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Loblaw Companies Limited

Second Quarter 2022 Earnings Conference Call

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Loblaw Companies Limited Second Quarter 2022 Results Conference Call.

This call is being recorded, Wednesday, July 27, 2022.

I would now like to turn the conference over to Roy MacDonald. Please go ahead, sir.

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

Thank you very much, Michelle, and good morning, everybody. Welcome to the Loblaw Companies Limited Second Quarter 2022 Results Conference Call.

As always, I'm joined here this morning by Galen Weston, our Chairman and President, and by Richard Dufresne, our Chief Financial Officer. Before we begin the call, I want 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 impacts 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 expectations. These results and uncertainties are discussed in the company's materials, filed with the Canadian Securities Regulator.

Any forward-looking statements speak only as of the date they're made and the Company disclaims any intention or obligation to update or revise any forward-looking statement, 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. Please refer to our annual report and other materials filed with the Canadian Securities Regulator for a reconciliation of each of these measures to the most directly comparable GAAP financial measures.

With that, I will turn the call over to Richard.

Richard Dufresne – Chief Financial Officer, Loblaw Companies Limited

Thank you, Roy, and good morning, everyone. I'm pleased to report that our performance in the second quarter continues to build on our positive momentum. Our business mix is well positioned for the current environment and our focus on retail excellence is delivering steady and consistent operational and financial performance.

During the quarter, we delivered solid top and bottom line performance. We continued to focus on delivering value to consumers and carefully managing our expenses, all part of retail excellence. On a consolidated basis, revenue grew by 2.9%, Adjusted EBITDA increased by 9.3%, and adjusted earnings per share grew by 25.2% to $1.69 a share.

Our GAAP earnings reflect a charge of $111 million associated with a recent tax court ruling relating to the deductibility of certain loyalty related expenses over the last 13 years. We are planning to appeal the ruling.

In Drug Retail, absolute sales increased 7%. Same store sales we're strong, up 5.6% lapping an increase of 9.6% last year.

Front store same store sales grew by 5.2%. We continue to see an acceleration in sales growth in our higher margin categories led by OTC and cosmetics. Sales and beauty and cosmetics are essentially back to pre-pandemic levels. Pharmacy same store sales grew 6.1%. Although we are seeing an acceleration in both acute and chronic prescription volumes, we have not yet caught up to normal levels.

Once again, growth in our pharmacy services business was strong with all major categories showing double-digit growth. Pharmacy services now include our Lifemark business, which closed on May 10, contributing $49 million in sales. In Food Retail, absolute sales increased 1.2% and same store sales group 0.9%.

Performance in our discount banners continue to strengthen, reflecting an ongoing shift in favour of discount. As part of our store network optimization initiative, we now have five stores that have been converted from market to discount and have downsized one market store. We are pleased to report that all such projects are performing ahead of plans on sales and therefore, are contributing to earnings.

Our market banners remain strong and continue to perform well. A great in-store offer, enhanced by optimized promotion using our data, have led to positive traffic trends and solid sales. Online sales in the quarter decreased by 17.5%. However, our online business continued to operate at penetration levels well above pre-COVID rates.

We are seeing consistent, stable, operational performance and pickup in growth and delivery. We are delighted with our launch of PC Express Rapid Delivery through a collaboration with DoorDash. The service will launch in Q3 and will not represent a headwind to earnings. Retail gross margin in Q2 was 31.4%, up 50 basis points compared to last year, driven by our Drug Retail business.

Higher margin front store categories, particularly cosmetics, grew substantially as customers returned to offices and social settings. Margins also benefited from growth and pharmacy services with COVID related services remaining strong. Gross margin performance in Food Retail was stable. Our unique data, less our merchants, set more strategic pricing and promotion levels. With grocery inflation as it is, this is an important balancing act.

As a result, today, and for the last quarter show, our businesses are doing well and remain profitable. They all also show that this improved performance has resulted from the return of customers to our higher margin beauty and drug businesses and the fact that increased pandemic costs are slowly going away.

Retail in G&E as a percentage of sales was 19.9%, an improvement of 30 basis points compared to last year. We lapped higher COVID costs in the prior year and continue to benefit from sales leverage, food to drug sales mix, and operating efficiencies. This was partially offset by higher labour costs across the network.

Adjusted retail EBITDA increased by $129 million or 9.8% in the quarter, yielding a margin of 11.4%. We were pleased with PC financials performance in the quarter. Revenue was up $25 million, driven by higher interchange and interest income with a broad-based increase in customer spending.

Contribution to Adjusted EBITDA from the bank was flat as we lapped last year's gain related to reversal and expected credit losses reserves and saw higher points cost due to higher PC points redemption. On a consolidated basis, Adjusted EBITDA margin was 11.7% in the quarter, up 70 basis points compared to last year.

In Q2, we repurchased $607 million worth of common shares representing 5.4 million shares. This brings year-to-date purchases to $755 million. Looking ahead, macro factors continue to make forecasting challenging. We are seeing signs that inflation as, or will soon peak. As such, we expect inflation to moderate in the second half of the year as we begin to lap higher levels from last year.

Commodity price are coming off their highs, some freight costs are coming down, and supply chain issues are normalizing other than fuel costs, which remain high but down from their peaks of last March. Finally, central banks are taking aggressive actions to tame inflation.

Today, we announced an increase in our full-year outlook. Based on our year-to-date operating and financial performance and momentum exiting the second quarter, we now expect full-year adjusted earnings per share growth in the mid to high teens. We have just cycled the first quarter of our 2021 strategic reset, delivering growth of 25% in EPS this quarter on top of 88% in the same quarter last year, is beginning to demonstrate that our plan is working.

Our focus on retail excellence is delivering strong and consistent financial results. While the environment remains volatile, Loblaw is well positioned for what is expected going forward.

I will now turn the call over to Galen.

Galen Weston — Chairman and President, Loblaw Companies Limited

Thank you, Richard, and good morning. I'm pleased with our performance in the quarter during this period of global financial uncertainty, prolonged pandemic caution, and global inflation. As Richard noted, our retail revenue performance was strong and consistent, with earnings growth linked principally to our Drugstore business.

Shoppers Drug Mart had an excellent quarter, generating high margin sales in beauty and cough and cold, while expanding pharmacy services for Canadian patients. These services and the pharmacists who deliver them are becoming an increasingly critical part of our country's primary care delivery network by providing expanded access to basic medical assistance at low cost.

As a matter of interest, as part of this evolution of our healthcare delivery strategy, last month, we opened Canada's first walk-in clinic, staffed exclusively by pharmacists. In a neighborhood with a critical physician shortage, this has been met with an enthusiastic local response. Our food business also performed well in the quarter with good sales and stable gross margins.

Our conventional market stores are competing well, consistently outperforming peers. This is in part driven by a strong relative price position and outstanding performance of several enhanced merchandising programs. The consumer shift to discounts also continues and is substantially benefiting our hard discount formats, where we see new customers coming through the doors every day.

As you know, inflation remains a significant external force shaping business performance. However, as Richard mentioned, we are seeing some signs of stabilization. Commodity costs are substantially off their highs and transport and freight rates are improving. Having said that, supplier costs are still high, putting sustained pressure on retail prices.

We continue to work hard to reduce their effect for our customers. This includes operating two of the lowest price formats in the country with No Frills and Maxi, investing in our famous low priced private label brand, No Name, the second largest consumer brand in the country and seeing historic growth. Not to mention, the over $1 billion of savings our customers will earn this year through our PC Optimum program. In fact, we just completed a piece of work which showed that customers who engage in the full benefits of the PC Optimum program are consistently saving as much as 10% on their grocery bill.

Touching on one more retail trend, Digital sales continue their retreat off pandemic highs, and we expect to return to ecommerce growth once we fully cycle the last of that COVID demand, and continue to improve and expand our offer.

Delivery is growing as part of our channel mix, and in Q2, we announced our partnership with DoorDash to serve as our primary last mile delivery solution. This relationship includes an exclusive presence on their marketplace and the introduction of a 30-minute Rapid Delivery service. We remain bullish on what's to come.

Loblaw's purpose is to help Canadians live life well. As the country's largest private employer, we endeavor to do that every day through innovative products at great prices, convenient access to high quality healthcare services, the country's best credit card and high quality apparel, but it is often the smaller activities of our teams that can make the biggest difference. I wanted to close my remarks with a particular example that stood out.

At the start of the invasion of the Ukraine, a small group of colleagues stepped forward, interested in how we could contribute to the humanitarian response. As a company that marshalls nearly a hundred million dollars a year to give back to local communities, this group of colleagues started with the question, how can we better support those who are building a new life in Canada? They observed that the diversity of our business put us in a uniquely compelling position to do so.

In the month since, our team has partnered with government, NGOs, and our customers contributing and raising millions in support to provide the building blocks for families who have lost life's most basic ingredients, including jobs, food, wellness, clothing, and financial products, a near perfect manifestation of our purpose.

At Loblaw, we continue to execute our strategy in the midst of a challenging period. We remain confident in our short-term outlook and our longer-term opportunities.

Thank you. I'll now open the call for questions.

Q & A

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

Thank you, Galen. Michelle, could I ask you to remind the participants the protocol for asking a question?

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Your first question comes from Mark Petrie of CIBC. Please go ahead.

Mark Petrie — Analyst, TD Securities

Yes, good morning. I wanted to ask about the retail gross margin. I know generally, you've been talking about sort of stable trading or stable gross margin, but mix is clearly a pretty favourable tailwind, and you also have media as another tailwind as it becomes more material in the coming year.

Can you give us a sense of the magnitude of the mix impact and sort of your implied medium term outlook across channels? Is there an overall number that kind of makes sense to shoot for just understanding that mix piece? I mean, 32% would seem like a good target. Just sort of wondering how we should think about a longer term kind of margin outlook.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Hey, good morning, Mark. No, we don't have a specific target as to where we want the gross margin to go. We're just trying to manage our business the best way we can, but we do feel good about our gross margin position now and then going forward.

Mark Petrie — Analyst, TD Securities

Okay, and perhaps you could just talk a little bit about some of the bigger picture opportunities for that margin. I mean, media is one that's come up and I can't imagine you're going to give specific disclosure on that, but directionally, anything would be helpful.

Also, the puts and takes in the Shoppers business, because clearly, the recovery in the Front Store is helpful, but the Pharmacy services is presumably going to be somewhat of a headwind in the second half of the year. Just sort of curious how you're thinking about the margin opportunity at Shoppers.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes, the key driver of gross margin, going forward, that will continue to be retail excellence, and running our retail business as best we can. Talking about Shoppers specifically, like obviously, mixes helped. We're going to see growth taper a bit because if you look at services, they were starting to grow at this time last year and accelerated in Q3 and Q4.

We're not going to see the same trend this year, but we do feel very good about our services business for the overall of the year. Therefore, we should not see significant increase in margin as we've seen so far there. It's going to start to slow down.

Mark Petrie — Analyst, TD Securities

Okay, and if I could just add one more, it was another good quarter in terms of OpEx management, particularly in the cost of inflation, but given the nature of your labour contracts and the longer duration of those contracts, how do you think about the outlook for SG&A over the medium term? I mean, should we be expecting above average inflation to be stickier in OpEx and potentially last longer than in other parts of your operations?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes. I think the organization has done a good job at managing SG&A so far, but it's important to point out that last year, at this time, we were still in lockdown. So, a big improvement in SG&A in this quarter has to do with just lapping those costs. We're going to come into a more normal environment going forward, but we do feel good about our ability to manage SG&A going forward.

Mark Petrie — Analyst, TD Securities

Okay. Thanks for the comments. I'll pass the line. All the best.

Operator

Thank you. The next question comes from Irene Nattel, RBC Capital Markets. Please go ahead.

Irene Nattel — Analyst, RBC Capital Markets

Thanks and good morning, everyone. I'd like to spend just a few minutes talking about the same store sales number because with inflation at 9.6%, I think we were all expecting a slightly stronger same store sales number, but of course, the offset is channel shifts and mix shifts. Can you please talk about what you're seeing, how you view same store sales, what consumer behaviour is, and how that all comes together?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Good question, Irene. I think it's important to reflect on what's been happening, more last year than this year. First of all, we're very pleased with our sales trajectory as it's going right now, but if we go back last year, at this time, we were—and Q2, we were in full lockdown, and unit counts, when we were locked down, benefited.

When we get into July of next year, that's when essentially all restrictions got lifted. People essentially started to go out significantly and we saw marked dropped in our unit count starting last summer, which has continued throughout this year.

As we move into Q3, we're going to be cycling these unit counts, and you're going to see a marked shift in same store performance, which does not mean anything other than what happened last year because we don't see a change in our sales trajectory going forward. Does that help?

Irene Nattel — Analyst, RBC Capital Markets

Yes, that helps. Just to make sure that I'm clear, it's not so much that your revenue run rate is changing Q3, it's just that on a year-over-year basis, the growth looks better. Is that the way to think about it?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

That's exactly the way to look at it because in Q2, we were—essentially, it was the first quarter that we essentially had no lockdown restrictions at all. We were comparing it to a quarter last year where we are all stuck home. That's why you see a same store sales figure that is lower.

As we get to Q3, you're going to start to see a sales performance that reflects people starting to go out. So you're going to see a marked increase in cough performance starting Q3. We're in Q3 now and we're seeing it, so that's what I think the street needs to appreciate.

Irene Nattel — Analyst, RBC Capital Markets

That's helpful. Richard, can you talk—or Galen, can you talk a little bit about what you're seeing in terms of consumer response to inflation, the magnitude of the channel shift, how much trade down are we seeing, and just in terms of branded private label, but also, just among categories and anything that you can provide would be very helpful.

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes. Irene, I know you ask this question every quarter and I think I give largely the same answer. The trends today are essentially the same as they were in Q1, which is that shift to discount continues at pace. Price sensitivity is growing. Promotional intensity is a little bit higher.

As I mentioned in my remarks, we're seeing control brand growth across the board, both at President's Choice and at No Name continuing to accelerate. We are seeing what I call kind of volatility in how people are trading protein depending on the price in any given period. So, there's really not much more to say than that. Those are the trends, and it might be a little bit more meaningful today than it was in Q1, but the trends are largely—are directionally all identical.

Maybe I'd add just one more incremental bit of context. We do, through our financial services business, still have a pretty good indication of the health of our consumer and payment rates remain at historic high levels, which suggests that at least with a large subset of our customers, they're still in reasonably good financial shape. That is a, call it a buffering effect on inflation.

Irene Nattel — Analyst, RBC Capital Markets

That's helpful. Thank you, and then just one final one, sticking with consumer behaviour, obviously, market—Walmart shook up the market earlier this week around their commentary. Anything you can share with us on what you're seeing in the right hand side, the store, whether it's Joe or just the general merchandise more broadly defined?

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes. I mean, a couple of highlights. Joe Fresh business was positive in the quarter, although we are starting to see a little bit of softening in that as we look forward. The right hand side, outside of apparel, was notably down and it definitely had a drag on our overall comp sales result.

The key in this circumstance is inventory, and so the question is, how do you feel about inventory and do you have aggressive markdowns that you need to put through to clear that inventory? The answer is, we feel good about inventory and we don't see any meaningful margin risk associated with clearing what's left.

Irene Nattel — Analyst, RBC Capital Markets

That's great. Thank you.

Operator

Thank you. The next question comes from Michael Van Aelst of TD Securities. Please go ahead.

Michael Van Aelst — Analyst, TD Securities

All right. Great. Thank you. Just going back to Irene's questions around trade down and shift to discount and private label penetration increasing, how do those factors impact your same store sales? When you calculate your inflation and compensation, is it on just a unit-by-unit basis, or does that inflation take into consideration the trade down in proteins and the shift to discount and things like that?

Richard Dufresne – Chief Financial Officer, Loblaw Companies Limited

Inflation captures everything, Michael. I think it's tough to answer your question, but it's prevalent throughout our business. We're seeing a bit less in private label than in other categories, and on the commodity stuff, it fluctuates like it has always done. Always.

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes. Simply put, we use an internal proxy. We look at CPI and then we look at our version of that basket to calculate our internal inflation. In that respect, it wouldn't take into account the mix shift, but we also look at a series of what I'd call kind of supporting metrics to triangulate the number which are much more inclusive and would capture a portion of the mix shift for sure. Does that help answer the question?

Michael Van Aelst — Analyst, TD Securities

Well, so I understand and so it's clear, so the inflation is capturing the actual unit price changes, but your trade down in proteins and private label, that's more being captured, I guess, within the de facto tonnage number that everybody calculates?

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes. I mean, think about the—looking at the average article price across the entire enterprise and what's happening in terms of its change, it's not specifically weighted for volume if you understand what we're saying.

Michael Van Aelst — Analyst, TD Securities

Yes. Okay. All right. That's helpful, and can you guys give us an indication of how much inflation is impacting the Front Store Pharmacy?

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes, it's about the same. I mean, there's not as much inflation in health and beauty, but certainly, we see the same inflationary pressures in all the consumable goods in the front shop of Shoppers Drug Mart. So that's a positive contributor for sure.

Michael Van Aelst — Analyst, TD Securities

If front store's 5.2% total same store sales growth, are you getting tonnage growth or unit count growth?

Galen Weston — Chairman and President, Loblaw Companies Limited

Well, we are because we're seeing substantial growth in key categories that are all driven by units. Think about flu cold medications, we're seeing major unit growth in cosmetics, substantial unit growth. All things that were essentially declining categories last year.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes. COVID brought so much volatility in front store and pharmacy that it's tough to look at it like we look at it at food, but these categories are coming back. Right now, cough and cold, it's like we're in the middle of winter. So, this is sort of an unusual phenomenon.

Michael Van Aelst — Analyst, TD Securities

Okay, great, and just finally, on the network optimization, I think you had 17 stores originally identified for either banner changes or downsizing. You mentioned five at the start of the quarter. I can't remember what you might have had in Q1 if at all. What's left to do this year, and based on, I guess, what you've been seeing of the results, where do you see this number being in the future years, or even do you have any plans to expand that shorter term?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes. Mike, so it's probably a little bit less than 10 for the rest of the year. So we're going at pace. Obviously, it takes time to get all these projects going, but now, they're well on their way. So, over the next few months, we're going to be reopening a few every month, so that's progressing nicely.

Galen Weston — Chairman and President, Loblaw Companies Limited

Then if you think about network optimization as a general strategic principle, just keep in mind it's about adding new stores where there's high population growth and high potential for incremental sales. It's about converting banners to more optimal formats, and it's about downsizing stores and productively making use of the downsized space.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes. Since Galen is expanding, I'm just going to add one more thing to it too. New stores takes a little bit more time to get going. So, you're going to see more new stores than typical more next year. Same for downsizing, it takes more work to get to agree to a downsizing, like, where are you going to do the downsizing? Who's going to come in the extra space, but those are also getting momentum.

So, this year, you're seeing way more conversions because those are easier to effect. That's what the bulk of what you're going to see until the end of this year.

Michael Van Aelst — Analyst, TD Securities

All right. Thank you.

Operator

Thank you. The next question comes from Patricia Baker of Scotiabank. Please go ahead.

Patricia Baker — Analyst, Scotiabank

Yes. Good morning, everyone. I just want to come back to the discussion on the retail gross margin. Obviously, Shoppers mix had a very nice impact in the quarter. You indicated that the food retail margin was stable or flat year-over-year. That's been a trend that we've been seeing over the last several quarters, which is quite nice because we've had years of you talking about wanting to stabilize that margin.

When we think about, and you think about good Food gross margin, do you think that the Food gross margin is where you want it to be and that we should think about that that—that it will just remain in a stable range?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Patricia, we feel very good about our gross margin in general and both our Food and Drug segment. I don't want to comment more than that at this point.

Galen Weston — Chairman and President, Loblaw Companies Limited

Maybe I'll add just a—so, we did a lot of work over the last 18 months to—we've talked about this, to remove wasted investment in our kind of margin structure. That's been very helpful as a driver of growth in Food margin. Going forward, it's about optimization, and we talk a lot about data and we are still in the, call it the mid earning innings of that journey. There is opportunity to continue to get more efficient, but it will be at the margin more so than fundamental changes.

Patricia Baker — Analyst, Scotiabank

Okay. That makes perfect sense, and then just in your discussion of the network optimization, are you in a position, Richard, to give us a sense of what square footage growth you'd be looking for next year when you're opening new stores?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Not yet. Well, I'll have a good sense of that probably around Q4, Patricia, but our plans are sort of being put together as we speak.

Patricia Baker — Analyst, Scotiabank

Okay. Fair enough, and then just the last, Galen, I am intrigued by the walk-in clinic staffed entirely by pharmacists. I think that's a really interesting idea. I assume at this point that's a pilot project, but you probably see opportunities, depending on how it performs, to roll out more of these at some point in time? Then can you just talk a little bit about what sorts of services those pharmacists are providing in that location?

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes. Starting with the principle of increasing, call it, basic primary care delivery pharmacists, the biggest potential for that is within our pharmacies, and the biggest potential for that is within Shoppers Drug Mart pharmacies. What we're doing with—what we're doing in this town with this dedicated clinic is we are taking over excess space inside a superstore and we are testing an expanded service experience.

We have four consultation rooms, we have four pharmacists, and we are seeing patients on a very, very frequent basis. The way to think about the future is, as the provinces get more confident in expanding the scope of practice for pharmacists, we see an opportunity to have selective dedicated locations that can provide a health clinic-like service delivered by pharmacists.

In terms of the types of services that they are delivering, it's the same things that you have heard us talk about before. It's minor ailment prescribing, cold sore medications, strep throat UTIs, and travel vaccinations, all the sort of the basic levels of care that pharmacists are trained to administer and to deliver.

The single regulatory barrier to that happening on a provincial level is working with the government to expand the scope of practice for those pharmacists, and as I think we've also mentioned, we are expecting to see 12 new expanded practices coming to Ontario before the end of the year. So there's, we believe, some runway ahead to help improve substantially access to care for Canadians by leveraging what pharmacists are already trained to do.

Patricia Baker — Analyst, Scotiabank

Okay. Thank you very much. Sounds really interesting.

Operator

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

Vishal Shreedhar — Analyst, National Bank

(Inaudible) questions. I was hoping you could give us some perspective on the Food market share between restaurants and grocery stores. Do you anticipate the restaurant industry to take more share back, or is that largely stabilized similar to the cosmetic trends that you called out earlier in the quarter?

Galen Weston — Chairman and President, Loblaw Companies Limited

Well, maybe I'll comment directionally as opposed to with specifics because these things are all moving with multiple forces sort of putting pressure on them. Without question, when the world opened up, you saw a flood of customers going into restaurants. That has a natural dampening effect on retail grocery sales.

Of course, as prices go up, prices are going up higher in restaurants, higher and faster in restaurants than they are in grocery stores. That has the opposite effect, which is, it starts to push people back into the supermarkets where they are looking for a value added equivalent to a restaurant meal. One of those merchandising programs that Richard and I touched on in relation to our market division has been the sustained and accelerating success of our entire value added meal program.

We've done a lot of work in that space and are really, really pleased with the results. One of the things we think is driving that is that you can get a fresh prepared salmon dinner that can serve four for

15 bucks, and you'll never get that at a restaurant. That is a big part of where we see opportunity for customers as food prices continue to go up.

Vishal Shreedhar — Analyst, National Bank

Okay. Just changing gears here, as you look at your in-stock positions and labour staffing in stores, are they at adequate level now?

Galen Weston — Chairman and President, Loblaw Companies Limited

Well, they should always be better, but yes, they've improved substantially over the last three or four months. We are always focused on in-stock physicians, but it's no longer what we would consider a critical issue for the enterprise, which is a good sign. It's not back to pre-COVID levels, and that's a function of the continued disruption in manufacturing that's out there, but the teams are managing pretty well.

When it comes to labour availability, that is a material pressure. We've talked about it before. It tends to be in pockets rather than sort of system wide. Certainly, this summer, it's been a challenge in our distribution centers in certain parts of the country, and we're working hard to backstop that. At the moment, we don't see labour availability as a material disruptor to our ability to do business.

Vishal Shreedhar — Analyst, National Bank

Okay, and you commented on the conventional banners. Is it fair to say that conventional banner performance was negative? And how is that trending most recently and how does management feel its performance of conventional banners is versus peers? I know you indicated some colour on them in your disclosure.

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes. Well, there's no question that volume is shifting out of the market segment, the conventional segment, and into the discount segment that is impacting our business. We look at our performance relative to peers, as you ask, and we're very comfortable, in fact, very pleased with the way that our market division is performing in that context.

Again, it's hard to comment on whether we're positive or negative because as Richard mentioned, how you cycle through last year's volatility has a very meaningful impact on what your sales growth actually looks like. It's been both negative and positive, that's the (inaudible) the matter, but as Richard said, the actual sales dollar rate has been pretty consistent.

Vishal Shreedhar — Analyst, National Bank

Okay, and with respect to how the customers have gone back to discounts similar to pre-pandemic levels, do you anticipate that trend is going to be sticky or the customers that that segment has won, or do you anticipate there could be a return back to elevated levels of conventional?

Galen Weston — Chairman and President, Loblaw Companies Limited

Oh, I think it moves—remember, we've got extraordinary forces out there. We've got unprecedented levels of inflation. We have all kinds of different things going on in terms of the economic confidence and the money that people have in their pockets, but the macro trend, if you look back over the last 10 years, is that the discount segment has been growing largely faster than the market division. I would say that trend is likely to continue if you were to fast forward over the next 10 years.

Vishal Shreedhar — Analyst, National Bank

Thank you for the colour.

Operator

Thank you. The next question comes from Chris Lee, Desjardins. Please go ahead.

Chris Li — Analyst, Desjardins

Oh, hi. Good morning. Galen, just maybe a follow-up to the last question. When you mentioned that conventional is outperforming your peers, just curious, what data are you basing that on? Is that the Nielsen data? Secondly, can you call some of the initiatives that are helping you drive that outperformance? Is it mostly in your strong own brand portfolio and your loyalty program? Thank you.

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes, I think you've answered the question. We use Nielsen to measure our share and our relative share performance, and the merchandising programs include what I mentioned, which is the value added food program. It's very, very effective activation of PC Optimum in our market stores.

Certainly, we would say, and I would say, given my own exposure to our stores, our operating conditions today are more consistent, you know, than they have been in the past, which is contributing very positively. Then control brand. I mean, I don't know the last time you went into one of our stores. We have a big No Name program running in the supermarkets, the conventional business today, and it's been a terrific success for us.

Chris Li — Analyst, Desjardins

Yes. No, that's helpful. Another question maybe on Shoppers, you mentioned earlier that the sales of the high margin front store categories are now pretty much back to pre-pandemic level. Is that also true for the gross margin level for the Shoppers business overall? Has it also returned to pre-pandemic level or is it still below?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes. Gross margin in front of store is back to normal. Pharmacy, we still have some work to do.

Chris Li — Analyst, Desjardins

Okay, and the last question is maybe a longer term question. As we look out to next year, there's maybe a potential for some deflation. When I look back at the last deflationary period in late 2016 and first half of 2017, Loblaw actually, I think, managed to achieve very solid earnings growth supported by tonnage growth, effective promotions, and good expense control.

I know you don't have a crystal ball, but just wondering, do you expect this to be the case again this time, especially with some of the retail excellent initiatives that are in progress right now?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Well, for us, we're always thinking about building solid plans for the years coming, and that's what we're working on right now. The team is all aligned so that we can deliver on our financial framework for 2023.

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes, I think Chris, yes, we're pretty—historically, we've had a good track record of performance in deflationary or low inflation periods. I think that may be partly because we have such a big discount business and it's very good at managing SG&A and leveraging volume. In terms of predicting what inflation's going to look like next year, that is still hard for us to get a grip of, but if it were deflationary, we're not concerned about our ability to deliver in that environment.

Chris Li — Analyst, Desjardins

Okay. Thank you.

Operator

Thank you. Your next question comes from Kenric Tyghe, ATB Capital Markets. Please go ahead.

Kenric Tyghe — Analyst, ATB Capital Markets

Thanks. Good morning. Galen, focusing for a minute on the beauty business, you called out the strength in the recovery and beauty and cosmetics. Can you just sort of speak to the supply chain and how suppliers are actually responding given the pace of that recovery and that it's not a recovery unique to Loblaw, but the broader market?

Is there any risk there with respect to the beauty business that you end up sitting in a position in the back half of this year where suppliers are simply unable to keep up with the pace of that recovery, or are you comfortable with sort of supply conversations in beauty and cosmetics, given how important they are to the margin profile and what lift they provided in the first half?

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes. Today, we're not concerned about the—look, the availability of the product is not perfect because the beauty vendors are struggling with a lot of the same general supply chain issues that the rest of the market is. But we don't see a shortage, if that's the question you're asking, materializing here. This is a return—well, for the most part, it's a return to normal as opposed to a major demand surge.

It just felt so far during the COVID period. The one place that just anecdotally we've been mystified with, is there's tremendous strength and fragrances, and we are kind of wondering what people are doing with all of those perfumes, but that's the only place where it might be running a little ahead of that return to normal.

Kenric Tyghe — Analyst, ATB Capital Markets

Thank you, Galen. So short version, groceries and retailers are much better at managing a return to normal than airlines. Apparently, they weren't caught quite as off guard is what I'm hearing. Fair comment?

Galen Weston — Chairman and President, Loblaw Companies Limited

Well, look, we believe so.

Kenric Tyghe — Analyst, ATB Capital Markets

Fair enough, and then just one more quick one for me. Richard, I heard you calling out the higher PC points redemption in the quarter. How material was that in terms of the underlying or sort of fundamental shift in behaviour, and how do you think about the, not just the evolution of that through the back half, but managing elevated points redemptions through the back half?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes, the elevated redemptions starts with us issuing more points. Our merchandising team throughout the organization are beginning to see more traction and more benefits of using loyalty, so they're using it more.

We saw a marked increase in the issuance, and because of the current environment with inflation, it's also affecting redemption. So, this is something that we're really happy about, and we hope to see more of it going forward. We expect to be issuing even more points in '23 than we have planned for '22.

Kenric Tyghe — Analyst, ATB Capital Markets

Great. Thank you. I'll leave it there.

Operator

Thank you. The next question comes from Peter Sklar of BMO Capital Markets. Please go ahead.

Peter Sklar — Analyst, BMO Capital Markets

Good morning. Back on the consumer, so your basket is down despite the basket inflating 9.5%. Now, Richard, in your comments, you seem to attribute that to the pantry loading that was going on last year when everyone was shut in, but I'm just wondering if you could also comment on the health of the consumer that's being squeezed by high food and fuel prices and just general overall inflation and has really less in their wallet.

I mean, would you attribute some of that to the weakness of the consumer? If you could just elaborate there, I'd appreciate it.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

The thing we're clearly seeing is new customers, so visits and number of transactions are up. If you go to our stores, you'll talk to store managers, they're seeing clients they've not seen in their stores for a long time. I think that's what's happening, that’s the more prevalent factor that's driving those metrics.

Peter Sklar — Analyst, BMO Capital Markets

So like, if your basket is down though, it's inflating 9.5%, your item count must be down dramatically. Isn't that true?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Item count has…

Peter Sklar — Analyst, BMO Capital Markets

I'm not sure how that relates to new customers.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes. Item count has been down since July of last year, but there's a significant shift in item count as quarter three begins because we're cycling what was like logged down last year.

Peter Sklar — Analyst, BMO Capital Markets

Right. Okay.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

So, we're not seeing significant change in trends on sales and tonnage going into sort of Q3 and in Q2, but to what you're comparing it with, that sort of creates all of this noise.

Peter Sklar — Analyst, BMO Capital Markets

Yes. I think what you're saying, you've now, in Q3, you would have lapped the pantry loading, so it's going to be more of a cleaner quarter.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes, and then towards the end of that quarter, we're going to start to cycle the beginning of inflation, so you're going to start to see that effect. Now we're starting to see the cycling of the unit count, and a month or two from now, we're going to be cycling the beginning of inflation.

Those are going to all be reflected in our comp, and we're going to have to explain what's happening specifically to understand what's going on, but the major point is that we're pleased with the trajectory of our sales at this point.

Peter Sklar — Analyst, BMO Capital Markets

Okay. Got it. Just last question on ecommerce that was down 17.5%. Assuming that you captured most of that decline and converted them to in-store shoppers at Loblaw Banners, I assume that's a positive because, I mean, you have less people running around picking and delivering to people's cars in the parking lot. Would that have had a noticeable, positive impact on margins or other operating parameters, or is it just something small at the margin?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

It's small at the margin, but your first assumption is true. We actually track the customers who've moved from online to in-store, and essentially, a large majority of them are back in store, but you're right. It's not a significant impact on our margin.

Peter Sklar — Analyst, BMO Capital Markets

Okay, great. Thank you.

Operator

Thank you. Our next question comes from Irene Nattel of RBC Capital Markets. Please go ahead.

Irene Nattel — Analyst, RBC Capital Markets

Thanks. At the risk of like really beating this horse, coming back to the whole issue of item count and item pricing, I just want to be very clear. If we take peanut butter, if I trade down from, let's say Craft to No Name, let's just say it's a 10% lower unit cost. Now that unit cost may be higher year-on-year, but overall, it's a headwind to your same store sales. Is it not?

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes, but we look at—yes.

Irene Nattel — Analyst, RBC Capital Markets

Okay. So, do you think that that—and again, Galen, obviously, what we're all trying to do is triangulate the 9.6% and the 0.9% to really understand, and I think we get that the comp is tougher in Q2, but I think what everyone's just trying to understand is whether you're losing share or not.

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes. No…

Irene Nattel — Analyst, RBC Capital Markets

Is it (inaudible) the bottom line?

Galen Weston — Chairman and President, Loblaw Companies Limited

Yes, and I think Richard did a very nice job trying to bring it back to the sort of the fundamental premise, which is there's a ton of comp noise and that noise is impacting the read of the results. We see it even more acutely because the opposite is the case right now in the way that the business is performing, and it's not a function in any meaningful change in the trend. It's just a function of noise on the comparables.

So, we will all be happier when we get through all of this cycling and we'll be able to see the numbers cleanly. The underlying performance from our perspective, we are very satisfied with, and that's the key message, and we expect that outlook to remain through the balance of the year.

Irene Nattel — Analyst, RBC Capital Markets

That's great, and then just one final question on that subject. Again, coming back to the Walmart commentary, based on your numbers, do you think you guys are losing market share to Walmart in Canada?

Galen Weston — Chairman and President, Loblaw Companies Limited

Well, on an overall market share basis, we are very confident about the trajectory that we're on. Certainly, Walmart, we're watching carefully. They've had some very strong quarters in terms of sales performance in their discount business.

When we look at our discount business performance today, Maxi and No Frills are particular highlights in terms of their performance, and so if I put it this way, we're less concerned about that GAAP today than we were say two months ago.

Irene Nattel — Analyst, RBC Capital Markets

That's great. Thank you.

Operator

Thank you. There are no further questions at this time. Please continue.

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

Great. Thanks, Michelle, and thank you, everybody, for your time this morning. I will be around waiting for your calls this afternoon. You can mark your calendars for November 16 when we'll be releasing our Q3 results. Thanks again. Have a great day.

Operator

Ladies and gentlemen, this does conclude the conference call for today. We thank you for your participation and ask that you please disconnect your lines.