Loblaw Companies Limited

Second Quarter 2021 Earnings

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CORPORATE PARTICIPANTS

Roy MacDonald
Loblaw Companies Limited — Vice President, Investor Relations

Richard Dufresne
Loblaw Companies Limited — Chief Financial Officer

Galen G. Weston
Loblaw Companies Limited — Chairman & President

CONFERENCE CALL PARTICIPANTS

Karen Short
Barclays — Analyst

Michael Van Aelst
TD Securities — Analyst

Irene Nattel
RBC Capital Markets — Analyst

Mark Petrie
CIBC World Markets — Analyst

Patricia Baker
Scotiabank — Analyst

Vishal Shreedhar
National Bank Financial — Analyst

Chris Li
Desjardins — Analyst

Kenric Tyghe
ATB Capital Markets — Analyst

Peter Sklar
BMO Capital Markets — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Loblaw Companies Limited Second Quarter 2021 Earnings Call. At this time, all lines are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star zero for the operator. This call is being recorded today, Wednesday the 28th of July, 2021, and I would now like to turn the conference over to Roy MacDonald. Please go ahead.

Roy MacDonald — Vice President, Investor Relations, Loblaw Companies Limited

Good morning. Thank you, Michelle, and welcome, everybody, to the Loblaw Companies Limited Second Quarter 2021 Results Conference Call. I'm joined in the room this morning by Galen Weston, our Chairman and President, and by Richard Dufresne, our Chief Financial Officer.

And before we begin the call I'd like to remind you that today's discussion will include forward-looking statements which may include, but are not limited to, statements with respect to Loblaw's anticipated future results and the impact of the COVID-19 pandemic. These statements are based on assumptions and reflect management's current expectations. As such, they are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from our expectation. And these risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulators. 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 what's required by law.

Also, certain non-GAAP financial measures may be discussed or referred to today, so please refer to our annual report and other materials filed with the Canadian securities regulators for a reconciliation of each of these measures to the most directly comparable GAAP financial measure.

And with that, I will turn the call over to Richard.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Thank you, Roy. Good morning, everyone. I'm very excited to be back at Loblaw and I'm pleased to share some details around what was a good second quarter for us.

The quarter reflected continued improvement in our businesses while lapping tougher performance last year. The environment remains dynamic and still difficult to forecast. As we report on our second year of the pandemic, comparable numbers do not tell the entire story. As such, I will include commentary and two-year data points to provide further context on our operating performance.

On a consolidated basis, our revenue for the second quarter grew by over $500 million, EBITDA increased 36%, and earnings per share grew by 87.5%. On a two-year basis, we saw average annualized growth in revenue of 5.9%, adjusted EBITDA of 8.1%, and adjusted earnings per share growth of 15%. These figures are well ahead of our financial framework.

Food retail same-store sales were flat in the quarter. Market declined slightly against same-store sales growth of 19% last year, while discount same-store sales were positive. Our average article price was up 1.4% for the quarter, a decline from 3.9% in Q1. The increase in average article price compared to last year was mainly driven by sales mix. Loblaw CPI comparable inflation rate was less than 1% in the first half of 2021. Traffic improved in Q2, recording growth for the first time since the beginning of the pandemic. On a two-year rate, food same-store sales reflected average growth of 5.6%.

Same-store sales in drug retail increased by 9.6% in the second quarter, trending positively compared to a decline of 1.1% last year. Front store same-store sales were better by 3.6% while pharmacy same-store sales grew 17.2%. Front store sales saw some sales momentum from cosmetics and OTC categories as restrictions loosened, recording strong growth compared to last year. Pharmacy performance was strong, lapping volatility of day supply restriction in the prior year. On a two-year average rate, drug same-store sales have grown 5.7% with front store at 4.6% and Rx at 6.9%.

Our online business continued to operate at penetration levels well above pre-COVID rates. After a record growth of 280% in Q2 last year, sales declined 0.5% versus Q2 of last year. That said, online sales increased in the mid-single digits versus Q1. We remain focused on driving customer metrics and delivered sequential improvements in both customer-facing metrics and profitability.

Retail gross margin was 30.9%, an improvement of 40 basis points compared to the second quarter of 2019. While gross margin improved 130 basis points versus Q2 of 2020, we are anchoring our financial performance to 2019. This is our second consecutive quarter of gross margin stability and we feel comfortable about our gross margin performance going forward. Improvement in mix versus second quarter of 2020 had a positive impact on margin.

Retail SG&A as a percentage of sales was 20.2% with the rate improving by 120 basis points compared to the first quarter of 2020. The improvement was primarily due to lapping of high COVID costs in 2020, sales leverage from strong prescription growth, and efficiencies achieved in our e-commerce labour model. COVID costs came in at $70 million in the quarter, in line with our expectations. Compared to Q2 of 2019, our retail SG&A improved by 30 basis points despite COVID costs and headwinds from our online growth. Strong sales performance is definitely a factor in driving rate.

Adjusted retail EBITDA improved by $347 million in the quarter. This compared to last year when we recorded a decline of $151 million driven by margin and COVID cost-related pressure. At PC Financial, revenue was up $39 million in the quarter, driven by higher mobile shop revenue and interchange income as we lap a period of low sales volume from prior year. Adjusted EBITDA at the bank increased $16 million year over year, primarily driven by changes in the expected credit loss provision and lower credit losses offsetting the lower impact of lower interest income as payment rates remain elevated. On a consolidated basis, adjusted EBITDA margin was 11% in the quarter, up 260 basis points compared to last year.

In the quarter, IFRS net earnings available to common shareholders was $464 million, up 78.5%, and fully diluted net earnings per share were $1.35. Free cash flow was $953 million in the quarter, but free cash flow in our retail business was $1 billion in the quarter. In Q2 we repurchased $350 million of common shares for a total of $700 million year to date. Today we announced a $0.03 or 9% increase in our quarterly dividend. This marks our 10th consecutive increase of our dividend.

As we look ahead, a great deal of uncertainty remains as the course of the pandemic, the reopening of the economy, and the resulting impact on consumer behaviour remains dynamic. Sales trajectory remains difficult to forecast. We are pleased with the financial performance of our second quarter. As such, we have updated our outlook to include the expectation of EPS growth for the full year 2021 of the low to mid-20s, excluding the impact of the 53rd week of 2020.

In the first four weeks of the third quarter, food same-store sales declined by 1% compared to the same period last year. Over the same period, COVID costs are estimated at around $9 million. As for inflation expectations, while inflation was low in the first half, proposed cost increases from vendors have been coming in rapidly over the last while so it is reasonable to expect more inflation going forward. Having said that, manageable level of inflation has positive impacts on our business.

Before I hand over the call to Galen, I would like to reiterate my excitement in being back in the business. Together with Galen and Robert, we look to the future with confidence as we reflect on the scale and strength of our food and drug retail businesses, our strong brands, our loyalty assets, and our already sizable online business.

I will now turn the call over to Galen.

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Good morning. Like Richard, I'm very pleased with the Company's results in Q2. The ups and downs of COVID continued to distort the year-over-year numbers, but when you look through that, this is the fifth consecutive quarter of improved performance and on a two-year basis we have out-performed on every key measure, from sales through to earnings.

Our grocery divisions performed well in the first part of the quarter, aided by COVID restrictions that kept Canadians eating at home during the spring and early summer. This translated into strong market share, demonstrating the underlying health of our business. As communities across the country began opening up, we were particularly pleased with the re-emergence of value-seeking shopping trips, which was good for our discount formats.

Our drugstore business was also impacted by the pandemic. Spring cough and cold season was virtually nonexistent due to mask usage and social distancing. On the other hand, allergy season was particularly robust, as people rushed outside at the first hint of spring. And we're seeing customers return to our beauty counters as communities open up. COVID testing and vaccinations continued at a stable pace as our pharmacists did their part to protect Canadians. When it came to more traditional prescriptions, our share growth accelerated as we finally lapped last year's supply restrictions and the start of what we expect will be a slow and steady recovery for acute medications.

As we look forward, the good news of an increasingly vaccinated nation and a far less restricted life for Canadians will change our business yet again and it is difficult to predict exactly what the magnitude of those impacts will be. We expect our Shoppers business to grow stronger, as some of its most important categories like beauty and pharmacy return to a more normal run rate, we expect our e-commerce business to shift from headwind to tailwind, and we expect the return of value-focused shopping to deliver a relative benefit for our discount formats. However, we also know that our entire food business, our entire business, will face top-line pressure as we lap the elevated sales from COVID. As Richard mentioned, that year-over-year contraction was already evident in the first four weeks of Q3. And while we are very well positioned relative to the industry, we will need to maintain a particularly sharp focus on gross margin and on costs.

Having now been back in the President's role for three months, that attention to core fundamentals has been front and centre. It's been busy. Loblaw is a fantastic company with a real opportunity to create value. We have amazing assets, great stores, incredible brands, leading customer loyalty, and very talented people. Our strategy remains the right one and we have made some important adjustments to accelerate our progress against it.

To start, we've reprioritized our strategic initiatives, doubling down on those with the most financial potential and the shortest journey to deliver it, while also recognizing those that are simply too small or too difficult to deliver against and stopping them. This has freed up capacity for the organization to refocus on retail excellence under the leadership of Chief Operating Officer, Robert Sawyer. This combination is bringing a renewed sense of clarity and urgency to everything we do.

There are some challenges ahead, especially over the next few quarters, but the team is crystal clear about where it needs to go and is more energized than ever.

Thank you. We'll now welcome any questions that you might have.

Roy MacDonald — Vice President, Investor Relations, Loblaw Companies Limited

Thanks, Galen.

Michelle, could you remind the audience what the protocol is for asking a question?

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the star followed by the one on your touchtone phone. You will hear a three-tone prompt acknowledging your request and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press the star followed by the two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment please for your first question.

Your first question comes from Karen Short of Barclays. Please go ahead.

Karen Short — Analyst, Barclays

Hi. Thanks very much. I just wanted to talk a little bit about your comments on inflation. Obviously, you gave us what we know at the 1Q average article price was and you gave us Q2. What are your thoughts on inflation for the remainder of the year and, I guess, what are your expectations in terms of your ability to actually pass through the inflation that you're seeing from the vendors?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Yeah, so we did see low inflation, as we mentioned, in the first half and we do see signs of increased pressure in the second half. There's no question about that. We see pressure in commodities, we see pressure on transportation, and particularly underlying pressure from the labour challenges that are being experienced specifically in the US. When it comes to our ability to pass things through, we're going to look to pass through legitimate cost increases as appropriate while all the while keeping a very close eye on our relative value proposition. But at this point we see there will be some opportunity to pass those increases through.

Karen Short — Analyst, Barclays

Okay. And then I'm wondering if you could give a little colour on performance in discount versus conventional and how you see that playing out throughout the remainder of the year given where the state of the Canadian consumer is in terms of their savings.

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Yeah. So, as the economy started to open up here in Canada, we saw a pullback in the conventional business that was fairly significant, in line with our expectations but meaningful, whereas on the discount side we saw continued positive performance. And the way to think about discount is that, with the return of the value-oriented shopper and the value-oriented shopping trip, there's going to be a reversion to discount from a market penetration perspective.

However, we do expect discount to run negative over the next few quarters as well as our market business and that's why it's going to be so important, in what is essentially a negative leverage situation, to stay laser-focused on margin. And we're really pleased with the results of margin in the last two quarters. As Richard said, we think we can sustain that through the balance of the year. And additionally, we have to be laser focused on cost.

Karen Short — Analyst, Barclays

Okay. And then just last one for me. You mentioned the $9 million in COVID cost for the first four weeks of this quarter; is that the right run rate to think about going forward?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

We think it can go down a bit more as we start to reduce these costs and the economy reopens.

Karen Short — Analyst, Barclays

Great. Thanks very much.

Operator

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

Michael Van Aelst — Analyst, TD Securities

Thank you. Just to follow up on that discount versus conventional conversation, so you're seeing a recovery in the discount versus conventional, but long term do you see it returning to where it was historically or do you think there's been some kind of permanent shift in consumer behaviour during COVID?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

You know, we're trying hard not to speculate too much on what the post-COVID world is going to look like. I don't think anybody really knows yet. I think there is reason to believe that the conventional stores will hang on to a few more customers perhaps than they have in the past, especially in our business where, as you know, we've made significant relative price investments in that format. So we have historically some of the narrowest gaps to discount that we've ever had and part of our thinking there is that we want to hang on to those customers who shop on the bubble. But it really is too early to tell. What we know for sure is that, and we're seeing it now, we saw it during the opening in the middle of last summer, is that there are a set of value-oriented shoppers who haven't been shopping in the discount stores who are going to start shopping in them again.

Michael Van Aelst — Analyst, TD Securities

Okay. And you mentioned that gap in conventional versus discount. Can you provide some more colour as to where you think you are relative to, say, I guess, Walmart, which is quite often where people index you to, and then how do you think your that gap has changed over the past 12 months following your price investments versus your peers?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Yeah, so I'm not going to give you the specifics around where we index versus Walmart, but we index better against Walmart today than we did, say, at the end of 2019. That's been part of a concerted effort by our market division. And it's been a strategic price investment looking to close gaps in particular categories as opposed to across the board and we've seen commensurate response from consumers in both categories. So it's indicative of the success of that strategy. What's also, I think, worth pointing out is that the gap, and in some ways more importantly, the gap between us and our market competitors is at an all-time high.

Michael Van Aelst — Analyst, TD Securities

Okay. And you don't want to give any kind of indication as to how that's changed in the last year?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Oh, it's improved.

Michael Van Aelst — Analyst, TD Securities

Okay. Is it a few hundred, like a hundred basis points?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

No, I'm not… Look, I mean it's not insignificant. It's noticeable. We're not talking about 10 basis points. We're talking about a meaningful gap.

Michael Van Aelst — Analyst, TD Securities

Okay, great. And then just finally, the comment on e-commerce, you said it's shifting from a headwind to a tailwind, which I can understand in part, but you're lapping a 280% growth comp of a year ago and in the second half of the year you'll be lapping easy comps. At the same time, you showed sequential growth from Q1 to Q2. So if you just kind of hold your kind of levels of Q2, won't you be higher in your sales for e-commerce in the second half of the year? And how would that be a tailwind then?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

For us, the way we look at it, Michael, is like the bulk of our infrastructure costs have been invested, I guess, and when we look at it last year at this time our labour costs were through the roof because like we're just like chasing sales. So we figured out how to be able to serve our customers, so we've been able to improve on our labour rates quite significantly, and so that's why we're seeing that business. While we will continue to invest in certain area, we feel that the big chunk of what we had to do is definitely behind us and, going forward, as we continue to tweak the model, it's no longer going to be a significant tailwind on our business.

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Headwind.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Headwind. Sorry.

Michael Van Aelst — Analyst, TD Securities

Great. Thank you very much.

Operator

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

Irene Nattel — Analyst, RBC Capital Markets

Thanks and good morning, everyone. I just to come back to some of your closing remarks, Galen, in which you said, I think, I think you said that you were laser focused on retail excellence. Can you sort of walk us through what that looks like and sort of how you think about how you define retail excellence, what it looks like, and what the key factors are that will get you to where you want to be?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Yes. I mean I think it begins with, as I described, as I sort of mentioned in my script, that reprioritization of our strategic initiatives to identify those that are truly compelling enterprise-level initiatives that we need to accelerate and then stopping essentially those other ones or pushing them into the direct accountability of the divisions themselves.

The whole objective is to create space for our retail teams to focus on retail fundamentals. And the way to think about that, you know, it’s an old adage, but retail is detail and if your teams are spending all of their time focused on supporting strategic initiatives then it comes at the expense of time that they would otherwise be spending on their merchandising programs or on store conditions and so on and so forth. So the big step to change that orientation is the reintroduction of the chief operating officer role, which is something we’ve had here for many years but not in the last two or three, and bringing Robert in. As many of you know, he really is, if not the best, he’s certainly very, very close to being the best retail operator in Canadian history, and he’s coming back to bring his instincts, his attention to detail, and focus on to the business. A good example of how to think tangibly about changes in the trajectory that that focus can make is he and Richard have just completed a really intensive look at our retail network and have identified opportunities to optimize that retail network. And think about a list of stores that are generating negative earnings today or negative EBIT today that could be converted to format at a very effective cost and very quickly both drive top-line sales through that format conversion and improve profitability. And there are a number of areas that Richard and Rob are focused on in terms of improving just that fundamental retail asset, which has perhaps not received as much focus over the last few years as it should have.

Irene Nattel — Analyst, RBC Capital Markets

That's great. So then if we're sitting here and looking at it from the outside, Galen, we should see that in the form of better and more consistent top line performance and profitability. Is that what it will look like to us?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Yeah. I mean that's absolutely the objective. And I think, you know, somebody asked me the other day what would you see as the biggest opportunity in the, call it, the short to medium term in the business, what would Robert see as the biggest opportunity, and are those two things aligned. And the answer is improving the retail fundamentals, just the day-to-day trading day in and day out, and improving retail network, you know, we've identified significant potential in those two areas to drive the financial performance, top and bottom line, if we're successful.

Irene Nattel — Analyst, RBC Capital Markets

That's great. Thank you. And if I could just ask one more sort of more near-term question, just thinking about the gross margin evolution in the back half of the year, presumably, if we see recovery at Shoppers, should that not, just on a straight mix basis, drive improving gross margins as we move through the year?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Definitely it'll help. Like we feel good about our level of gross margin, which is a mix of both food and drug. But you're right, like as the Shoppers business opens up, this business has a higher gross margin than our food side, so we should benefit and that should help us deliver on our outlook.

Irene Nattel — Analyst, RBC Capital Markets

That's great. Thank you.

Operator

Your next question comes from Mark Petrie of CIBC. Please go ahead.

Mark Petrie — Analyst, CIBC World Markets

Good morning. Thanks for all the comments. Just a couple actually just to follow up on specifically, first on the gross margin. Could you just give us a sense of, in the quarter, the relative performance in the food and drug segment? I know you don't give detail, but any sort of directional commentary about the materiality of the improvements in each of the segments would be helpful.

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Well, let me give you a sense of all the key areas that we saw improvements in mix that drove gross margin. So, the first was a positive mix shift in food. And that was largely driven by the strength in the service counters and other high-touch categories and so customers are coming back to those counters and we're seeing really significant lifts. And if you remember Sarah's comments from about this time last year, that was one of the places where business was particularly impacted by the COVID restrictions and that had a dilutive effect on our margin.

The second has been strength in key non-food categories. So apparel has been strong from a margin perspective. Rx also is a positive contributor to margin. And OTC, which came back strongly, as I mentioned, in allergy season, is also a really profitable category and quite big in the pharmacy business. And then if you kind of think, as Irene mentioned, on an overall basis, strong sales performance in the drug channel, which is a naturally more higher gross margin business, just lifts the margin mix for the total organization as well.

Mark Petrie — Analyst, CIBC World Markets

Okay. That's helpful. Thank you. And then I guess with regards to the work on process and efficiency, thanks for all the colour in terms of a refocus on strategic priorities, with the COVID cost now sort of seemingly stabilized or maybe a little bit of reduction possible, what would be a reasonable expectation for SG&A growth relative to sales growth for the second half of the year but, probably even more importantly, as we think about next year?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

So rate becomes very difficult to predict for the second half as food sales turn negative. So it's going to put pressure on rate. Also, as the pharmacy business gets going, the SG&A rate in that business is higher, so that will also affect rate. So it's very tough to try to manage the business looking at rate. You need to be focused on dollars. So right now our energies are all focused on dollars and that's how we're managing the business to be able to deliver our outlook for the second half of the year.

As for 2022, you need to break the year in two. Like the first half is going to be lapping this first half, which was very high sales performance. So again, looking at dollars more than rate is going to be key. And as we lap these two quarters we should be starting to get back more to normal.

So I know I'm not helping you with my answer, but that's exactly how we're looking at it right now.

Mark Petrie — Analyst, CIBC World Markets

Okay. I appreciate that. And I guess just a follow-up also on the topic of e-commerce, I mean you mentioned sort of how you're thinking about it at a high level, but I'm just wondering if you can give any sort of specific examples with how the efficiency has improved. And then any commentary in terms of the actual net impact of that on the consolidated results would be helpful.

Galen G. Weston — Chairman & President, Loblaw Companies Limited

I'll start with a couple of good examples. So if you imagine a world where demand is dramatically outstripping supply and you're investing in order to try and meet that demand as well as you can, which was the decision that we took last year, it results in a huge amount of labour inefficiency. You're basically throwing labour at everything you possibly can, you're not spending a ton of time on the pick path efficiency, on organizing how your teams are actually functioning, you're investing in building additional capacity. As you know, we opened a number of dedicated manual fulfillment picking centres. All of that increases cost. As the volume normalizes, then your ability to schedule orders improves dramatically and then you can start optimizing labour.

So how do you optimize labour? Will you move from basket picking? So you have one person picking entire order to batch picking where you have pickers working in produce, grocery, and meat and so on. All of these types of opportunities improve labour efficiency. We've introduced a digital check-in desk through the app, which improves the speed of fulfillment when people are trying to pick up their groceries and also improves the way that you allocate labour during those pickup (inaudible). So it's really just attention to detail and making sure that you don't have inefficient wasted labour throughout the organization.

The second thing to think about is the amount of investment in infrastructure that we've made is we're not doing it anymore. So we're not adding that capital cost and we're starting to see the depreciation come off that part of the P&L as well. So, net-net, it just improves the overall economic proposition. There's still a lot of distance to travel to make our e-commerce business profitable and we'll talk about that another time.

Mark Petrie — Analyst, CIBC World Markets

Appreciate the comments. Best of luck.

Operator

Your next question comes from Patricia Baker of Scotiabank. Please go ahead.

Patricia Baker — Analyst, Scotiabank

Good morning, everyone. Thank you for taking my questions. Galen, my first question is for you. In your opening remarks you said that you're convinced that the strategy is the right one and that you have reprioritized strategic initiatives. Can you just very quickly review with us what the strategy is and what the changes have been?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Yes. So, we have recently undertaken a strategic review process of about, call it, around 17 strategic initiatives that have been prioritized by the organization over the last couple of years. A big part of that is how do we drive our digital relationship with customers in a positive way as possible? And we've really zeroed in on the ones that we think have the greatest potential and, as I mentioned in my script, potential, both in terms of size of the prize and also proximity to deliver positive results.

Clearly, and it won't surprise you, the biggest and most important one right now is e-commerce. We've invested substantially in it over the last number of years. We've now achieved significant scale with sales over $3 billion. And our focus now is to improve the efficiency of that business and then to substantially improve the customer proposition. And we've made excellent progress on improving the efficiency, as a couple of people have asked, turning e-commerce from a headwind to a tailwind, which is pretty meaningful and I think certainly not the case in many grocery retailers in this country and around the world. And that's because we got way in front of it in terms of the investment cycle and now we can actually focus on optimization.

And the second thing is to improve the customer value proposition. Sarah talked about it at the end of last quarter, that we'd seen significant improvements on the three metrics that were most important to us, most important to customers, you know, the ability to find what you're looking for, so shopability of the website, availability, getting what you order when you do your grocery shop, and then, third, the wait time for pickup and the availability of slots for delivery. We've seen a 15% consecutive increase in NPS driven by improvements on all thee metrics that I mentioned. Still lots of opportunity for improvement and every week we're seeing the implementation of new solutions and improvements on all three of those fronts, so feeling pretty confident about the journey that we're on there.

There are other significant strategic initiatives at the enterprise level, which we'll talk about again sometime in the future, but a good example of what would be next would be media. That is a big opportunity generating a positive contribution to EBIT today with significant upside.

And then to give you an example of something that we looked at and said, gosh, we've got to stop investing in this, because the distance to travel for it to be highly impactful on the overall business picture is just too far and the cost to get there is too high, and that would be our PC Chef meal-delivery service. So, great service, customers loved it, but it was going to cost tens of millions of dollars of investment over the next four or five years to get even to the beginning of meaningful scale. So our view is that we need to take that yield expertise and deploy it against our stores and deploy it against our existing very successful e-commerce channel and take all that operating cost and the future investment cost out of the P&L to help drive the financial performance.

Patricia Baker — Analyst, Scotiabank

Okay. Thank you very much for that. It's very helpful. Just on the optimization, and you discussed optimizing the network, I think you said that you'll be looking at converting maybe, that Robert and Richard have looked and identified stores that are not contributing as well as they should now and you'll convert them to a different format. Are those mostly conventional stores that will convert to discount or…?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Good morning, Patricia. So, it's a bit early. Like we've just actually finished doing the work and so we're going to operationalize it over the coming weeks and months. But the focus was to look at stores that are losing money, okay, and figure out what is the best solution. So, as Galen mentioned, some are going to be converted, a few will be closed, and also some will be downsized. So that's the piece of work that we've just completed. But also we're also going to look at new store opportunities. Like we see significant opportunities to build new stores in Canada, so that's also part of this exercise. So, as you can imagine, this is not something that you just do in two months. But we have laid out the foundation of that work and we're going to get going quickly because we want to have stuff that can hit our numbers in 2022. And so those are probably going to be more the conversions, because that requires not much capital, and you can quickly turn a store that's negative to positive from an earnings perspective and you get the lift in your numbers right away.

Patricia Baker — Analyst, Scotiabank

Okay. Thank you. That's very good. So, just following up on Michael's questioning on the pricing gap and that you indicated that the gap between yourself and the competitors is better than it has been in years, have you seen no response from the competition to your price investments?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Well, it depends on the competitor. And I think there have been different strategies undertaken through COVID. Our strategy, as I think we've repeated on a number of occasions, was to make sure that we were delivering the right level of value to our customers across both formats. And this was an opportunity that we identified on the market side before COVID happened and we made the decision to lean into it during COVID at a time where there was a good strong tailwind behind the market division. So I can't comment on competitors' strategies other than to say that we've seen a different approach from them over the last 12 months in the market segment and ultimately it's been working very well for us to date.

On the discount side, when you're a discounter, your biggest opportunity for customers is to have great prices, and there are pretty strong competitors who have a similar philosophy to us, like Walmart and others, and we're staying very cognizant of how aggressive they will be over the next number of months. But if you think about the discount businesses, they're all going to do better over the next number of quarters and that's something we're looking forward to.

Patricia Baker — Analyst, Scotiabank

Okay. Thank you very much. And if I may ask one last question, it's on the gross margin. So obviously mix was a big driver of that 128 basis improvement. Were there also benefits to the gross margin from specific things that you're doing operationally as well?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

The biggest increase in rate, Patricia, was just when you compare to last year. Like last year our GP rate was much lower on the food side and so that's been fixed like later in last year, so that's why we're anchoring our performance on 2019. Like for us, from my perspective, like we were there more or less in Q1. So we've just continued the same strategy from a gross margin perspective and so when you compare it to last year that's why it created that gap. So we're focused on the level of our gross margin now and that's what gives us confidence that going forward we should be able to maintain it.

Patricia Baker — Analyst, Scotiabank

Okay. Thank you very much.

Operator

Your next question comes from Vishal Shreedhar of National Bank. Please go ahead.

Vishal Shreedhar — Analyst, National Bank Financial

(Inaudible). Just on the new (inaudible), specifically Robert Sawyer, you offered some fairly complimentary comments on him. Just wondering how long we should expect him to be in the role in your view and his view. Is it a longer-term placement or more of a shorter-term placement?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Yeah, so he's committed to a couple of years. And I think I've said that publicly. And hopefully it'll be longer, but he has come out of retirement to do this job and he's committed fully to a couple of years and we're fully committed to him for that period and I think that's the way to think about it.

Vishal Shreedhar — Analyst, National Bank Financial

Sure. Will the COO role stay in place after those couple of years expire?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

Never say never, but yes. It's a really important part of the way that we run this business. You know, Loblaw is a big company that does a lot of things and to have someone providing very experienced permanent oversight over the retail operations, I think, is an essential element of how we need to run this business.

Vishal Shreedhar — Analyst, National Bank Financial

Okay. With respect to just the market reaction, I mean inflation is starting to creep up, sales are going to turn negative in grocery just given a difficult comparison. It seems like, from a high level looking down, that could be a fairly difficult situation to manage. I know Loblaw said they're focusing on the dollars. Just wondering how you're seeing your competitors react to this more difficult type of outlook. Are they reacting with price as an initial driver or you're still seeing those varied strategies persist?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

I mean it's very early, right, in terms of this and nobody really knows what it's going to look like. I mean Richard shared our first four weeks of sort of post Q3, which are giving us a strong indication. Look, I think the message from our perspective is, in the same way that our business was disadvantaged during the peak of COVID, it will be relatively advantaged as we come out of COVID. And that's because of our strength in discount and it's because of the role of Shoppers Drug Mart in our overall mix and the improvement in margin that we expect to come out of those categories that underperformed during COVID and will come back during that normal period. So I think for us that's the most important thing and then that laser focus on maintaining the right margin structure and maintaining the right dollar level of SG&A.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yeah, Vishal, what I would add, we issued an outlook where essentially we said we're going to grow EPS this year between 20% and 25% of that effectively what we said. The implication of that is that, despite the fact that we're going to see negative sales in food, we are going to grow earnings in the second half. So our financial framework is something that we want to be very focused on, so we see a good path for the rest of the year and the framework will form the basis as to how we put together our budget for 2022. So, despite this negative sales environment, our plan is to deliver on that framework.

Vishal Shreedhar — Analyst, National Bank Financial

Thanks for the colour.

Operator

Your next question comes from Chris Li of Desjardin. Please go ahead.

Chris Li — Analyst, Desjardins

Good morning. Just maybe another follow-up question on gross margin, I apologize, because it's such a big beat compared to my estimate. Is it fair to say that the underlying margin rate improvement would have been even stronger if it weren't for the ban on nonessential product sales in Ontario during the quarter?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

That's a good one. I'm just thinking about that. Like for me it was more relative to last year, because if you look at our gross margin rate this quarter versus Q1, it's not that different. So our strategy is try to maintain our gross margin level there. So, as to what changed versus last year, you're comparing two very different, I guess, eras from a grocery perspective, so I think it's a little bit more difficult to do the comparison that way.

Galen G. Weston — Chairman & President, Loblaw Companies Limited

And I think it's probably also worth remembering that that nonessential product assortment, for us, is pretty small in the overall mix of our business. So, for it to materially impact the business, the change would have to be very, very significant. And, as you know, we only call it out on the basis of big changes once in a while. It was the combination of Rx, OTC, and apparel that contributed to the mix, not just that right-hand side, which is the part that was constrained during much of the quarter.

Chris Li — Analyst, Desjardins

Right. Okay. That's helpful. And maybe just related to that is just another driver I was thinking about was just the restatement of the click-and-collect fees, which were obviously discontinued in Q2 of last year. Was that meaningful or is it not meaningful enough for you guys to call it out?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

No, it was marginal. Positive, but marginal.

Chris Li — Analyst, Desjardins

Okay. And I know you don't have a crystal ball, but I mean is the gross margin rate improvement in Q2 a good proxy for what you can expect for the second half?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

You should not look at the gross margin improvement. You should look at the gross margin rate.

Chris Li — Analyst, Desjardins

Okay. So the rate improvement in Q2 is a good proxy for what we can expect in the second half?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

What I'm saying is that gross margin rate in Q2 should be a good proxy of the gross margin rate in Q3 and hopefully Q4. That's the plan.

Chris Li — Analyst, Desjardins

Okay. Gotcha. Okay. Maybe just another sort of boring number question, if I remember correctly, the non-controlling interest line in the income statement largely reflects the portion of profits which are attributable to your franchisees. It was a relatively high figure in Q2, I believe it was $56 million, which I think makes sense given the business improving and especially the discount division. I guess my question is do you expect the level of non-controlling interest number to remain relatively high in the second half as the discount division continues to improve?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

That's a good question. As to the precision of that number, it's tough for me to answer, but directionally you are right, because the discount business is better than it was last year. That's why the number is much higher than it was last year. So, assuming we maintain a similar level of profitability, it should remain in that zone.

Chris Li — Analyst, Desjardins

Gotcha. Okay. That's helpful. Maybe my last question is just on SG&A. Can you review for us maybe what are some of the major puts and takes in the second half? For example, like do you expect discretionary spending to start picking up again in the second half? And then related to that, the $20 million of incremental expenses related to connected healthcare, has most of that been spent or are they still yet to come? Thank you.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

I think that has been spent. As I said earlier, for us, the way we're looking at SG&A right now is we're looking at the dollars. So we have a plan that we want to hit and so the way to hit it is to look, yes, at rate, but, because sales are turning negative, you can't manage your business on rate. You need to manage it on cost.

Chris Li — Analyst, Desjardins

Sorry, maybe just one last one. You mentioned new store growth opportunities. Is that mostly for food or do you see opportunities like in the pharmacy space going forward as well?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

We see opportunity for new stores in both our food and drug retail businesses.

Chris Li — Analyst, Desjardins

Gotcha. Okay, thanks. Thanks very much.

Operator

Your next question comes from Kenric Tyghe of ATB Capital Markets. Please go ahead.

Kenric Tyghe — Analyst, ATB Capital Markets

Thank you and good morning. Galen, I wonder if I could just follow up with respect to the performance in B2C. Obviously, some encouraging comments on the recovery in quarter, but that's also on a pretty weak year prior. Can you just speak to sort of the expected part and evolution of your B2C business? I think last year you had the benefit of a lot of the health of health and beauty mitigating some of the pressures in cosmetics, which perhaps less of a tailwind through this year. But also, to that end, can you give us some indication as to how, through all of this, your share and prestige in mass or even just B2C more generally has trended over the last year?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

So, in a funny way, it's the reverse story of what's happening in food. So if you imagine our beauty business, we were one of the very few beauty retailers who were open through the bulk of COVID. The department stores were all closed, so on and so forth. So our market share skyrocketed. But the amount of money that people were spending on cosmetics dropped dramatically. So, net-net, it was a negative financial impact on the Shoppers Drug Mart business.

What's going to happen, we believe, with the sustained reopening, is that people start going out, people will start seeing one another, and so cosmetics and all of those external sort of beauty categories will start to come back in a very significant way. It will also be on the back of all of Shoppers Drug Mart's competitors reopening. So the entire water level is going to rise. Our objective is going to be to hold on to as much market share in those categories as we possibly can and we feel well positioned to do so, certainly to hold on to a meaningful portion of it, not all, and we're working hard to make sure that we do.

From a big-picture perspective, the way to think about the role of beauty is that it is a very high-margin contributing category and it is going to grow as the market reopens and that is going to have a notable positive effect on the overall margin of the business.

Kenric Tyghe — Analyst, ATB Capital Markets

Thank you, Galen. That's great colour. And just one quick further question for me. In discount and on sort of the migration back to discount on more normalized consumer behaviour, what sort of increase in utility or how useful has your Optimum program proved or been proving and how much more can you do to sort of lever those insights and expertise to make sure that, on that transition back to discount, that you're capturing every dollar in the most efficient way possible?

Galen G. Weston — Chairman & President, Loblaw Companies Limited

So maybe the way to think about this is through COVID you had a substantial drop in the price sensitivity of customers in the way that they made their shopping decisions and so our loyalty offers were less valuable in grocery shopping in particular than they would have been before COVID, because people weren't looking to save a dollar here or a dollar there and the algorithms that are designed to stimulate sales and loyalty, as a result, were less effective. As price sensitivity returns to the marketplace, those algorithms will become more effective, and we are seeing that now. So the wave of algorithms that we built at the end of 2019 that were relatively impotent through COVID are now starting to generate the kind of return on sales that they were originally designed to. So yes, we think that loyalty will become more potent, especially when it comes to more efficient forms of promotion, and that will be part of the toolkit that particularly the two food divisions are expecting to leverage in the back half and then we're looking for some positive acceleration in 2022.

Kenric Tyghe — Analyst, ATB Capital Markets

Thanks very much. I'll leave it there.

Operator

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

Peter Sklar — Analyst, BMO Capital Markets

Thanks. So I'm still looking for some clarity on this gross margin improvement you've had. You said, like, Richard, you said we should really anchor it to 2019 to remove the COVID effect. And when you look at that, your gross margin is still up 100 basis points versus two years ago. Now, in your explanation you did say that the fresh counters are contributing to the gross margin, but those high-margin counters would have been open two years ago, so that kind of leaves us with mix. You did explain how you are getting some favourable mix. So is it all this mix effect that is helping your margin versus two years ago and is that mix effect sustainable? Or are there structural changes that have happened? So I'm just kind of looking for more clarity in that kind of discussion, if you don't mind.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yeah, there's not been any structural change. It's essentially mix and merchandising that allowed us to deliver this margin. So, nothing more than that. And so that's why we're trying to anchor everybody there, because that's how we are looking at it. But that's it. And don't forget one thing, Peter. Like one thing sometimes that you forget is like the scale of each of our business, like if you look at our Shoppers business, it represents 40% of the EBITDA of the whole enterprise, so that's something that has, it's a bit of, not a lever, but the gross margin of Shoppers is significantly higher than the business in food, so it moves the needle when you compare both businesses and when you look at the gross margin rate consolidated of Loblaw.

Peter Sklar — Analyst, BMO Capital Markets

I know, but what has changed in the mix, Richard, versus two years ago? Has there been a permanent change in the mix or is this just a temporary change in the mix? Like I mean Shoppers was 40% of the business two years ago as well.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

No, you're right. I think we devised a level of margin last year, as the year was progressing, that we felt comfortable with that allows us to continue to gain share and be well priced. And we like that level, so we feel we can sustain it. So that's why we're sort of exhibiting this confidence we have with our rate right now. And the difference, the only thing I have in my head versus 2019 is mix. Like it's not anything more that we did structurally to the rate.

Peter Sklar — Analyst, BMO Capital Markets

And do you think that mix change is sustainable?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

We think that level of gross margin is sustainable.

Peter Sklar — Analyst, BMO Capital Markets

Okay. Okay. And then just lastly then, in terms of your outlook for that 20% to 25% EPS growth, Richard, does that assume the buyback in the second half of the year is kind of at the same level of what you did in Q2?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Like we said to the market that we buy about $1.1 billion and that's our plan. And we spent $700 million, so we theoretically have $400 million left. So that's what we have in our outlook calculation.

Peter Sklar — Analyst, BMO Capital Markets

Okay, great. Thank you.

Operator

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

Michael Van Aelst — Analyst, TD Securities

My follow-up has been answered. Thank you.

Operator

Ladies and gentlemen, as a reminder, should you have a question, please press the star followed by the one.

Mr. MacDonald, there are no further questions at this time. Please go ahead.

Roy MacDonald — Vice President, Investor Relations, Loblaw Companies Limited

Thanks very much, Michelle, and thanks, everybody, for your time this morning. You know where to find me if you have follow-up questions and mark your calendars for November 17th for our Q3 results call. Have a great day.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.