# FINAL TRANSCRIPT

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# L.TO - Q4 2008 Loblaw Companies Earnings Conference Call

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*Loblaw Companies - Executive Chairman*

**Robert Vaux**
*Loblaw Companies - CFO*

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*Loblaw Companies - President & Deputy Chairman*

**Frank Rocchetti**
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## CONFERENCE CALL PARTICIPANTS

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

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

**Ryan Balgopal**
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## PRESENTATION

**Operator**

Good morning, ladies and gentlemen. Thank you for standing by. Welcome to the Loblaw Companies Limited fourth quarter results conference call. (Operator Instructions). I would like to remind everyone that this conference call is being recorded today, Wednesday, February 18th, 2009, at 11:00 am Eastern Time. And I would now like to turn the conference over to Ms. Inge van den Berg, Vice President, Public Affairs and Investor Relations. Please go ahead.

**Inge van den Berg** - *Loblaw Companies - VP-Public Affairs, IR*

Good morning, and welcome to the Loblaw Companies Limited fourth quarter conference call. This call is also been webcast simultaneously on our website, www.loblaw.ca. I'm joined here this morning by Galen G. Weston, Executive Chairman; Allan Leighton, President and Deputy Chairman; Dalton Philips, Chief Operating Officer; Frank Rocchetti, Chief Merchandising Officer; Bob Vaux, Chief Financial Officer; and Sarah Davis, Executive Vice President - Finance. Before we begin today's call, I want to remind you that the discussion will include forward-looking statements, such as the Company's beliefs and expectations regarding certain aspects of its financial performance in 2008 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 fourth quarter news release, for 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 fourth quarter news release 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 fourth quarter news release, as well as the archive of this conference call, will be available on our website. I would now like to introduce Galen Weston.

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

Good morning. Thank you for joining us today. Our fourth quarter performance demonstrated that we are continuing to edge forward. Sales performance, cost management, and operational effectiveness were acceptable, and we are making progress on our transformational priorities of food renewal, store enhancements, product innovation, infrastructure improvement, and customer value. However, we need to build more consistency into our execution on all of these fronts. We are confident that our approach is the right one. We remain cautious and are proceeding at a measured pace. Given the unpredictable economy and tough competitive environment, we are prepared for a challenging 2009. I'll now turn the call over to Bob Vaux to discuss our financial performance.

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**Robert Vaux** - *Loblaw Companies - CFO*

Thank you, Galen, and good morning. Total sales in the fourth quarter of 2008 increased 11.2% to CAD7.7 billion, while same store sales increased by 10.6%. The extra selling week in the quarter positively impacted sales and same-store sales growth by about 7.9%. In addition, sales and same-store sales were positively impacted by about 0.8% as a result of the shift of Thanksgiving sales into the fourth quarter of this year compared to the third quarter in 2007. On an equivalent 12 week basis, sales growth was strong in both food and drugstore. Apparel sales growth was strong; however, overall general merchandise sales declined, largely due to reductions in assortment and square footage, and Gas Bar sales declined as a result of lower fuel prices.

National food price inflation, as measured by the Consumer Price Index for food, was 8.4% in the fourth quarter of 2008. Our internal food price inflation was higher than the year to date trend, but lower than the CPI index for food. It is important to note that we experienced food price deflation in the fourth quarter of 2007. Operating income was CAD317 million for the fourth quarter compared to CAD134 million in Q4 2007. Operating margin was 4.1% in the quarter compared to 1.9% in Q4 last year. The increase in operating income was mainly due to higher sales, lower restructuring, lower net stock-based compensation costs, and the impact of cost reduction initiatives. Loblaw realized fourth quarter basic net earnings per common share of CAD0.69 compared to CAD0.14 for the same period of 2007.

On an equivalent 12-week basis, and after considering the impact from restructuring costs, the net effect of stock-based compensation and the gain on the sale of the Company's food service business, operating income, EBITDA, and basic net earnings per common share in the fourth quarter of '08 improved compared to the fourth quarter of '07. Free cash flow in Q4 was CAD216 million compared to CAD335 million in the fourth quarter of '07. The year-over-year Q4 improvement of CAD119 million in cash flows from operating activities was more than offset by an increase in capital spending and the timing of common share dividend payments. Net debt at the end of 2008 was about CAD3.3 billion, a year-over-year reduction of CAD440 million. The preferred share issued earlier this year represented CAD218 million of the change, with all other factors accounting for CAD223 million of the improvement. We are continuing to invest in renovations to our existing store base and in upgrading our information technology and supply chain infrastructure.

Capital expenditures in 2008 were CAD750 million, and we estimate capital expenditures for 2009 will also be close to this level. During 2009, we will step up our investment in IT and supply chain, which will increase the associated expense by approximately CAD100 million. Given the continuing difficulties in the credit markets, I would like to address the Company's liquidity. The financing transactions completed in 2008, existing cash and cash equivalents, future operating cash flows and the amounts available to be drawn against a credit facility are expected to satisfy the Company's requirements to finance its capital investment program and fund its ongoing business requirements, including working capital and pension fund planning, over the next 12 months. At this time, we also anticipate being able to satisfy the Company's liquidity needs beyond 12 months. I would now like to introduce Allan Leighton, who will update you on our priorities for 2009.

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

Thank you, Bob, and good morning, everyone. I thought it may be useful to give you a year-end review from my perspective, and in addition, give you a heads up on the context for '09. 2008 showed some progress, and the business continues to edge forward. We've created a trading and an operational approach which is food-focused, more value-led in our hard discount and Superstore banners, which are about two-thirds of our sales, and more service availability and fresh-led in our conventional banners.

We're on track with all of the elements of the five-point plan. The Back to-Best programs have worked well, and from these and our other pilots we have produce, meat, seafood, and grocery programs that can now be rolled out to the rest of the chain. President's Choice, both in positioning and packaging has and is being revitalized and no name similarly improved. Our physical supply chain structure is much improved, and availability in our stores is significantly better than a year ago. Operational focus on shrink and real productivity is now baked in to our approach. Apparel is strong, and we have a very clear idea of core general merchandise, which is -- and will become -- more tailored and largely a Superstore business, with any excess footage going to grocery and (Inaudible), where we remain tight for space.

Our grocery performance and our performance in Ontario and the west was particularly good. All this is progress, but we're still too inconsistent in our execution. However, the core trading idea is set, and with time and experience, it will become the way we do things around here. 2009 will be focused from a trading perspective on more of the same, betting in the model, and getting better as our people gain experience. Value will be tweaked in the early part of this year. The price freeze, No Frills, and the no name programs are early examples of this, as we believe continuing to own the value high ground, particularly in hard discount and Superstore, will become increasingly important as the year unfolds.

President's Choice will undergo a comprehensive ranging and merchandising review at the next stage of its revitalization. There is an element of blurring of the roles that no name and President's Choice play in the categories, and this is holding back the profitability of both brands. Control label profitability will be a major focus in 2009. We will also touch around 300 of our stores in some way, as the relevant pilot programs are rolled out to the relevant stores. It will be the most extensive refresh and renovation program in the Company's history. We clearly expect positive results from these changes, but there will be disruption as we go. But the majority of these core stores have had little change for a long time, and no change is no longer an option.

We will also start to really invest in our systems, infrastructure which is archaic by any measure. Our objective is to have all of our financial reporting and general ledger on the SAP finance platform by the end of 2010. To have perpetual inventory -- PI --

and ordering and forecasting ready to roll out from P1, 2011, and to have new transport and warehouse management systems in all depos by the same date. All of these are basic infrastructure programs, and we will be implementing the plain vanilla versions that have been tried and tested by most retailers of our size in the world. This is two years worth of work. All the cost is up front, and all the benefits at the end; and hence Bob's comment that the impact of these programs is CAD100 million incremental costs, with no benefit for at least the first two years. So lots done that now needs to be consistently executed.

Lots to do, but in the short-term it's costs; but that mid-term transforms the Company. As we enter year three of renewal, we remain confident in our ability to both deliver our plan and renewal within the three to five year timeframe. Operator, I'd now like to open the call to questions.

## QUESTIONS AND ANSWERS

**Operator**

Thank you. (Operator Instructions). Your first question today comes from Irene Nattel of RBC Capital Markets. Please go ahead.

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

Thanks. I was wondering if you could just spend a couple of minutes talking about how you see your overall relative market position at this point? Because if we look at some of the wording in the press release -- notably, the customer count flat and item count down a little bit -- it would suggest that on a relative basis you seem to be losing a little bit of traction.

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

Irene, it's Allan. I have two things, really. First of all, remember we're comparing this quarter versus quite an unusual quarter of a year ago, where we had a lot of deflation and a lot of volume increase. And so I look at the fact that basically, that our volume is only marginally down, and that our market size is up, as a relatively good position to be in. And I think that's the sort of way we would look at where we sit today. You know, okay, but in a relatively good position.

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

Okay. Would you be able to quantify the impact of inflation in the quarter?

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

As you know, we don't give numbers on inflation. And as I say, I can give you a bit of context and hopefully, a couple of clues. Clearly, the real piece of context is that this quarter this year was up against a quarter of deflation in Q4 of '07. The clues, really I think, go around the points I've already made. Our volume is only marginally down versus a lot of volume growth a year ago. Secondly, our basket size is up. Thirdly, produce, which clearly plays a big role in inflation, is at double-digit. And like any issue that will face us all -- and we're not alone in this -- anybody that sells produce will be in the same place -- at some stage, that will unfold. And so the second half of this year, unless something dramatic happens to the dollar, then most of us are going to be cycling very high inflation in produce and we'd expect some produce deflation. And if final point really is the point that we make in our release, that our food inflation is below CPI, but trended up in the quarter.

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

Okay. And then finally, one last question if I may. The word "execution", is one that I think you used, Allan -- and Galen, you used as well. And could your just, again, provide a little bit more color around your assessment of where the Company is right now in terms of execution and what needs to be done from here?

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

It's Allan again. I think we are -- we're getting better. I think we're getting better every day. I think there's no doubt about that and that's the way that I look at it. But we are far from perfect. And I've said many times before that we can do anything -- the issue is our ability to do it on a consistent basis. We would be in much better shape than we were a year ago, but I think that we've still got some way to go. And you can look at that two ways. One is, it's sort of -- it's frustrating while you're going through that phase; but it makes us feel good about the opportunity going forward, because without a doubt, all of our people are getting better on a daily basis. And a good example of this is we would have thought that our execution of the Christmas program and the availability that we had over Christmas would probably be the best that the Company has done for 10 years.

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

That's great. Thank you.

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**Operator**

Your next question comes from Perry Caicco of CIBC World Markets. Please go ahead.

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

Yes, thank you. Allen, would it be safe to say that with the economy being where it is, that your discount banners performed very well for the quarter?

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

Safe is an interesting word, Perry. I think it would -- actually, most of the banners performed similarly. I think we would expect the hard discount and the Superstore banners to perform slightly better, perhaps in the sales perspective of going forward.

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

And then given that you're obviously putting more effort now behind the conventional and some of the larger Superstore operations, are you concerned at all about the positioning of those stores coming into a recession? And what would the prospects be for some of the changes that you're embedding in those stores to begin to make a difference at the sales line?

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

I think conventional and the Back-to-Best programs, I'd say, have worked pretty well actually. And so we feel pretty good about where we sit from a conventional perspective. They could still be (inaudible) to put a bit more value in there, but I'm not overconcerned about that. I think the real opportunity for us, Perry, is that -- my view is that -- people always accuse me of being too cautious on this -- I think this will be a very tough year. And I don't think we've yet seen the beginning of it, and I think that having in the hard discount and Superstore businesses, particularly; building on the momentum we've got there and building on our value positions there -- and you've seen a lot of the activity in January -- I'd like us to tweak a little bit more in terms of where we sit in terms of price; but it would be a tweak and no more than that.

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

And so if we could, then, delving into your EBITDA margins, you've beaten the last year's numbers now for a couple of quarters. Would it be accurate to say that your gross margins are holding flat to last year and the bulk of the improvement has been in the SG&A rate?

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

There's -- our gross margins, which again (inaudible) -- I think you could -- we'd be pleased with what we've done with the gross margins, largely through what Frank and the team have been able to do on a cost of goods basis, and we've also had some benefit from what's happened in the stores in terms of costs. So it's a combination of events.

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

And what do you think the outlook is for your SG&A rate for this year -- because obviously it's going to be a tough year? Are there more costs to come out of the business, or is it just a matter of driving sales as much as possible?

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

Well, I think, you know, Perry, you have to do both of them. We believe there's more costs to come out of the business, but that's why we also believe that we've now have got to move on the IT front, and because a lot of the costs that are tracked in the business are tracked in the business because we have very archaic systems; and the benefit of -- from an administrative or SGA perspective -- of just getting to a much simplified systems base will mean that our productivity will go up, our headcount the will go down, we'll have more (inaudible). So I think we've been able to get quite a lot of costs out of the business, and there's still always that bit that you can squeeze out. But I think the real opportunity for us now lies in transforming the way we do things; and to be able to do that, that's why we need to be able to move into this phase now -- which we've always said we'd move into -- as we got in the second half of the renewal period, which is we've now got to really step up our investment in IT -- and that has a cost to it, as we've articulated.

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

Okay, and my last question for now. I think there might be some confusion among investors about your Western Canada strategy. So as No Frills rolls out aggressively, what is the relative position of Superstore and Extra Foods?

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

in terms of which way, Perry?

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

Just the relative positioning in the marketplace of the three banners as you roll out No Frills in Western Canada?

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

So we've said (inaudible), clearly our Superstore business is very powerful and it's had a very, very good year. So that would sit very much as it does today. Most of the Extra Foods that are being converted to No Frills -- No Frills paid that very hard discount role in those areas. And of course, the other piece for us is where we're going to use new frills is urban infill. We think that that is a big opportunity for frills in the West. We said that we would open, I think, 20 stores over a period. We've got already 10 of those lined up and we'll open the first one in March. So then the rest of Extra Foods we'll sort of convert the more urban ones -- will convert at the back end of that program. But we think -- and certainly the evidence is so far -- that the combination of Superstore punching its way on a broad-based, large scale, and No Frills sitting around at the very low end in terms of discount, has been very powerful in the West. We think it's a pretty potent combination.

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

Okay, thank you.

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**Operator**

Your next question comes from Michael Van Aelst of TD Newcrest. Please go ahead.

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

I just need to clarify something first. You said the basket size is up. Is that entirely due to inflation, or when you said that item count was -- growth was down a bit? Is that actually this negative growth, or it's just slower growth?

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

Well, again, we don't comment on that. So we leave it to you to work out. But I think we've given you a clue that said the basket is up and that the volume is only marginally down, and that that's probably quite good versus where we were a year ago.

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

Okay. No, that's clearer then. And then secondly, if you look at the -- if you looked at your space that -- the square footage that you're reallocating from general merchandise into (inaudible) and food, the sales -- the net sales of general merchandise obviously are going down. But it doesn't seem like you're getting an increase in the food and health and beauty, because your net -- enough to offset it, at least -- because your net sales real growth is flat.

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**Robert Vaux** - *Loblaw Companies - CFO*

I'm not sure how you're coming up with that. But what I can tell you is where we are converting, we are picking up more sales than we're losing, and you picked up on the business that we're growing. It's being converted into food primarily, baby and drug where we can; and we made reference to the expansion of apparel and the sales there being quite strong.

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

All right. And then the IT and supply chain. Can you give us an idea of when that CAD100 million of cost is going to be kicking -- start to kick in in 2009? Is it right from the beginning? And then, what's the total budget of this two year plan?

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

It's Allan again. It will cover the -- it's spread during the course of the year, so it's already started to kick in. The number we said -- which is EBIT, and that's the way to think about it -- it's 100 million of EBIT costs in this year, and I'd expect the number to be around that level next year, too. So it's two years' worth of work.

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

Okay. And then in your CAD750 million CapEx budget, what kind of square footage growth are you looking for?

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

Marginal. Most of our capital, as you know, goes into our existing store base. Most of that capital will go into the 300 refresh and renovation program that I talked about earlier on.

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

Thank you very much.

**Operator**

Your next question comes from David Hartley of BMO Capital Markets. Please go ahead.

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

Hi, and thank you. Just back to the question of deflation, you talked a bit about produce. Do you have an expectation what you expect to see by the end of the year in terms of the whole food category for you?

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

It's Allan again. Clearly, we have a view. But I think that -- I think the whole inflation, deflation mix is still uncertain. And that's why when people say to me, "Why are your cautious?" I see things as a pretty big role to play in how everything plays out. And so, yes, we have a view, but I think our view would be only as good as yours probably. And so we'll have to see how it plays out.

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

Just on the apparel, you mentioned that it's strong. Are you talking about you're seeing sales growth there -- I think Q3 it was down a little bit -- Or are you talking versus the industry? Can you just give me some color there?

**Frank Rocchetti** - *Loblaw Companies - CMO*

Yes, it's Frank. I've talked to both. Actually, we're seeing comp store increase that's pretty strong across apparel, as we said throughout the fourth quarter, with kids doing particularly well, because we've had a very strong women's business, as you know. So we've been expanding it, and the customer response to it has been very good.

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

And have you expanded the availability of apparel in stores? Is that driving a lot of it? Or is it just pure, like, ID sale-type growth?

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**Frank Rocchetti** - *Loblaw Companies - CMO*

I was commenting both on comp stores and just absolute; we're getting growth in existing stores as well.

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

Go through a few housekeeping things. The strike in Quebec, you referenced it in your material today. Could you give us an update at where that stands? Has there been other -- more progress made there, and kind of resolved that?

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

David, this is Dalton. You may have seen yesterday, we announced that two stores we were closing -- two stores of the twelve that were on strike -- and we've reached a tentative agreement now with the Union, which they're taking it back to the membership body for ratification. So we closed two stores and ten are now going to the Union body to vote on.

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

I didn't see that. Thank you. And just on your tax rate, what are you expecting, Bob, next year?

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

David, it's Allan -- just before we go. It's worth mentioning, is that you can see that it had about a 1% impact on our sales (inaudible).

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

Yes, I saw that. Thank you.

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

But it had little to zero impact on our profitability.

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

Okay, good. Thank you.

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**Robert Vaux** - *Loblaw Companies - CFO*

And on the tax rate, probably 31% would be a good number.

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

Okay. And is that going to be fairly even throughout the year? Or are you expecting some things to affect that quarter by quarter?

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**Robert Vaux** - *Loblaw Companies - CFO*

Well, it always moves around a little bit quarter by quarter. I mean, you can see it in the fourth quarter of this year. So I would say I'd budget based upon it being flat over the year. But it's like -- it does tend to move around a little bit from quarter to quarter.

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

Just on the food service sales, I saw that you sold that business worth about CAD150 million in sales. How much of that, I guess -- I mean, what did that contribute to the quarter this Q4?

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**Robert Vaux** - *Loblaw Companies - CFO*

Well, first of all, it's about CAD120 million of sales on an annualized basis, and the EBITDA from the business was less than CAD5 million, and we've reflected the gain.

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

I thought it said 150 in the release. And then finally, just on -- I notice you also signed a long-term supply agreement with Weston. Anything we should know about that?

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**Frank Rocchetti** - *Loblaw Companies - CMO*

No. It's Frank here. No, nothing out of the ordinary with regards to that agreement.

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

I'll pass it along. Thank you, guys.

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**Operator**

Your next question comes from Ryan Balgopal of Scotia Capital. Please go ahead.

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**Ryan Balgopal** - *Scotia Capital - Analyst*

Good morning. Just a question on the volumes. I mean, they have been moderated. I guess that's a trend for the last four quarters. It appears that some of the major price initiatives that you put in a year ago kind of didn't hold their traction. I'm wondering is some of this just that renovations in the stores haven't happened as quickly? Or is it that the impact of the renovations is not as great as you would have hoped?

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

Ryan, it's Allan. Again, that's your conclusion. I mean, first of all, we're pretty pleased with the renovations. That's why we're going to do another 300 of them. Secondly, I keep going back to point, is that if you take the quarter and you look at the fact that we held our volume largely flat, marginally down, versus where we a quarter ago, we're sort of reasonably pleased with that performance. We were countering a quarter of a year ago that was odd in many ways, described by you, almost (inaudible) around. So I think this was an attempt to try and get a bit more of a sensible approach to trading that particular quarter.

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**Ryan Balgopal** - *Scotia Capital - Analyst*

Okay. Thank you. Two other housekeeping questions, because most of my stuff has been answered. Just the depreciation was down a fair bit in the quarter from a year ago. I guess, how should we think about depreciation going forward, and maybe what caused the blip down after it being up in Q3?

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**Robert Vaux** - *Loblaw Companies - CFO*

Okay. Well, again, we trued up the depreciation in the fourth quarter, and that's what gave the lower number. Same thing basically happened last year, that the run rate and the first three months -- in the first three quarters was higher than Q4. The full year depreciation both this year and last year was around 585 to CAD590 million; and we expect for '09 that it will be up somewhat.

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**Ryan Balgopal** - *Scotia Capital - Analyst*

Okay, no. That's helpful. Last question, just the impact on EPS from the extra week? Can you quantify that?

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

No, we don't quantify that.

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**Ryan Balgopal** - *Scotia Capital - Analyst*

Okay, thanks. That's it.

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**Operator**

Your next question comes from Jim Durran of National Bank Financial. Please go ahead.

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**James Durran** - *National Bank Financial - Analyst*

Yes, just on general merchandise, like how far along would you say you are at downsizing the general merchandise business now?

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**Frank Rocchetti** - *Loblaw Companies - CMO*

This is Frank. I'd say we're probably 40% of the way there, feeling pretty good about hard discount positioning and our smaller (inaudible) stores. We've still got some work to do in some larger (inaudible) stores. As we said, over time you'll see it be primarily a Superstore business. I'd think of it about 40 to 50% done.

**James Durran** - *National Bank Financial - Analyst*

And as far as getting to 100% done, like, does that involve the renovation of existing real Canadian Superstores mostly to get over that finish line? Or what else is happening there?

**Frank Rocchetti** - *Loblaw Companies - CMO*

Yes, it's part of this renovation program that Alan made reference to. That's one of the benefits we get out of it, is that we end up converting the space at the same time in general merchandise into food and resetting ourselves.

**James Durran** - *National Bank Financial - Analyst*

Okay. And on the private label side of your business, can you give us an idea of how much of an increase in penetration you saw this year versus last year? Or what the growth on private label is compared to your total reported sales growth?

**Frank Rocchetti** - *Loblaw Companies - CMO*

Okay, it's Frank again. I would say it's above national brand marginally. And we made reference to the work that's going on with PC and no name. But clearly, our opportunities to improve our profitability of our controlled brand versus getting our penetration up solely.

**James Durran** - *National Bank Financial - Analyst*

And how big a spread do you see there on your private label margins? Are they significantly below where you think they should be?

**Frank Rocchetti** - *Loblaw Companies - CMO*

There's lots of work to be done. That was the answer -- sorry.

**Operator**

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

**Winston Lee** - *CSFB - Analyst*

Thank you. I'm just thinking that if we're going into maybe moderating price inflation food in the second half, making 100 million more in IT investments, and seeing sort of relatively flat volume but no major price tweaks anticipated but some tweaks along the way, how do you adjust if the consumer really starts to become very value conscious and starts trading down in a lot more ways? Is there a lag that could happen in terms of price reductions that are much more significant than expected in the second half of the year?

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

Winston, it's Allan. First of all, we feel pretty good about where our price position sits, one. Two, I made reference to the fact that actually, we have -- and intent to -- tweak our prices, particularly hard discount and Superstore businesses, because I actually fundamentally believe that the value, particularly in those banners, will have a big role to play in how this year unfolds. So I think that's the way that you should think about that. But it's a tweak, not a major adjustment.

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**Winston Lee** - *CSFB - Analyst*

Okay. That's great. And I guess as you go and you see how things unfold, the 300 stores that you're going to touch up, can you give us a sense in terms of how much of that is Superstore or discount versus conventional?

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

It's a mixture of all. They're largely our 300 -- or would be 300 of our 400 top sales stores, because obviously, that's the place that you go. And there will be sort of three variations on a theme. Some will be half a million spends, some will be one to one and a half million spends, and some will be two and a half million. And the idea is to take what we've learned from our pilots, which has been pretty good, and take the elements of that that are appropriate to those stores and make that happen. And as I say, it's a very expensive program. Our team learned a lot last year how to do these, because clearly, this is something we've not done for a long period of time -- you know, spend money on existing stores -- and it's actually much more difficult to renovate stores than it is to build new ones for obvious reasons, because you've got customers in the way. So we feel pretty good about it and the team feels pretty good about it, and that's roughly the way it's going to sort of play out.

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**Winston Lee** - *CSFB - Analyst*

Okay, and I guess on that, are you -- some stores have been converted that are conventional to like a -- say, a Loblaw store to a No Frills store. Do you see more of that happening throughout this year? Is that -- that is not just maybe a refresh -- that's probably a conversion. Maybe -- is the 300, does that capture the conversions too?

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

Yes, but they would be a small part. The conversions will continue at the sort of level they've been at. It's a relatively small part of what we do. The real thing is to get those stores that trade well today that have not been touched for a long period of time, to give them some identity and to give them some of the learning and some of the departments and some of the products that we've been able to do well in the pilots. And that's really the major purpose of that.

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**Winston Lee** - *CSFB - Analyst*

Okay, great. The D&A -- or actually, I guess the D&A, I wonder if it was affected by the writedown on the fixed assets? And Bob, what was the nature of that writedown?

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**Robert Vaux** - *Loblaw Companies - CFO*

Well, we review the profitability of all of the various stores across the system each year, and if certain stores are not performing, then we've got to -- we then look at them from an impairment perspective; and we concluded that certain stores were impaired, and therefore took the writedown.

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**Winston Lee** - *CSFB - Analyst*

Okay. And as we look forward, you think that the D&A is going to be at about the same level as we saw for all 2008, which has an extra week in it?

**Robert Vaux** - *Loblaw Companies - CFO*

Yes, but depreciation -- like, depreciation is done on an annual basis. It's not done a weekly basis, so that it's not impacted by the 53rd week. But having said that, we expect depreciation in '09 to be somewhat higher than it was for the full year '08.

**Winston Lee** - *CSFB - Analyst*

Okay, so the incremental 100 million of IT investment won't see a partial offset in D&A is, I guess, what you're saying?

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

Well, I don't -- Winston, I don't think that's what we did say, but I think we've made a few comments. One is that, obviously, there's some work that can be down on SG&A. But that's just a continuation of where we've been. But second, we have said that that 100 million of incremental EBIT -- that's going to be associated with the cost of the next stage in IT, has no benefits for two years.

**Winston Lee** - *CSFB - Analyst*

Okay, thanks. Just wanted to make sure.

**Operator**

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

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

Yes, I had a question on the capital expenditures. Could you identify what you expect to be spending on the IT and supply chain capital side in addition to the 100 million per year on the expense side?

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

Okay, so it's Sarah speaking. Good morning, everybody. In 2008, we spent about 750. 55% of that was related to upgrading the stores, and 45% was on infrastructure. In 2009, we're going to -- we're expecting to spend the same amount, around 750, with the retail portion slightly less than the 55% that we spent in 2008. So the -- obviously, the increase is going to IT and supply chain.

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

So about 50/50? Is that broadly right? Or --

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

That's pretty close.

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

And then just in terms of the accounts receivable on the credit card, what's your expectation on securitization in 2009?

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**Robert Vaux** - *Loblaw Companies - CFO*

Well, coming into 2009, we had CAD200 million of securitization available under the revolver we put in place last year. Given the state of the securitization markets right now, we're not planning our liquidity based on doing additional securitization other than that availability of 200.

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

And then just a question on the CAD65 million to the supplier. Is that just for the security of the long-term contract? And how do your amortization that? Is it amortized over time?

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**Robert Vaux** - *Loblaw Companies - CFO*

Yes. It will be amortized over the term of the contract.

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

So is that just for security of the --

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**Robert Vaux** - *Loblaw Companies - CFO*

Well, it's not -- like, in terms of what it did, it formalized a long-term agreement that had been in place for a long time between Weston and Loblaw's But in the context of Weston selling the business, the buyer wanted to have that formalized. And it's not unusual in terms of a relationship between a retailer and supplier, that if it is a long-term contract, from time to time there's an upfront payment. So that's -- it's normal practice, and that's what led to it.

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

Thanks. And is that -- that reflects the products that come from the US into Canada?

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

No, it's purely the dairy. It's --

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

Yes. Oh, I'm sorry.

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

Yes, it's purely the dairy. It's -- as we sold the dairy -- the Neilson Dairy -- then that supply went along as part of that.

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

I see. Great, thanks very much. And just on the outlook ahead, a lot of the consumer packaged goods companies have increased their prices. I'm wondering as we go forward, do you think they'll give some of that back in terms of rebates or rollbacks? Or how you see that progressing as the underlying commodities are starting to go the other way?

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

We hope so. We're looking forward to it?

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

And just one last thing on the equity forwards. I was just wondering why there's no tax effect on the equity forward CAD17 million in the fourth quarter?

**Robert Vaux** - *Loblaw Companies - CFO*

Well, the -- I mean, basically, the equity forwards is as the share price goes up, we're bringing income in because we've been under water historically, and if it goes down, we have income going out. But we effectively don't tax it like that.

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

No tax effect on it. Great -- greatly confusing to me, those equity forwards. And then just finally, on the consumer behavior, are you seeing any dramatic shift between channels? I guess all channels did equally -- or broadly equally as well. So I guess you're still not seeing a channel shift by consumers. Is that fair?

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

We didn't in the quarter. We'd expect to see a bit more now.

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

Great, thanks very much.

**Operator**

(Operator Instructions). Your next question is a follow-up from David Hartley of BMO Capital Markets. Please go ahead.

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

Hi, I just wanted to clarifying something on the 100 million in incremental EBIT investment in 2009. What was -- I mean, is this coming on top of the investment of 100 million in 2008, or is this a whole new slew of money that's being thrown into the mix?

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

This is the increment. It is a -- we didn't really -- we hadn't really started to investment at any great level in the software, the IT systems, until this year. So this is the real first big step-up in terms of investment. So this -- if you look at what we spent in the past, then this would be 100 million on top of that. And we obviously signaled it because it's a big increment, and we won't be able to be aware of the money that's being spent.

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

Okay, yes. It is a big increment. And I'm just wondering, when you look at that CAD100 million, how do you plan to, I guess, source that money, if you will? Do you have programs in place where you see costs coming through to offset it? Will this just kind of be, if you will, dead weight loss -- at least in year one -- to the -- kind of the earnings we're seeing over the last year?

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

David, you know, we don't give guidance; and as I say, we sort of made the point --which I think is the major point on this -- is that clearly, every year we look at our SG&A and we look at how we can improve it. But in addition, this sum of money has all the costs up front and no benefit for two years.

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

Just, is this -- is there more -- like, when you look at 2010, if we're looking that far ahead, will you require another incremental EBIT investment with similar characteristics of no return up front? Or --

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

Yes. As I said, upfront -- if you look at the two years, the two years are going to be around this sum of money, and there are no benefits in these programs until you've got them in place, because you can see that they're pretty basic infrastructure things. But at the end of it, for me, it does transform the business significantly; because as I say, from a purely administrative point of view, where we have lots of people and lots of complexity, you've got productivity up, you've got headcount down, you've got speedier, more "right the first time" data. In the supply chain, where we really improved our physical infrastructure, clearly the impact of the new ordering and forecasting PI and basic management systems -- the warehouse and transport -- means the service levels will go up. The availability will go up. The sales go up and the inventory goes down, so that these are big benefits to play for at the end of the investment period. But it's a two year period. It's two years' worth of work.

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

Got you. Okay, thanks for that clarity. And just on -- a follow-up on a question from another caller. Writing down the value of some stores. Where were those stores located?

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**Robert Vaux** - *Loblaw Companies - CFO*

Across the country.

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

There are not any in any specific area. They're cross-country.

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

Thanks a lot, guys.

**Operator**

Your next question is a follow-up from Keith Howlett of Desjardins Securities. Please go ahead.

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

Yes, I had a question on the new No Frills stores that you're opening in urban areas in Alberta. What do you anticipate the size of those stores will be?

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

30, 35 model size.

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

Model size. And then in Quebec, I was wondering what the outlook would be for moving some of the Loblaws to Maxi and Cie stores?

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

It would be an outlook. As you know, we have taken one Loblaw and converted it to a Mazi and Co. to see whether -- how that performs. And that's a pilot that's been going for a couple of months. It looks reasonably good, and we'll determine at the end of probably a six-month period whether that could be something that worked for some of the other Loblaw stores in Quebec.

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

And then just on -- I know you don't speak on regional performance -- but in certain markets that are -- have had early and deep economic stress, like Southwestern Ontario or perhaps markets in British Columbia, have you seen any change in consumer behavior there that's different than in other areas?

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

Not really. I think that in those areas, the sort of flight to value is more apparent than it would be in other areas.

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

And just one final housekeeping question. On the reduction in the value of the store assets, I presume there's no tax effect on the charge? Is that correct?

**Robert Vaux** - *Loblaw Companies - CFO*

No, they are tax effected.

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

They are tax effected. Great, thanks very much.

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**Operator**

Your next question is a follow-up from Irene Nattel of RBC Capital Markets. Please go ahead.

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

Thanks. Also a similar type of housekeeping question -- maybe you can help us with this. Although gas is only, I believe, about 5% of your total sales, with the sharp decline that we've seen in prices, that clearly had to have an impact on same-store sales. Is there any way you can help us with that?

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

Yes, Frank will be helpful Irene.

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**Frank Rocchetti** - *Loblaw Companies - CMO*

So you're very accurate. Our unit volume, as Bob mentioned, is actually showing some good growth, so our leader at the pump that we're putting through is up and doing well. So think of it as approximately .2% of sales in the quarter impact.

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

Thank you very much.

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**Operator**

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

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**Inge van den Berg** - *Loblaw Companies - VP-Public Affairs, IR*

Well, thanks very much, everyone, for your interest in Loblaw Companies Limited, and we look forward to speaking with you on our Q1 call, which will be May 6th.

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**Operator**

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

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