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CORPORATE PARTICIPANTS

Kim Lee *Loblaw Companies Limited - Vice President, Investor Relations*

Galen Weston *Loblaw Companies Limited - Executive Chairman*

Sarah Davis *Loblaw Companies Limited - CFO*

Vicente Trius *Loblaw Companies Limited - President*

CONFERENCE CALL PARTICIPANTS

Patricia Baker *Scotia Bank - Analyst*

Michael Van Aelst *TD Securities - Analyst*

Irene Nattel *RBC Capital Markets - Analyst*

Perry Caicco *CIBC World Markets - Analyst*

Jim Durran *Barclays Capital - Analyst*

David Hartley *Credit Suisse - Analyst*

Vishal Shreedhar *National Bank Financial - Analyst*

Peter Sklar *BMO Capital Markets - Analyst*

Chris Li *Bank of America Merrill Lynch - Analyst*

Keith Howlett *Desjardins Securities - Analyst*

PRESENTATION

Operator

Good morning. My name is Tracy, 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, and I will now turn the call over and introduce Ms. Kim Lee, Vice President, Investor Relations. You may begin your conference.

Kim Lee - *Loblaw Companies Limited - Vice President, Investor Relations*

Thank you, Tracy. Good morning, and welcome to the Loblaw Companies Limited Fourth Quarter 2011 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, 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 2012 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 2011 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 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 Weston.

Galen Weston - *Loblaw Companies Limited - Executive Chairman*

Good morning. Thank you for joining us. I'd like to begin by saying we are pleased with our performance in the fourth quarter and for the year. The ongoing strengthening of our customer proposition delivered improved sales at satisfactory margins, particularly in the second half of the year.

Looking ahead to 2012, we estimate incremental costs related to investments in information technology and supply chain to be approximately CAD70 million and the continuation of investments in our customer proposition to be approximately CAD40 million. We do not expect our operations to cover these incremental costs, and as a result, we anticipate full-year 2012 net earnings per share to be down year-over-year with more pressure in the first half.

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

Sarah Davis - *Loblaw Companies Limited - CFO*

Thank you, Galen, and good morning. Let me start with the performance in our retail segment. In the retail segment, sales increased by 3.2% to CAD7.2 billion in the fourth quarter of 2011.

Same store sales increased by 2.5%. Both absolute and same store sales were positively impacted by approximately 0.8% to 1% due to an extra day of store operations when compared to Q4 of 2010. The increase in Q4 sales was mainly driven by strong sales in food as well as strong growth in our gas bars and apparel sales. Drug store sales were flat, and other general merchandise decreased marginally.

During the quarter, our average quarterly internal food price index experienced moderate inflation, which was lower than average CPI in the quarter of 5.2%.

The retail segment gross profit was 21.7%, consistent with Q3 of 2011, but a decrease of 90 basis points over the fourth quarter of last year. The year-over-year decrease was mainly due to higher promotional activity and higher input costs outpacing internal food price inflation, greater penetration of lower margin gas bar sales and increased transportation costs, partially offset by improved strength.

Retail operating expenses as a percent of sales decreased year-over-year from 18.3% to 17.6%. The decrease in expenses was primarily due to continued improvements in our investments in our franchisees, and labor, supply chain and other cost efficiencies.

These improvements were partially offset by a CAD23 million charge related to the transition of certain Ontario conventional stores to the more cost effective and efficient operating terms of collective agreements ratified in 2010, incremental costs of CAD22 million related to IT (inaudible), CAD16 million in Joe Fresh US startup cost, a CAD5 million net charge related to fixed asset impairments, and a CAD4 million charge related to share based compensation net of equity forward.

Operating income in the retail segment decreased 2% to CAD297 million in the fourth quarter compared to CAD303 million in Q4 of 2010. Operating margin was 4.1% in the quarter, a 20 basis point decline over last year.

Now, turning to our financial services segment, revenue in the segment increased by 24.6% to CAD147 million compared to CAD118 million in Q4 of 2010. The increase was primarily driven by increased credit card transaction values in the quarter resulting in higher interchange fee income and higher PC telecom revenue.

Operating income in the financial services segment was CAD18 million in the fourth quarter of 2011, down from CAD21 million in the same quarter last year. The decrease was mainly due to investments in PC telecom and an increased credit card loss provision due to quarterly growth in our receivables program, partially offset by an increase in interchange fee income.

On a consolidated basis, operating income was CAD315 million in the fourth quarter compared with CAD324 million in Q4 of 2010. Operating margin was 4.3% compared to 4.6% in Q4 of last year. The decrease in consolidated operating income was due to the year-over-year decrease in the retail and financial services segments.

Interest expense decreased CAD2 million to CAD81 million compared to Q4 of 2010. The year-over-year decrease was primarily due to lower debt levels.

Our effective tax rate for the quarter decreased to 25.6% from 31.5% in Q4 of 2010 due to further reductions in the federal and Ontario statutory income tax rate and a decrease in non-deductible items.

Loblaw realized fourth quarter basic net earnings per share of CAD0.62 compared with CAD0.59 in the fourth quarter of 2010.

Adjusted net debt at the end of the fourth quarter was CAD2.6 billion, down CAD270 million from the end of Q4 2010, primarily driven by positive cash flows from operations due to positive EBITDA and proceeds from fixed asset sales, partially offset by fixed asset purchases, interest and cash dividends paid in the year.

Capital expenditures in Q4 were CAD347 million and CAD1 billion for the year. For the full year 2011, we reported consolidated revenue growth of 1.3%; EBITDA of CAD2.1 billion, up 5.5%; and net earnings per common share of CAD2.73, up 12.3% from the prior year.

Looking ahead to 2012, our estimate for capital expenditures is approximately CAD1.1 billion. Approximately 40% of these funds is expected to be spent on investing in IT infrastructure and supply chain with the remainder invested in retail operations. We expect costs associated with the transition of certain Ontario conventional stores under collective agreements ratified in 2010 to range from CAD30 million to CAD40 million compared to CAD35 million in 2011.

In 2012, we expect CAD90 million in incremental IT system expenses, partially offset by a CAD20 million decrease in supply chain project costs for a net expense increase of CAD70 million. In addition, we expect to invest approximately CAD40 million in our customer proposition. We do not expect our operations to cover these incremental expenses. As a result, we expect our full-year 2012 net earnings per share to be down year-over-year with more pressure in the first half of the year.

I would now like to turn it over to Vicente, who will provide some context for the quarter.

Vicente Trius - *Loblaw Companies Limited - President*

Thank you, Sarah. Good morning, everyone, and thank you for joining us this morning. In 2011, we have put a stronger focus on doing what's right for our customers, and this has enabled us to grow the top line and close the year with positive comp store sales whilst continuing to deliver EBITDA growth.

I am pleased with our performance for the year and the quarter. We are on the right path. We have clear objectives. We're doing what's right for the customer in driving sales growth. We are establishing the right infrastructure that will enable us to drive efficiencies and leverage expenses to grow profitably against increased competition over the long term.

At the beginning of the 2011, we realigned the organization around our conventional and discount businesses, put in place to allow us to better focus on the specific customer needs and preferences and targeted at driving growth. This two-division structure continues to gain traction. In the second half of the year, we started to see the benefits of our new structure with our sales trajectory taking a turn for the better.

We're also seeing improved trends in customer count and tonnage. Our focus is in our customers and delivering a strong customer proposition. It starts with our stores and our colleagues.

During the quarter, we opened three new full service conventional stores that each set a new standard for grocery shopping in Canada, our new flagship Loblaw store at Maple Leaf Gardens, its sister store at Queen and Portland and our new Fortinos in Burlington. Each of these stores has elevated the bar on what a great conventional supermarket should offer in terms of assortment, service, price and experience.

If you haven't visited them, I highly recommend that you do. They are models of innovation and best practices in grocery retail today and prime examples of how our conventional supermarkets offer a great experience, broad assortment, high level of service and competitive prices.

Also in the quarter, we opened three more No Frill stores, Shawn's in Dartmouth, Nova Scotia, Scott's in Woodstock, Ontario, and Rusty's in Branford, Ontario. We now have 203 No Frill stores in eight provinces. Our discount stores remain the lowest price, lowest cost operators in the country focused on a core assortment with great specifications and service where it counts.

Today, we have rolled out our new Store Time and Attendance System, STAS, to substantially all of our corporate stores. STAS in our new Ontario conventional labor agreement provide us greater visibility and flexibility on how to best allocate our resources and have helped to drive meaningful operational improvements, with productivity up 34 basis points and overall improved customer service.

As for our strong Control brands, sales continued to grow, with profitability initiatives approaching their target ranges. We continue to innovate with new products, new lines and healthier alternatives to drive penetration of our Control brands, as they are a key strategic differentiator for us.

Behind the scenes, we're strengthening our foundational infrastructure. With our supply chain infrastructure projects substantially complete, we are delivering industry-leading service levels, up 90 basis points and availability up 110 basis points year-over-year. We now have three DCs piloting flow and establishing processes necessary to drive greater efficiency through our supply chain.

For SAP, with merchandising category product listings now in the system, we have begun to lay the groundwork for systems integration, a top priority in a critical phase of our system implementation in 2012.

As Galen and Sarah mentioned before, this year we expect to expense an additional CAD70 million in IT infrastructure and supply chain projects as well as invest CAD40 million in our customer proposition, investments that we do not expect our operations to cover. SAP is the backbone of driving efficiencies. Until the system has been rolled out to stores, we will not realize the full benefit of our renewed infrastructure and new technology.

In 2012, we are committed to getting SAP into our first store by year-end. In advance of that milestone, we will be implementing merchandising functionality such as pricing and promo across all categories and integrating our supply chain systems with SAP. The entire organization will be involved in some way or another. The project has my full attention.

Our approach is to move quickly, but our priority is to implement SAP correctly. Our goal is to roll out with little to no impact on customers' experience in our stores.

At the same time, we will build on the momentum that we gained in the second half of 2011. We will continue to invest in our customer proposition, ensuring that we offer the right assortment, the right experience, service and price across our formats and banners to continually improve our competitive position and drive sales.

Our mission is to be the best retailer in Canada. Our way forward is to grow sales and operate the most efficient retail business in the industry. This will help solidify our established leadership position and give us more runway to further strengthen our competitive advantage, which is being the best in food with excellent execution in our premium locations, with the strength of our brands and a non-food offer that gives our customers more reason to shop with us.

A lot of hard work will be done throughout the year by our talented and dedicated colleagues to deliver on all initiatives. I look forward to communicating our progress with you as we move through the year.

With that, let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions.)

Your first question comes from the line of Patricia Barker (sic), Scotia Bank. Please go ahead.

Patricia Baker - *Scotia Bank - Analyst*

Good morning. I won't -- it's Baker, as you all know. I wanted to thank you first, Sarah, Vicente, Galen, for providing guidance for 2012 and what looks to me to be quite realistic guidance.

But, related to that, if maybe you could help everybody sort of understand a little bit more - you called out the incremental spend on IT and supply chain and on customer proposition. But, if we go back a few years and look at what happened the last several years, you spent a fair bit of money on IT, supply chain, etc., and yet, you were still able to grow the earnings and expand EBITDA margins.

Can you talk a little bit about why going forward we won't actually see this? And does this in any way really reflect perhaps the nature of a changed landscape, a changed industry and perhaps a new reality going forward for Loblaw?

Vicente Trius - *Loblaw Companies Limited - President*

Look, Patricia, first of all, good morning. We -- first and foremost, we will do what's right for the customer. And I believe that this is the way you build the business for the long term, and a business that will generate shareholder value over the long term.

As we look at 2012, you know, SAP is a very important implementation. It's when we integrate merchandising with supply chain and we roll out our first store during Q4. And by investing those CAD40 million, I believe that will allow our merchants to consistently focus on our customer.

This investment is also investment that we will balance. I mean, we have a great portfolio of premium banners and great locations. And it's an investment that we can invest in service, fresh areas, in service at the register in some banners. Other banners, we will invest more in the value and price.

Patricia Baker - *Scotia Bank - Analyst*

Can I just ask a little follow up there? And thank you for -- I really welcome it as a customer and also as an analyst, the fact that you are very, very focused and you sound quite passionate in your presentation on the customer. And I think that that's very important. But, the customer proposition spend, am I right in assuming that we could also look for that to have a labor feature here to see the stores better stacked and the customers thereby better served?

Vicente Trius - *Loblaw Companies Limited - President*

Patricia, I believe that we lost some momentum. And a lot of things were done right in the past, but I believe we lost some momentum in competitiveness in the last half of 2010 and maybe the first half of 2011. And, again, I mean, we will definitely focus on the customer.

And, yes, this means better service in some of our banners, which I think this is critical. And this to me means a lot in fresh, and it means a lot in service at the register. Yes, we will do that. It's the right thing to do.

Patricia Baker - *Scotia Bank - Analyst*

Thank you so much.

Operator

Your next question comes from the line of Michael Van Aelst with TD Securities. Please go ahead.

Michael Van Aelst - *TD Securities - Analyst*

Hi. I'd like to touch first on the IT spend, which I think last quarter you suggested was going to peak -- CapEx would peak in 2011 and IT spend in 2012. And now, it looks like it's going to be peaking in 2013 on the, at least on the IT spend and only declining somewhat modestly by 2016. Can you talk a little bit about what's -- why the delays, why it keeps getting pushed back in terms of peak spending?

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay, I'll take that, it's Sarah. So, basically, what we'll find in 2011, if we look at both the supply chain and the IT, because we've combined those, we've talked about them as a combined number, what you'll find in 2011 for supply chain, the cost peaked in 2011 for supply chain. And what you'll see is a CAD20 million reduction in the supply chain project costs in 2012.

On the IT side, they -- the cash costs are peaking in 2012, and that is what we said last quarter, as well. So, the cash costs are peaking in 2012. But, we do have a lag of the depreciation.

So, all that factored in, so the increase in the cash -- the peaking of the cash cost in 2012 but the increase in the depreciation in 2013 will mean that 2013 supply chain and IT project costs combined will be roughly the same as what they were in 2012. So, 2012 is the -- is basically the peak, and then we stay at that level in 2013. And we will see a reduction over time.

And from a -- you're saying that we don't see much of a reduction. I would say, in 2012, we're at about 1.8% of our revenue on the combined project spend with supply chain and IT. And by 2016, we're saying we'll be at 1.2%, which is a 60 basis point improvement, just by stopping the spend. And 1.2% we feel is a pretty standard industry average from a spend on IT.

Michael Van Aelst - *TD Securities - Analyst*

When you're talking about spend in that case, are you talking about cash and depreciation?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes, I'm talking about P&L expense.

Michael Van Aelst - *TD Securities - Analyst*

Okay. Although depreciation is what, a three- to five-year amortization on these systems?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes. Yes, it is.

Michael Van Aelst - *TD Securities - Analyst*

Okay. And then, just finally, on the Ontario transition costs of CAD30 million to CAD40 million, you had them last year, you'll have them in 2012. Is there anything else beyond that, or is there more to come beyond 2012?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes. So, we spent CAD35 million in 2011, and we'll spend CAD30 million to CAD40 million in 2012, so basically, roughly on par with what we saw. And we've got another two or three years of spending, and we'll highlight the costs as they come through as we convert additional stores.

Michael Van Aelst - *TD Securities - Analyst*

Okay. And just finally, I guess going back to that customer proposition, is it -- maybe you said it and I didn't quite understand it, but are you doing this simply because -- in terms of increasing your service and reducing your prices or improving your value proposition, are you doing that in response to the competition going down? Are you trying to get the first mover advantage? What exactly are you trying to accomplish there?

Vicente Trius - *Loblaw Companies Limited - President*

I think it's -- very simply, I think it's about bringing more customers into our stores. If you look at the performance that we had over Q4, I mean, we had increasing customer accounts, we had increase in tonnage.

And this is driven through slowly. You do this slowly. You build a foundation. I mean, this is not something that happens overnight, as we know. But, this is about building a much more solid customer proposition.

And to me is -- one and foremost in this market is to be about the best in food. It is about fresh. It is about localized assortment. This is about leveraging our brands, giving better service in our conventional business. And I think that's the way you build it, and I like the traction that I see.

Michael Van Aelst - *TD Securities - Analyst*

Thank you.

Operator

Your next question comes from the line of Irene Nattel with RBC Capital Markets. Please go ahead.

Irene Nattel - *RBC Capital Markets - Analyst*

Thanks, and good morning, everyone.

So, just listening to everything that you're saying, clearly, you're investing for the future, and that makes a great deal of sense. And we're now in year six of this proposition. And as I said, understand that we have another two to three years of this.

But, it also seems like you're investing in PC Financial, you're investing in Joe Fresh. And I don't know how to phrase this other than, at this point in time, given the level of investment that you're doing in your core business, do you really need to be investing above and beyond that in all these other initiatives?

Vicente Trius - *Loblaw Companies Limited - President*

Let me take it first here, Irene. Good morning, by the way.

I feel very good about the PC Financials (sic). The investments that we did last year enabled us to get a -- acquire another 1 million apps, and this translates into 500,000 active cards. This translates into more customers and more loyal customers in our stores, and I see something that builds strength.

As I look at Joe Fresh, I mean, and in my experience, having worked in different parts of the world and seeing different brands, I see a huge strength behind that brand. I mean, it's top notch from the standpoint of design, value.

And I tell you what, it's doing very well in Canada. I am -- very initial stages. As you know, we opened their stores in November. But, I feel very strong about the customer response, the sales performance. It is a brand that could have a global reach because of its strength behind its design and value, and so far at least with what I see, I believe it's the right thing to do.

Sarah?

Sarah Davis - *Loblaw Companies Limited - CFO*

And I can just add something on the financial piece. So, for PC Financial, 2011 was our investment year, and we did -- we have talked about that. And we've seen obviously the impact in our earnings in the PC Financial segment. But, what we also saw in Q4 in particular was a big sales increase of 24%. So, we're pleased with that.

When we look to 2012, we're not looking at another big investment in PC Financial. We expect earnings to be in line or slightly above where they were in 2011.

On the Joe US perspective, we did highlight that it was CAD16 million to do some startup costs in the US. They're startup costs. It included things such as setting up a supply chain infrastructure, the IT, the point of sale, store opening costs as well as marketing associated with those stores.

We don't expect at this time to have another large chunk of investment related to startup costs. What we will have is just the ongoing operations in store performance going forward. So, I don't expect to be talking about it every quarter.

Irene Nattel - *RBC Capital Markets - Analyst*

Okay. And presumably, though, it will continue to be a drag on earnings as we go through 2012.

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes, but not materially.

Irene Nattel - *RBC Capital Markets - Analyst*

Okay, thank you.

Operator

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

Perry Caicco - *CIBC World Markets - Analyst*

Good morning. On same store sales for the quarter, netting out the extra day, and considering the role of inflation in that number, can you let us know if same store tonnage or customer count was negative or positive in the quarter?

Vicente Trius - *Loblaw Companies Limited - President*

Yes, we're very pleased with our performance of the quarter. As you factor in -- we anticipated that day to be about 0.8% to 1%. So, it would be landing at a comp growth of about 1.5% to 1.7%. But, what we're the most pleased about is that we're getting solid customer account growth and tonnage growth.

Perry Caicco - *CIBC World Markets - Analyst*

And what was inflation in the quarter?

Vicente Trius - *Loblaw Companies Limited - President*

We're well below a CPI of about 5.2%.

Perry Caicco - *CIBC World Markets - Analyst*

So, when you say that tonnage and customer account were positive, do you mean that on a same store basis or on a total basis?

Vicente Trius - *Loblaw Companies Limited - President*

Yes, I always talk same store basis and total basis. We had customer account growth and tonnage growth.

Perry Caicco - *CIBC World Markets - Analyst*

And so, the trend is accelerating. Is that what you would say?

Vicente Trius - *Loblaw Companies Limited - President*

I cannot give you trends to the future. What I can tell you is that I'm pleased with our performance this far.

Perry Caicco - *CIBC World Markets - Analyst*

Okay. In your discussion on gross margin, you called it a high level of promotional activity. I'm just wondering if your promotional penetration rose in the quarter, and would you have characterized that as defensive or strategic?

Vicente Trius - *Loblaw Companies Limited - President*

No, I think the promotional did grow in the quarter, but we were in line with the market, or I would say, slightly below the market from a penetration, from an implementation standpoint. The other thing that happened in the quarter is that, obviously, we did not pass the cost increases at the same level as inflation.

Perry Caicco - *CIBC World Markets - Analyst*

And given now that you've had many months of experience, I mean, how do you see your pricing strategies unfolding over the course of 2012?

Vicente Trius - *Loblaw Companies Limited - President*

Look. This is a long journey. This is something that takes time. And you have to build it over time. And I think it's more about the overall customer proposition.

It is about, like I said before, it is about the service, and it's also about the price and how we invest that across different banners. Some banners -- I mean, if I look at discount, I'm the most price in the market and we'll continue to be so. In other banners, maybe we need to invest a little bit in some categories. In others, we'll invest more in service.

But, it's a long journey. I mean, this is something that you build step by step. That's the way you build the customer loyalty.

Perry Caicco - *CIBC World Markets - Analyst*

All right. Then, on another topic, how much square footage growth do you see in 2012, and what is your attitude or strategy regarding new footage over the next couple of years?

Vicente Trius - *Loblaw Companies Limited - President*

Yes, we see organic growth over the next couple of years across all divisions, whether it's conventional or discount. And we're looking at about 500,000 square foot year-on-year.

Perry Caicco - *CIBC World Markets - Analyst*

Okay, thanks.

Vicente Trius - *Loblaw Companies Limited - President*

You're welcome.

Operator

Your next question comes from the line of Jim Durran with Barclays Capital. Please go ahead.

Jim Durran - *Barclays Capital - Analyst*

Yes, I just wanted to go back to some of the incremental expense items and just see if we can get some detail. So, on the CAD70 million of IT and supply chain, how much is going to be in SG&A and how much is going to be D&A?

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. So, the way that we report under IFRS, it's all combined in SG&A, although you can split it out. But, of the incremental CAD70 million, 70% of it is depreciation and amortization and the rest is cash expense. Both will go through SG&A.

Jim Durran - *Barclays Capital - Analyst*

Okay. And on the CAD40 million for the consumer proposition, can you give us some indication as to how that's going to be allocated? Like, is it mostly price and value in the discount segment, or how's it going to work?

Vicente Trius - *Loblaw Companies Limited - President*

So, like I -- I guess I'm going to become maybe a little bit repetitive now, and I apologize for that. But, like I said before, I mean, it's an investment that -- I mean, we have these multiple banners, right? So, it's an investment.

In some cases, we will put it in service because I think it's very relevant for our customers. In other cases, we'll put it in price. This could go -- again, this category is, again, it's an overall market basket, which I think is the overall offer that you have in the store.

Sarah Davis - *Loblaw Companies Limited - CFO*

And from a P&L perspective, part of it will go -- if it's in price, it'll go through GP, and if it's in labor, maybe operating will go through SG&A, and we're not giving -- providing the split between those. We actually think it's kind of competitive.

Jim Durran - *Barclays Capital - Analyst*

Sure. No, understood. On Control Label, you talked about the profitability improving. Are we largely tapped out on that gross margin improvement in private label, or is there still a fair amount of runway to go?

Vicente Trius - *Loblaw Companies Limited - President*

I think that there's been -- a fantastic job has been done over the last four years of Control Label, actually. We've been able to increase its penetration by 3 full percentage points. And the profitability, I can tell you, versus the national brands is about 8.3% better, and I think we gave you a target a while back of 10%.

So, we're very close to there. So, I can see some room for improvement. I see good traction with innovation behind products like Black Label, in categories we have introduced products where we're getting 70% market share like Greek Yogurt.

So, I tell you, this is a strong, strong asset of this Company. And we will continue to leverage it. But, obviously, I do not foresee the same leverage that we have experienced over the last four years.

Jim Durran - *Barclays Capital - Analyst*

Okay. That's great. Thank you.

Operator

Your next question comes from the line of David Hartley with Credit Suisse. Please go ahead.

David Hartley - *Credit Suisse - Analyst*

Yes, good morning. There's no question you're making strides in driving improved margins if you X out all this investment in IT. I wanted to get some clarification, though.

You -- Sarah, you'd mentioned 1.8% going down to 1.2% of sales for your IT budget. Maybe I've got that wrong. Could you clarify what that means? And it seems to me that that would be about a delta of CAD190 million. Where does that fall when that 1.8% falls to 1.2%?

Sarah Davis - *Loblaw Companies Limited - CFO*

Okay. So, basically, I'll do a little bit of history. I would say back in 2007, we invested at about 0.4% of revenue, which was very, very low and under, basically under-invested compared to the industry.

What we've now done as we've gone through this project is we've had to compensate for that, put in all the new systems. And we've gone out to between IT and the supply chain project cost, up to 1.8% of our revenue, which is very high.

What we anticipate is that by 2016, so we're saying 2016 is our estimate on when we will be at a normal run rate, which we estimate to be around 1.2%. All of these costs are recorded in SG&A. They're split between cash cost and depreciation. And as I mentioned, the cash costs are now peaking.

And so, what we will see is depreciation, which will be heavy throughout the year. And we'll provide a little more color on this on next Tuesday, as well.

David Hartley - *Credit Suisse - Analyst*

Okay. So, that still leaves CAD190 million. Just using 2011 sales of CAD31.2 million, that's a CAD190 million delta on that kind of number. Have I got that correct? And where does that number go, then? Does that fall to earnings, fall to reinvestment? Where is that going?

Sarah Davis - *Loblaw Companies Limited - CFO*

It -- well, it's there to either fall to earnings or to further investments, and that's what we'll have to decide as time goes on.

David Hartley - *Credit Suisse - Analyst*

So, that would be the 2013 target is 1.2%, correct?

Sarah Davis - *Loblaw Companies Limited - CFO*

No, no, no, that's 2016. We're not there yet.

David Hartley - *Credit Suisse - Analyst*

Oh, 2016. I'm sorry.

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes.

David Hartley - *Credit Suisse - Analyst*

I miswrote that. Okay. Fantastic.

And just on the Control Label, also if you could explain that a little better, as well -- 8.3% better versus a 10% target. Sorry. Could you just define that better for me what that means?

Vicente Trius - *Loblaw Companies Limited - President*

What this means is 8.3 percentage points better than the national brand's rate. And the 10% target is a target -- I was not here, but it's a target that was set a while back as what we believe we could reach from a profitability standpoint behind the Control brand.

David Hartley - *Credit Suisse - Analyst*

Oh, okay. So, you get a 8.3% lift, if you will, off national brands today than you would -- and you want 10%.

Vicente Trius - *Loblaw Companies Limited - President*

Yes, yes. So, we're about 83% of the way.

David Hartley - *Credit Suisse - Analyst*

Got you. Okay. Thank you very much.

Operator

Your next question comes from the line of Vishal Shreedhar with National Bank Financial. Please go ahead.

Vishal Shreedhar - *National Bank Financial - Analyst*

Thanks a lot. Sarah, I know you've already spoken to this, but I just want to make sure I understand. So, we should expect these IT supply chain costs to be in the CAD500 million range for the next, call it for the next three to four years?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. And then, how about our CapEx? How do we think about that?

Sarah Davis - *Loblaw Companies Limited - CFO*

Well, we've given you numbers for 2012 of CAD1.1 billion, and we have another (inaudible) we'll do that as we finish the IT and supply chain, we'll have more money, which likely will decrease, maybe to the CAD850 million to CAD900 million range.

Vishal Shreedhar - *National Bank Financial - Analyst*

So, is your CAD850 million to CAD900 million, is that like a run rate CapEx or is that still an elevated level?

Sarah Davis - *Loblaw Companies Limited - CFO*

That's a run rate.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. And what kind of return on assets or return on capital is Loblaw targeting after this is all said and done?

Sarah Davis - *Loblaw Companies Limited - CFO*

We've never provided our target on that.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay. Do you have some sort of internal target, or how do you measure the success of these programs?

Sarah Davis - *Loblaw Companies Limited - CFO*

We definitely did a business case for both the supply chain and the IT projects, and we have adjusted the SAP program as we've gone through it. But, we're largely on time -- on schedule to meet the benefits and the cost that we started at the beginning. And it beat our hurdle rate, which I'm not going to tell you what it is, either. But, we're anticipating to have good returns on it.

Vishal Shreedhar - *National Bank Financial - Analyst*

Okay, that's it. Thank you.

Operator

Your next question comes from the line of Peter Sklar with BMO Capital Markets. Please go ahead.

Peter Sklar - *BMO Capital Markets - Analyst*

Thank you. Sarah, just to make sure I understand, and to be clear, these percentages you're throwing out, the 1.2%, the 1.8%, is that cash expenditure or is that expense you're going to incur from an accounting perspective on the P&L?

Sarah Davis - *Loblaw Companies Limited - CFO*

It's a total expense number.

Peter Sklar - *BMO Capital Markets - Analyst*

So, it's an accounting number.

Sarah Davis - *Loblaw Companies Limited - CFO*

It is. It will be what goes through our P&L in the expense line in SG&A.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. I wanted to switch topics, go back to the 90 basis points decline you had in your retail gross margin.

In the MDNA, you attribute it to a number of factors. One was, you said, higher input costs, outpacing -- sorry -- I lost my words there. But, basically, you're saying that inflation is not keeping up with higher internal costs. When you're referring to internal costs, are you referring to cost of grocery inflation or are you referring to other costs such as labor or a combination of all?

Vicente Trius - *Loblaw Companies Limited - President*

No, I'm referring to cost of goods.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay.

Sarah Davis - *Loblaw Companies Limited - CFO*

So, the labor wouldn't go through the gross profit line. So, it's--.

Peter Sklar - *BMO Capital Markets - Analyst*

--It's G&A--.

Sarah Davis - *Loblaw Companies Limited - CFO*

(Inaudible.)

Vicente Trius - *Loblaw Companies Limited - President*

Yes.

Peter Sklar - *BMO Capital Markets - Analyst*

Is there any labor in gross margin, or is all labor in G&A?

Sarah Davis - *Loblaw Companies Limited - CFO*

All labor is in SG&A. In gross profit, it includes the cost of the product, it includes shrinking, it includes the transportation cost, and supply chain.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. But, what about labor to put it on the shelf?

Sarah Davis - *Loblaw Companies Limited - CFO*

Labor is all in SG&A.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. And lastly, your tax rate was low during the quarter. Could you provide some guidance for 2012?

Sarah Davis - *Loblaw Companies Limited - CFO*

I would use 27% to 27.5%. That would be my guidance.

Peter Sklar - *BMO Capital Markets - Analyst*

Okay. That's all I have. Thank you.

Operator

Your next question comes from the line of Chris Li with Bank of America Merrill Lynch. Please go ahead.

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

Hi. What was your private label penetration for 2011?

Vicente Trius - *Loblaw Companies Limited - President*

We have never given our private label penetration. But, we're pleased with the penetration of our Control Brand.

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

Okay.

Vicente Trius - *Loblaw Companies Limited - President*

Like I said, it increased by 3 full percentage points over the last four years.

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

And in terms of the initiatives that you've been working on to reduce the number of non-profitable or less profitable general merchandise items, can you give us an update on where you're at right now? Are you pretty much done with that program?

Vicente Trius - *Loblaw Companies Limited - President*

We're well underway into the program. If we look at our non-food offer, we're very pleased with the apparel performance. We had a very strong quarter, actually, with positive same store sales.

We see good trends in home, and we're still working through some of the rationalization on the assortment especially in categories like electronics. I would foresee that being done within the next 12 months to 18 months.

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

And--.

Sarah Davis - *Loblaw Companies Limited - CFO*

--And, Chris, if I could just go back on the -- we do actually on an annual basis provide our Control Label. So, it is in our Annual Report, and it's CAD8.3 billion of Control Label sales on CAD30.7 billion. So, it's around 27%.

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

27%, okay, that's great. And for Joe Fresh in the US, can you share with us what your expansion plan is for that in 2012?

Vicente Trius - *Loblaw Companies Limited - President*

Look, these are -- this is a startup now, right? Those are early stages. We opened five stores of which a couple were pop up stores. I see us probably opening a couple more stores next year.

But, this is about building a brand. This is about building the foundation. So, it's early stages to forecast any sort of future growth.

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

Okay. And just last question, just maybe to help us better model the EPS for this year -- the interest expense level, do you expect that to decline versus last year?

Sarah Davis - *Loblaw Companies Limited - CFO*

No, I think 2011 is a good rate for 2012, dollar amount.

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

Great. Thank you.

Operator

Your next question comes from the line of Irene Nattel with RBC Capital Markets. Please go ahead.

Irene Nattel - *RBC Capital Markets - Analyst*

Thank you. Sorry. I'm going to come back to the whole notion of the incremental expense and how we should think about all this going through, because the incremental CAD110 million is about 35 basis points, given your current run rate on sales.

Now, when we take into account that you've been at this -- as I said, we're going into year six now -- is it just that we've now gotten to a point where all of the early savings have been realized, and the next chunk won't come until we get into 2013? Is that what the problem is here at this point?

Vicente Trius - *Loblaw Companies Limited - President*

Simple answer would be yes. Now, if I look at the -- my experience in implementing systems, if you look at a systems implementation, it takes usually anywhere between five to ten years. And I've done that before in other companies. And I think -- I believe, as a Company, we're going at the right speed. But one and foremost, we will do it right.

Remember, 2012 was about integrating merchandising with supply chain, having our first pilot stores in Q4. With the success of those pilot stores, we will roll out the implementation across 1,200 stores. This is through 2013 and 2014.

Our efficiencies -- if I look at efficiencies as a business, I think this SAP implementation is the single most important initiative to drive efficiencies. And this goes beyond the IT expense that Sarah referred to. To me, there's many more efficiencies that will cut through the business, that will improve our value proposition and that will flow to the bottom line.

Irene Nattel - *RBC Capital Markets - Analyst*

Okay. So, I -- and I'm sorry to keep pushing the point, but from an investor perspective in terms of thinking about the evolution of Loblaw's earnings, as we go through 2013, 2014, when is it realistic to expect some kind of growth in earnings to return?

Vicente Trius - *Loblaw Companies Limited - President*

I mean, everything is determined on how well we implement (inaudible) 2012. But, I definitely foresee this goes well, with no disruptions, improvements starting in 2013, but much more so once it's completed, which we're talking about '14, '15 and '16.

Irene Nattel - *RBC Capital Markets - Analyst*

Okay. Thank you.

Vicente Trius - *Loblaw Companies Limited - President*

You're welcome.

Operator

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

Keith Howlett - *Desjardins Securities - Analyst*

Yes, the first question on the supply chain initiative on transportation warehouse systems. Would you be already getting pretty much all the benefits of that as we go into -- or as we progress through Q1 of this year? And how much additional lift do you get when you integrate supply chain with the rest of the SAP and with merchandising?

Vicente Trius - *Loblaw Companies Limited - President*

I tell you, I mean, there's been a lot of progress being done in the supply chain. But, I believe there's still a lot more that can come. I mean, I referred a little bit like on the three pilots that we're doing on flow. So, if I look at the level of cross stock, for example, that we have in our facilities, it's in the low single digits.

So, just think, I mean, many retailers run about a 60/40 split, 70/30 split when you look at staple stock versus cross stocking. So, I see lots of improvements still coming in the supply chain and benefits going forward that translate not only in efficiencies in the warehouses and physical supply chain, but also huge efficiencies in the store, how we execute the processes in the store, the availability of the product, better execution in our inventories, planogramming and so forth. Reduction of shrink I think is also a good opportunity for us.

Keith Howlett - *Desjardins Securities - Analyst*

And then, on the CAD40 million to be spent on customer proposition, it mentions just a continuation of investments in customer proposition. Does that mean there was an incremental amount in 2011 that this is on top of, or am I reading too much into the word continuation?

Vicente Trius - *Loblaw Companies Limited - President*

When -- could you repeat the question? When you say on top of on 2011?

Keith Howlett - *Desjardins Securities - Analyst*

Yes. You mentioned that there was a continuation of investments in customer proposition that would incrementally be CAD40 million. I was just -- I didn't -- should I read into that that there was incremental spending on customer proposition in 2011?

Vicente Trius - *Loblaw Companies Limited - President*

Yes, yes, we did, and we did that in Q3 and more so in Q4, and there's a continuation of that in 2012.

Keith Howlett - *Desjardins Securities - Analyst*

And when we look beyond, is this -- should we view this as a step up? Like, we're not going to -- it's not incremental like IT that it eventually goes down. This is really a permanent step up in the cost of what you want to offer the customer in terms of price, service and environment or whatever?

Vicente Trius - *Loblaw Companies Limited - President*

No, this is a journey. This is long term. And what we're doing now is just building a much better solid foundation for the customer. So, I foresee that as one for 2012 because, one, SAP implementation will allow our merchants to focus more on the customer. And it's about tracking sales and getting a more positive customer count in our stores.

Keith Howlett - *Desjardins Securities - Analyst*

Great. Thanks very much.

Vicente Trius - *Loblaw Companies Limited - President*

You're welcome.

Operator

Your next question comes from the line of Michael Van Aelst of TD Securities. Please go ahead.

Michael Van Aelst - *TD Securities - Analyst*

I apologize, but I need to clarify a few more things here.

On the IT rollout into the stores, in the past, you said that you'd get the bulk of the business or bulk of the core -- all the core banners and, sorry -- and the corporate stores done in 2013 and the smaller stores would be done in 2014. Is that still applying, or when you said that you're going to be doing this right through 2016, is there -- is this going to get dragged out?

Vicente Trius - *Loblaw Companies Limited - President*

No, no, no, no, no, there's a -- yes, yes. We will do the bulk of the stores in 2013 and the rest in 2014. We should be completed in 2014.

Michael Van Aelst - *TD Securities - Analyst*

So, there's -- after that, there's no IT, no more implementation. It's just that your SG&A starts to roll -- continues to roll off.

Vicente Trius - *Loblaw Companies Limited - President*

Your normal expense in investment that's basically very standard in the industry if you benchmark it.

Sarah Davis - *Loblaw Companies Limited - CFO*

And your depreciation will hang on for a couple of years, too.

Michael Van Aelst - *TD Securities - Analyst*

Okay. And, Sarah, you mentioned 1.8% in 2012. But, I think in the -- if I'm not mistaken, your Annual Report says 1.5%.

Sarah Davis - *Loblaw Companies Limited - CFO*

I'm adding the IT and the supply chain costs together to get to 1.8%. So, IT is 1.5% and supply chain's 0.3%.

Michael Van Aelst - *TD Securities - Analyst*

Okay. And those -- that's a 2012 number?

Sarah Davis - *Loblaw Companies Limited - CFO*

Yes.

Operator

Your next question comes from the line of Chris Li with Bank of America Merrill Lynch. Please go ahead.

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

Hi. I was just wondering if you can give us your view on industry consolidation, both on the -- for retailing and the pharmacy side. What is your outlook for that for the next 12 to 24 months?

Vicente Trius - *Loblaw Companies Limited - President*

I'm not here to give you a view on what can happen on the next 24 months. I tell you what. If there are opportunities there, we're more than happy to look at them as long as they give the proper returns to our customers.

If I look at our pharmacy, I am -- internally, I would be very encouraged on our performance. We have implemented systems that have allowed our pharmacies to engage better and better with the customers, and we see solid prescription account growth of about 5.1% year-over-year. So, we're very pleased with our pharmacy and drug store side of the business.

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

Okay. And just also in terms of capital return, I mean, is it reasonable to assume that your dividend will probably be stable for the next two to three years in light of the spending that you'll be investing in the stores and in the Company?

Sarah Davis - *Loblaw Companies Limited - CFO*

Our plan is to -- once we start to see some of the efficiencies related to the SAP project, we would be looking at the possibility of a dividend increase as well as looking at the possibility of a more extensive share buyback program.

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

Okay. Great. Thank you.

Operator

This now concludes the Loblaw Companies Limited Fourth Quarter Results Conference Call. Thank you for joining. You may now disconnect.
