

Loblaw Companies Limited

Fourth Quarter 2022 Results Conference Call

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PRESENTATION

Operator

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

This call is being recorded on Thursday, February 23, 2023.

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

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

Great. Thanks very much, and good morning, everybody. Welcome to the Loblaw Companies Limited Fourth Quarter and Full Year 2022 Results Conference Call.

This morning, as usual, I'm joined 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. These statements are based on assumptions and reflect Management's current expectations; as such, are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from our expectations. 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 day 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. 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.

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.

We're pleased to end the year with another quarter of consistent operational and financial results.

Our focus on retail excellence and careful management of expenses continued to deliver strong earnings growth. Our unique assets, value offerings, and promotional effectiveness continued to be reflected in the strong sales across our businesses.

On a consolidated basis, revenue grew by 9.8 percent; EBITDA increased by 12.8 percent, our highest quarterly growth in 2022; and earnings per share grew by 15.8 percent to \$1.76 a share. On a GAAP basis, our earnings per share reflected a 26.4 percent decline in the quarter as we lapped a one-time gain last year.

In Drug Retail, absolute sales increased 11.6 percent and same-store sales grew 8.7 percent, lapping an increase of 7.9 percent last year. Front-store same-store sales grew by 11.5 percent. The strong cold and flu season and elevated demand for beauty products continued to drive growth in margin-accretive categories like cosmetics and OTC.

Pharmacy same-store sales grew 5.4 percent. Acute and chronic prescription performance levels are back on track. The slowdown in demand for COVID vaccines and testing was expected. However, we're pleased to see strong growth in other core pharmacy services like med reviews and flu shots, trending above pre-COVID levels and positioning us well for the future. Pharmacy services now represent a significant business for Loblaw, and we expect them to continue growing going forward.

In Food Retail, absolute sales increased 8.8 percent and same-store sales grew 8.4 percent. Improvement in our market share and strong traffic reinforced the belief that our offer is resonating with customers. In Q4, our internal food inflation was generally in line with CPI.

Our discount banners continued to perform well, with strong traffic and items count growth in our hard discount banners. We strengthened our discount position, having converted four additional stores in the quarter for a total of 11 last year, all with strong initial results. Going forward, in 2023, we plan to convert over 20 market stores to discount and plan to open some 30 new food and drug stores. Though discount continues to outperform conventional grocery, our market banners are also delivering strong results. Having the right customer offer in all of our stores remains a key focus.

In Food Retail on right-hand side, had a negative impact on same-store sales of 110 basis points. I will add that sales growth remained positive in apparel and home and entertainment, and we are comfortable with our inventory levels.

Online sales in the quarter increased 8.3 percent. Online penetration rates have been stable over the past two quarters, trending at two times the pre-pandemic rate.

Q4 retail gross margin was 30.6 percent, down 30 basis points compared to last year. This was driven by a decrease in Food Retail margin that was partially offset by growth in higher-margin Drug Retail front-store category. Our decrease in Food Retail gross margin ties directly to the combination of continued cost pressures and higher investments in promotion, including our No Name price freeze initiative. Our Food Retail gross margin peaked in mid-2021 prior to the onset of accelerating inflation. Since then, our Food Retail gross margin has not returned to those levels. Our Q4 results are further evidence that retail prices are not growing faster than costs and the Company is not taking advantage of inflation to drive profit, and our strong sales and market share performance this quarter are a clear indication that our efforts resonate with customers.

On the topic of inflation, we continue to receive a large number of higher than normal cost requests, which leads us to believe inflation will remain elevated through the first half of 2023. We expect our Full Year 2023 consolidated gross margin to be in line with our full year margin of 2022 at about 31 percent.

Retail SG&A as a percentage of sales was 20.2 percent, an improvement of 70 basis points compared to last year, resulting from careful cost management and improved leverage related to higher sales.

Adjusted retail EBITDA increased by \$174 million or 14 percent in the quarter, yielding a margin of 10.4 percent and up 40 basis points compared to last year.

Although earnings before tax of PC Financial were down \$20 million in the quarter due to the lapping of a one-time gain last year, we were pleased with its core business performance. Revenue was up \$55 million, driven by higher interest income from growth in credit card receivables and an increase in consumer spending.

On a consolidated basis, Adjusted EBITDA margin was 10.7 percent in the quarter, up 30 basis points compared to last year.

Our Retail free cash flow was \$408 million in Q4 and over \$2 billion on the year.

In Q4, we repurchased \$175 million worth of common shares and \$1.4 billion on the year.

Our role is to meet the needs of the communities we operate in and the expectation of our customers. This means refining the promotions, mix, and presence of our supermarkets and drug stores. If we're successful, results follow. A good example this year is in Quebec, where we are modifying our profile, adding discount stores, refining market stores to suit local markets and increase our share.

We opened the province's first T&T store in Montreal just before Christmas. The store has been a roaring success, serving an eager customer base who lined up for hours day after day, breaking all Loblaw sales records for a new store.

Looking ahead to 2023, we have strong plans and feel well-positioned to execute in our core businesses while advancing our growth initiatives. For Full Year 2023, we expect our Retail business to grow earnings faster than sales and adjusted earnings per share growth in the low double digits.

We plan to increase our capital this year, investing more in our store network and distribution centres. We plan to invest approximately \$2.1 billion in growth capital expenditures or \$1.6 billion net of proceeds from property disposal. The increased level of investments will largely be funded through the sale of approximately \$500 million in real estate assets. We currently have over \$1.8 billion in excess real estate that we plan to dispose at a more rapid pace over the next few years as we accelerate our investments in assets that drive our core business.

Finally, we will continue to return capital to shareholders by allocating a significant portion of our free cash flow to share repurchases.

We are pleased with our performance in the fourth quarter, as we capped off another strong year. Underpinned by our focus on retail excellence, we continue to demonstrate steady, consistent performance and have positioned ourselves well for 2023.

I will now turn the call over to Galen.

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

Thank you, Richard.

Q4 continued the momentum that we saw in previous quarters, helping the Company finish the year with strong results.

Shoppers Drug Mart had an exceptional performance in the quarter and for the full year. This was due to both strong cough and cold season that essentially lasted all year long and sustained strength in cosmetics and fragrance. It was also a great year for our pharmacies as they shifted from COVID testing and vaccinations to delivering important day-to-day health services.

Patient feedback has been extremely positive, and many provinces are now embracing pharmacists as a way to dramatically improve Canadians access to basic primary care.

As Richard described, in our food business, higher cost of goods, coupled with active investments in value, put pressure on gross margins in the quarter. The strong performance in our drug store business provided some relief. However, overall gross profit still declined as the cost from our suppliers continued to increase faster than our prices. The good news is that customers responded well to our efforts, helping deliver strong sales and market share growth. The No Name price freeze was an important driver of that success, as was the strength of our weekly promotional programs. This was true in both divisions. One notable item in the quarter was the outstanding growth in our prepared meals categories as customers chose fresh prepared food at great value as an alternative to dining out.

Looking forward, we expect that managing the balance between cost and price inflation will remain difficult. We are seeing some costs stabilize and even begin to reverse in a few areas, and we are

actively lowering prices in key categories. However, we still have over a thousand supplier requests on our desks for significant cost increases. We continue to believe that these inflationary pressures are temporary and that they will ease with time, but predicting how long that will take is proving extremely challenging.

In that context, we recently reaffirmed our commitment to No Name prices being an average of 25 percent less than national brands. We're delivering the best available value in our 400 No Frills and Maxi hard discount stores, and we will continue to push back on unjustified cost increases from suppliers.

Finally, we're stepping up our support for those most in need. Last year, we provided more than five million kilograms of food to Canadian food banks. This was in addition to over 120 million healthy snacks and meals through the President's Choice Children's Charity on our way to feeding a million children a year.

In the upcoming year, we'll invest over \$2 billion to grow and improve our store network, provide more health and wellness care to Canadians, create jobs, reduce waste, and meet our carbon reduction commitments. We will do so while delivering consistently against our long-term financial framework.

We're proud of our achievements in 2024 and of our over 200,000 hardworking colleagues, and believe that we are well-positioned for 2023.

I'll now open the call for questions.

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

Thank you, Galen.

Colin, would you mind introducing the Q&A process, please?

Q & A

Operator

Okay, your first question comes from Irene Nattel from RBC Capital Markets. Irene, please go ahead.

Irene Nattel – Analyst, RBC Capital Markets

Thanks, and good morning, everyone. Obviously, a great quarter.

Can you talk to us about what you're seeing in terms of consumer behaviour, where we are now in terms of private label penetration, broader—more broadly speaking, trade down, and what you're seeing in the competitive environment?

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

Yes, absolutely, it hasn't changed a lot since Q3. There's still that sustained shift to discount. It hasn't slowed down. It hasn't speeded up. Control brand continues to be very, very strong, particularly at the lower end with No Name, although you can imagine that was supported significantly by the price freeze in the quarter. There's a shift happening in proteins, as you would normally expect, away from

higher-priced proteins like beef towards lower-priced proteins like chicken or pork, and then from a competitive perspective, yes, it remains an intensely competitive environment.

We're still not all the way back to promotional penetration levels that we had pre-COVID, which is an interesting thing to watch, but it certainly continues to ramp up, and we're seeing customer price sensitivity, really, across the board promotionally so in market stores, and then both promotionally and on EDLP basis in the discount division.

Irene Nattel – Analyst, RBC Capital Markets

That's great. Thank you.

Just looking ahead to the 2023 guidance, if gross margin is going to be stable, then presumably, you see significant ongoing opportunities on the OpEx efficiency side and I guess sort of what you guys refer to as retail excellence, so can you give us some more information, please, on what those sort of big buckets are and whether you're going to get all the way right to 2023 or whether we should continue to see some improvements in 2024?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Big picture, Irene, for 2023, we're sort of getting back to normal market conditions. We're anchoring ourselves on our financial framework, and when we built our plans, it provides us with the outlook that we just talked about. We think we're going to be just slightly a bit ahead of our financial framework and the business is going to be more stable than what we've seen over the last few years, and we feel good about '23.

As to the big initiatives like—we don't want to get into much details, but there's a number of those that are on the way that are becoming, I guess, somewhat more important from a financial perspective, but they're nowhere near maturity yet.

Irene Nattel – Analyst, RBC Capital Markets

That's great. Thank you.

Operator

Your next question comes from Kenric Tyghe from ATB Capital Markets. Kenric, please go ahead.

Kenric Tyghe – Analyst, ATB Capital Markets

Thank you, and good morning.

Particularly strong front-store performance, especially if we look at it against a prior year comp of 6.1 percent, that 11.5 percent really does stand out. You called out the big flu season, which I think we expected, but could you provide a little more insight with respect to beauty? That's a high-price, high-margin category in which you appear to still be delivering very strong results. Have you seen a shift in terms of promotional attachment, and does the success in front-store represent very effective promotions in beauty and a higher attachment of promotional activity, or how should we think about that beauty performance?

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

Kenric, the way, really, to think about what's happening in the front of store is that it's demand-driven in those two key categories. Those are disproportionately driving the results. Beauty is not a particularly promotionally-intensive category to begin with. There's promotions that run through the PC Optimum program, which were very potent and attractive, but this is really underlying demand. I think you know as you visit our stores that it's hard for us to stay in stock in OTC product and cold and flu medication, and that's what's driving it.

As far as the everyday commodity products that we would typically sell in Shoppers Drug Mart, we'd see that not as strong as perhaps in typical years, but that's largely driven, again, by the promotional intensity in the big box stores and the food stores.

Kenric Tyghe – Analyst, ATB Capital Markets

Thank you, Galen.

Just one further one for me. Just with respect to the No Name price freeze, can you speak to how strategically, and perhaps from a share perspective, that initiative played out versus your own expectations? I mean certainly, there were headlines around the initiative. It would be useful to understand just how effective that was relative to your own internal expectations?

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

Yes, it was very successful and lots of public awareness around the program. The yellow packaging stands out in a particularly impactful way on the shelf, I think which contributed to its success. The most important thing is we save customers a lot of money, and as we move forward, we're

committed to maintaining that 25 percent price gap, as I mentioned, and the No Name sales performance continued to be very strong. It lifted during the price freeze from what was already a pretty high rate of growth and it's continued post-January, and we continue to see it as a really important part of the way we deliver value to Canadians and help save them money.

Kenric Tyghe – Analyst, ATB Capital Markets

Thank you. Perhaps I'll get back in the queue.

Operator

Your next question comes from Mark Petrie from CIBC Capital Markets. Mark, please go ahead.

Mark Petrie – Analyst, CIBC Capital Markets

Yes, good morning.

I think Q4 was the first time we saw a basket size flat in 2022. Do you attribute that mostly to inflation continuing to flow through, or was there a normalization or a shift in consumer behaviour, or is that a payoff from work specifically targeted at that?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

You're saying gross—you were talking about gross margin?

Mark Petrie – Analyst, CIBC Capital Markets

Grocery. Yes, grocery basket size, yes.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Oh, basket. Yes. Well, it's just like—that's where I think we are in the cycle. I think we've seen traffic go up like—we've seen inflation affecting people—how people fill their baskets, it's tough to see what's going to happen over the next few months, but I think we're sort of—I don't think we finished the shift to discount, but we're still leaning towards discount more and more.

Mark Petrie – Analyst, CIBC Capital Markets

Okay, and specific to the Shoppers' gross margin, hoping you can help us understand some of the puts and takes there, specifically as it relates to the impact of the mix shift to higher-margin products, but also the actual product margins, the performance of private label, and then also the impact of pharmacy services.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

The bulk of it is mixed. Essentially, that's the story on gross profit for Shoppers, period.

Mark Petrie – Analyst, CIBC Capital Markets

Is private label penetration rising within Shoppers, or—I mean, I know it's more—happening more in food, but is it happening at Shoppers, or not really?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

To be honest, I don't have the answer. The private label activity has been very much on the food store in the quarter, and the story on Shoppers is it's front of store, and that's where the activity has been. On pharmacy, what we've mentioned is we—the COVID services peaked last year in Q3 and Q4, so we were expecting them to go down, but despite that, we've seen great pickup in flu shots and med use, which allowed us to deliver decent growth, albeit not at the same rate as we did in Q4 of last year.

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

Yes, and maybe I'll just add that No Name doesn't have quite the same presence in those small front-shop Shoppers Drug Mart stores, but President's Choice actually has higher penetration in Shoppers Drug Mart than it does in the rest of the food stores. That's how strong it performs and it continues to do so.

Mark Petrie – Analyst, CIBC Capital Markets

Okay, thanks.

Then just one last one, more of a housekeeping, but is the real estate that's going to be disposed of in 2023, is that occupied by Loblaw? Will it bring incremental rents into the system, or is that separate?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

It's occupied by Loblaw and it's not material for Loblaw.

Mark Petrie – Analyst, CIBC Capital Markets

Okay, thanks. Best of luck.

Operator

Your next question comes from George Doumet from Scotiabank GBM. George, please go ahead.

George Doumet – Analyst, Scotiabank GBM

Yes. Thanks. Good morning, and good quarter.

On the outlook for the double-digit growth in EPS, can you maybe tell us a little bit what you're baking in in terms of food inflation, and from a cadence standpoint, is it going to be a stronger first half versus a weaker second half? Maybe any colour you can provide there.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Our plan contemplates a relatively stable performance by quarter.

George Doumet – Analyst, Scotiabank GBM

Okay.

In terms of the food inflation, can you maybe give us a little bit of a sense of what you guys are baking into that guidance for the year or for the exit?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

As we said, we expect inflation to remain elevated in the first half. Your guess is as good as mine for the second half.

George Doumet – Analyst, Scotiabank GBM

Okay. Thanks, and just more broadly on—can you talk a little bit about the automation opportunity, where we are today in terms of maybe the DCs, and perhaps how long it will take to get to where you want to get, and how should we think of the returns to the margins there?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Our DC is currently being built. The building should be completed by the end of this year. Automation will start to be installed at the beginning of next year and should take about a year to get finished; we expect our new automating centre to begin operation end of '25, early '26, and the way you need to look at that—at this investment, it's an opportunity cost. The automation is way more productive; it allows us to significantly increase the throughput, and that's how we derive our return from such projects.

George Doumet – Analyst, Scotiabank GBM

Okay. (Inaudible).

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

Maybe just worth mentioning, we have already a fully operational automated warehouse in Cornwall that serves ambient food, and we've been operating automated warehouses to support the drug and beauty business in the country for some time.

George Doumet – Analyst, Scotiabank GBM

Thanks, guys.

Operator

Your next question comes from Michael Van Aelst from TD Securities. Michael, please go ahead.

Michael Van Aelst – Analyst, TD Securities

Hi, there.

I'll start off with an easy one, hopefully. The NCIB, you purchased, I think, 3.3 percent of your shares last year. Do you expect that to increase given the rise in the free cash flow?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Right now, it's steady as it goes. No change.

Michael Van Aelst – Analyst, TD Securities

Okay, should we expect steady in terms of share count, steady in terms of dollar amount, or percentage of free cash flow? How do we model that?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

We look at both, but we lean more on dollars.

Michael Van Aelst — Analyst, TD Securities

All right.

The e-commerce, this is the second quarter in a row that we've seen it starting to grow again, up 3 percent and up 8 percent this quarter. Is this just inflation, or is it the users—the number of users increase again, and what do you think is leading to this growth overall?

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

Yes, the way we think about it now is that it's stable following the pre and post-pandemic periods. Yes, there's a little bit of growth, but we're not yet—we don't yet have full visibility into what that normalized growth rate is going to be. Inside the numbers, there's multiple parts to our e-commerce business. There's a drug business, which is quite significant. There's the front shop or Shoppers Drug Mart, and then, of course, there's the large part through PC Express, and we see some strength on the drug side.

In particular, we see strength on the home delivery side growing materially faster than what we're seeing in pickup, although pickup's holding pretty steady, and pick—and delivery's still very small for us, but growing rapidly. It's going to take us, I'm going to guess, now through the balance of 2023 before we have a really clear sense of what this new run rate is for e-commerce.

Michael Van Aelst – Analyst, TD Securities

Based on the penetration that you're at now and the level of disruption that we're seeing in the store, can you comment on that level of disruption and the picking? Has it been an issue, or have you been able to kind of figure out a way to keep it a little less noticeable, and then how does it alter the way you decide to go—to pick—your picking strategy, I guess, over the next few years?

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

Yes. Look, there are some stores where the picking penetration is so high that it is very visible, and it is—and is maybe on the edge of being disruptive to customers, but the number of stores where that's even the beginning of an issue is very small.

Having said that, we are constantly looking at new ways to improve pick efficiency and productivity, and we have multiple projects going on with that goal in mind, both improving the manner and fashion in which we pick in stores, and we've also opened a pretty successful manual facility here in the west end of Toronto, downtown Toronto. That is picking in a dark warehouse, for lack of a better word, for a pretty extended market all across Toronto. We're very happy with the way that that is operating with the pick accuracy, the speed; we're increasingly confident that these medium-sized, dark, manual picking facilities will play a complementary role to store pick in our network.

Michael Van Aelst – Analyst, TD Securities

Okay.

Then just finally on that side, at the current level of penetration, is media revenue opportunity significant? Where do you stand in terms of ramping that up, and do we need to see a lot more growth in e-commerce for the media revenues to start becoming more meaningful?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes, media is still small, but growing rapidly. I think we reached a milestone in December when we launched our retail media platform, which will allow customers now to do self-serve, i.e., build their own campaigns on their own. We're excited with what's ahead in '23, but it's still a small business, albeit profitable.

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

Yes, and I wouldn't tie directly e-commerce growth to our ability to realize value in media. It's an important element of the model, because, of course, online eyeballs are easier to monetize, but the loyalty program and what we can do there is also a source of media dollars leveraging our existing store traffic footprint, and then there's also a third-party media channel that we are exploring and see opportunity into. It's an important part of the way we grow the media business, but it is not the determining factor limiting growth.

Michael Van Aelst – Analyst, TD Securities

Great. That's helpful. Thank you.

Operator

Your next question comes from Peter Sklar from BMO Capital Markets. Peter, please go ahead.

Emily – Analyst, BMO Capital Markets

Hi. Good morning. It's Emily (phon) for Peter.

Just wanted to go back to gross margin. We understand that pharmacy and front-store gross margins have been offsetting the retail food gross margin, and with the front-store sales so exceptionally strong this quarter, 11.5 percent same-store growth, it really had a mixed impact. We're really wondering on a sequential basis, maybe versus Q3 or maybe the cadence through Q4, how has the grocery gross margin trended, like how you entered the quarter and how you exited?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

What we're ready to disclose is that our gross margin in Food Retail was down and our gross margin in Pharmacy was up, and that's as far as we'll go from a detail as to what's happening with the gross margin.

Emily – Analyst, BMO Capital Markets

Okay. Thank you. Let's switch gears to PC Optimum then. Similar to our question on gross margin, we're just wondering how has usage in PC Optimum trended in Q4 versus previous quarters? Do you see more redemptions and more participation, and if there is any insights on trends that you could glean from the data that you get from the program, that would be helpful.

Thanks.

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

Yes, so two things are happening, positive trends in relation to the PC Optimum program.

The first is that our points value proposition is viewed by customers to be an equivalent to cash, so it's a really important part of the savings equation as customers think about how best to save money. As we headed into the fourth quarter and the end of the year, we saw a noticeable, but not significant, increase in the rate of redemption; people essentially using their points to reduce the cost of their grocery bills, but I wouldn't over-rotate on that trend. It's notable, but it's not a massive shift off what would be typical.

Then the second thing that's been happening is the number of actively-engaged PC Optimum users has been growing at a very satisfactory rate, and so for us, two things happened. The existing core Optimum customers redeeming a few more points, actively engaging in the program, and responding to our personalized promotions; and then secondly, we have materially more customers who are in that field of active-engaged, and they are also contributing to the earn and the burn of points and also making a positive impact on our sales.

Emily – Analyst, BMO Capital Markets

Thank you very much. Those were my questions.

Operator

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

Vishal Shreedhar – Analyst, National Bank

Hi. Thanks for taking my questions.

Just related to the step-up in CAPEX, wondering if this is a longer-term CAPEX cycle that we should see, and do you have—on these heightened investments or the increased investments, do you have a line of sight on the returns and if they can exceed the current thresholds that your—that the business is currently generating?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Our objective on return has not changed. It's just that over the last few years, we're probably running a bit behind the industry in terms of square footage growth, and we're doing a bit of catch-up, and so that's what we're doing.

Vishal Shreedhar – Analyst, National Bank

Sure, in terms of the CAPEX, at the current levels, how long should we model that? Is that a few years kind of thing, and then it goes back down to the historical rate, or is that more of a long-term run rate?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes. For now, what I'd do is I'd probably do that for maybe two, three years. We'll revisit that number after that.

Vishal Shreedhar – Analyst, National Bank

Okay.

With respect to the general merchandise business, just wondering—I know you gave some details in your preamble at the top, but just wondering what you saw. Did that pressure the comp on the total comp, and was that a pressure that you see gradually improving?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

The pressure we saw in Q4 was somewhat similar to the one we saw in Q3. For us, the key was to make sure that we were managing our inventories well, because that's what we were seeing, what was happening with other retailers globally, and I think we've managed it well so far, but we remain very focused on making sure we don't over-purchase going forward so that we can protect our margins as much as possible.

Vishal Shreedhar – Analyst, National Bank

Okay, in terms of the same-store, it's about, call it, one percentage point pressure in terms of same-store?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes, and it was about the same in Q3.

Vishal Shreedhar – Analyst, National Bank

Okay.

On the strategic procurement activities which was indicated in the disclosure material, I presume that's something that Loblaw regularly does, just wondering why it was called out. Is the magnitude of opportunities larger than you would otherwise see in prior years?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Well, we started on that initiative last year. We're extracting as much value as possible from the—from using the scale of our enterprise, and that initiative has been growing nicely in '22 and is sort of gaining traction for '23; that's going to be one of the initiatives that will help our gross margin in '23.

Vishal Shreedhar – Analyst, National Bank

Okay.

Lastly here, just on the street tonnage math, I know there's—I know it's not perfect, so just wondering what Loblaw saw specifically on tonnage in the quarter.

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

I guess a starting point, very happy with the sales, as you can see in the results. Equally happy with the tonnage market share growth, which is the—an important measure and metric for us, and then in terms of absolute tonnage growth, we're still moving through the cycling challenges of COVID, but the underlying performance, we're very comfortable with, and we saw—we've seen improving trends on tonnage really since the beginning of the year. The caveat that I would offer up is that in Q1, we're

headed into another COVID-lapping distortion, and the relative performance from a sales and tonnage perspective is going to look a little wonky, but the underlying trend, which is what's important for us, will continue to be where we need it to be.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes, I want to double-click on that. I think the same-store sales performance we delivered in Q4, you're not going to see the same thing in Q1. It's very important that we were—we were locked down for the first six weeks of 2022, please make sure you keep that in mind when you build your models.

Vishal Shreedhar — Analyst, National Bank

Thank you.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

We're focused on absolute sales level, not comp performance right now, and so that's what—that's how you should look at our business.

Vishal Shreedhar — Analyst, National Bank

Thanks.

Operator

Your next question comes from Chris Li from Desjardin Capital Markets. Chris, please go ahead.

Chris Li – Analyst, Desjardins Capital Markets

Hi. Good morning, everyone.

Galen, you mentioned in your opening remarks that promotional intensity has not fully returned to the pre-pandemic level. I'm just curious why do you think that is, and does your outlook for the year kind of contemplate an intensification of the promotional environments as we go through the year.

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

Yes. I mean, look, it's—it just is a fact, something that we observed. There was a real retreat in promotional intensity through COVID, as people had historically low levels of price sensitivity, and it's just an interesting call-out; continues to grow, promotional intensity. We continue to engage customers that way. We're trying to do it as sensibly and as intelligently as possible, and will it return to pre-pandemic levels and when will that happen? I don't know the answer to either of those questions, but we are seeing an increase in promotional intensity with customers at the moment, but certainly not something that is radically different from where we were in Q4.

Chris Li – Analyst, Desjardins Capital Markets

Okay.

It sounds like it is a manageable risk, that if it does intensify, it looks like you have other levers to kind of offset that to allow you to achieve your earnings growth guidance. Is that fair to say?

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

Yes. I mean look, this is a normal part of how we trade and how we manage the business, is trying to manage the balance between shelf prices, promotional investments, and then improvements in mix, and we'll just continue to manage effectively, as we have for the last number of quarters.

Chris Li – Analyst, Desjardins Capital Markets

Okay. That's helpful, and then just in terms of your capital expenditure, the incremental CAPEX you're spending on new store growth, does that essentially get your retail square footage sort of back to around 1 percent? I know it's been flattish for the last few years. Is 1 percent kind of the number you're shooting for, for this year?

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

About that, well, I don't think we'll be all the way there at the end of 2023, but that's the growth rate that we think keeps us in line with the rest of the market, and I should say, one of the real learnings over the last 24 months has been the identification of new store growth opportunities and material incremental sales options as a result, and I think Richard called out a particularly outstanding one, but we put that T&T in an old Loblaw store that had been closed for, I think, years, so dark, closed, and we added that store at 70,000 feet, really blowing the doors off in terms of its sales. That's 100 percent incremental business for us, and as I said, that's at the top end of the available options, but there are quite a few others out there that we are intentionally pursuing.

Chris Li – Analyst, Desjardins Capital Markets

That's great. We look forward to seeing that in a few weeks.

Maybe just on the CAPEX, Richard, I wanted just to confirm, so you are essentially right now expecting that the gross CAPEX for the next two to three years will be kind of about \$2 billion, same as this year, but you would be funding some of that through real estate divestiture, so from a net CAPEX basis, (inaudible) kind of \$1.6 billion is the run rate that we should be expecting for the next two to three years. Is that correct?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes.

Chris Li – Analyst, Desjardins Capital Markets

Then just want to confirm, you said you still have \$1.8 billion of excess real estate after you sell the \$500 million, or do you have \$1.8 billion in excess real estate right now?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

That's including the \$500 million that we're in process of disposing right now.

Chris Li – Analyst, Desjardins Capital Markets

Okay. That's helpful.

Then just in terms of the outlook, you mentioned gross margin rate will be stable. Can you talk about your SG&A expense rate? Do you expect more improvement this year?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

I wanted to give a sense on gross margin to sort of give you a perspective on how we feel about the business. We're going to keep working really hard on SG&A to make it better every quarter as we progress the year, but I'm not going to comment on the specificity of where we're going to be with SG&A.

Chris Li – Analyst, Desjardins Capital Markets

Okay. That's good.

Then lastly, I know I always ask you guys this, but any update from the government with respect to changes in generic drug prices later this year?

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

You know what, let us get back to you on that. I don't want to give—there's been a moderate update. It's not material to the business looking forward, but we can give you a few more details. Roy can give you a couple of more details on it if you'd like.

Chris Li – Analyst, Desjardins Capital Markets

Okay, fantastic. Thanks. Thanks a lot.

Operator

We have a follow-up question from Irene Nattel from RBC Capital Markets. Irene, please go ahead.

Irene Nattel – Analyst, RBC Capital Markets

Thanks.

Just one point of clarification, then another question. Point of clarification, when you're talking about a revenue run rate, if we go back and look relative to 2019 and kind of look at CAGRs and trends, that should be the way that we are looking at it, or is there anything above and beyond that that we need to keep in mind in terms of quarterly cadence in 2023?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

No, Irene, we look at our absolute sales number every week. That's what we're looking at. We're not looking at CAGRs. We're not looking at same-store sales. We're looking at how much sales are we delivering week in, week out, and that's what we're very focused on right now.

Irene Nattel – Analyst, RBC Capital Markets

Understood. Okay.

Then just one follow-up or one question on President's Choice Financial. In your outlook for 2023, are you anticipating any additions to PCLs, any changes in allowance rate, that kind of thing?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Nothing significant for PC Bank on our results for '23.

Irene Nattel – Analyst, RBC Capital Markets

Thank you.

Operator

There are no further questions at this time. I'll turn it back to Mr. Roy MacDonald for closing remarks.

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

Great. Thanks, everybody, for your time this morning. I'm around if you have follow-up questions, and please mark your calendars for Wednesday, May 3, when we will be releasing our Q1 results. 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.