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PRESENTATION

Operator

Good morning. My name is Michelle and I will be your conference operator today. At this time I would like to welcome everyone to the Loblaw Companies Limited fourth-quarter and fiscal 2013 results conference call.

(Operator Instructions)

I'll now turn the call over to Janet Craig. You may begin your conference.

Janet Craig *- Loblaw Companies Limited - SVP, IR*

Thanks, Michelle, and good morning. Welcome to the Loblaw Companies Limited fourth-quarter and fiscal 2013 results webcast and conference call. I'm joined here this morning by Galen Weston, Executive Chairman; Vicente Trius, President 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 2014 and future years and the Company's plans and projections with respect to Shoppers Drug Mart Corporation, which the Company entered into an agreement to acquire. These statements are based on certain assumptions and reflect management's current expectations and they are subject 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 Canadian securities regulators from time to time, including the Company's annual report filed today.

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 annual report and other materials filed with the Canadian securities regulators from time to time for a reconciliation of each of these measures to the most directly comparable GAAP financial measures. An archive of this conference call will be available on our website. I will now turn the call over to Galen.

Galen Weston - *Loblaw Companies Limited - Executive Chairman*

Good morning, everyone. Loblaw made measurable progress in 2013 as we continued to focus on long-term value creation by executing against our strategy. In 2013 we increased our dividend following on a dividend increase in late 2012. We launched Choice Properties, a leading real estate investment trust, as well as announced the acquisition of Shoppers Drug Mart.

We also made great strides in our core food operations. In an environment of growing retail square footage and increased competition our strategy delivered same-store sales growth, revenue and adjusted EBITDA growth.

In Q4, we focused on balancing sales and margin, generated another quarter of same-store sales growth while at the same time continuing to gain incremental efficiencies in our business. In fact, we realized roughly CAD50 million, or 80 basis points of efficiencies, in Q4 alone. These savings were generated through a combination of lower shrink, transportation and administrative costs.

Looking forward to 2014, we will continue to execute on our strategy of improving our customer proposition, which we expect to result in continued sales momentum, while at the same time focusing on creating a more responsive and lean organization. The implementation of SAP is part of this effort and I'm very pleased to say that we have achieved a scalable model and are now rolling out stores at an accelerated pace.

We also look forward with great anticipation to the close of the Shoppers Drug Mart transaction, which we continue to expect this quarter. The implementation teams have been hard at work planning and are ensuring that when the transaction closes we will be very well positioned to implement our post-closing plans and achieve the targeted synergies.

The advances we have made this year serve as a firm foundation as we move forward into the next chapter of growth for Loblaw. Now I will turn the call over to Sarah for more details on our performance.

Sarah Davis - *Loblaw Companies Limited - CFO*

Thank you, Galen, and good morning. At Loblaw we have been investing in a group of diversified but complimentary businesses. And it is our objective to steadily grow our earnings and cash flow on a long-term basis through our retail, financial services and real estate operations.

In order to achieve these objectives in our retail business we are focused on making targeted investments to improve our price position while differentiating versus our competitors through investments in areas such as service and assortment as well as through initiatives like PC plus. The aim of these initiatives is to drive sustainable top line growth with a specific goal of growing annual same-store sales at a rate greater than internal inflation. We delivered on that objective in 2013, generating same-store sales of 1.1% in a very competitive environment. This is a positive indicator of the impact that our customer proposition investments are having.

As we invest we are also committed to levering targeted efficiencies. Between revenue growth and operating efficiencies it is our goal to drive solid, long-term returns for the business.

In our retail operations during 2013, we generated efficiencies in shrink and transportation costs, which are both recorded in cost of goods sold as well as in labor, warehousing and supply chain costs, which are recorded in SG&A. On the consolidated business, because of improvements in our retail division as well as continued growth in our Financial Services operations, we successfully delivered on our goal of gaining leverage from our business. We grew adjusted EBITDA by 3.9%, compared to a 2.4% increase in revenue. Adjusted operating income grew 2.6% for the full year.

Focusing on Q4 now, during a competitive quarter we grew same-store sales and improved our gross margin compared to Q4 of 2012 as we focused on achieving a balance between the top and bottom line. Same-store sales grew 0.6% in Q4. We had the same number of shopping days in both years. However, Q4 2013 results were boosted by an additional week of pre-Thanksgiving shopping that fell in Q3 last year.

The ice storm in Ontario and the Atlantic region during the quarter represented a negative impact of approximately 20 basis points on same-store sales as 80 stores and three of our distribution centers were closed for between 1 and 3 days. The labor action that affected 28 of our stores in Alberta for 2 to 3 days represented a negative impact of about 10 basis points. The combination of these three factors increased same-store sales by approximately 30 to 50 basis points. So we are looking at an adjusted comp number of approximately 0.2% just using the midpoint.

In a competitive Q4, we are satisfied with this result. Our internal measure of inflation was up compared to Q3, reflecting continued inflation in fresh areas as well as less deflation in grocery quarter-over-quarter. Inflation was lower than CPI during the quarter.

Drugstore sales declined marginally as a result of reform-induced deflationary pressure. Apparel sales grew modestly driven by our -- both our Canadian retail and US wholesale businesses. Excluding apparel, sales in our general merchandise business declined marginally versus Q4 of last year. Declines were primarily related to categories we are downsizing such as electronics and leisure.

In Q4, gross profit was CAD1.6 billion, CAD68 million higher than last year, while gross margin was up 50 basis points to 22.1% from last year's 21.6%. The increase in gross margin compared to Q4 last year was primarily a result of improved shrink and transportation costs as well as improved margins in our GM business. These gains were partially offset by continued investment in food margin as our pace of shelf price investment remained on strategy. By the end of Q4, the efficiencies we generated outweighed the margin investment we deployed during the quarter, resulting in a higher gross margin than we had outlined for you when we reported Q3.

Core operating expenses were well controlled in Q4. We targeted and achieved efficiencies in labor as well as administrative costs of roughly 35 basis points and 20 basis points respectively. The decline in adjusted retail operating income was primarily a result of investments in and changes in the accounting valuation of the Company's franchise business. In addition to the franchise charge, we had higher costs associated with the growth of certain of our emerging businesses as well as CAD8 million in lost ancillary property net income, which is now reflected in the REIT segment, and higher depreciation costs primarily related to our IT project.

In Q4 financial services revenue grew by 15.9% driven by higher interest income from increased receivable balances in our PC Mastercard business as well as higher revenue from the growth of our Mobile Shop business. PC financial earnings before tax grew by CAD6 million, or 26.1% year-over-year.

Q4 revenue at Choice Properties was CAD165 for the quarter, CAD148 million of which came from Loblaw's retail segment. Net operating income for Choice Properties was CAD114 million. The Q4 results for Choice Properties were in line with the IPO financial forecast.

Turning to our consolidated results for Q4, adjusted basic net earnings per share of CAD0.65 was 1.5% lower in Q4 than in the prior year. Our interest expense is higher in the quarter than last year. For the purpose of calculating adjusted net earnings and adjusted net earnings per basic common share, we have backed out the net costs related to the CAD1.6 billion in debt we have taken on to fund the Shoppers Drug Mart transaction because the transaction has not yet closed. We have also backed out and will continue to back out the impact of any changes in the fair value related to the Choice Properties trust unit held by third parties.

The units are considered liabilities for accounting purposes and fair valued each quarter. The fluctuations in the value do not reflect our underlying business performance so we have adjusted for them.

Before taking you through our expectations for 2014, I would like to briefly touch on foreign exchange and its impact on our business. The US dollar has appreciated in recent months. On the food side of our business the vast majority of our direct FX exposure is in produce with a smaller exposure in meat.

Historically we have passed FX related cost increases on to customers in these areas. We also purchase goods for our GM and apparel businesses in US dollars. We primarily utilize hedging on the apparel side and manage our pricing strategy within the context of the competitive environment to minimize the impact of any changes in FX.

FX is certainly a risk. However, some inflation can be a good thing for our business. Historically when the US dollar has appreciated, we have been able to keep our gross profit margin relatively stable while sales have inflated, leading to growth in gross profit dollars. Currently we are seeing more -- seeing some FX-related inflation in our fresh businesses and we expect to continue to pass some of these cost increases on in a measured fashion within the framework of our ongoing strategic program of shelf price investments.

Turning to 2014, this year we are going to spend approximately CAD1 billion in capital, roughly 60% for Loblaw retail, 15% for Choice Properties and 25% to infrastructure. We expect to grow net retail square footage by 0.5% in 2014. In recent years, we have pointed to the 1% range as allowing us to keep pace with population growth. But the reality is that as Canada's largest food retailer we have to find smarter ways to grow as we seek to maintain our position and focus on making our existing assets more productive.

The Shoppers Drug Mart transaction is the key component of this plan, but the way we grow going forward in our grocery retail business will also change. Digging further into the 0.5%, we plan on growing supermarket type merchandise footage at a higher rate than the 0.5% while downsizing footage in some of our less productive non-food categories to align with core strengths.

This year, we will continue to focus on driving the top line through investments in our customer proposition, value assortment, and service. We are focused on maintaining P&L accountability as we execute the strategy and are committed to offsetting the investments we make with savings in the business. To meet this goal, we have outlined specific targets across a handful of areas. For example, we expect to be able to drive additional supply chain savings in 2014 in areas where we have already seen efficiencies in 2013 such as transport and warehousing.

For 2014 we see the environment remaining extremely competitive driven by continued greater than historical square footage expansion, which is expected to moderate in the second half of the year. 2014 is going to be a complicated year from a financial perspective. As a result, I would like to provide some clarity on how to set the base in 2013 for 2014.

In 2014 we will not be adjusting for equity-based compensation net of equity forwards because we do not anticipate much volatility in this number. We will also only adjust for Choice Properties general and administrative costs in Q1 and Q2 until we lap the IPO. As a result of these changes, full-year adjusted operating income for 2013 will be re-based to CAD1,287 million from CAD1,325 million. And adjusted EBITDA will move to CAD 2111 million from CAD 2,149 million. The difference between the figures is CAD32 million in equity-based compensation net of equity forwards and CAD6 million in Choice Properties general and administrative costs.

We look forward to providing additional color following the close of the Shoppers Drug Mart transaction. With that, I'll pass the call over to Vicente.

Vicente Trius - *Loblaw Companies Limited - President*

Thank you, Sarah, and good morning everybody. We continued to make progress in 2013. We grew same-store sales at a better pace than internal inflation, achieved efficiencies of approximately CAD100 million and maintained our tonnage share. While we have some challenges, like our earnings revision in Q3, I am proud of the strides we made in our core business as we continue to execute our strategy in an environment of unprecedented competitive square footage growth.

We continue to invest in our customer proposition to drive the top line while consistently achieving efficiencies, which together should deliver long-term growth and profitability. In Q4 we generated positive same-store sales with strong results in fresh. Fresh is a competitive differentiator and is a key driver of traffic and basket. As we have worked to improve our offering through changes in sourcing, assortment and the way we merchandise fresh products, we have seen good results with positive comps in this area. Fresh is outpacing other areas of our food business, helping to drive larger baskets throughout the year.

As we focus on leveraging sales growth into earnings growth over the full year, we are committed to balancing investments with efficiencies. Our price investment strategy could be broadly divided into strategic and tactical categories.

Ongoing investments in shelf are strategic investments because while we expect the long-term result to far outweigh the cost, we are steadily investing ahead of the market on a trajectory we have previously determined in balancing with offsetting efficiencies. Promo investments will primarily be considered a tactical lever to keep up with the market and gain traffic or share on a short term basis.

This played out in Q4. We maintained our pace of strategic shelf price investments to encourage loyalty, held promo penetration's steady compared to a market that penetrated higher than last year and balanced our investments with efficiencies. During the quarter, average basket size was up. Traffic was down and tonnage share declined slightly.

We are continuing to attract the right type of customers through our customer proposition and initiatives like our PC plus program. These initiatives are driving loyalty and building baskets. In fact, high value customers compose the greater proportion of our sales year-over-year.

The competitive environment remained intense in Q4 as square footage grew 3.5% to 4% compared to the 4th quarter of 2012. This is well above historical levels. The back half of the year saw disproportionate store opening activity with 60% of the openings executed by our two large multinational competitors occurring during that time. These two competitors executed 50 new store openings in Q4 alone compared to an average of 35 per quarter for the first three quarters of the year.

In a tough environment we generated good top and bottom line performance. Regionally, the competitive pressure was varied during the quarter, but on a total company basis the impact of the expansion of our large competitors has been roughly in line with our expectations.

Q4 presented further evidence that the investments we have made to drive differentiation are working. We're generating improved net promoter scores in our conventional division.

We view net promoter scores as a leading indicator of sales performance and are starting to see improved same-store sales performance from this division. We look at net promoter score in tandem with customer satisfaction surveys at a granular level by store as well as by time and day of shop across multiple categories to identify areas of weakness.

We have made targeted improvements in a number of areas as a result of feedback from these measures, including improvements in areas like signage, stocking processes and scheduling in order to improve consistently the customer experience.

Our Inspire stores are performing well. We had 11 stores open by the end of 2013 and they are making a noticeable difference in our same-store sales as well as realizing higher levels of fresh penetration. Fresh as a category generates higher gross profit margins than other food categories. So while a better fresh offering can drive traffic and basket, growing fresh penetration is also a good thing for our bottom line.

We continue to use our Inspire stores as an innovation platform for improvements to the rest of our network. We are currently in the process of rolling out an improved HMR offering to our conventional store network. This offer is now available in 63 stores with plans to roll out to just under 200 more stores by mid-year.

We will also be rolling out fresh juice bars in roughly 100 Ontario, Atlantic and Quebec conventional stores starting this spring. Our 35 recipes of fresh in store produced 100% natural juice, offered great value to customers looking for a convenient way to support their healthy lifestyles. This offer generates higher in category average margins and helps to reduce shrink in some of our highest risk fresh fruit items.

We continue to work on executing our category reviews to cover a larger percentage of our sales base. We expect to have 50 to 60 unique categories complete and implemented by the end of this year in each of our businesses. While this is just normal course for a retailer, it is our business. We have taken an intensive approach to each category, target a better competitiveness sales and margin performance.

Our plan around discipline and quality has improved since we started the process, continuing to improve results. As we invest in our business, the category views have also helped us to optimize the location of our investment dollars. We have added to the original number of categories that we plan to review and we will continue to execute those as well as to refresh core categories beyond the end of 2014.

PC plus continues to perform beyond our expectations. We currently have over 4 million total members after launching nationally in Q4. Over one-third of sales in the stores where we have launched are accompanied by the scan of a PC plus card, which is aligned with the results we produced in our test launch in our Loblaw's banner in Ontario. Customers that are engaged with PC plus continue to make more trips to our stores, shop larger average basket and they also shop more categories.

PC Plus is an important part of our investment strategy going forward. The program enables us to invest more selectively in promo to drive a higher return investment on those dollars while driving larger baskets with our best customers. We expect the program to be a meaningful contributor to our overall comps as a company as we continue to grow penetration. Investments in shelf and initiatives like PC Plus are aimed at driving loyalty, which will ultimately drive sustainable performance and volume for our shareholders.

We exceeded our Q4 financial goals for JoeFresh.com, with both sales and profitability coming higher than our expectations. We are generating an average order value online that is double what we see in our retail stores, supported by healthy growth in traffic. Our investment in building a mobile responsive website has resulted in very strong mobile sales, accounting for over 25% of our total E-commerce sales and outpacing the market.

Now turning to 2014, we resumed our SAP rollout late last month after putting the process on hold starting in November through the holiday period. On February 9 we rolled out 17 stores, and as of this past weekend had 114 stores live as well as 12 distribution centers. We plan to roll out approximately 20 stores this coming weekend. Our goal is to have all corporate retail stores in all DC's live by the end of the year.

Beyond the insight we expect SAP to bring, as we complete the rollout we will see IT related expenses come down. Capital spent on our IT project will be down roughly 50% in 2014 versus 2012, which will free up capital that we can allocate against our retail network to further improve our customer proposition.

We have executed the rollout to this point without impact on our customers or the trading performance of our business. These remain our primary objectives as we progress our rollout this year. Our expectation is that the environment will remain intense throughout 2014 with some easing in the second half of the year as we cycle one of the highest growth periods in competitive footage we have seen in Canada.

The competitive landscape has fundamentally changed with new competitors growing strongly and incumbents competing to maintain share. We're facing tougher comps this year, given our positive 2013 performance, but we will continue to execute against our investment program while balancing those investments with targeted efficiencies.

Before closing I wanted to touch on the Shoppers Drug Mart transaction. My confidence grows every day about the opportunities that this will drive for our Company. This transaction will enable us to more conveniently meet the food, health and beauty needs of Canadians, both immediately and long term while positioning us strongly to tackle key long-term consumer trends such as convenience, health and wellness and technology.

We are committed to the synergy targets we have outlined to you in prior calls. We will be transparent about our achievements there and intend to protect those synergies to deliver them to the bottom line. Our team continues to work diligently for the close by the end of March.

In an intense competitive environment, I am proud of our accomplishments as a company in 2013. We remain committed to executing our strategy in 2014, we're focused on progressing the initiatives that will continue to drive the critical strategic pillars in our business; best in food experience, drive efficiencies and driving growth. I will now pass the call to Janet.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thanks Vicente. And before I open up the call for questions I just want to let you know that for those of you that are madly writing, we will send out the live transcript to you, the analysts, at the end of this call. Because I know there was a lot of data provided. So you'll have it right away. And with that, Michelle, we are now ready to open up the call to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Irene Nattel, RBC Capital Markets.

Irene Nattel - *RBC Capital Markets - Analyst*

Thanks and good morning, everyone. When we look at the Q4 results, clearly your gross margin -- your actual gross margin in Q4 was far stronger than what you're indicating you expected it to be when we had the call in mid-November.

So wondering what the sources of the outperformance were. Was it less intense investment in promotions? Was it greater than anticipated efficiencies? If you could kind of walk us through that 90 basis point or so gap.

Vicente Trius - *Loblaw Companies Limited - President*

Good morning, Irene. By the way, great question. And the way I see the gross margin is first we did continue to invest in Q4 as we look at the food business by about a rate of about 21 basis points.

The difference versus what we said in Q3 would have been a lot more around efficiencies that we generated in shrink and supply chain of about a rate of 30 basis points. Better margin in general merchandise and better penetration of fresh. It is in my mind -- I think the key in Q4 is that we really balanced the investment I believe in the right manner.

We focused strategically towards the customer on shelf and we consistently are improving our customer proposition on shelf while at the same time, I mean, we had a good strong promo plan, pretty much equal to what we had last year. But to be honest not penetrating as higher as maybe some of our competitors.

Irene Nattel - *RBC Capital Markets - Analyst*

Okay. That's great. So if we think about this and how we should expect this to flow through in 2014, it sounds as though what you tried to communicate both in the press release and in the comments was that we should keep our expectations relatively modest for the first half of the year, but then the back half of the year we've got easier comps and also presumably as you roll out the SAP lower cash expenses. Is that kind of the way we should think about it?

Vicente Trius - *Loblaw Companies Limited - President*

Definitely we see maybe the first half a little bit more challenging than the second half. We will manage the year balancing those investments in the correct manner and focusing on our strategy that has proven to work for us while at the same time leveraging efficiencies.

We see ourselves capable of continuing to leverage efficiencies across the business, whether it's supply chain, productivity or areas like shrink. We are quite encouraged on SAP and our capacity to roll out SAP. And as we approach the second half and as we see some areas in SAP that show potentially new efficiencies, we will share them with you.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. And then just finally, on the SAP, any glitches? From where you stand right now can you see any reason why you wouldn't be able to get it out to all the corporate stores this year?

Vicente Trius - *Loblaw Companies Limited - President*

As it stands right now, Irene I do not. We have rolled out 114 stores and 12 VCs. We're going to go this weekend with north of 20 stores. In my mind this is a large sample of stores and I use that internally all the time.

If there were any challenges, the challenges have been covered and what we're performing today as an organization that is basically delivering SAP and adopting SAP. So we feel all in all pretty comfortable that we ought to be able to deliver all of the corporate stores and all VCs.

Irene Nattel - *RBC Capital Markets - Analyst*

That's great. Thank you.

Operator

Jim Durran, Barclays.

Jim Durran - *Barclays Capital - Analyst*

Yes, I just wonder if you can give us an idea of how traffic and basket unfolded as the quarter progressed? And now that you're in the new quarter now has competitive intensity continued?

Vicente Trius - *Loblaw Companies Limited - President*

Our basket size was higher. Having said that we inflated less than CPI. Our traffic was slightly down, although you should filter that against an ice storm and a strike that we had in Alberta. So when you think about the fact that we had 80 stores closed for three days and three VCs closed for three days that does have an impact.

So all in all, we're getting better baskets. We're getting an improvement from our high value customers and our medium customers. And we're actually pretty pleased with our performance.

Jim Durran - *Barclays Capital - Analyst*

And Sarah alluded to the inflation of FX. Was there any for you in the fourth quarter? And what's your optimism on regular price as well as promo price coming up?

Vicente Trius - *Loblaw Companies Limited - President*

We are experiencing obviously driven by foreign exchange, but I would say as well as a little bit of a drought in California as it refers to produce. And a little bit of -- you look at North America, a cattle herd that maybe it's at its all time low, like 1952, when you look at meat.

Having said that, I believe it's a process that is manageable. It's manageable. And let's see that maybe at the beginning not all of the inflation was being passed on. But we see it manageable in those categories going forward.

Jim Durran - *Barclays Capital - Analyst*

That's great, thank you.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thank you, next caller, please.

Operator

Michael Van Aelst, TD Securities.

Michael Van Aelst - *TD Securities - Analyst*

The main questions have been answered. But I wanted to ask you about the IT spend. You said that it was going to be down, the CapEx portion of it was going to be down significantly, I think down 50%.

Can you give us what the actual numbers were in 2013 and what it will be in 2014? And then at the same time when are you targeting hitting your 1.2% IT expense as a percentage of sales?

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. Hi, Michael. It's Sarah. So we spent about CAD500 million in 2013 on IT expense, which would include the cash expense as well as the depreciation associated with it. We expect it to be about the same in 2014 at around CAD500million. But what does change is there's about CAD50 million less cash expense with an offsetting 50% increase in depreciation.

The CapEx that Vicente mentioned is down 50% from 2012 to 2014. So we are slowing down definitely the CapEx spend, but the depreciation is coming through. So CAD500 million in both years with CAD50 million reduction in cash with an offsetting CAD50 million increase in depreciation. And as far as the 1.2%, we still anticipate hitting the 1.2% in 2016.

Michael Van Aelst - *TD Securities - Analyst*

Just so I understand your comment, the cash and depreciation of CAD500 million that was -- that include CapEx?

Sarah Davis - *Loblaw Companies Limited - CFO*

No, it includes the depreciation associated with CapEx. It's an operating expense number.

Michael Van Aelst - *TD Securities - Analyst*

Got you. Thank you.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thank you, next caller, please.

Operator

Patricia Baker, Scotiabank.

Patricia Baker - *Scotiabank - Analyst*

Thank you very much. Two things. I have a specific question but I also have a request. Despite the fact that we're going to get the transcript, Janet, Sarah, your commentary cut out in the webcast. Can you repeat -- not your entire commentary. But can you repeat those re-based figures for everybody? Maybe a little slowly? And then I'll ask my question.

Vicente Trius - *Loblaw Companies Limited - President*

Interesting.

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. Certainly. I can do that. So basically what we're doing is we're just changing -- we're not going to adjust for stock based comps in 2014. We're not going to adjust for the G&A and the REIT in 2014.

So basically what ends up happening is that in 2013 we had adjusted operating income of CAD1,325 million and that goes to CAD1,287 million. And EBITDA was CAD2,149 million as reported and it will go to CAD2,111 million. So that's an adjusted EBITDA number and the difference between the figures is CAD32 million in equity based compensation and CAD6 million in Choice Properties' general and administrative costs.

Patricia Baker - *Scotiabank - Analyst*

Brilliant. Thank you so much. Okay, my question. Vicente, you indicated that on a go forward basis, particularly with respect to the integration of Shoppers Drug Mart, that you will be -- hope to be quite transparent. So I'm going to give you a chance to be a little bit more transparent today.

Can you talk a little bit about -- is there anything quantitatively you can give us on that push to fresh and the fact that you saw better increased penetration in fresh in 2013?

Vicente Trius - *Loblaw Companies Limited - President*

When you say, sorry Patricia, when you say push to fresh, are you referring to push to fresh in Shoppers?

Patricia Baker - *Scotiabank - Analyst*

No, no, no. I was just drawing a line there. No, I'm talking about your food business and the fact that fresh penetration was better. So can you give us something --

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Vicente Trius - *Loblaw Companies Limited - President*

I understand. In reference to Shoppers Drug Mart the process -- I'm going to take advantage that you asked the question just to say the process is going as expected. And we believe that we will close by the end of March, okay? And as we progress then we can tell you a little bit more about the synergies and how the implementation plan will unfold.

In reference to the fresh, we are actually -- and I would say I'm going to even personalize, I'm quite encouraged with what the organization is doing on fresh penetration and how we're driving the sales. And it's really happening across all of the categories. And it's not limited to one format.

So I can tell you that what we're doing in the conventional side of the business, not limited to the 11 Inspire stores because a lot of those learnings are being transferred to other stores is very, very good. And I see many more initiatives that we can drive across the business beyond what I quoted on HMR and the juice bars.

The same thing is happening in discount and how we focus on quality and assortment behind hero categories as we look at produce, as we look at meat, as we look at deli, across the whole area of fresh. The answer would be yes. It is at the core of our strategy of best in food experience to be a loyalty pull with our customers and to improve the overall experience as a food business.

Patricia Baker - *Scotiabank - Analyst*

I'm going to ask it, I think we just misunderstood each other so I'm going to ask it slightly differently. You probably have a goal of where you want to get your fresh penetration over time as you try and differentiate your business model, be it conventional or be it discount.

Where in that scale did you get in 2013? Or can you give us any indication in terms of basis points of what improvement to penetration you got on fresh?

Vicente Trius - *Loblaw Companies Limited - President*

All right, I didn't interpret it that you wanted that --

Patricia Baker - *Scotiabank - Analyst*

I'll always want numbers if you can give it to me.

Vicente Trius - *Loblaw Companies Limited - President*

I know, I know Patricia. I tell you what. I see ourselves being able to maybe penetrate an additional 2 to 3 points.

Patricia Baker - *Scotiabank - Analyst*

Okay, great. Thank you.

Vicente Trius - *Loblaw Companies Limited - President*

You're welcome.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thank you, next caller, please.

Operator

Peter Sklar, BMO Capital Markets.

Peter Sklar - *BMO Capital Markets - Analyst*

Sarah, I just want to make sure I understand your segmented reporting. When you report -- specifically on the retail segment. So when you report adjusted operating income of CAD273 million is that after rent paid to choice REIT?

Sarah Davis - *Loblaw Companies Limited - CFO*

No, it's before the rent. It's assuming -- it's the way that we would have reported it before we had the REIT. And so in order -- if you wanted to do that, the information's there so you have the amount of rent that was paid. So you just have to subtract it out.

Peter Sklar - *BMO Capital Markets - Analyst*

And how would I find the rent? That would be the revenue line of the REIT segmentation?

Sarah Davis - *Loblaw Companies Limited - CFO*

That's right. And they would specifically highlight how much of it is related to Loblaw versus how much is the third party as well.

Peter Sklar - *BMO Capital Markets - Analyst*

Right. So if I add up the operating income then of the three segments, that should be significantly in excess of consolidated rent, would it not?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes. The segments are actually in the release. So basically what you'd have to do is add up the three segments and take out the inter-company portion in order to get to the consolidated. And in that you would see where the inter-company rent is going through as well.

Peter Sklar - *BMO Capital Markets - Analyst*

Right, okay.

Sarah Davis - *Loblaw Companies Limited - CFO*

I can go through it with you after the call if you'd like.

Peter Sklar - *BMO Capital Markets - Analyst*

That would be great.

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay.

Peter Sklar - *BMO Capital Markets - Analyst*

On the -- your tax rate for the quarter. Do you know what the tax rate is for the quarter, excluding the tax impacts of the two adjustments you had?

Sarah Davis - *Loblaw Companies Limited - CFO*

So the all in tax rate for the quarter is 26.6% and the year is 26.6% as well. So within the range of the 26% to 27% that we had sort of highlighted, which is a pretty good number for next year too.

The adjusted tax number is actually 20.4% in the quarter and the year-to-date adjusted tax number is 24.7%. So it is low in the quarter. We did have some true-ups for prior period adjustments in the quarter. And going forward I know a lot of people have asked this question as well, so we'll put the adjusted number into the press release going forward as well.

Peter Sklar - *BMO Capital Markets - Analyst*

And you talked about that there was an adjustment related to the interest expense on financing you've incurred in preparation for the Shoppers acquisition. Where is that disclosed? Where is the interest amount?

Sarah Davis - *Loblaw Companies Limited - CFO*

The interest amount is disclosed in the non-GAAP measures and in the earnings portion of the press release.

Peter Sklar - *BMO Capital Markets - Analyst*

How much is the interest expense? Do you know off the top of your head there?

Sarah Davis - *Loblaw Companies Limited - CFO*

I actually don't know off the top of my head, but I can look it up. I can give that to you after the call too.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. I'm done then. Thank you.

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. You're welcome.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Oh thank you. Sorry, next caller. I was thinking about interest expense.

Operator

Perry Caicco, CIBC World Markets.

Perry Caicco - *CIBC World Markets - Analyst*

Thanks. Vicente, as 2014 unfolds do you expect you'll be able to continue investing in pricing, manage the FX issue and yet have enough offsets to continue improving gross margins? Or should we think about gross margins as being flat to down over the course of this year?

Vicente Trius - *Loblaw Companies Limited - President*

So we landed the year at about a 22% gross margin, right? So we feel comfortable at that level. We feel comfortable at the way we're balancing the investments, shelf versus promo. If there were to be any additional investment we would leverage that to additional efficiencies.

Perry Caicco - *CIBC World Markets - Analyst*

And so when we think about your outlook for this year, which is to grow revenue and adjusted operating income, how important will cost cutting be to achieving that goal? Is that going to be critical over the course of 2014?

Vicente Trius - *Loblaw Companies Limited - President*

It's right within our plan, like it was in 2013. So there's different areas in the business that we've become more productive. And they will unfold at a higher level during 2014, whether it's supply chain, whether it's productivity across the network, whether it's areas like shrink.

So yes, we see a capacity to continue to do that. And we feel overall pretty decent as we look at 2014.

Perry Caicco - *CIBC World Markets - Analyst*

And when I think about everything on your plate this year, the IT rollout, cost containment, store conditions, the fresh progress, staying price competitive in the Shoppers integration, can you rank these for me on your priority list? What are the most critical activities in your view?

Vicente Trius - *Loblaw Companies Limited - President*

Oh my gosh. (laughter) Perry, that's a good question. I would say that to me number one priority is staying the course consistently on our strategy because that's what has driven results for us, right? And we are with our strategy's all about how we improved the food experience, how we drive growth and how we drive efficiencies.

And it's doing just that consistently that I believe will deliver a good year for us in 2014. The Shoppers -- we will give more transparency obviously after the closing of the transaction. But I can tell you that we already have an implementation team and we are encouraged. We're encouraged from what we see going forward. That's as much as I can give you today.

Perry Caicco - *CIBC World Markets - Analyst*

Okay, thanks.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thank you, next caller, please.

Operator

Chris Li, Bank of America.

Chris Li - *BofA Merrill Lynch - Analyst*

Good morning. I was wondering if you can share with us in terms -- your adjusted operating income growth outlook for 2014?

Sarah Davis - *Loblaw Companies Limited - CFO*

Pardon me. Sorry Chris, we didn't quite hear that.

Chris Li - *BofA Merrill Lynch - Analyst*

Oh sorry, I just wondered if you can share with us what your expectation is in terms of your adjusted operating income growth outlook? Just directionally maybe either of you can share with us some numbers, how much do you expect income growth to be?

Vicente Trius - *Loblaw Companies Limited - President*

We're not going to share any specific numbers. What I can tell you is that our visibility and confidence in the business remains unchanged.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. But you are expecting adjusted operating income to grow for this year?

Sarah Davis - *Loblaw Companies Limited - CFO*

That's right. So in our 2014 we do expect our operating income to grow. It's a complicated year to give any type of -- with the Shoppers deal coming in in Q2. So we're not providing any specific numbers on the Loblaw standalone business at this time.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. In terms of your target for your IT expense going down to 1.2% of sales by 2016, what needs to happen from a store implementation perspective? Is it all your corporate stores by this year and then the franchise stores by 2015? Do you need that to happen to achieve that target?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes, we do.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay. And for CapEx, the CAD1 billion that you mentioned. I guess going forward once the IT expense is finished, what is a maintenance sort of or sustainable CapEx do you see for the food retail business?

Sarah Davis - *Loblaw Companies Limited - CFO*

Well, we said that we thought that -- well now we've got the REIT, so the REIT's included in that as well. So I would say the CAD1 billion is a good number -- well it's a good number obviously for 2014. I would say there is some room to bring it down from there when we've finished off the SAP to the CAD850 million, CAD900 million range would be my estimate.

Chris Li - *BofA Merrill Lynch - Analyst*

And my last question is just on the cash portion of your IT expense that you incurred in 2013. What was that amount?

Sarah Davis - *Loblaw Companies Limited - CFO*

We didn't split out the pieces. I can tell you that it's CAD500 million in total in 2013, CAD500 million in 2014 and a reduction of CAD50 million in cash. But we haven't given out the specifics of how much the split was in 2014.

Chris Li - *BofA Merrill Lynch - Analyst*

Okay, that's fine. Thank you.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thank you, next caller.

Operator

Kenric Tyghe, Raymond James.

Kenric Tyghe - *Raymond James - Analyst*

Vicente, could you highlight for us the engagement of the existing or core PC Plus base and perhaps more importantly the trends you're seeing in new member adds within that base?

Vicente Trius - *Loblaw Companies Limited - President*

It's actually very, very encouraging. As you know we started our rollout across our corporate stores, including some of the discount stores, in November. So it's only maybe about three months. And today we have north of 4 million card holders of which close to 2.2 million would be registered card holders.

Of all of our sales it's participating north of one-third, actually 37% to 38% to date. And if you look at the banners that have been on it for awhile, like for the last six months in the case of Loblaw Ontario, we see a very good positive response in overall sales performance.

Kenric Tyghe - *Raymond James - Analyst*

Just thank you for that. Just in terms of new member adds, I mean are they even just directionally the trends as you sort of look through into the beginning of the year. Have you continued to build on the registered base?

Vicente Trius - *Loblaw Companies Limited - President*

Absolutely. We were -- when I talk about the 4 million if you look at where we were in November we had about I think we told you at that time about 700,000, 800,000. So we added north of 3 million over the last three months and it continues.

Kenric Tyghe - *Raymond James - Analyst*

Great, thank you. And just very quickly switching gears. Sarah, just on that 30 basis points from supply chain improvements. Could you just refresh my memory on what that would have translated into from supply chain efficiencies dollar-wise in 2013?

Sarah Davis - *Loblaw Companies Limited - CFO*

The 30 basis points on the total, well the 30 basis points -- are you talking about the Q4 30 basis points?

Kenric Tyghe - *Raymond James - Analyst*

Yes, the Q4 30 basis points. I'm trying to put a number to that for the what supply chain efficiencies translated into for the full 2013 year.

Sarah Davis - *Loblaw Companies Limited - CFO*

Well the 30 basis points for Q4 is actually a pretty representative number for the year as well. It might be slightly less than that, like 25 to 30, but in that. And on the total sales that's how you calculate the number.

Kenric Tyghe - *Raymond James - Analyst*

Thanks very much, Sarah. I'll leave it there.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thank you. Next caller, please.

Operator

Keith Howlett, Desjardins Securities.

Keith Howlett - *Desjardins Securities - Analyst*

Yes, excuse me. I wanted to ask about on the IT implementation front, what sort of benefit from your merchandise or your category managers are you already seeing from SAP? Do they have full visibility in terms of making pricing decisions? Are they significantly more well informed or able to act than they were say four years ago? Or do you need the store element in place before that's the case?

Vicente Trius - *Loblaw Companies Limited - President*

Remember, our merchants are operating on two systems today, on legacy and SAP. So I would say on the 114 stores that are on SAP we definitely have better visibility on product, on assortment, on availability, on replenishment, on -- far better planogramming in the stores.

But again, think about individuals working in with two systems. With two environments. So I would say that the bulk of the benefits will start coming a lot more stronger once you deliver let's say all of the corporate stores, which is a tilting point from a standpoint of the amount of volume that it will generate and so forth as a company.

Keith Howlett - *Desjardins Securities - Analyst*

And then just a little bit on the fresh business. Can you speak on the Provigo Le Marche and how that's doing in the Quebec market?

Vicente Trius - *Loblaw Companies Limited - President*

Yes, we are very, very pleased with Provigo Le Marche in Quebec. We opened a new store and all together converted others to a total of seven stores that will be Provigo Le Marche inspired.

What we see in that model is an improvement on penetration of fresh and an improvement on penetration of fresh, an improvement of margin of fresh that exceeds let's say an investment that we put on a better experience from a colleague perspective. And we see improvement in sales as well. So all in all, it's a very, very good -- very good format.

Keith Howlett - *Desjardins Securities - Analyst*

Just a question generally on some of the initiatives like PC Plus. You're obviously a huge discount grocer with Maxi and No Frills and, I don't know, a Real Canadian Superstore out west. Perhaps they're on PC Plus, I'm not sure. Where does PC Plus fit with the discount banners?

Vicente Trius - *Loblaw Companies Limited - President*

When I said all the corporate stores and then I talked a little bit about discount. So all of the conventional division today plus Superstores will be on PC Plus.

The Maxi banner and No Frills is not on PC Plus. We're in the process of really analyzing if we will introduce PC Plus to No Frills or Maxi. We haven't discarded that possibility at this stage.

Keith Howlett - *Desjardins Securities - Analyst*

And then in terms of your fresh initiative, do you view that as equally important or more important at the discount channel?

Vicente Trius - *Loblaw Companies Limited - President*

Absolutely. I think it's a huge, huge piece of differentiation in discount channel as you look at our competitors in the marketplace. So as you look at the way we trade in fresh, not naming any of the competitors, but versus our competitors I believe is a huge piece of differentiation for our business and customer loyalty.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thanks, Keith. We're actually going to move on to the next caller.

Operator

Vishal Shreedhar, National Bank.

Vishal Shreedhar - *National Bank - Analyst*

Thank you very much. Just hoping you could help us better understand the magnitude of the --

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Vicente Trius - *Loblaw Companies Limited - President*

Could you speak louder, please? We cannot hear you.

Vishal Shreedhar - *National Bank - Analyst*

Can you hear me now?

Vicente Trius - *Loblaw Companies Limited - President*

Yes.

Vishal Shreedhar - *National Bank - Analyst*

I was hoping you could help us better understand the magnitude of the franchise market adjustments which are seemingly non-cash, non-operating similar to the REIT market adjustments made in your adjusted numbers.

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. So we're not going split out the specific adjustments because really the franchise is part of our business and we would have an adjustment in every quarter. It's just bigger in this quarter than in some which is why we highlighted it as a reason.

So there's two things happening in that -- in operating expenses. One is the actual on -- you do have to look at the valuation of your franchise, so it would be related to that. And that's the market valuation that we talked about. And on the other side, we're also provide subsidies to our franchise based on the performance of their business.

And so both of those components would be going through in Q4. And we're not adjusting for it because it's not something -- it is part of our business. We're a franchise business. We don't consolidate the results of our franchise. And so any adjustments to their performance goes through the SG&A line of the consolidated business. And so we're not going to separate it out since it is part of our ongoing business.

Vishal Shreedhar - *National Bank - Analyst*

Okay. So the market adjustments, just so I'm clear, that's some sort of adjustment reflecting the value of the franchisee business to Loblaw?

Sarah Davis - *Loblaw Companies Limited - CFO*

That's right. So basically we don't -- as I said, we don't consolidate. So it's basically our value of our investment in the franchise business. And it's, under IFRS it's fair valued every quarter. And once we have information on cash flows going forward, which happens with budgets in Q4, that's where the bigger adjustments happen, in Q4.

Vishal Shreedhar - *National Bank - Analyst*

And your commentary when you say franchise market adjustments refers to that adjustment as well as payments to the franchisee?

Sarah Davis - *Loblaw Companies Limited - CFO*

That's right. There's both pieces happening.

Vishal Shreedhar - *National Bank - Analyst*

Could you also, just a last question here, help me understand what were the key drivers of SG&A growth in the quarter? Maybe rank order them if you can't give the numbers?

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. So the highest growth would be that. The franchise value adjustment as well as the subsidies to the franchise. It would be -- the other pieces would be smaller, like I mentioned, the ancillary income from the REIT, which is now in the REIT segment, that's like CAD8 million.

And there's other smaller pieces. We're growing our E-commerce business so there's some costs associated there. But the biggest piece would be the investment in the franchise business.

Vishal Shreedhar - *National Bank - Analyst*

Thank you very much.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Thank you. I believe we have one more caller.

Operator

David Hartley, Credit Suisse.

David Hartley - *Credit Suisse - Analyst*

Thanks. Good afternoon we'll call it. Just curious about the Joe Fresh business and future initiatives. Because I know you reference that in your SG&A commentary. On Joe Fresh, just curious how that's doing south of the border at the JCPenney stores and your own standalones.

Galen Weston - *Loblaw Companies Limited - Executive Chairman*

It's Galen. I'll answer that question because actually we have some exciting news that will be in the paper I think tomorrow. Which is that we're announcing three international partnerships that will represent expansion into somewhere in the range of 25 countries, primarily in the Middle East, Eastern Europe and in South Korea. That should result in somewhere in the range of 120 new stores over the next four years.

It's a wholesale arrangement, so no material risk from a capital perspective or a P&L perspective. But is representative of what has been a long standing belief on our part that there is an international level of opportunity for the Joe Fresh brand. And lots of people interested in helping us to realize that.

David Hartley - *Credit Suisse - Analyst*

That's helpful, thanks. That's great to know. And with JCP, though, has that kind of gone to plan or per expectation? Because I've noticed in my travels that some of the presentations have been cut back somewhat and I'm just wondering if they're still committed to the brand.

Galen Weston - *Loblaw Companies Limited - Executive Chairman*

So it obviously hasn't gone quite the way that we hoped that it would. The change of leadership at JCPenney, a the change of strategy at JCPenney.

But I think we are comfortable that they are committed to some lower volumes, but to a sustained relationship with Joe Fresh. And so we continue to be optimistic about that business.

David Hartley - *Credit Suisse - Analyst*

Okay. And just my final question, when I think about the new emerging online world and what's happening in the UK with click and collect and of course your acquisition of Shoppers Drug Mart pending, how does that all fit together in how you think about setting up your E-commerce business for today, backend systems for today? Are you working towards the eventuality that this kind of business in the UK will find its way into Canada in particular?

Vicente Trius - *Loblaw Companies Limited - President*

This year we launched our E-commerce platform behind Joe Fresh. For 2014 we have plans to let's say pilot three stores. It would be in the greater Toronto area on a click and collect model behind food and consumables.

So it is part of our strategy. It's part of our more comprehensive strategy behind the Omni channel. And yes, we're bringing this to Canada.

David Hartley - *Credit Suisse - Analyst*

Thank you very much for that.

Janet Craig - *Loblaw Companies Limited - SVP, IR*

Great. Thank you. And at this time I think we are ready to close the call. Just before we close I just wanted to thank everyone for their cooperation today. And if you have any follow-up questions please don't hesitate to call the IR team. We will be happy to help you. Thanks again.

Operator

Ladies and gentlemen, this does conclude your conference call for today. You may now disconnect your line and have a great day.
