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FINAL TRANSCRIPT

Loblaw Companies Limited

Third Quarter 2021 Earnings

November 17, 2021 — 10:00 a.m. E.T.

Length: 59 minutes

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PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Loblaw Companies Limited Third Quarter 2021 Earnings Conference Call. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star zero for the operator. This call is being recorded on November 17, 2021.

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

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

Great. Thank you very much, Kelsey, and good morning, everybody. Welcome to the Loblaw Companies Limited Third Quarter 2021 Results Conference Call. I'm joined this morning, as usual, by Galen Weston, our Chairman and President, and Richard Dufresne, our Chief Financial Officer.

And before we begin 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 impact of the ongoing 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 risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulators. Any forward-looking statements speak only as of the date they are made.

The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise, other than what's required by law.

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

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

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Thank you, Roy. Good morning, everyone.

The performance of our third quarter continued the trends of the last quarter, characterized by a steady improvement across our businesses. Year-over-year comparable numbers do not tell the entire story given the volatility caused by the pandemic. For that reason, using some two-year average data points helps provide further insight into our operating performance.

On a consolidated basis, revenue for the third quarter grew by 2.4% to over $16 billion, EBITDA increased by 10.3% to $1.67 billion, and earnings per share grew by 24% to $1.59 a share. On a two-year basis, we saw average annualized growth in revenue of 4.7%, adjusted EBITDA growth of 6.2%, and adjusted earnings per share growth of 14.1%. These results exceeded our financial framework despite the more moderate sales growth.

Our drug retail business delivered most of our sales growth in the quarter. Absolute sales increased 4.7%, reflecting strong Rx and growth in all major front store categories, led by cosmetics and OTC. Same-store sales in drug retail increased by 4.4% in the third quarter, lapping strong third quarter growth of 6.1% last year. Front store same-store sales were better by 4.1%, while pharmacy same-store sales grew by 4.8%, benefitting from a 270% growth in pharmacy services, which includes COVID vaccines, testing, and medication reviews. On a two-year average, drug same-store sales have grown 5.3% with front store at 3.3% and Rx at 7.6%.

In food retail, same-store sales improved as the quarter progressed, up 0.2%. Lapping a strong quarter, same-store sales benefitted from continuing eat-at-home trends. Our pricing position remains strong and we are pleased with our market share performance. Eat-at-home trends remain elevated despite the easing of restrictions. Compared to last year's results that were driven by extended lockdowns and few social events or celebrations, this year saw strong sales in the back-to-school season and for Thanksgiving. Halloween was also strong. More generally, entertaining at home is helping drive sales in food retail. On a two-year average, food same-store sales reflected average growth of 3.6%. Traffic continued to improve in Q3 and is showing signs of beginning to normalize to pre-pandemic levels.

We are paying a lot of attention to cost inflation. In mid-summer, inflation materialized in both fresh and grocery. In produce, prices have remained more or less flat to down as we've been sourcing locally and in the US. Meat prices have gone up, but have stabilized recently. Grocery remains the area with the most activity. The number and size of cost increases requested by vendors has been elevated since the summer. Our team uses a thorough process to vet pricing requests. We work hard to negotiate those increases down so that we offer our customers the best value. Our internal measures of inflation are trending slightly higher than CPI.

Our online business continued to operate at penetration levels well above pre-COVID rates, albeit lower than the peak of last spring. In Q3, online sales were flat to last year but we know that last year was up 175% compared to 2019. Online grocery sales in the quarter were down slightly to last year. Online pharmacy continued to grow nicely and covered the slight gap generated by food. Within grocery, we have a strong and loyal base of online customers but, as lockdowns ease, some customers shifted back to in-store shopping. Online is here to stay. Although penetration in grocery has eased since the peak driven by lockdowns, customers expect us to offer a seamless experience whether in-store or online. We are confident that online will play an important part in the future of our business. Speed and convenience are the way to win and I'm confident that, over time, we'll be able to improve the profitability gap as technology and new ways of doing things will reduce the cost structure of this channel.

Retail gross margin in Q3 was 30.7%, up 140 basis points compared to last year. Improved merchandizing initiatives and traction using our data are key drivers of our margin improvement in food retail. Drug retail margins benefitted from improved mix, higher pharmacy services, and a slow return of acute prescription volumes. Pharmacy service growth is driving both margin and SG&A. This category has a high labour component that increases SG&A, but its contribution is in line with the overall EBITDA pharmacy margin. Gross margin in our front-of-store business also improved with the steady recovery in higher-margin categories such as beauty and OTC that were negatively affected by COVID lockdowns. (Inaudible) to 2019, we have recovered from the challenges of last year. Gross margins have improved by 80 basis points with similar improvements in both our food and drug business. This is an improvement over Q2 where our drug business dragged down our gross margins versus in Q3 where it lifted it. We remain confident about our gross margin performance going forward.

Retail SG&A as a percentage of sales was 20.5% with the rate higher by 70 basis points compared to last year. The increase was primarily due to a return to normal levels of spend, this after a much lower level last year, because of COVID. For example, returning pharmacies to their pre-pandemic operating hours and supporting the growth in Rx services. COVID costs came in at $19 million in the quarter, in line with our expectations. Anchoring to 2019, our Q3 retail SG&A rate increased by 60 basis points driven by higher labour costs to support the growth in Rx services, e-commerce fulfillment labour associated with higher digital penetration, and COVID costs. Retail EBITDA improved by $149 million in the quarter.

At PC Financial, revenue was up $19 million in the quarter driven by higher interchange income as we're benefitting from increased spending on PC MasterCard. EBITDA at the bank increased $7 million year over year, primarily driven by favourability in interchange income and lower credit losses, partially offset by higher point cost for redemption and increased marketing spend compared to low spend in the prior year.

On a consolidated basis, adjusted EBITDA margin was 10.4% in the quarter, up 70 basis points compared to last year. In the quarter, IFRS net earnings available to common shareholders were $500 million, up 17.6%, and fully diluted earnings per share were $1.59. Consolidated free cash flow was $455 million in the quarter, but retail free cash flow was $498 million in the quarter. In Q3 we repurchased

$300 million worth of common shares for a total of $1 billion year to date. So far we have repurchased 13.6 million common shares.

Today we announced some details regarding our store network optimization initiative. We have reviewed our network of stores and have finalized plans to address approximately 20 of our most unprofitable stores. In almost all cases, this involves reformatting the store to better serve the local market. Most of these stores will convert to our discount banners, some will be downsized, but only three will be closed. We expect to record a charge of $25 million to $35 million, most of which in Q4. These projects should substantially be completed by the end of next year. We expect to realize approximately $25 million in annualized EBITDA run rate once these projects are completed.

We are pleased with our financial performance in the third quarter and year to date. As we approach year end, we have updated our outlook for 2021. We expect EPS for the full year to be up in the low to mid 30% range, excluding the impact of the 53rd week, of 2020 in charges associated with our new network optimization initiative. Finally, in the first four weeks of the fourth quarter, COVID-related costs are estimated at $4 million.

Q3 demonstrated steady, consistent performance. As we continue our focus on retail execution and maintain our attention on a fewer number of strategic initiatives, we feel our business is well positioned for the long term.

I will now turn the call over to Galen.

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

Thanks, Richard, and good morning.

I'm also pleased with Loblaw's performance in the third quarter. Sales remained strong while we delivered continued gross margin improvement in both our food and drug businesses. And as we look through the volatility of COVID and consider our results on a two-year basis, the Company exceeded its financial framework. With each of our key metrics pointing in the right direction, it's clear that the underlying health of the business, combined with our focus on retail excellence, have positioned us well as the country emerges from the pandemic.

This steady return to a new normal is showing up in many ways. At Shoppers Drug Mart, both acute and chronic prescription volumes are returning to our pharmacies as Canadians increasingly access the primary care which they had deferred during the pandemic. At the same time, we are all gathering in larger settings and beginning to return to the workplace, driving helpful tailwinds in beauty and cough and cold. This was accompanied by pent-up enthusiasm for celebrating the holidays, such as Thanksgiving, with customers shifting back towards larger turkeys and other entertaining staples. As they did so, our market division focused on retaining the large number of new customers that it attracted over the last 18 months by continuing to offer exceptional products and service. At the same time, our discount business welcomed many of its loyal value-seeking customers back through its doors, a trend which we expect to continue as inflation is increasingly showing up in many aspects of our lives.

As these shifts signal return to many of our customers pre-pandemic shopping habits, other areas such as online suggests a more sustained change in behaviour. As Richard mentioned, e-commerce revenue remained flat in the quarter over last year as we held on to the significant gains from 2020. Today, customers are looking for a seamless experience when they shop and PC Express is meeting that expectation by tapping into the best of multiple fulfillment options. We continue to improve the efficiency and accuracy of our in-store picking processes and are also adding new manual micro-fulfillment centres where it makes sense. This flexible approach has allowed us to evolve with the customer, continuing to serve the strong demand for click and collect while at the same time addressing the growing interest in delivery. With online penetration now stabilizing higher than pre-pandemic levels, it’s clear that e-commerce is here to stay. We remain absolutely committed to its success over the long term, leveraging our existing reach and scale to improve its profitability as we deliver the convenience and flexibility that have proven to be key differentiators with customers.

Whether online or in store, the market will continue to evolve as we emerge from the pandemic. With remote work becoming more prevalent and hybrid models gaining traction, more meals will take place at home. This requires us to think carefully about how we serve Canadians as they spend more time juggling work and family life. As we do so, our conviction around offering choice, convenience, and immediacy is as strong as ever. Whether through in-store, pickup, or delivery, we need to be there for each specific occasion. We’ll do this for our customers while thoughtfully managing through the current global supply chain pressure and the resulting inflation with minimal disruption to stores and customers in the fourth quarter. It is this discipline and commitment to serving our customers that will continue to drive long-term value for shareholders. Our strategy remains the right one and we are accelerating our progress against it thanks to the hard work of our colleagues.

Thank you and we’ll now welcome any questions.

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

Thanks, Galen. Kelsey, if you don't mind, could you introduce the Q&A process?

Q & A

Operator

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

Your first question does come from Michael Van Aelst from TD. Please go ahead.

Michael Van Aelst — Analyst, TD Securities

Hi. Good morning. Galen, I think I missed your comment on discount versus conventional, so can you start off by just providing a bit more colour as to what you saw during the quarter on discount versus conventional and then how it might be changing as the price increase or the price inflation has been ramping up?

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

Yeah, absolutely. So, a return of strength to the discount business, but we haven't returned all the way to the pre-pandemic normal in terms of mix and, as I mentioned in my remarks, our market division has done a terrific job holding on to a substantial portion of those sales gains that had picked up during COVID. So what we expect is, with the continued inflationary pressures, with the continued kind of journey to that normal pre-pandemic behaviour, we expect the discount business to continue to build volume and that mix between market and discount to improve in favour of discount.

Michael Van Aelst — Analyst, TD Securities

So in the quarter discount did outperform conventional?

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

Not quite, but it's getting close.

Michael Van Aelst — Analyst, TD Securities

Okay. But you're seeing that start, I guess, as inflation picks up, by the sounds of it.

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

Yeah, it's basically a trend that's been continuing since the opening up of the country really in the mid-summer.

Michael Van Aelst — Analyst, TD Securities

Okay. Now is there any reason for you to believe that we might not go back fully to the pre-pandemic ways or the pre-pandemic mix of discount versus conventional and, if so, does it make you rethink already the optimization, converting 20 stores or up to 20 stores from conventional to discount?

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

I think they're two separate questions. So, first of all, yeah, I think there's reason to believe that the return to that discount versus conventional mix might take longer than we initially anticipated. Our market division invested in price, as you know, during COVID, narrowing that price gap differentiation between discount and market, and we're hoping to hang on to as much of that business as we can. It's a good channel for us. And so (inaudible) and sort of, you know, question, yes, we'll try and hold on to as much market business as we can.

The 20 stores that we're converting are very specific markets, locations, with very specific business cases that are completely disconnected from that macro trend. So no, we will not rethink those conversions.

Michael Van Aelst — Analyst, TD Securities

Okay. And you also mentioned that you're pleased with your market share, but does that mean that it was flat, up, down less, or up?

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

It was good.

Michael Van Aelst — Analyst, TD Securities

So would you say that your market share is similar to where it was pre-pandemic?

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

Yes.

Michael Van Aelst — Analyst, TD Securities

Okay. All right, I'll leave it at that for now. Thank you.

Operator

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

Irene Nattel — Analyst, RBC Capital Markets

Thanks and good morning, everyone. I'm very happy to hear, the good is good. So if we just, for a moment, talk about inflation, I think you mentioned in the remarks that you saw your internal inflation a little bit higher than CPI. Is that a reflection of mix? Or could you just expand on that a little bit? And also the trends that you're seeing now and what your anticipation is.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Good morning, Irene. Inflation is quite volatile right now, as you are probably noticing, so it's very tough to draw like very precise inference about what is going on. So like the key point from our perspective is that we feel our pricing position is very strong. And so that's what we're focused on and we're managing our business to maintain that pricing position so that we can best serve our customers.

Irene Nattel — Analyst, RBC Capital Markets

That's helpful. Thank you. And I think one of the topics that we discussed is the degree to which consumers, who a year ago were not shopping multiple banners, were aware of just how strong your price position might be. As you do your surveys or as you look at consumer behaviour now, do you think that you're getting more credit for that strong pricing position?

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

Yeah, I think there's two things going on and, as we've talked about, we made a series of ambitious price investments through COVID, but there were a whole lot of them which were probably not well, you know, not quite right, over investing, let's say, in certain areas where we weren't getting the credit and where perhaps it wasn't going to translate into sales growth as we emerged from the pandemic.

So that focus on retail excellence has included looking with a lot of detail and precision into those investments and making adjustments where appropriate. In other words, raising prices on certain items where we felt we're not getting credit. And that's part of what's been going on when you look at our performance relative to CPI inflation. It's partly that set of adjustments. And Richard's point is a really critical one, which is when we look at that on a macro basis we're really pleased with our continued price position relative to our competitors and also very pleased with the market share performance that we've seen really over the last six months.

Irene Nattel — Analyst, RBC Capital Markets

That's really helpful. Thank you. And just continuing on the subject of retail excellence, certainly the gross margin gain is impressive, you're doing a good job on the cost side. If we look at it sort of from zero to 100 or innings or however you want to think about it, where do you think we are on this journey and how much more do you think is in the tank?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

We're beginning, okay. We've just been back, the three of us, for six months, so we're working hard to get this going more and stay tuned.

Irene Nattel — Analyst, RBC Capital Markets

Okay. And then just one final one, if I might, on Shoppers. If we look at both Rx and from the store, how close are we to where we would have been pre-pandemic and what are you seeing the trends look like in Q4, particularly early vaccination, and the rest?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

We're recovering, but we're not fully recovered yet. I think we've got ways to go. And it's tough to predict. Like we're seeing it happen the same time as you. But we still have a ways to go, but we like the trajectory we're on right now. And obviously all pharmacy services have grown significantly, especially since the summer, and so that's helping, and we're awaiting what else is going to come out over the coming months on that front also.

Irene Nattel — Analyst, RBC Capital Markets

That's great. Thank you.

Operator

Thank you. Your next question comes from Mark Petrie from CIBC Capital Markets. Please go ahead.

Mark Petrie — Analyst, CIBC Capital Markets

Good morning. Just with regards to your renewed efforts on discipline and execution, I appreciate that this cuts across most aspects of the operations, be it sort of supply chain, procurement strength, et cetera, but can you just discuss where you think you've made the most progress so far and what areas present the greatest opportunity for next year?

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

Yeah. So I'll maybe start with a more disciplined approach to pricing and promotion, so feeling really confident about that. As Richard touched on, we've done a full network review in terms of the performance of our assets and we've made a series of decisive choices around banner conversions, and you're seeing maybe call it the first wave of that. It's worth noting that, in that entire review, we're only closing three stores, which I think is a vote of confidence in the robustness of our network. Procurement is always an important area of opportunity for us and we're going to continue to work hard on that, especially in the context of this inflationary pressure, really trying to make sure that we're taking the cost increases that are justified, but that we're not doing it if they're unjustified or in a way that is detrimental to the customer experience.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

And Mark, I would add one more thing, is like we're getting better at using data and it's starting to make a difference. So it's translating in more effective promotional strategies that are driving both sales and margin. So that's probably something that we've noticed that made a difference over the last six months.

Mark Petrie — Analyst, CIBC Capital Markets

Okay, helpful. And Galen, you mentioned this is sort of phase one of a network review. What would further reviews potentially entail? Is that mostly additional conversions or sort of adjusting footprint or what would that look like?

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

Yeah, I mean it's nothing super fancy. It's the usual stuff. Making sure that we have the right format in the right location, making sure that we're understanding areas to add new square footage. I think we mentioned in the last quarter that we are looking at opportunities to put new stores in markets where we have low penetration and they have strong population growth. So it's that. A lot more attention to be paid to the physical fleet as part of the way that we allocate capital across the business, but think about it all as enhancements and optimizations as opposed to a substantial shift in strategy.

Mark Petrie — Analyst, CIBC Capital Markets

Understood. And when it comes to the earnings growth framework, obviously you've outperformed materially this year, lapping a weaker 2020, but even on a two-year basis still well above the sort of 8% to 10% range you've discussed previously. So I guess first question, do you attribute that more to sort of your retail excellence efforts or to the higher consumer demand that sort of stemmed from the pandemic? And then second, assuming that consumers continue to sort of slowly shift back to sort of pre-pandemic levels of demand, do you think you can exceed that range again in 2022 driven by your optimization efforts?

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

So let me start and then I'll ask Richard just to comment on our outlook. And I'm sure you know what he's going to say. I think we've been fairly transparent about what we felt was underperformance, particularly in the earnings range in the business in 2020, and so what are we doing in 2021, we're sort of bringing that sort of performance level back into balance. And with sales growth rates well above normal, we should expect a retail grocery business to deliver earnings results that are well above normal. And that's, I think, a reflection of what you're seeing and the two-year numbers, I think, are indicative of us starting to perform at a level that's commensurate with what is appropriate for the business.

In terms of the long-term trajectory for business performance, we have affirmed our commitment to our financial framework and that, I think, is the right way to think about it.

Richard, I don't know if you want to comment on 2023?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

No, I'm not going to comment on 2022. I'll give you some perspective on that next time we meet. But we gave you an update on Q4 and so we feel good about that outlook.

Mark Petrie — Analyst, CIBC Capital Markets

Okay. I appreciate all the comments and all the best.

Operator

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

Patricia Baker — Analyst, Scotiabank

Thank you very much and good morning, everyone. I have a couple of questions. First of all, Richard, Galen, what have you been seeing in terms of any supply chain disruptions? Any issues with availability in certain categories?

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

So let me speak to that in two parts, Patricia. I mean first, there's the domestic and North American supply, so think about it as the bulk of the centre of store and the key items on the perimeter in fresh. There is meaningful commodity price pressure, as you know, you're reading about it, you've heard about it from us and others. And then there's labour supply pressure. Those two things are creating substantial challenges for our manufacturing base for our vendors. That is putting pressure on availability, particularly around what we would call the peripheral SKUs, so kind of secondary sizes, secondary flavours. And what you see is the manufacturers consolidating their production into their highest volume SKUs and putting those secondary SKUs on allocation.

And so what customers, this is an industry-wide thing, what customers will be frustrated to see is something's in stock for a week and then it's out of stock for four or five weeks, then it comes in stock again and then it goes out. That's really the consequence of this allocation approach that is being undertaken by many of the vendors. So we need to work hard to make sure that we're getting our share of the allocation, and we think that we are. We expect to see that level of, call it, instability to continue for a few more quarters and then we'll have to see.

The second is the global supply chain pressure and, for us, think about that as disproportionately impacting our general merchandise business, our apparel, and any food products that we might be importing from offshore. There's an impact that we're managing very, very carefully there. It's not easy, but the teams have been managing through it extremely well.

And it's important to distinguish between the northwestern ports in North America versus the southwestern ports. Those northwestern ports have, over the last number of months, been performing substantially better than the southwestern ports. And so the Canadian offshore supply chain has not been as disrupted as a result of that as it has perhaps in the US. We'll have to see, given what's happened in British Columbia with weather over the last couple of days, whether that has any kind of incremental disruption. We suspect it will, but only for a limited a limited time. And so the net-net of it is, as we head into Christmas, when it comes to all of our seasonal programs, we feel very well positioned, we feel the stores are in terrific shape and ready for the fourth quarter surge.

Patricia Baker — Analyst, Scotiabank

Okay. That's great to hear. And then secondly, I'd like to ask Richard about the gross margin. So, thank you for giving us, I think he gave four or five drivers of the year-on-year 140 basis point strong improvement in the gross margin and you notice that the gross margin was up a nice 80 basis points versus 2019. Just two things there. Is it the same factors driving that 80 basis point improvement and could you rank order them?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Well, the way to think about it, Patricia, is essentially the Shoppers business margin has improved in this quarter because the higher growing categories, the higher margin categories have sold more, like OTC and pharmacy, so therefore gross margin of Shoppers has improved and that's why our overall gross margins have improved.

Patricia Baker — Analyst, Scotiabank

So that was the biggest driver. Okay. Excellent. And then my third question is on the network optimization that you referred to, and perhaps this is more colour than you'd choose to share, but the 20 stores that are subject to this first phase of the optimization, is there any banner or regional concentration with respect to the stores that have been subject to the shift?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

No, it's all across the country, Patricia.

Patricia Baker — Analyst, Scotiabank

Okay. And my final and last question, and I guess it's a question and it's a comment, so you indicated that your basket inflation was slightly ahead of CPI and some quarters you'll tease us with a number and some quarters you won't, so just curious why we're back to the nuanced verbiage as opposed to actually giving us the inflation number.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

I think when we were looking at all the inflation metrics we track, like it was very hard to draw anything from it, because it's been so volatile, so we thought it'd be a more accurate description of what's going on to just talk to it.

Patricia Baker — Analyst, Scotiabank

Okay. okay. Which CPI number are you talking about then, Richard? Are you talking about CPI food at home or are you talking about a broader CPI number?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yeah, we look at CPI food. But we have our own internal metrics, we look at Nielsen, we look at a bunch of metrics, and so those are the ones we focus on.

Patricia Baker — Analyst, Scotiabank

Okay. Thank you.

Operator

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

Kenric Tyghe — Analyst, ATB Capital Markets

Thanks and good morning. Galen, you touched on the trade down in response to inflation from market to discount, which is typical in sort of the first wave response by consumers, but could you speak to, just in the context of your loyalty journey, on the potential sort of substitution in that second wave within stores and within each specific channel and how well positioned you think you are and will be should the spike in inflation prove both protracted and as pronounced as it's looking, you know, relative to where you've been in the past?

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

It is a tricky time, and Richard's touched on it as well. You've got two things happening. You have this end of COVID, which is we're coming out of it, let's just say, more slowly than we anticipated a couple of quarters ago. And that means that customers are spending more money in stores, they're returning to discount at a slightly slower pace than we expected, all of that we've tried to talk to.

Then you layer on this very recent acceleration in inflation rates and the lack of predictability in what inflation is going to look like in the coming months and quarters and it gets very, very difficult to, call it, navigate or to identify any sustained trends at this point. There's just too much all converging at the same time.

Having said that, we have seen a return to a promotional sensitivity of significance, we are seeing a change in customers shopping more often in our discount businesses, and we are seeing the one-to-one marketing tools, promotional tools that are being deployed across the business performing much better today than they were in an environment when there was very little price sensitivity. Okay? In other words, COVID. So our strategy would indicate that we are more able to deploy promotions against specific price-sensitive customers with specific price-sensitive items than we would have been the last time we had this kind of inflation, so it bodes well. But we don't have any meaningful underlying data at this point that we can build that case on.

Kenric Tyghe — Analyst, ATB Capital Markets

Great colour. Thanks, Galen. And just one more for me quickly. On your beauty business, how much of that was a natural lift on a return to normal versus promotional driven? In other words, was it perhaps margin that you've had to invest in beauty to drive that change? And then any colour or insights you're willing to give with respect to where beauty is today versus where it was? And if we can't get into anything there, perhaps even just some perspective on where your share in mass and prestige sort of are today versus where they were and how to think about the sort of continued potential evolution or ramp of that business, or recovery of it, sorry.

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

I think it's fairly simple. So this is a natural return to beauty that is coming as our customers spend more time going out. So that, I think, is the first thing. Second, if you look at beauty, it was a contracted market during COVID because people weren't going out and because many of our competitors in beauty were closed during lockdowns. That accrued substantial market share gain to us, because we had the good fortune of being open, but there was a lot less sales. So our objective is to try and hang on to as much of that share as we can as those retail competitors open and we've been very pleased, I would say, with the results so far, but it is early.

Kenric Tyghe — Analyst, ATB Capital Markets

Thank you. I'll leave it there.

Operator

Thank you. Your next question comes from Karen Short from Barclays Capital. Please go ahead.

Karen Short — Analyst, Barclays Capital

Hi. Thanks very much. Just a couple of questions on the competitive landscape. So your bigger-box competitor commented several times yesterday on strength in Canada and I'm wondering what you're seeing in terms of the competitive landscape in the context of their comments in conjunction with your comments on return of strength in discount. And then the other thing I wanted to ask is just what your perspective is on the health of the Canadian consumer going into 2022 as we lap or as they lap stimulus general benefits. And then I have one other question.

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

I think probably the best way to answer the question about competitiveness, it's very competitive here. As Richard mentioned, we feel good about our price position, we feel good about our market share performance, and that was an issue for us last year and so we, we're not giving you the numbers, but when we say we feel good about it, it's because we feel good about it. But we have been, I don’t want to say surprised, but I think we would have expected our discount business to drive stronger sales performance at this point in time than perhaps it is, but that’s been offset by us expecting to have seen less strong performance in our market division over that period and we’ve been very happy with that. So we watch those other big-box retailers, we read their results very carefully as well, and are focused on them and are going to make sure that there’s nothing that they are doing that would see them pull away from us in that sector. We lead the discount market in this country and it’s our intent to continue to do so.

In terms of the health of the consumer, lots being written about that. I think I can provide a tiny bit of colour based on our credit card. So, we are seeing a return to spending on the credit card that’s nearing pre-pandemic levels. What we’re not seeing is a return to balances at anywhere near the same rate. So that, I think, suggests, it’s just one data point of many that you could pick up across the economy, that the consumer balance sheet is in a pretty good state.

Karen Short — Analyst, Barclays Capital

And then just in terms of the Ontario minimum wage announcement, obviously the last time this happened it was a big problem for all retailers and it resulted in significant margin erosion. Maybe just a little context on how you’re viewing the most recent announcement on minimum wage.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

When we look at minimum wage for 2022, we think we’re going to be able to absorb it within our budget for next year.

Karen Short — Analyst, Barclays Capital

So you would not raise prices to offset the cost increase?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Like it's definitely not as significant as what we felt a few years back, so therefore we think we're going to be able to just absorb it and be able to focus on delivering our financial framework.

Karen Short — Analyst, Barclays Capital

Okay. Thank you.

Operator

Thank you. Your next question comes from Peter Sklar from BMO Capital. Please go ahead.

Peter Sklar — Analyst, BMO Capital Markets

Good morning. I have a couple of questions about online. The first one is, when you talk about your year-over-year improvement in your overall results, you haven't mentioned online and, as I recall, during last year, during the COVID bubble when the online demand was just skyrocketing, you really had to throw resources at it in a very inefficient way. And I think you've articulated that online cost you $200 million last year. So I would have thought it would be quite a bit better this year as things moderated and you could take a more structured approach to it and not just throwing labour at the problem. So can you talk a little bit about the performance of your online this year versus last year from a financial perspective?

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

From a starting point, I think we both mentioned that e-commerce volume was essentially flat or was flat really in the quarter versus last year. There has been a slight pullback on grocery e-commerce and both that and the fact that we were lapping that significant ramping up and acceleration of costs has e-commerce, call it, being a positive contributor to our financial performance in the quarter, a little bit of a tailwind as opposed to a meaningful headwind at this time last year.

That's not the way to look at e-commerce and its impact on our P&L over the long term. We expect it to be a headwind as we return to normal growth rates in e-commerce. But of course our objective is to offset those headwinds within the e-commerce strategy itself and through other undertakings in the business. You know what those are. We won't need to improve pick efficiency, primarily, and then we see opportunity to offset the cost of fulfillment through the growth in our media business as well.

Peter Sklar — Analyst, BMO Capital Markets

And Galen, when you say it was a positive contributor this quarter year over year, I assume that means less loss. It's not like the e-commerce business is anywhere near approaching profitability. Is that the way to think about your comment?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes, but I think the key point I would add to that, Peter, is essentially, with the lower penetration rate, the big driver of cost is in labour, and so the labour component of those sales has gone down, because we don't need as many pickers as we had in the rest of the quarters. So from that context, that's what's happening.

Peter Sklar — Analyst, BMO Capital Markets

Okay. And then the other question I had on your e-commerce business, as you know, your home delivery is mostly focused around Instacart. Instacart, I think, can be an expensive proposition for the consumer. Is that going to be your long-term solution for home delivery or do you anticipate that Loblaw will develop its own in-house proprietary home delivery option for consumers?

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

Yeah, so we have our own PC Express delivery channel and it has full coverage in the city of Toronto now and you should expect to see an increasing amount of coverage for what we call PCXD in the key urban centres across the country where we see the largest opportunity for demand in delivery.

Peter Sklar — Analyst, BMO Capital Markets

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

Operator

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

Vishal Shreedhar — Analyst, National Bank Financial

Hi. Thanks for taking my questions. In light of your announcements on network optimization and commentary on future network optimization, wondering if you can give us a perspective on real estate growth for the year ahead, if that's going to go positive or should we expect a (inaudible) to negative year?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Well, as we've said, Vishal, essentially the way to think about this is we focused on our 20 most unprofitable stores. So, as we deal with those stores, we're going to deal with this unprofitability and actually turn it into a profitable initiative. And once it's all said and done, we expect a $25 million EBITDA improvement to our business.

Vishal Shreedhar — Analyst, National Bank Financial

Sure. Is there any way that we should think about real estate growth and your aspirations to expand your network and grow stores, particularly in light of strong demand?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes. Yes. As we said last quarter, opening new stores is going to be part of our strategy, but to build a pipeline of new stores takes time. So that's probably, you're probably going to see more, I guess, traction of that initiative 18 to 24 months down the road.

Vishal Shreedhar — Analyst, National Bank Financial

Okay. I just want to switch gears back to e-commerce, if that's okay. Obviously e-commerce and grocery, it's relatively nascent at this point. Wondering if you can comment on customer satisfaction associated with e-commerce. Is it trending favourably and is it at a level of performance which you deem to be appropriate?

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

Yes and yes. So our focus in 2021 has been really improving the fundamental value proposition of our existing e-commerce offer and we've seen substantial improvements in the key areas that we've been targeting over the last six months. That includes reducing wait times, it includes pick accuracy, pick efficiency, making sure that people are getting everything that they ordered, all of which has been trending substantially in the right direction. And we're very happy with our NPS and customer SAT scores for our e-commerce business at this moment, but we always want it to be better and we continue to see opportunities and we are continuing to deploy technology enhancements and solutions to drive that NPS up.

Now the second focus in, call it, the last few months and the last quarter and a half of the year has been on standing up the delivery channel that pairs very nicely with PCEX in-store pickup, and we've been really happy with the trajectory of that business too. It's, call it, running slightly behind from an NPS perspective, but we're comfortable that we'll get that into the right place in short order as well.

Vishal Shreedhar — Analyst, National Bank Financial

Okay. And I think in the prepared remarks I heard management comment that they're planning to open new manual pick fulfillment centres. I was surprised at the option for the manual pick, so maybe you can provide some colour on that. Why not an automated pick fulfillment centre given that labour is the highest cost? I presume one of the highest costs. And can you also give us commentary on if you have line of sight of technologies that will reduce costs in the future?

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

Yeah, so, I think we have talked a little bit about this in previous quarters. So absolutely, pick efficiency is one of the big drivers to improve economics. There are multiple ways to improve pick efficiency and we are pursuing them all. One of them is standing up dedicated, call it, dark store facilities that can get our pick efficiency items per hour well up into kind of the 200 level. And manual facilities are much quicker to build and so that's where we're focused at the moment.

You know we have an automated facility. We're in partnership with a company called Takeoff. We're still working, learning to understand the best ways to optimize that facility. We don't yet think that manual or that automated fulfillment in micro-fulfillment centres is quite ready for prime time. So you're not going to see us announce a wave of robot facilities going out in the next number of months, but we are certain that that technology will come right at some point and we are very, very close to that technology and we'll deploy it when we're confident about its effectiveness.

Vishal Shreedhar — Analyst, National Bank Financial

Thanks to the colour.

Operator

Thank you. Your next question comes from Chris Li from Desjardins. Please go ahead.

Chris Li — Analyst, Desjardins

Good morning. Just first question is, for the $3 billion of e-commerce sales that you're on track to achieve this year, just wondering if you can share with us sort of the breakdown between grocery and non-grocery.

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

We'll share that with you when we finish the year.

Chris Li — Analyst, Desjardins

Okay. Okay, that's fair. And another one just on e-commerce, maybe on Loblaw Media, just wondering how long would it take before it becomes a more meaningful contributor that will help you start to offset some of the online fulfillment costs?

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

Think about it as moving forward on a very satisfactory trajectory. And that means growing fast, but still not small, sorry, growing fast but still small, and an expectation that it will be a big contributor. And I'm not going to say exactly when, but certainly over the next couple of years.

Chris Li — Analyst, Desjardins

Okay, that's helpful. And maybe just a few quick ones on capital allocation. First one, do you expect the level of CapEx for next year to be similar to this year?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Right now, yes.

Chris Li — Analyst, Desjardins

Okay. And then in terms of share buyback, I mean you guys have been very consistent buying back, I think, roughly about $1 billion worth of shares every year in the last few years. Again, do expect a similar level for next year?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yes.

Chris Li — Analyst, Desjardins

And then just in terms of M&A opportunities, are there any attractive ones that might be appealing to you?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Nothing of scale. We're always looking at opportunities, if they become available, but right now nothing on the radar.

Chris Li — Analyst, Desjardins

Okay. This last one is, I know you guys publish a return on invested capital number every quarter, just wondering, I'm sure you have a target internally, are you willing to kind of share with us what sort of the long-term sustainable ROIC target would be?

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Yeah, we'll share that with you when we come back with our outlook for 2022.

Chris Li — Analyst, Desjardins

Okay, great. And all the best in the holiday season.

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

Thanks.

Operator

Thank you. And your last question comes from Patricia Baker from Scotiabank. Please go ahead.

Patricia Baker — Analyst, Scotiabank

Thank you very much for letting me do a follow-up call. So, in your discussion of operational excellence and retail excellence, you noted that you're getting better at using data, and that's pretty obvious given the results that you've shown this quarter and last quarter. I'm just curious, what can you share with us? What did you do to get better at using the data? Was it hiring different people? Was it different processes? What was the secret sauce there?

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

Yeah, so I'd say two things. First and foremost, focus on just a very short list of, call it, tools that have very a measurable targeted benefit and impact if deployed correctly. So, instead of trying to make 10 tools work across a million dollars of sales each, we want to make two tools work across hundreds of millions of dollars of sales each. And that's how you start to scale the impact of this analytical capability.

Second thing, which we can take less credit for in terms of the change, is that these algorithms are designed to understand price sensitivity in the minds of individual customers. And if you go through a period where there is no price sensitivity, which is what COVID was, then those algorithms don't function all that well. And that's changed.

Patricia Baker — Analyst, Scotiabank

Okay. That's very helpful, Galen.

Operator

There are no further questions at this time. You may please proceed.

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

Great. Thank you very much. Thanks, everybody, for your time this morning. If you have any follow-up questions, drop me an email or give me a call. And circle your calendars for February 24th when we'll be back online to talk about our Q4 and full year 2021 operating results. Thanks and have a great day.

Operator

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