FINAL TRANSCRIPT

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PRESENTATION

Operator

Good morning. My name is Shannon, and I will be your conference operator today. At this time, I would like to welcome everyone to the Loblaw Companies Limited fourth 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, VP, Investor Relations. Ms. Lee, you may begin.

Kim Lee - *Loblaw Cos. Ltd. - VP IR*

Thank you, Shannon. Good morning, and welcome to the Loblaw Companies Limited fourth quarter 2010 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.

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 2011 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. 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 release, our 2010 annual report, MD&A and financial statement and notes, as well as the archive of this conference call, will be available on our website.

I'll now turn the call over to Galen Weston.

Galen G. Weston - *Loblaw Cos. Ltd. - Executive Chairman*

Good morning. Thank you for joining us. I'm pleased with what the Company has achieved in 2010. We've made substantial headway against our plan. In the year ahead, we expect to continue our focus on execution in a market environment that remains unpredictable and competitively intense. We plan to continue our investment in information technology and supply chain. This investment will negatively impact our operating net income by CAD135 million over 2010 (sic), and we estimate capital expenditures for the year to be in the range of CAD1 billion.

As we now enter the final year of our renewal program, I'd also like to comment on the progress that has been made over the last four years. We are now operating as a centralized, marketing-led retailer that appropriately leverages its scale. We've improved our infrastructure, our stores, our products, our balance sheet, and our people, all with an eye to driving profitable growth.

And while there's still a great deal of work to do, we continue to develop our thinking about the future. As part of that thinking, we've spent considerable time planning management succession, and as you will have read in our announcement this morning, in the second half of this year, Vicente Trius will succeed Allan Leighton as our President. Vicente will bring his considerable experience as a global retailer to Loblaw and build on the solid foundation established by Allan over the last few years and move the Company further forward. I will be delighted to welcome him aboard.

I'll now turn the call over to Sarah Davis to walk us through the results.

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

Thank you, Galen, and good morning. Sales for the fourth quarter of 2010 decreased by 2.1% to CAD7.2 billion. Same-store sales decreased by 1.6%. In the fourth quarter of 2010, sales of food declined marginally. Sales of drugstore declined moderately, impacted by deflation due to regulatory changes in Ontario and certain prescription drugs becoming generic.

Sales growth in apparel was moderate, while sales of other general merchandise declined significantly due to lower discretionary consumer spending and reductions in assortment and square footage. And our gas bar sales were strong as a result of higher retail gas prices and moderate volume growth. In Q4, our internal retail food price index was flat, whereas we saw internal food price deflation in Q4 of 2009.

Gross profit in the quarter was CAD1.8 billion, or 24.8% of sales versus CAD1.7 billion, or 23.6% of sales in the fourth quarter of last year. The improvement was primarily due to improved control label profitability, continued buying synergies and disciplined vendor management, the shift of pharmaceutical vendor rebates from SG&A expenses to gross profit, improved shrink, and a stronger Canadian dollar, partially offset by increased transportation costs.

Operating income was CAD289 million in the fourth quarter compared to CAD277 million in Q4 of '09. Operating margin was 4% in the quarter, a 20-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 CAD7 million charge related to stock-based compensation net of the equity forwards, CAD27 million in incremental costs related to the Company's investments in IT and supply chain, and a charge of CAD28 million for fixed asset impairment.

With respect to our investments in IT and supply chain, our incremental expenses this quarter were CAD27 million, of which CAD14 million was depreciation and amortization. For the full year 2010, our incremental IT and supply chain spend was CAD142 million, of which CAD59 million was depreciation and amortization. In 2011, we estimate an incremental spend for IT and supply chain of approximately CAD135 million.

Loblaw realized fourth quarter basic net earnings per common share of CAD0.54 compared with CAD0.60 in the fourth quarter of 2009. This decrease is the result of higher income taxes in Q4 2010 versus Q4 2009, which had an unusually low income tax rate of 18.3%. Subsequent to the year end, the Board of Directors approved the discontinuation of the DRIP program after the dividend payment on April 1, 2011, when approximately CAD300 million in common share equity will have been raised through the program, as planned.

Net debt at the end of the fourth quarter was CAD2.5 billion compared to CAD2.8 billion at the end of Q4 '09. The year-over-year decrease in net debt was primarily due to capital from operating activities and proceeds from fixed asset sales, partially offset by fixed asset purchases. Capital expenditures in Q4 were CAD453 million and CAD1.3 billion for the year. Our estimate for capital expenditures in 2011 is approximately CAD1 billion. Approximately 50% of these funds are expected to be spent on operating IT and supply chain, with the remainder being spent on renovating our stores.

I would now like to turn it over to Allan Leighton, who will provide some context for the quarter and the year ahead.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Thank you, Sarah, and good morning, everyone. The fourth quarter was much the same as the rest of 2010. We continued to take steady, consistent steps and closed the year having made real progress in our renewal plan.

Like the rest of the year, in Q4 the market and the economy remained uncertain, with high competitive intensity and promotional activity across the industry, with everyone really fighting for share of an increasingly tight consumer wallet. Our focus was on intelligent sales, and our enhanced control brand and general merchandise profitability continued to edge up our gross margin.

In Q4 we had zero food inflation, and that was lapping significant food deflation in the prior year, and significant deflation in drugstore. It's difficult to predict where inflation will go, and we're planning on little change in trend for the first half of 2011.

With a strong focus on our infrastructure programs, we continue to make headway with our SAP implementation. As we mentioned on our last call, we successfully moved from what we called a baby SAP pilot in merchandising with a few categories, to a super pilot that involved more than 15 categories. We're now starting the next wave with an even larger group of categories in the merchandising area, and in 2011, our priority is to really roll up and roll out SAP to our merchandising organization in total, with a lot of focus on clean data and robust processes.

Our supply chain infrastructure transformation priority is actually beginning to near completion. From a physical infrastructure standpoint subsequent to the year end, we opened our new Regina DC, as planned. We completed rolling out the new transport management system to our DCs which, as you know, is focused on improving fleet productivity and routing and scheduling. And also during the quarter, we rolled out new warehouse management systems, WMS, to three DCs.

At year end, we have 50% of our DCs on new WMS, and in 2011, we plan on rolling out WMS to six more of our DCs. And we'll be close to 100% of the network finished on the new system at the end of that year.

We continue to implement our new forecasting systems, ITFR, and expect our grocery and general merchandise on the system and fully integrated with SAP by the end of this year. We're also in our initial stages of reengineering our DC processes with our first flow pilot in our Ajax DC.

2011 will be the final year of major investment in our supply chain. Five years of hard work will have delivered us one of the most cost-effective supply chains in North America.

In driving store productivity, we completed the implementation of our store time and attendance system, STAS. It's in 329 stores to date, and we continue to be on track to have all corporate stores on the system by mid-2011.

As Sarah said, we're planning on spending another incremental CAD135 million or so to our P&L on IT and supply chain programs in 2011, and we also spent around CAD50 million in buyout costs as we convert our stores to the new Ontario labor deal.

By the year end 2011, we will have invested close to CAD700 million over our base costs in supply chain and IT infrastructure. We'd expect a further year investment in 2012, then the build-out costs will gradually disappear, with a significant portion of the cost reduction flowing through for use in the P&L.

Our store renovation program and process is probably the largest in North America and becoming the most efficient. During the year, we touched over 200 stores, improving standards, conditions, profitability, and overall shopping experience at the stores we touched. We're roughly two-thirds of the way through our base program of renovating all of our core stores.

In 2010, we opened six Nofrills in the Atlantic, for a total of seven in that region. Customer response is very positive, and we're still on track for 20 Nofrills in the Atlantic. Our Nofrills expansion program in the West has now got critical mass, with over 28 Nofrills stores opened in the West.

And also in the West, we renovated 16 of our Real Canadian superstores. They're large projects involving significant investment and a strong focus on fresh and have been well received, and we'll have more of these in 2011.

In Ontario, we completed 16 Zehrs renovations and seven Fortinos. Our plan is to continue this successful investment program in 2011. We'll open a new Fortinos alongside our new urban stores, including Maple Leaf Gardens. These will be our first conventional new builds in 10 years.

In Quebec, we've now converted 25 of our Provigos, the rural ones, to franchise operations, and have repositioned 110 Maxi and Maxi and Co. stores, with improved offering focused on meeting customer needs and increasing volume. And, as Sarah said, we plan to spend about CAD1 billion of our own capital in 2011.

2011 is the fifth and final year of our renewal program. It will be much of the same, with core infrastructure programs a key priority. But we will have one eye focused on driving profitable market share and delivering the infrastructure program, and the other eye now starting to look to the future, past renewal and the opportunities to build out from the core, building out from the foundation of a solid infrastructure the renewal plan is starting to create.

The first phase of this was the realignment of the organization, based around our conventional and discount businesses. We see these as two distinct businesses with different priorities. Discount is clearly about lowest price and lowest cost. Conventional is about fabulous, fresh, service and choice. This change allows us to better focus on specific customer needs and preferences, be more agile in responding to the changes in competitive environment, and focus on the unique drivers that each of these business has. This change is targeted at market share growth in food.

We've also built in the organization the ability to capitalize on opportunities and emerging trends in apparel, financial services, health and wellness, and the growing ethnicity of our customer base, markets where we have low market share and high opportunity.

In apparel, the Joe Fresh brand is one of the most recognized brands, with strong brand equity in Canada and still tremendous growth prospects. Moving on our equity, we recently announced we'd be opening another four standalone stores in key shopping locations in Canada -- three in Ontario and one in Alberta. And as we announced yesterday, we're also going to test the waters in the US and pilot the Joe Fresh concept in four stores in the New York-New Jersey area.

PC Financial is another one of our brands that has huge credibility, another growth engine that we can leverage by expanding its banking, credit card, insurance, mobile telephony business, as well as its loyalty program.

Looking to demographics and our aging population as well, as consumers' increasing desire for healthy living, we're also prioritizing our health and wellness business. Here again we can build on our established Blue Menu, PC Organics, and Natural Value brands, as well as growing our network of 500 drugstores, 100 medical centers, and onsite fitness centers to deliver a more holistic in-store experience.

The fourth leg of our growth strategy is the very important ethnic market. This is a huge opportunity. Immigration to Canada is driving long-term growth over the next 20 years and will have a defining impact on retail grocery. Our objective is to be the number-one ethnic player in Canada. Building on our established bases, Fortinos and T&T, we'll expand into other key ethnic areas of food in the fastest-growing South Asian and Middle Eastern segments.

We expect 2011 to be one of our toughest years yet. Economic conditions are still not favorable. Inflation will be limited, and we have big investments to make. We still have much to do. But we are breaking the back of our infrastructure programs, can see where the investment reduction and supply chain IT benefit will waterfall through to our P&L, and setting the business for the post-renewal era, focused on market share growth in food and market share growth in Joe, financial service, health and wellness, and ethnic.

And with that, operator, I'd like to hand over to questions.

QUESTIONS AND ANSWERS

Operator

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

Michael Van Aelst - *TD Newcrest - Analyst*

I want to touch first on the sales trends, which seemed to deteriorate in Q4. It seems like it was mostly in general merchandise, but food volume's also down slightly. Can you give us some color on that and on what happened in Q4 versus the prior quarters?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Yes, Michael. If you really look at Q4, much of the trends on most of the businesses were much the same. I think that the two that were slightly more significant is drug, which is not a volume issue; it's a deflation issue. We have huge deflation now in our drugstore business, which we're quite content with. We knew this would happen, and we continue to drive script growth in those areas. So drugs had a much more significant effect.

Food was down a tad, but nothing that we're too worried about. And general merchandise, a little bit, but that was more to do with, it's not really, it was a lot of promotional activity on general merchandise towards the end of the year, and frankly, today, that's not our bag. Our task on GM has been to build the profitability of that business up. And it's worth saying for the first time in 2010, the contribution of our GM business is higher than our food business, which is exactly where we want it to be.

And a bit of our thinking is, I use this word about intelligent sales. There is this balance at the moment. The market's very tough. There's not a lot of volume growth. And we're being very selective where we attack for that growth, because it can be very costly.

Michael Van Aelst - *TD Newcrest - Analyst*

When do you see the general merchandise sales finally hitting bottom and starting to show a growth again?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Well, I think they may be pretty close now. As you know, that market is pretty tough. You look at all our major competitors in that area, they're not producing particularly strong numbers. And it's very tough right at the moment. And so we've been very much focused on reestablishing the ranges, getting the right pricing position, and building the profitability of that. And I think Joe would say that he feels that in range shape, we're probably now six or seven out of ten in terms of where we get something about core GM and not apparel.

We've been doing a lot of work on what we call the right-hand side of the store. We've done about 14 pilots to decide what that looks like, and that's very encouraging. And so, presuming that that market flattens out a bit, then we'd expect to start to see some growth in the core GM business.

Michael Van Aelst - *TD Newcrest - Analyst*

And how do those new product lines that came in during Q4 actually perform?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

They were good. I think we were very happy with them. The big driver of the under-performance in most GM business was actually electronics, which has become very cutthroat. And it's something that Joe is basically redesigning for us. The traditional way in which we handle that is not the way we'll handle that in the future.

Michael Van Aelst - *TD Newcrest - Analyst*

And just finally, apparel. You had set a target of CAD1 billion. Can you give us a sense as to how close you are to that? Because it sounds like your pace of growth -- your growth continues, but the pace appears to have slowed, based on your commentary.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Yes, I think, again, relative to the market. We're tracking nicely towards our billion dollars, and we see a very clear way of getting there. The growth slowed a bit in Q4, but it's still, compared to most of the clothing business, it's very strong. So we're still very confident in that business. And again, we've got great new consistency. We've got these new standalones to come out. And we've still got a lot of work that we can do in our core base. So actually, I'm feeling pretty good about both the apparel business and the GM business, and certainly significantly better than we would have been three or four years ago.

Michael Van Aelst - *TD Newcrest - Analyst*

That CAD1 billion target is for what date?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Never given one.

Michael Van Aelst - *TD Newcrest - Analyst*

I thought originally you gave one.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Yes, but that was amidst Galen.

Michael Van Aelst - *TD Newcrest - Analyst*

Galen? Okay, thank you.

Operator

Perry Caicco, CIBC World Markets.

Perry Caicco - *CIBC World Markets - Analyst*

I just want to spend a few more minutes on the core food business, which you mentioned declined marginally, and you also mentioned that you're not too worried about it. I'm just wondering, Allan, what you think it's going to take to reenergize food sales in your business.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Well, it's two things, Perry. I think that the reason I'm not over-worried about it is to say -- you and I have had this conversation before -- I just think that there's elements of volume you can chase in the market, but it's fool's gold, basically. And I'd rather be sure that the sales that we get are really profitable sales.

Having said that, in part, I think the change that we've made in terms of the organization to get the two businesses focused on these -- and we do see it as very two distinct businesses -- I think that, you can read that as the start of the catalyst to really get after getting that food business going again, but done in a way in which we continue to drive the profitability of the business. Because for me, the reason to get sales is to improve your profitability, not to reduce your profitability. And so I think you can assume that that organization will change, is a major catalyst in that. And as I said in my remarks, they have a clear objective, which is to grow market share in food.

Perry Caicco - *CIBC World Markets - Analyst*

And how does the new CEO fit with this sort of catalyst organization which you've set up?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

First of all, the new CEO won't be here until the second half of the year. And so very much we are focused at the moment as business as usual. But clearly, we've set up the organization, and we set up the strategy of the business, and that is very clear. And Vicente, including we've been talking to this, is very attached to that. And then when he comes into the business, his role will be to take up where I left off and make sure all this stuff happens.

So I think you should see the new CEO as a piece of evolution, a very good piece of succession that's very seamless. And that's the way we'll see it.

Perry Caicco - *CIBC World Markets - Analyst*

Okay, just, my second question would be, I just wonder if you could talk about the challenge of pushing through cost increases into retail pricing, whether you think there will be a squeeze at the margin level as you try to feather that through and whether you think once the price inflation comes, that could impact profit for tonnage in your business?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

I think that there isn't a lot of tonnage growth in the market. So whatever inflation comes through. In my mind it's a couple of points of inflation would be useful. Five points of inflation wouldn't be useful, because I think you've got the balance of where it helps the retailers and then where it starts to impact on consumers.

We've got a little bit of inflation in produce and meat, which you'd expect. But our grocery business is not showing any signs of it. And so, and I think the vendors clearly will try and pass through pricing where they've got a cost base adjustment. But as you know, I'm also concerned that what happens is you put through the price increase, and then all that happens is it all gets promoted back. And so you end up in the same place, but in a market that's even more volatile than it is today.

So my sense is that, as I said to you, I'm not counting on a lot of inflation in the first six months. I think people will proceed cautiously. And certainly, we're only interested in passing prices through where there's a cost behind them, and that's going to be price in the marketplace rather than, "Let's put the prices up and then promote it all back."

Perry Caicco - *CIBC World Markets - Analyst*

Okay, thank you, Allan.

Operator

Peter Sklar, BMO Capital Markets.

Peter Sklar - *BMO Capital Markets - Analyst*

Sarah, I just had some questions on the incremental spend on IT and supply chain. So my understanding is the spending in 2010, the incremental spend, was CAD142 million. So are you saying now that the spending of CAD135 million in 2011 is above and beyond the CAD142 million? Is that how I should read that?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

Yes, it's all cumulative.

Peter Sklar - *BMO Capital Markets - Analyst*

Is that different than what you were saying before? I think I was under the impression before that the spend level in 2011 was going to be somewhat where it was in 2010.

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

No, I don't think we've got -- no, 2011 is going to be higher than 2010.

Peter Sklar - *BMO Capital Markets - Analyst*

By the CAD135 million?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

That's right.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And then in Allan's comments, he seemed to imply that that spending would continue in 2012. Is that spending going to continue at the 2011 level, or is it going to go up, or go down? Where's it going to go incrementally?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

It's going to go up in 2012 from 2011, and then 2012 will be our peak, and then it will start to come down from there.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay, and can you give some order of magnitude?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

No, we're just not giving it out on the outer years.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And was that different before? I think you indicated before that you thought it would be coming down in 2012.

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

I'm not sure we ever gave an estimate on 2012. If we did, then it's different now. It's definitely going to be up in 2012.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And just one item that was disclosed I missed. Of the CAD27 million spend in the fourth quarter, how much of that was depreciation? I think you gave that number, and I missed it.

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

Yes, CAD14 million.

Peter Sklar - *BMO Capital Markets - Analyst*

CAD14 million. Okay. And then just a question for Allan. Just wondered if you could give some of your thoughts on what you're seeing on Joe Fresh in your US efforts, what you're seeing in terms of your market research and what your thinking is and why you think it could potentially be successful in, I think, what you would agree is a more competitive retail environment than you generally have in Canada?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Are you talking about the four-store expansion or the 800-store expansion?

Peter Sklar - *BMO Capital Markets - Analyst*

Well, both, and I assume if you're going to do a pilot, you have some anticipation that you could have success.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

So we have done a lot of work in terms of determining what the opportunity may be in the US. And most of that work has been around acceptance of the product and looking at where people have, both inside the US and outside the US, done well and not done well. And out of that work, we got a clear stated back of Joe and that proposition may occupy a space which could be very good.

So the next stage of that, having done that research, is you've got to go live. And so we decided that we would do a pilot in New York, that we would pick four stores, and we would get the product down there, and let's see what happens.

That will not, those stores won't be up until the end of this year. So the reality is, it's going to be way into 2012 before we can take a read on the performance. And then, when we take a read on the performance, clearly, then we can decide what to do next.

As you know, Joe yesterday, we're talking about envisioning 500 or 800 stores. That comes a bit from the work that was done that said in the endgame, what could the opportunity be. But we're a long way from that. That has to be proven out. But clearly, in my mind, we're not going to end up with four stores in the US. We're either going to end up with zero or something. And the four stores will be the proving point of that.

But we're very encouraged by Joe, both in Canada, where it still outperforms any other clothing brand, and therefore, we think there is an opportunity in the US. And it's on our growth horizons, but very much to be proven.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. Thank you for your comments.

Operator

Irene Nattel, RBC Capital Markets.

Irene Nattel - *RBC Capital Markets - Analyst*

Thank you. If I could, my first question is for you, Galen. And it's around in looking for a successor for Allan, what really were the key elements and key criteria that the Board was looking for?

Galen G. Weston - *Loblaw Cos. Ltd. - Executive Chairman*

That's a great question. I think what I'd like to do, Irene, is chat about Vicente when he gets here. We can talk a little bit about who he is and what he's done. But from a high level perspective, Allan is a big set of shoes to fill, for sure. And we consider ourselves a global-scale retailer, even though we operate inside the borders of Canada. And so we wanted to go out there. We felt that the Company deserved, and should get, one of the senior retail executives around the world. And we feel that that's exactly what we've done.

And this is an individual who has experience in drugstores and health and wellness. He has deep experience in fresh food. He spent a number of years in Asia and in Latin America. So when you line up the strategic priorities that Allan laid out a few minutes ago against his CV, you'll see that they're pretty well aligned.

And I just want to echo what Allan said, which is he's very familiar with the strategy of the business. And part of the basis on which he's coming into the organization, and part of his experience base and his talent base, is he's a builder. We've had a long period of change, and we've established a very firm foundation and base for the business. And his mandate is to take that base, vet it down, and deliver the potential that exists within it.

Irene Nattel - *RBC Capital Markets - Analyst*

That's very helpful. Thank you, Galen. And then my next question, and I guess in some way it relates to the first one, is one of the key objectives in this whole five-year program was to get to the point where Loblaw really could take its significant size and scale advantage relative to its domestic competitors and use that as a basis to grow and really be more of, I guess, a maker than a taker, if you will, in terms of market dynamics. How far away do you think we are from that point?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

It's Allan. Clearly, the other piece of thinking in our thinking of Vicente is that we're coming to the close of a new period. And therefore, the next phase, which I think is your major point, also was a large part of our thinking, and that, clearly, we needed somebody who could run the business for the next five to seven years in that place.

And so I think you should see this passing of the baton, which is the way I think about it, is as this phase that starts to take us into the phase that you talk about. But there still is at least another 18 months to two years of digging work to do. It's a different piece of digging. We've dug the supply chain, we've made that work, and now we're getting to the merchandising business, and then run to our stores. But you should see this as that is very much part of the evolution that we thought about in terms of where the business is, and having bring in Vicente at this time with the skill set that he has.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great and very helpful. Thank you.

Operator

Jim Durran, National Bank Financial.

Jim Durran - *National Bank Financial - Analyst*

Thank you. Just going back to Joe Fresh and your move into the US, what's the major driver to that? Aside from growth for growth's sake, are there some other opportunities or dynamics that it might deliver to you that you think are beneficial and necessary?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

We don't do anything growth for growth's sake, because I know lots of people who tried that and it ended up very badly for them. So anything we do, we think through very methodically. And we see an opportunity, perhaps, for that brand in the US. There is a void in that market which this brand may fit. And clearly, we're not a million miles away from the US. Joe has experience down there, as a number of us have. But as I say, I see this as a horizon approach of which we are now at the pilot stage. But the horizon of buildup of that growth, as I say, is a good 18 months to two years away. So that's the way we look at it.

Jim Durran - *National Bank Financial - Analyst*

Is this the only element of your business that you'd consider taking outside of Canada?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Yes, I think so. It's the only element of our business that we're thinking about taking outside of Canada. And because our main task is we're retailers in Canada, that's the core of our business, and that's what we have to be better at. But sometimes you have something in your business which is exportable. And I guess that our view is, and having had done the research that we've done, that this is the case.

I think the other thing which is very important, there's only, we're a scale operator. We only do scale stuff. So the only reason to do anything is if you believe that at the end of it, there's some real scale that can add to the scale of this business. And it's very easy to do lots of little things, but we're really only interested in the scale things.

Jim Durran - *National Bank Financial - Analyst*

Okay. High control label. Can you just give us an idea of where you're at in terms of profitability improvement and are we even close to lapping the benefits of last year and seeing that as a driver, not having as much benefit in 2011?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

So first of all, we've made good progress, I would describe it, on the control ramp possibility and clearly, that's a significant part of our objective to improve our gross margins, and designed as such. So it's delivering what we said we'd deliver. And my view is that there is still some opportunity there. We clearly will start to lap what we did last year, but you can, suffice it that the merchants are still tasked with improving from where they are today. Because in my view, there's still scope.

And of course, the other way that it helps is in our mix. And that's my whole thing about intelligent sales, because clearly now we have control brand which is more profitable. And therefore, if we drive the control brand part of our business, then that also enhances that profitability. It's not just the straight margin; it's the share of business, too, that makes a difference.

So good progress. I'd say 6.5 out of 10 in terms of where we can get to, and that will be a continued focus for the guys this year.

Jim Durran - *National Bank Financial - Analyst*

Okay. And then last question, we were all holding our breath on SAP. You've done a super pilot. Sounds like it's all guns a-blazing for 2011 in terms of continuing with the program. I assume that means you're happy with the quality of the data and happy with the transition in terms of people using the system?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Well, "happy" is a big word to me. I'm pleased with the transition, and I'm becoming more pleased with the data. That is, clearly, is always the issue. We've made a few adjustments, and generally, I think the finer stuff is going well. The supply chain stuff has gone well. The pilots have worked well in merch. The big test is we're going to go to all of merchandising this year. That's pretty big. And we adjusted the timing a little piece, which is I wanted to make sure we put the organization in place in January, and then did the SAP in merchandising after putting the organization in place, because clearly, that makes much more sense.

So I'd say that we're probably three to five months behind where we originally had planned, of which the majority of that was the organization, the decision of just decide to flip it. We'll be pretty much close to the original plan by the time that we get there, but we've got, as I say, that this merch piece will be a big piece. And we've taken the opportunity of this slight lull in activity in the first quarter to really get after the data, and that's why I'm feeling slightly more pleased with where we are on that. But generally, touch wood, in a good place.

Jim Durran - *National Bank Financial - Analyst*

Okay, thanks, Allan.

Operator

Patricia Baker, Scotia Capital.

Patricia Baker - *Scotia Capital - Analyst*

I have two questions for you, Allan. I want to come back to the realignment. Now, you did give a reasonably cogent explanation of why you chose to align the change in structure along discount and conventional, with two distinct businesses. And it may well be the perfect framework for the organization, but it does seem like a very simple, perhaps even parsimonious, idea. And I'm just curious as to the timing, as to why did this big idea only come up now, at the beginning of what you're calling the last year of change? And why would we have not seen that start to change? The right organizational alignment, to me, I would have thought that we would have seen that earlier. There must be something I'm missing.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

No. So cogent, simple, and parsimonious we like. We see those as good things.

Patricia Baker - *Scotia Capital - Analyst*

I didn't say they weren't.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

The reality is this. I think we've learned as we've gone, I think is the first thing. And the first thing was to centralize the business, get all of the benefits that that clearly brings, and then take stock of what we've got. And what became very clear as we were moving on is that these are two distinct businesses.

Actually, if you've read our strategic plan, which of course, you won't have read, because we haven't sent it to anybody -- .

Patricia Baker - *Scotia Capital - Analyst*

I'd be happy to, though.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

This has actually been planned for the last two years. But in my view, is I wanted to make sure that a lot of the basic infrastructure was in place and a lot of the work that was to do with centralizing the business was in place, and, frankly, that the people were in place. And they are three boxes that we can tick, and therefore, we clearly decided to do it.

Plus, also, this piece of succession is something that we've been thinking through for a period of time. And then clearly, it makes more sense to do this ahead of time, in this fifth year, and then everything else is built up against an organization which is now organized to deliver the things that it's focused on -- discount and conventional in our core business -- and attack these four areas about the growth as we see it, which we think are areas that are important to the business and that need to be focused to.

So it's as simple as that, actually.

Patricia Baker - *Scotia Capital - Analyst*

Okay, that's fair. If, even though you determined when the right timing is, if, in your heart of hearts four or five years, ago, if you were asked, "What's really the appropriate alignment for this business?" would you have been leaning there but not ready to put it in, or would that have evolved over the first two years of making change?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

I think, hand on heart, four or five years ago, I wouldn't have known to go there, and--.

Patricia Baker - *Scotia Capital - Analyst*

Okay, that's fair.

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

And I think it is a piece of evolution. And we're evolving on lots of fronts -- the market, there's a lot of change. We all think we're in the same industry, but there's a lot of change happening over a relatively short period of time. So I absolutely believe that this is the way the business should structure.

And it is very interesting. If you take the temperature of the organization, it's pretty good, sensing whether they think something's right or wrong. The temperature of the organization thinks that this is absolutely right. We've got all the store managers here at the moment, and we were with them last night and we've been with them this morning, and we talked to them. And they absolutely believe this is the way the business should be structured, because it enables them to focus on the things that are different and distinct in their businesses.

Patricia Baker - *Scotia Capital - Analyst*

Oh, excellent. Second question, Allan, you did give us your normal expected hawkish comment. You said that 2011 would be the toughest year yet. Simple question -- do you mean the toughest year of the five transformational years, or the toughest year in the history of the Company?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

I can't remember the history, although Galen often tells me that it was much harder when he was running it. But I think of the renewal. And the reason I say, actually, generally the fifth year always is. Everybody thinks you get into the fifth year, that should be easy. Generally, the fifth year is the toughest because of the things you have to knock over that you've not been able to knock over so far.

So I think of the renewal. As you know, you can sense my point. We still have great confidence in where the business is going, in a strange way, more because we can see more of it. But it has to be done, this stuff has to be dug out. And it's hard enough doing it when you're doing it, but say, the market environment, there's no growth in the market. And it's going to be not a lot of inflation for the first six months. And I read different things in the newspapers. How do I really feel about the economy and confidence and all this stuff that's happening down in the Middle East? I think it's tough. And so that's the way we think about things, and that's the way the business then gets on with it.

Patricia Baker - *Scotia Capital - Analyst*

Okay, thank you very much.

Operator

Winston Lee, Credit Suisse.

THOMSON REUTERS

Winston Lee - *Credit Suisse - Analyst*

Thank you. I know that you're going to touch on this later on, but I'm just wondering if you could help us understand. The new CEO that's coming into the second half of the year, Vicente, how important is his experience in emerging economies important to the development for Loblaw in the future? And I'm thinking about the ethnic side, one of the pillars of growth that you've mentioned here. Or is that not really the importance? Is it more about just operating a larger business and being able to just leverage the size and scale further as you have Wal-Mart and Target more in these markets over time?

Galen G. Weston - *Loblaw Cos. Ltd. - Executive Chairman*

I think it's both. Vicente, again, you'll get a sense as we talk more about him later in the year. But if you investigate his track record, you'll see that he's a superb operator of supermarkets, has lots of experience with multiple formats, he's a good team builder and understands store operations like the back of his hand. So all of those basics are going to build on the foundation that we've been working on for the last three or four years and push the business to new heights just around the fundamentals. And then take what Allan outlined as our areas of attack and the fact that his experience lines up so nicely against them, not because of emerging markets, but because he has an understanding of Asian retail, South Asian retail, and what constitutes a great way to grab those customers.

So I think he's going to deliver both for us. But to Allan's point, we still have work to do to finish the five years, and that's right now what we're focused on. And Allan is the President of the Company and will continue to be until the day he isn't, and we'll continue to deliver against his objectives.

Winston Lee - *Credit Suisse - Analyst*

Okay, thank you. If I could ask the President of the Company, Allan, then, chasing volume, you say, is maybe a fool's move if it's not profitable. I wonder, is that, do you think, now a greater reflection of what's happening in the industry as inflation has been relatively tame at this point? Do you think that that rationality, if there is rationality right now in behaving as a whole, will persist?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

I think everybody is having to manage conditions in the market which are quite exceptional, and they have been around a long time. I've never been in a market where there's been deflation for nearly a year. And that does make people think, and frankly, if you've not been here before, you have to learn how it works. And part of the way that it works, that people do get angst -- I do -- about sales. And therefore, you think, "Well, we'd better go and get some." And then you realize you've got a business that costs you a fortune. And I just don't think that, in our business, we don't have the subtlety yet, which we will get through our systems, that enables us to chase that 1% and do it in a way which makes some sense.

And that doesn't mean you shouldn't read into it, by any means, that when I say I'm not worried about sales, it means I'm not worried about them. Would I like some more? Absolutely, but not at any cost. And I think everybody's learning how to manage in this environment, whether they're food retailers or whether they're general merchandise retailers. And I think that if there may be more irrationality -- irrationality tends to be in promo, and I guess it generally is because you've had a bad week, and then the general reaction is, "Let's get after it promo-wise." And that is fool's gold, because you generally sell the product to people who aren't your regular customers, and you lose a fortune on it.

And so I think this is something that will evolve. And I actually think the industry may be stronger as a result of it, actually, because it does make you think about other ways in which you have to grow the profitability of the business. So we'll see what happens over this first half.

But the only irrationality I see tends to be flyer-based.

Winston Lee - *Credit Suisse - Analyst*

Okay. And Allan, would you say that when you look across at other countries, maybe less developed countries, that they have different challenges than we do with inflation? Maybe they have more inflation? I know that you said above 5% or five points or so is not necessarily a good thing. How do you think about Canada's ability to use inflation versus other countries for its benefit?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

I think Canada is not in a bad place. In a strange way, to have deflation on food and some inflation in the rest of the market is actually quite a good play for customers. It's been a fantastic time. And I, in a strange place, I'd rather be here than the UK. They're looking at six or seven points of inflation. Well, that will have an impact on consumer spending, and that's going to whack you in the end, anyway. And I always think there's this sweet spot. And generally, for food retail around the world, the sweet spot is 3%; 3% inflation is a nice number that just keeps everything constant.

So this market is a long way off 3%. But you could see an environment down the track, not to know when, when it could be close to that. And as I say, I think that that number, around 2% to 3%, is a good number. And I think when it gets, because I think it roughly holds the volume that it covers people's costs. I think when you go higher than that, then it really starts to whack the market, basically. And I think that's -- so I'd rather, bizarrely, I'd rather be in a place of deflation than a place of high inflation.

Winston Lee - *Credit Suisse - Analyst*

And just on your prior comment about being primarily in Canada at this stage, is there -- the proximity's there with the US in some ways, and I know the US is a very difficult competitive environment. But is there something more that you can do down the road by following one of these channels in apparel -- not necessarily apparel; I'm thinking more about ethnic -- closer to the border?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

There's two things. We're primarily a Canadian retailer, and there's lots to do. We have lots of opportunity in this business. And this is the jewel in the crown, and this is absolutely where our focus needs to be. I'm not a great fan of getting into food retail in the US or any of that. And as I say, our only interest, apart from anything we do, would be to have any scale attached to it. And the only thing we have in our mind at this moment is about Joe Fresh. And that's because we've got research that says it's a good idea, and we're going to pilot it. And then we'll decide.

I think the other thing is, everybody always says the US is a very difficult market to go into. Most markets are very difficult to go into. And if you look at every market, there are companies that do well and companies that don't, and generally, the ones that do well have got a very good customer proposition and a very good management team. And that tends to be the driver of whether anybody does well or not.

Winston Lee - *Credit Suisse - Analyst*

Thanks. That's very clear. Appreciate that.

Operator

Chris Li, Bank of America Merrill Lynch.

Chris Li - *Bank of America Merrill Lynch - Analyst*

My first question is, can you give us a sense of your business performance by region?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

No.

Chris Li - *Bank of America Merrill Lynch - Analyst*

Okay. Maybe, can you talk about, particularly in Quebec, just because I think your recent commentaries have suggested that you're starting maybe to turn around the corner a bit, can you put any color -- ?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

We don't talk about the regionality in the same way we don't talk about the banners, because that's just useful competitive information. I think you've seen that there's a lot of investment gone into Quebec, primarily into the Maxi banners, and we would expect, and do expect, for that to improve the performance in that market. And that's something that people are very focused on.

Chris Li - *Bank of America Merrill Lynch - Analyst*

Okay, and second question, just in terms of your use of free cash flow as your CapEx continues to trend down, your free cash flow should improve this year and over the next few years. What are your priorities in terms of use of free cash flow going forward?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Sarah?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

So right now, we're focused on hanging onto a bit of cash, so we like having the cash balances that we've got. We paid down an MTN in January of this year, so we used CAD350 million there, and we still have a big capital build of CAD1 billion this year. So we think we're -- we have no plans to change that, any of our plans, no plans to change anything this year. And the other years, we're going to wait and see. We still have a scale, and as Allan has mentioned, we've still got a lot of digging out to do. So throughout those years, the year and a half of heavy digging we still have left, we're going to hang onto the cash, and then we'll take it from there.

Chris Li - *Bank of America Merrill Lynch - Analyst*

Okay. And just the third question's just on the gross margin improvement. Can you maybe explain and quantify for us the benefit from the shift of the pharmaceutical vendor rebates from SG&A expenses to gross profit?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

Okay, so basically what happened was as a result of Bill 102 in Ontario, the pharmacy allowances were previously earned only as we reimbursed costs at the pharmacy level. The changes to the pharmacy legislation enacted in the third quarter have eliminated the requirement to match these allowances to specific expenses incurred to earn them. So the impact on gross margin in the fourth quarter is just a shift of these pharmacy allowances from SG&A to cost of goods sold as a result of the change, and the net impact on operating income is zero. So there's no impact there. It's just a marginal impact between the two that we're not going to split out, as we don't the components of gross profit changes in gross profit.

So no impact at the operating income level, and just a marginal increase, impact between SG&A and gross profit.

Chris Li - *Bank of America Merrill Lynch - Analyst*

Okay. And just in terms of the increase in transportation costs, was that mainly due to the closure of the Quebec DC?

Allan Leighton - *Loblaw Cos. Ltd. - President & Deputy Chairman*

Yes.

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

That's part of it, and then the other piece would be the increase in the fuel cost, which helped us on our revenue in our gas bars, but hurt us in the cost of transportation.

Chris Li - *Bank of America Merrill Lynch - Analyst*

Okay. And just my last question, just more for modeling. The CAD135 million of IT expenses this year, do you expect them to be incurred evenly throughout the year, or is it more front-end loaded, or back end?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

I think having a pretty even split across the year would be a pretty good assumption.

Chris Li - *Bank of America Merrill Lynch - Analyst*

And the D&A split should be similar to 2010?

Sarah Davis - *Loblaw Cos. Ltd. - CFO*

About 50/50.

Chris Li - *Bank of America Merrill Lynch - Analyst*

50/50. Okay, thanks very much.

Operator

This ends the Q&A portion of today's call. I would now turn the call back over to Ms. Kim Lee.

Kim Lee - *Loblaw Cos. Ltd. - VP IR*

Thank you, everyone, for joining us this morning. We look forward to speaking with you again next week on March 3 for our IFRS. Thanks and have a great day.

Operator

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