO Capital Markets - Analyst*

Yes, okay, thank you.

Operator

Jim Durran, National Bank Financial.

Jim Durran - *National Bank Financial - Analyst*

Good morning. Just going back to the consumer behavior right now. Have you seen any notable contraction in the traffic or volume that you're getting in your stores?

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

No, I think the consumer behavior is a continuation of where the consumer behavior has been. I think I said a few quarters ago that it changed and it changed when the recession took place. And it's going to be like that for a period of time. Clearly because the market is pretty aggressive, then to a degree that affects consumer behavior. You cannot escape that consumer confidence is not in a good place and that people are concerned about the future and their own economics.

And so there's a bit of a thought. Is it the fact that we're all very aggressive and that's bringing the prices down and that's changing consumer behavior or is it because actually consumer behavior is changing? And the truth is we won't know probably for another six or nine months. But my sense is that you can sense there is a bit of a trend here and clearly the way in which all the retailers are reacting in terms of trying to drive sales probably plays to that.

Jim Durran - *National Bank Financial - Analyst*

Okay. And just on your control label business, can you give us an update on where you're at in terms of the refinement and profit enhancement of control label as of the end of this quarter and do you expect to be finished with that initiative largely at the end of this fiscal?

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

We don't expect to be at the end of this fiscal, I think it will carry over into next year. We've made very good progress and you've seen what's happened to our gross profit. A big contributor to what's happened to our gross profit is that our control brand is clearly much more profitable than it was a year ago and needs to be. And is in my mind beginning to get directionally close to what it should be. But it isn't there yet. And until it gets there then we'll be very fixated on making sure that we do get there.

Jim Durran - National Bank Financial - Analyst

And you've seen a pickup in private label volume or dollar sales in the last six months compared to what you were doing the six months previous?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

That's much the same. I mean, if you think about it and you see the market is pretty flat and it doesn't matter who it is, nobody is really getting any sales. So, much of the characteristics are much as they've been.

Jim Durran - National Bank Financial - Analyst

Okay, that's great. Thank you.

Operator

Patricia Baker, Scotia Capital.

Patricia Baker - Scotia Capital - Analyst

Thank you, good morning, everyone. Allan, just two very quick questions. First of all, and you may have implied the answer to this, but I might have missed it. Of the CAD40 million differential in what you were going to spend and what you are spending on IT, is the procurement shift -- is that the bulk of that differential or (multiple speakers)?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Think about it one-third, one-third, one-third, Patricia, that's the way I sort of think about it. One-third is the procurement piece, one-third is actually just more effective, it's been like -- in a strange way it's like scheduling labor -- as you schedule labor in a store (multiple speakers)

Patricia Baker - Scotia Capital - Analyst

Sure, that makes sense.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

(multiple speakers) efficiently. And one-third of it is timing adjustments.

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Patricia Baker - Scotia Capital - Analyst

Okay, so roughly one-third of it will just get [shifted]?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes.

Patricia Baker - Scotia Capital - Analyst

Okay.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

That's the way to think about it.

Patricia Baker - Scotia Capital - Analyst

Yes. And then you referenced -- for the first time we are hearing you talk about opening some new stores and you referenced that you would -- we could you look to you developing both a small and a large urban format. Can you talk a little bit about that? And just for my edification, how big is the urban store that you have open in Toronto?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

The urban store we've got open in Toronto, probably about 20,000 square feet.

Patricia Baker - Scotia Capital - Analyst

Okay.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

And it's just -- as you know, that's the small one and we've got a couple of big ones to come, Queen and Portland and Maple Leaf Garden. And I actually believe that big urban stores are very effective. I think about it, probably those -- the small urban stores probably do CAD200 million, CAD215 million a week, perhaps CAD300 million. You get those big stores doing one in excess of CAD1 million, CAD1.2 million, CAD1.3 million. It's four or five times the power.

So for us, I think the way we see about urban and we think about urban in (inaudible), the major cities, I think we see it as a combination of large urban and small urban, which is a slightly different way of thinking about it. The one thing about opening new stores is we have to learn from our experiences, that we didn't have a very good experience when we went through a rash of opening new stores before. And it was very good for our topline sales for a bit but it didn't do very much for our profitability.

And so we will open some new stores, we are very disciplined about it. And I think we understand our economics better now, including our economics have shifted too with what we're doing with control brand and what we've been doing with general merchandise.



Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

So we will open some new stores. It will be done in a very controlled way and we're in quite a fortunate position where we've got a design bank and therefore we can pick which stores to open. And clearly the profitability of that will be a big element of that.

Patricia Baker - Scotia Capital - Analyst

Okay. For me that's a little bit cryptic, Allan, when you talk about you'll be very disciplined about it. What exactly are you referring to here? Just the sheer magnitude of how many you'll open or is it more than that?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Sheer magnitude. And because the point I made earlier on, the reno's are still our focus. We had a store base that had not been restored for a long period of time and that is still the number one priority of the business. And until that is done, which is probably another 12, 15 months away from getting around the hoop, then new stores are a secondary thought. But I think I would describe them, they are now a thought that is coming into our heads based on the fact that we have a very disciplined way of controlling our capital.

Patricia Baker - Scotia Capital - Analyst

Okay, thanks.

Operator

Winston Lee, Credit Suisse.

Winston Lee - Credit Suisse - Analyst

Maybe I misunderstood, Allan, but at the end of the year you're still going to have 200 stores which is unchanged from before. But you've ramped up CapEx by CAD300 million. Partially because you said that some of the renovations are exceeding expectations and you're doing things like in half the time with better results, but how does that translate into more spending?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Because we'll be -- there's a difference between completing and starting. So one of the things that we're going to do is it's very important for us to get off to part -- get as much done early in the year as you can. And so next year we're going to do a lot of activity probably in Q1. And therefore there's a lot of prep work that you can do between now and then.

And secondly, there's a slight shift in the capital, which is where we've invested -- we've moved the capital program around a bit. So as you know some of the renovation costs much more than the others, superstores in the West have been a very good example.

So, because of our superstore in the West, we're very pleased with the renovations of those, we'll shift the mix a bit. And sometimes they can be two, three times the cost of a standard conventional. So there's a bit of change in the mix to -- and some of the more expensive reno's and there's a bit of just getting ahead of ourselves for Q1.

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Winston Lee - *Credit Suisse - Analyst*

Okay. So I take it that in part of all this you're not seeing -- it's not going to increase the level of sales disruption. In fact maybe it's less than expected which is allowing you to pursue this in a more accelerated fashion?

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

Well, I mean, there's always a bit -- I wouldn't underplay the sales disruption. We're much better at it, but even when we can do these stores in half the time that is still a long time that the customers are inconvenienced. So, I'm not going to -- do we still get disruption? Yes we do. Clearly the bigger the store often the bigger the disruption. And so you've got that balancing there. But we're playing (inaudible) we play for the long-term and therefore we have to take a bit of pain in the short-term to make sure we get these stores right and that's what we're doing.

Winston Lee - *Credit Suisse - Analyst*

Okay. And can you just kind of touch base on thoughts on real Canadian superstore? How you feel about that particularly in Ontario if there's more to do. I remember the Milton prototype some years ago and is there a next devolution to these stores?

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

Yes. I mean, when we think about our superstores we think about them two ways. The West which has a very potent model and a potent system and we are investing heavily behind with a fair degree of success. Ontario is still an issue for us. There's been a lot of good work done, which I think has helped improve the profitability of that business. But it still is one of the parts of our business that we need to have more clarity on the consumer proposition and I think that's something you'll see develop more next year.

We've got [Sylvan Prudun] who runs all those businesses now and he's a very smart guy and we really wanted to get a bit of a sense of his grasp of what needs to be done. And he's working very hard on that and I think you will see more change next year in Ontario superstore than for some time.

Winston Lee - *Credit Suisse - Analyst*

Okay. And lastly on the apparel business. Do you have any thoughts or concerns about pricing -- cotton prices going up? Everybody is kind of talking about it, but do you see this -- any threat to margins going forward like next year?

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

I mean, it's like -- cotton is like all other commodities and it's up -- will it have an impact? Perhaps, but at the same way around, the manufacturers and everybody else are always trying to find a way to make sure that that stuff doesn't get passed through. And so I think it could have a bit of an impact, but my sense is and talking around outside of the Joe business is that people are very conscious that that would need to be mitigated in some way, shape or form.

Winston Lee - *Credit Suisse - Analyst*

Okay. And my last question is on deposits. So you started out this quarter. Where do see that growing? Is that just like a matter of like replacing the securitization efforts? Or do you actually think that there's a lot of growth in that business?

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Well, I'll get Sarah to go over GICs and then I'll come back on PC Bank. Do you want to --?

Sarah Davis - Loblaw Companies Limited - CFO

Okay. So on GICs we have 7 million at the end of Q3, so it's a pretty small piece of our piece, but it is exactly what you mentioned to date of diversifying our funding so it did not rely 100% on the securitization market. And it's a nice new offer for the PC Bank as well. So it's a combination of both.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

And I think it's worth -- clearly our mind is beginning to move to other areas of growth that we can build on from our core business. And PC Financial, which is the way we think about it, which is the bank and the credit card and insurance and mobile end points, we'll start to talk a little bit more about because we do believe that that is a growth engine. And as you know, we ran a -- Galen ran a campaign on no fee banking in this quarter which people should see as a bit of a sign of our support for that idea.

Winston Lee - Credit Suisse - Analyst

Is that coming into Quebec at some point?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

It is -- I mean, it will be. As you know, there's a slightly different set of circumstances in fact. But again, one of the things I think we will talk to you about when we get to the year-end numbers is a little bit more detail about the Bank.

Winston Lee - Credit Suisse - Analyst

Okay, looking forward to it. Thanks.

Operator

(Operator Instructions). Keith Howlett, Desjardins Securities.

Keith Howlett - Desjardins Securities - Analyst

Yes, on the capital program in 2011, do you anticipate it will also be higher due to more store renovations?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

I mean, yes, I mean it will be -- I think this year's number is a good walk around number for next year. But it will continue to be the same sort of split -- say marginally more new because clearly we've got Maple Leaf Gardens and Queen and Portland and some of those that are coming down the track. But it will be much (inaudible).

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

And I think it will be a good final push on the renovations in terms of just making sure that we've got -- then we're back in cycle. I said it before, as we've spent a lot of money catching up and then we'll get more into cycle of doing these stores on a five- to seven-year basis.

Keith Howlett - *Desjardins Securities - Analyst*

And then on the supply-chain project, it sounds like the transport management system will be pretty well done by January, is it?

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

Yes, it will be done by the end of the year.

Keith Howlett - *Desjardins Securities - Analyst*

And so how long does it -- is the payback on that sort of program more or less immediate or is it -- is there quite a bit of learning in terms of the use of the system?

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

Well, I mean, we've been doing it for a period of time so we actually -- each one gets better because all of the learning of the previous one. I think if you're going at pace we've been doing like one a month. And so the guys, [Rob Weaver] and (inaudible) is doing a very good job on it and so the paybacks -- the payback comes at a reasonable pace including there's a lot of money on the outlay. But it's a very high return project.

Keith Howlett - *Desjardins Securities - Analyst*

And does that same sort of phase in and knowledge as you go along apply to the supply-chain information system?

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

(inaudible), yes, I mean all of it. The way we build it is in modules. So TMS went DC by DC, WMS is going DC by DC, IPFR is going to desk by desk. And so this is part of everybody is going to have to get used to it a bit. When you get -- we're doing this at a hell of a pace, it's a huge project. And you do adjust as you go. And we'll see a lot more of that over the next 12, 18 months.

Keith Howlett - *Desjardins Securities - Analyst*

On the drugstore business, can you speak as to the impact of Ontario and Quebec reform and where you see that?

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

Yes, I mean, there's a big deflationary pull on us now. I mean, it's our most deflated business and you can see that in the top line, that sort of Lipitor to generic and the other changes, driven -- but we're in a phase of investment in that business and we're sort of mitigating the top-line (inaudible) more difficult, but we tend to look at how we're doing in terms of scripts and things like that which we made progress on.



Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

And as you know, we've been extending hours, we've been building out medical centers and we've got Frills with that \$8 fee. So it is -- it's going through an investment phase with us and we feel pretty confident that we'll be able to, A, grow the business and then mitigate any big P&L and its impact.

Keith Howlett - *Desjardins Securities - Analyst*

Then on the balance of the general merchandise business where the sales are still going down, which I think is -- well I guess that's my question. Is that still mostly the shift to the new mix that you're hoping to have in most of the stores more or less now or --?

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

Yes, I mean it's a combination. I mean, as you know -- I mean if you'd looked at Wal-Mart's results yesterday, I mean in fact that market is still -- if you take apparel out, which is performing particularly well for us still, that market is a market that's under pressure. And so you've got -- in our case you've got two factors. One is the both those markets are not performing particularly well. And secondly, we're re-adjusting.

I'm pleased with the progress we're making because, again, we're sort of rebuilding the business. And again, when you look at our gross profit one of the big drivers of improving our gross profit -- it's not a control band -- is also what we've been able to do on general merchandise profitability, managing the inventory, managing the range, managing it in a complete different way.

So we've yet to get the benefit of the new ranges which Joe is bringing in. They're starting to come through into the business now and I know he feels very confident about those. And I think we've also developed a layout and design concept for that side of the store, which we've got in a couple of stores at the moment, which I think just makes it much easier to shop.

And so I think what Joe has done is he's created a set of products that really fits with our customer base and a much easier way of shopping general merchandise in our stores. So, I think we've got a lot -- there is still a lot to come from that from a sales perspective. But I'm -- I think we're in a pretty good place.

Peter Sklar - *BMO Capital Markets - Analyst*

And would it be sort of Spring/Summer 2011 before most of the general merchandise assortment ex-apparel would look the way you want?

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

Yes, probably -- I mean, remember, there's bit of seasonality in it all. But I think Spring would be a good way of thinking about it. I think Joe would say probably we'd be 50% of the way there by the time -- in the range of it having the holiday period. And then the rest will work its way through. Because you know we work on very long lead times on this. But I think we feel better about general merchandise from a construct, both consumer and P&L, than we've done since we went into the business.

Keith Howlett - *Desjardins Securities - Analyst*

And then I know you don't speak specifically about banners, but you are opening quite a few T&T stores. Could one presume that its performance is quite distinctive amongst grocery store formats or --?

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

I mean, no, I think T&T, we're very pleased with it, but they're in the market. Remember our market -- Canada is a very ethnic and diverse country and therefore they are seeing exactly the same market conditions as we all do. But we're really pleased with it -- we're opening a new store today which is over in Vancouver which is very exciting. We do plan to open four next year.

We've always said from the beginning this is a business we should think we can double up on. And we bought it with that intent, we bought it to understand this market, we bought it to have that team, which is a really good team. And we built it to drive our objective, which is we are the number one player and we continue -- we intend to be the number one player because that market is going to be very big.

Keith Howlett - Desjardins Securities - Analyst

Just lastly, there's been a lot of activity here with banners and new square footage in Ontario. Is there much -- does that reflect in deflationary numbers? Is Ontario the most deflationary or is it pretty much a national picture that prices are flat or deflationary?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

It is pretty much a national picture. It's all relative to where everybody was and everybody is relatively in the same place.

Keith Howlett - Desjardins Securities - Analyst

Great. Thanks very much.

Operator

[Chris Li], Bank of America.

Chris Li - Bank of America - Analyst

Good morning. Sorry if you answered this already but, Allan, can you give us maybe a bit of a pecking order in terms of what were the key gross margin drivers during the quarter?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Well, I'm not sure I can do them in a pecking order, but it is roughly as they come out my head probably is the pecking order. Clearly we've got -- there's vendor management that plays a part in that, control brands, profitability, improvement in profitability plays a big role in that, general merchandise, improvement in profitability plays a big role in that, and just generally and how we've managed our inventory. And particularly [GN]. And they're really the four major characteristics.

Chris Li - Bank of America - Analyst

Okay. And can you also give us an update on the new smaller pharmacy format that you've rolled out recently where you're at?

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Yes, we -- the one in Nofrills worked pretty well, we moved another one into Peterborough, which is early days but we're quite pleased with it, so we're playing around with that. And we're still targeting to have around about a dozen by the middle of Q1 by now, and we won't mess around too much now in the stores -- those stars are being renovated. And so by probably middle of Q1 we'll have about a dozen of them.

Chris Li - Bank of America - Analyst

Are they performing in line or better or --?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

In line and -- but there's a lot of operational (inaudible) that we're getting from it. Because it may well -- my whole thing on this is (inaudible) an opportunity to put those in some of the smaller stores. I actually think there's a real piece of learning about how we run the pharmacies more efficiently and our larger stores and bizarrely it may be the latter which has the biggest benefit for us.

Chris Li - Bank of America - Analyst

Okay, great. And just a couple of ones for Sarah. Just for the incremental IT spend for the quarter. Can you maybe help us break out like how much of that was recorded in your operating expenses versus in your depreciation expense?

Sarah Davis - Loblaw Companies Limited - CFO

Of the CAD46 million, CAD25 million was in operating expenses and the rest was in depreciation and amortization.

Chris Li - Bank of America - Analyst

Okay. And then just on the increase in the CapEx for the year of CAD300 million increase, what would be roughly the corresponding increase in the depreciation expense for next year -- from that CAD300 million increase?

Sarah Davis - Loblaw Companies Limited - CFO

So the CAD300 million is mostly going into renovation, store renovations. So it would be over an eight-year depreciation, it's calculated on eight years assuming it's all done by the end of the year.

Chris Li - Bank of America - Analyst

Okay. And just last question, just square footage growth for next year is still sort of 1%?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

We don't give any numbers, we may talk a bit about it when we talk at the year end.

Nov. 17. 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

Chris Li - Bank of America - Analyst

Okay, thanks very much.

Operator

Michael Van Aelst, TD Newcrest.

Michael Van Aelst - TD Newcrest - Analyst

Yes, thanks, most of them have been answered. But just to clarify on the general merchandise side, when you say that you expect to have the bulk of your new assortment the way you want it by, I think it was spring of 2011, does that mean that you've got all your new assortment in or does that mean you've also got (multiple speakers)?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

No, it doesn't. I mean some is in for Christmas and the holidays and some will come in in Q1 of next year.

Michael Van Aelst - TD Newcrest - Analyst

Okay. And how about getting the -- like changing the SKUs or getting out of the other categories that you had that -- will you be done at that at the same time?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Largely, yes. I mean, you obviously do that as you go, it's sort of in and out. And so, again, certainly 80%, 85% of that will be done by then. And the big stuff will be largely all done by then. Okay? Good, okay, well, Kim, do you want to finish?

Kim Lee - Loblaw Companies Limited - VP of IR

Operator?

Operator

Vishal Shreedhar, UBS.

Vishal Shreedhar - UBS - Analyst

I was a bit surprised that your drugstore sales declined marginally given one of your peers experienced, call it, marginal growth. Are you gaining or losing market share in drugs given your significant advertising (inaudible)?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

Well, we never talk about where we are in market share. I mean -- and I don't know who you're referring to. It is a -- the big driver in our drug top line is significant deflation. And then probably the way I look at it is if I look at scripts, for example, then we'd

Nov. 17, 2010 / 4:00PM, L.TO - Q3 2010 Loblaw Companies Earnings Conference Call

have quite positive momentum. And so I think that's the way to think about it. I wouldn't necessarily read into the fact that the top line was down with the deflation that we've got that we're losing volume.

Vishal Shreedhar - UBS - Analyst

Can you talk about your scripts, is that above 4% in the quarter, scrip growth?

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

We don't talk about the number. I think I'd just say we've got positive momentum in scripts.

Vishal Shreedhar - UBS - Analyst

Okay, thank you.

Allan Leighton - Loblaw Companies Limited - President & Deputy Chairman

So I think we -- Operator, I think we'll call it a day if that's okay now. And we'd just like to thank everybody for calling in and we'll talk to you in the new year. Thanks a lot.

Operator

This concludes today's conference call. You may now disconnect.

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