FINAL TRANSCRIPT

Loblaw Companies Limited

First Quarter 2020 Results Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Loblaw Companies Limited Q1 2020 Earnings Conference Call.

At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. To ask a question during the session, you will need to press star, one on your telephone. Please be advised that today's conference is being recorded. If you require any further assistance, please press star, zero.

I would now like to hand the conference over to your speaker today, Roy MacDonald, Vice President, Investor Relations. Thank you. Please go ahead, sir.

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

Thank you very much, Julianne, and we apologize for the brief delay getting moving this morning, but I'd like to welcome you to Loblaw Companies Limited First Quarter 2020 Results Conference Call.

I am joined in the room today by our Executive Chairman, Galen Weston; Sarah Davis, our President; and Darren Myers, our Chief Financial Officer.

Before we begin the call, I want to remind you that today's discussion will include forward-looking statements, which may include, but are not limited to, statements with respect to Loblaw's anticipated future results and the impact of the COVID-19 pandemic. These statements are based on assumptions and reflect Management's current expectations, and are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from our expectation. These risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulators. Any forward-looking statements speak only to as of the date they're 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 regulator 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 Darren.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Thank you, Roy, and good morning, everyone.

It's certainly a different world from a little over two months ago, when we reported our fourth quarter results. Before I get into the numbers, let me begin by expressing my gratitude to all our colleagues for their incredible dedication throughout this crisis. Our frontline teams and the supporting organizations adapted swiftly and with compassion to ensure we continue to deliver the services that Canadians count on in a safe and secure environment.

Moving to the quarter, on an adjusted consolidated basis, our reported revenue grew by 10.7 percent, Adjusted EBITDA reached 12.4 percent, adjusted net earnings increased by 21.4 percent, and adjusted earnings per share grew by 24.4 percent in the quarter. Our sales were positively impacted towards the end of the quarter by COVID-19 in an unprecedented increase in the purchase of essentials.

As a reminder, our quarter ended on March 21. In the final two weeks of the quarter, our grocery stores saw an incredible traffic spike, with sales growth of approximately 44 percent. Our pharmacies saw similar levels of growth, with front store up 42 percent and pharmacy up 26 percent in the final two weeks. The significant quick increase in volumes delivered positive leverage for the business, which were only partially offset by COVID-related costs. Those costs started ramping as the quarter closed. We estimate that COVID-19 generated an incremental $751 million in revenue in the quarter, with a corresponding increase in adjusted diluted earnings per share of $0.14.

Our same-store sales and drug retail grew 10.7 percent. Front store same-store sales grew 10.7 percent, while pharmacy same-store sales grew 10.6 percent. For font store, we saw significant growth in all categories, except cosmetics. Pharmacy also saw strong growth, with prescription count growth of 5.5 percent and a 4.8 percent higher average script volume, driven mainly by early fills and shift to higher days of supply of prescriptions due to COVID-19.

Food retail same-store sales grew 9.6 percent in the quarter. Our average article price was 1.5 percent for the quarter. The quarter saw very strong comps in both basket and traffic. Total retail gross margin was 29.8 percent. Excluding the consolidation of franchises, retail gross margin declined 30 basis points, compared to last year. Food margins were stable, offset by pressure on the drug side, largely driven by mix. Retail SG&A as a percentage of sales was 19.8 percent. Excluding the benefit from franchise consolidation, retail SG&A improved by 70 basis points, as we benefited from favourable sales leverage. Retail EBITDA increased 17.9 percent and EBITDA margin came in at 10 percent, an increase of 60 basis points, compared to last year.

Moving to PC Financial, revenue was approximately flat in the quarter, while Adjusted EBITDA contributions declined $47 million year-over-year, primarily as a result of increased provisions for the potential credit losses associated with COVID-19. Adjusted consolidated EBITDA margin was 9.9 percent in the quarter. Normalized for the consolidation of franchises, EBITDA margin was flat, compared to last year.

In the quarter, IFRS net earnings available to common shareholders was $240 million, up 21.2 percent, and fully diluted earnings per share were $0.66, an increase of 24.5 percent.

Free cash flow was strong, with $1.19 billion generated in the quarter, as we benefited from the increase in demand towards the end of the quarter.

In the quarter, we repurchased 2.8 million common shares at a total cost of $188 million.

Now, let me spend a little bit of time talking about what we are seeing as we look ahead. As noted in our April 9 press release, there remains a high degree of uncertainty about the duration and the impacts of the COVID-19 pandemic on the Canadian economy. We expect continued volatility in our business as shopping behaviours continue to evolve, as does the demand for the types of products and services we provide. In light of these uncertainties, we withdrew our 2020 outlook.

Our focus as we continue to navigate through the COVID crisis is to do the right things to protect our colleagues and customers, while taking all the necessary actions to meet the needs of consumers. These actions include enhancing customer convenience, supporting our colleagues in our stores and distribution centres with temporary pay premiums and pay protection safeguards, securing our operations, and providing financial support to our communities and customers. These investments are significant, but we believe they are necessary and the right thing to do.

As we look more closely at the second quarter, it is very difficult to predict how sales will evolve. We expect potential reductions in some discretionary spending categories, as we expect the current social distancing requirements will also impact our sales trajectory. Since the beginning of the second quarter, we have experienced a pronounced change in the trajectory of our sales. For the first five weeks, food sales growth was approximately 10 percent, while drug sales declined approximately 6 percent. This, combined with an estimated $90 million per month of incremental COVID investments to keep our stores safe for our customers and our colleagues, will put financial pressure on our business.

Both our process and efficiency initiatives and our CAPEX program continue, with some adjustments necessary to ensure that our retail operations are not impacted during this busy and critical period. We continue to invest in our long-term strategic initiatives.

Our liquidity remains strong, supported by a strong balance sheet and the ability to generate significant cash flow from our operations. As of Q1, Loblaw's consolidated cash and short-term investments balance was $2.2 billion. This includes $350 million which we drew on in the quarter from our committed credit facility to backstop a $350 million bond maturing on June 18, 2020. With our strong investment grade credit rating and good standing in the credit markets, we intend to access the bond market to refinance the maturing debt. PC Bank has also increased its funding activity, both prior and subsequent to the balance sheet date, to maintain a surplus liquidity position relative to regulatory requirements. Overall, we feel confident in our liquidity position.

Also, note that we are very pleased to have received the Court of Appeal ruling in our favour overturning the 2018 Lower Court decision related to Glenhuron Bank.

In conclusion, this is certainly a challenging time. We believe we are doing the right things to protect our colleagues and customers, while taking all the necessary actions to meet the needs of consumers. While we expect short-term challenges, we are well positioned to continue to help Canadians navigate through today’s extremely challenging time and to continue to build on a foundation that positions us well for the future.

I will now turn the call over to Sarah.

Sarah Davis – President, Loblaw Companies Limited

Thank you, Darren, and good morning, everyone.

We began the year much as we ended 2019, well within our expected performance range, with continued strength at Shoppers Drug Mart and good signs of share growth in our grocery businesses. Without the impact of COVID-19, we were trending toward a very complete quarter. All elements of our strategy were in order. As it turned out, Q1 was a tale of 14 days. When the government offered their pandemic warning and suggested Canadians prepare for a long stretch at home, we saw a rush to retail that no desk study could have anticipated.

In a matter of days, customer counts and basket size spiked fourfold; sales of paper, frozen and meat products skyrocketed; e-commerce traffic tripled; restaurants closed and our prepared meal business and recipe-making categories took off; and pharmacies were lined with patients filling prescriptions, seeking health essentials and advice. While the extreme stockpiling is over, we are clearly still facing new consumer behaviours and an altered, continuously changing trading environment. We meet daily now on a few key priorities, keeping people safe and well served, optimizing store operations and e-commerce, and advancing business strategies to prepare for what comes next.

Today, we must not only anticipate a return to past shopping and consumer habits, but also plan for the fact that many recent changes will not reverse entirely.

First, we have to look at our P&L and bring it back into balance over time. As Darren said, that will be a big task, particularly in the second quarter. The impact of wage increases, safety and social distancing investments made in Q1 will fall heavily in Q2. We have committed hundreds of millions of dollars, thoughtfully and decisively, for the safety and security of our colleagues and our customers.

Next, we need to advance our plans for the back half of 2020, fine-tuning as the economy opens and we better understand the expectations for social distancing and other safety controls. We also need to monitor near-term conditions for our core businesses. For example, early stockpiling benefited all of our stores, but the market division has been a bigger benefactor of the sustained increased buying. People are shopping less, buying more, favouring one-stop-shops without long lines, and focusing less on price. These conditions benefit market stores, but a prolonged economic pinch or resurgence of general merchandise may favour discount stores. We’re well positioned either way, but it is something we’ll watch carefully. At Shoppers, we must understand the opportunity to assist the primary care response to COVID, while also assessing the current drag on certain in-store categories, like beauty.

Finally, we need to look to the future at emerging trends and match them against our own business strategy, particularly in areas where we have been investing for many years. For example, the industry is using fewer flyers, so we are offering more personal offers through PC Optimum. We have demonstrated our connected health strategy, facilitating virtual physician consults and using our pharmacies as community health hubs, and we are clearly in a new phase for e-commerce. Our online apparel, beauty and pharmacy businesses are up. Our PC Express online grocery volumes are three times the norm, hitting levels we didn’t expect for many years. Within weeks, we’ve scaled our online capacity by enhancing technology, increasing labour hours, adding overnight picking slots, and optimizing store space. We scaled the system and are now refining how it works at high volumes.

Enterprise-wide, I believe we have executed on our strategies well and made the right choices in our COVID response. It makes me so proud and thankful: proud that our customer satisfaction scores have climbed steadily since mid-March, in some cases dramatically; and thankful for the effort of our team, which has been tireless and caring for nearly two months straight. I can’t say enough about the pharmacists, cashiers, stock clerks, managers, franchise owners, truck drivers, pickers in our distribution centres, and our vendor partners and farmers who are keeping the food and drug systems rolling.

I've been sending daily notes to our nearly 200,000 colleagues, sharing news, observations and customer praise for their efforts, and many have been responding with suggestions and stories of encouragement of their own. I received one email early in this crisis from a colleague in our Replenishment Team. It was a short and simple message that quoted Winston Churchill. It read, "After all this is over, all that will matter is how we treated each other." I couldn't agree more.

I will now turn the call over to Galen.

Galen Weston – Executive Chairman, Loblaw Companies Limited

Thank you, Sarah.

The global COVID-19 pandemic has led to unprecedented circumstances at Loblaw. As an essential service providing access to food, drugs and healthcare services across the country, our focus has been anchored in an absolute commitment to do what is asked of us, while at the same time keeping our colleagues and customers safe. Although we appear to be moving into a new phase of the crisis, it is far from over, and we remain committed to sustaining the measures needed to support our communities appropriately until the pandemic is behind us. On the frontline of that commitment are nearly 200,000 of our colleagues, and I offer them my sincere thanks for the way they are rising to that challenge.

At this point, it's very difficult to anticipate precisely how our business will change in any emerging new normal. However, there are certain customer trends we expect to accelerate substantially from pre-COVID run rates. We believe that online grocery shopping will retain a significant proportion of the current sales penetration that Sarah referred to, and that our Company’s national leadership position here will serve it well.

We are also seeing more and more customers responding to digital promotion strategies, setting the stage for a potentially significant change in how Canadians shop. In that context, the strength of PC Optimum and Loblaw’s one-to-one communication channels will be an increasingly valuable asset.

Finally, the adoption of digital healthcare services has also grown rapidly over the last few weeks. As patients become increasingly familiar with these services and provinces recognize their important role as part of existing provincial healthcare reimbursement programs, we believe that their use will remain at substantially elevated levels.

In the coming months, the Company will continue to move quickly to build on its strength in each of these areas of opportunity. We do so from a position of strong financial liquidity and rooted in a compelling strategy, and we remain steadfastly focused on the day-to-day challenges facing our Company, with a close eye on how best to serve Canadians in the future.

I’d now like to open the call for any questions.

Q & A

Operator

Thank you. As a reminder, to ask a question, please press star, followed by the number one on your telephone keypad.

Your first question comes from Karen Short from Barclays. Your line is open.

Karen Short – Analyst, Barclays Capital

Hi, thanks very much. I'm wondering if you could just talk a little bit about, I guess, first, starting with the e-com, you said, obviously, that was up threefold, and it looks like you made a lot of changes to meet that demand, but can you talk about what you think the sustainable run rate is of that, in terms of dollars, and what the mix is between, say, click-and-collect versus actual delivery, and then I had a couple of other questions?

Sarah Davis – President, Loblaw Companies Limited

Okay. So, I'll take that. It's Sarah. Hi, Karen.

Karen Short – Analyst, Barclays Capital

Hi there.

Sarah Davis – President, Loblaw Companies Limited

In terms of e-commerce, we have seen a threefold increase in the penetration. That means that in many of the stores where it's offered we're up into the double-digits in terms of penetration in food. We don't know exactly where it's going to land, but we're pretty pleased with our business, because it's very scalable. It's national in scale, we can offer it based on what customers want right across the country, and we can scale it up and down. There's a lot of variable costs, and now that we've got it scaled to a high level, we can pull back on that if we need to, or we can continue at the level that we've got. So, difficult to predict. We expect that it will continue higher than it was pre-COVID, but we do think it will settle in at a lower level than where we are right now.

I think there was a second part to your question, as well.

Karen Short – Analyst, Barclays Capital

Well, just wondering (multiple speakers) behavior…

Sarah Davis – President, Loblaw Companies Limited

Oh, the delivery…

Karen Short – Analyst, Barclays Capital

Yes, yes.

Sarah Davis – President, Loblaw Companies Limited

Okay. So, I would say that delivery has had a higher increase, but it's on a smaller base, so overall the majority of our business, in terms of grocery online, is still being done through click-and-collect and pick up at store.

Karen Short – Analyst, Barclays Capital

Okay, and then, I guess, a couple questions just on the costs. You called out the $90 million in incremental costs for the period. First of all, I just want to clarify. You said period, but then I think in the prepared remarks you also had the same comment related to five weeks, so I want to clarify if that's a five-week number of if that's a month or four-week period, because normally I think of the period being four weeks.

Then, the other question I just wanted to ask is, you gave a comment on the sales in the last two weeks, and then also the EPS contribution, but that would imply north of 20-plus percent in terms of contribution margin on EBIT, I think, in the last three weeks, so can you maybe just parse that out a little bit?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Yes, hi, Karen. It's Darren. On your first question, yes, no, the four weeks, the costs is for a four-week period, and the five weeks, we just wanted to give everybody, all the investors, the most relevant data we have, and so the most recent data we have is a five-week period, so we gave a five-week sale picture, but the costs is definitely four-week amount, and our period is four weeks.

On your second question… sorry, the second question was?

Karen Short – Analyst, Barclays Capital

(Multiple speakers)

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

(Multiple speakers) definitely, the flow-through was incredibly strong. What you have to think about is, as this was announced by the government, the level of stockpiling traffic we saw was through the roof, and so, from a store perspective and operations perspective, we're really just trying to keep up, from a labour point of view, to a very heightened demand. So, the flow-through was very good, even despite the fact that there were some COVID-related costs in that final period, as well.

Karen Short – Analyst, Barclays Capital

Okay, and then just the last question on the $90 million. I know, obviously, that some of it is… well, a lot of it is incremental hours, and things like that, but do you have any sense, when we get into, I guess, the new—what people are saying—new abnormal post-COVID period would look like, how much of that is just embedded costs that you will have now, like from a cleaning, you know, disinfecting type of perspective, once the labour hours can maybe normalize a little bit?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Yes, Karen, I mean, it's incredibly hard for us to predict the future after all this, so we're going to try not to give any colour going after the pandemic. I would say these are temporary costs right now that we expect to continue through the pandemic, but it's too difficult for any of us to predict what happens afterwards.

Karen Short – Analyst, Barclays

Okay. Thanks very much.

Operator

Your next question comes from Mark Petrie from CIBC. Your line is open.

Mark Petrie – Analyst, CIBC World Markets

Hey, good morning. I just wanted to ask about your approach to promotions, primarily in the food channel, but also drug, I guess. I know you've made some adjustments to distribution and that varies by banner, but, overall, how have you seen the dynamics around promotions change over the last, I guess, eight weeks? Obviously, not really appropriate to drive traffic, but of course you still want to bring excellent value to your customers, so how have you sort of balanced those dynamics?

Sarah Davis – President, Loblaw Companies Limited

Okay. So, I'll start with that. Hi, Mark. I would say that what we've committed is that we would continue to provide as much value to our customers as we did pre-COVID, so we've continued with the promotional activity, but, yes, we have had to adjust it to make sure that we didn't have promote rushes into our stores. For example, we did do a no-tax event across our Superstore business, we extended it. Normally, it would be over a weekend. Given that we're encouraging customers to come one time per week per family, we had it over a seven-day period. So, great value for our customers, but at the same time being respectful for what we're asking of our customers to make sure that they stay safe, as do our colleagues.

I would say we're also looking at some changes in terms of the amount of paper we're using. We have gone to more digital flyers in our discount business. They've gone to 100 percent digital in some of the Superstore business. We've reduced the flyers in Quebec. Some of it is dependent on some of the provincial guidelines, as well. I would say on the Shoppers side, pretty similar, they've gone to some promotional activity through digital, trying to keep the exact same price position through this to make sure our customers continue to get value, and just reflecting some of the rules that we've got that we're working within.

Mark Petrie – Analyst, CIBC World Markets

Okay, thanks. I mean, I guess, just sort of netting it all out, I'm just curious about your perspectives on gross margins in the short term. I mean, obviously, bigger basket size, lower shrink, those are all beneficial. Presumably, there's also less contribution from suppliers in terms of trade spend. So, just wondering how investors should think about gross margin in the short term.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Hi, Mark. Again, we're going to hold back from giving colour as to predicting what will happen in gross margin. I think there's a few moving parts, which I think you touched on in your question there, and it's just difficult to see how these are going to play out. We are seeing more cost pressure from vendors, as well, and our goal is to keep prices as low as we can for Canadians. So, there's a lot of moving parts in terms of gross margin and it's a bit difficult to predict right now.

Sarah Davis – President, Loblaw Companies Limited

I'd say there's a little bit of mix change, too, because what we have seen is an increase in some of the… obviously, in sales, that's sort of the pantry-building, but we're seeing declines in our general merchandise business, which also has an impact on margin. So, apparel and general merchandise and beauty are all down, they're all relatively high-margin parts of our business, but we're seeing the very high margins, or increases in sales in terms of the food part of our business.

Mark Petrie – Analyst, CIBC World Markets

Okay, thanks, that's helpful. I mean, I guess, just touching on that, are you able to quantify, or will you share the quantification of the impacts from the general merchandise and apparel decline on your food same-store sales comp, I guess, either for Q1 or, maybe more importantly, for the Q2 to date number?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

I'm not going to provide that today, Mark. I'd say in Q1, given the growth we saw, it was less impactful. Certainly, in Q2, in the five weeks, it's had a bigger impact. In particular, as you note, with Shoppers Drug being down, there's a bigger impact in there, and there's some impact on the food side, as well, but we're not going to break that out today.

Mark Petrie – Analyst, CIBC World Markets

Okay, thanks. All the best.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Yes, thanks, Mark.

Operator

Your next question comes from Patricia Baker from Scotiabank. Your line is open.

Patricia Baker – Analyst, Scotiabank

Good morning, everyone. I have a few questions. My major questions have been addressed, but, Sarah, I just want to get a clarification first of something you said in your opening remarks, and my phone cut out, so I missed the beginning of what you said. But I heard the last part of a phrase which said, will fall heavily in Q2. And so were you referring to the costs?

Sarah Davis – President, Loblaw Companies Limited

Yes. So, the impact of the costs that started in Q1, but not in a significant way. The $90 million that Darren mentioned per period will have an impact, clearly, on Q2.

Patricia Baker – Analyst, Scotiabank

Right, and the definition of the word fall here was more like it will hit in Q2, rather than fall as in decline?

Sarah Davis – President, Loblaw Companies Limited

Oh, I see what you mean. No, it will hit.

Patricia Baker – Analyst, Scotiabank

Okay, great.

Sarah Davis – President, Loblaw Companies Limited

So, make sure that’s perfectly clear.

Patricia Baker – Analyst, Scotiabank

Okay. Then, just talking about the online and the big surge there, you said triple, up three times, and you also indicated that your online business is way ahead of where you would have expected it to be in 2020. Can you just give me some sense of your online business, as a percent of sales, is it where you would have expected it to have been in 2021, 2022?

Sarah Davis – President, Loblaw Companies Limited

We are saying a couple of years ahead of where we were, so I would say two or three years ahead. It's hard to know exactly, because obviously things have an impact on that, but it would be a couple years ahead of where we were anticipating.

Patricia Baker – Analyst, Scotiabank

Okay, that's very helpful. Then, when did you start to see the right-hand side of the store, or general merchandise and apparel start to drop off?

Sarah Davis – President, Loblaw Companies Limited

We saw it in the last two weeks. They were definitely negative in the last two weeks of Q1, and they've continued negative in most of the weeks of Q2 so far.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

And apparel has been a larger drop.

Sarah Davis – President, Loblaw Companies Limited

That's right, apparel is down more. General merchandise, we have seen some—depending on what's happening in the store—we've seen sales in those ones, so not as big a drag, but apparel has been down.

Patricia Baker – Analyst, Scotiabank

Okay. Have you done anything on the apparel side, like sort of lowering your inventories or delayed purchasing, or anything?

Sarah Davis – President, Loblaw Companies Limited

We have. We're absolutely preparing for what the back half of the year will look like. Of course, apparel has long lead times, so you're limited in what you can do, but we are reducing our buys where we can, and also looking at changing some of the merchandise that we getting, in terms of the type of merchandise we're getting, as well, so definitely factoring that in, and I would say that sales online are actually up, but it's a small base, so not as much to offset the decrease in the bricks-and-mortar.

Patricia Baker – Analyst, Scotiabank

Okay, and just with respect to Shoppers Drug Mart, when did you start to see the decline there? Did that start when the government started to expect you to lower the density of people in the store and when you limited, you know, put in the social distancing measures?

Sarah Davis – President, Loblaw Companies Limited

Well, Shoppers was up significantly for the last two weeks of Q1, and then I would say, as the stockpiling stopped and levelled off, we would have seen a decline in the pharmacy business, and the beauty business would have dropped before that. The beauty business dropped in Q1, in the last two weeks, and has continued, and we have changed the… so there's a couple things happening in beauty. It wasn't the focus of what people we're coming into the stores for. We changed the role of the beauty advisors and did just have them help out in-store, so we weren't actively selling beauty at that time, as well. Some of that, we're starting to change now, depending on the store.

Then, of course, as you said, the impact of reducing the number of people in store would have also had an impact. The change in the number of days of supply also would have had an impact, and of course just the stockpiling, people had bought up their prescriptions for a period of time. All of that would have had an impact and the decline we're seeing in Q2.

Patricia Baker – Analyst, Scotiabank

Okay, excellent. Just sticking with Shoppers—this is my last question—we don't know how long this is going to last, and as you indicated, the first five weeks, they saw a 6 percent decline in sales. Are you looking at potential things that you could do to help associate owners should it impact their business?

Sarah Davis – President, Loblaw Companies Limited

We have been looking at all aspects, because we have a lot of franchise owners on the food side of our business, and of course the colleagues in our business, as well, so we have been looking at ways.

There are some Shoppers stores that have been closed, because they are in shopping malls, so that will be something that we factor in.

Sarah Davis – Analyst, Scotiabank

Okay, thank you so much, Sarah.

Operator

Your next question comes from Peter Sklar from BMO Capital Markets. Your line is open.

Peter Sklar – Analyst, BMO Capital Markets

Hi, good morning. Just a question on the credit card business. You took the allowance up in the quarter, for obvious reasons. I quickly did the math. It looks like you took the allowance up about 175 basis points, though I'm not sure. Can you talk about, like, is that right, is the allowance rate up about 175 basis points? And also can you talk about other indicators of credit performance, such as past due or write-off rates, anything you could provide?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Yes, Peter, I don't have the exact number in front of me, so I don't want to be misquoted, whether that's exactly right, so I'd have to run the math after, but, as you mentioned, the ECL provision is very forward-looking, and so it looks at a whole bunch of macroeconomic trends. The idea is that you're taking the hit before things happen, looking at what could happen in the economy. That's why we saw the $45 million increase there. But, from what we're seeing so far, I mean, we're a very high-transaction portfolio. We're not seeing any major changes at this time in terms of payment pattern. You wouldn't expect, probably, to see that yet. As the economy goes into a further recession, as people are more cash-strapped, you start seeing things, but so far we haven't seen a lot of change there. We're obviously watching for that closely and we'll have to continue to update our ECL provision as we look at more of the macroeconomic trends that are out there.

Sarah Davis – President, Loblaw Companies Limited

I think what we have seen on our credit cards is a reduction in spend.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Yes.

Sarah Davis – President, Loblaw Companies Limited

So, we have a significant reduction in spend. People obviously aren't travelling, aren't buying some of the things that they normally would. We are seeing an increase in the spend on food, as you can imagine. But, overall, the spend is down, so the receivable balance is actually coming down, and the payments have not changed significantly, so we're in a good position, we feel. But as Darren mentioned, the ECL is based on economic trends, it's based on unemployment rates, lots of other things that are future-looking, as well.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

The final one just on that point, as Sarah said, we do expect to see some pressure still from the bank in Q2 because it's based on a high-transaction portfolio and we're seeing lower purchases, so obviously there'll be some impact from that.

Peter Sklar – BMO Capital Markets

When you describe it, Darren, as a high-transaction portfolio, does that mean also relative to the portfolios of other credit card companies; like people pay off their balances, they don't borrow the way they do with other cardholders?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Exactly, Peter.

Sarah Davis – President, Loblaw Companies Limited

A lot of the earnings are based on interchange as opposed to interest in our portfolio, so as people spend less, it has an impact on the amount of interchange.

Peter Sklar – Analyst, BMO Capital Markets

Okay. That's all I have, thanks.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Thanks, Peter.

Operator

Your next question comes from Irene Nattel from RBC Capital Markets. Your line is open.

Irene Nattel – Analyst, RBC Capital Markets

Good morning. A couple of questions, if I may. Coming back to recurrent trends, or the sales trends in-store, could you talk a little bit about what you're seeing around category, you know, sort of have you seen the normalization-centred story, is it more now the periphery, what's happened to private label, those types of things?

Sarah Davis – President, Loblaw Companies Limited

Hi, Irene, it's Sarah.

Irene Nattel – Analyst, RBC Capital Markets

Hi, Sarah.

Sarah Davis – President, Loblaw Companies Limited

I would say the biggest trend, that I did mention in my comments, that hasn't come up as a question, is actually the trend between our two divisions in food, so I do want to sort of highlight that as a big trend. Market division, our conventional stores are seeing very large growth, continue to see very large growth, and I would say our discount stores have not seen the same growth, which is why, when Darren talks about the first five weeks having 10 percent growth in food, that is skewed quite significantly between the two divisions. Which is interesting to see, because I would have said over the past few years we would have seen discount, and as a Canadian market, discount would have been growing faster, and now we're seeing the opposite during this pandemic.

We're attributing it to the fact that there's less… people are only doing one shop, that they're only doing one shop in the week, they want to make sure that they have the best assortment, they want to make sure that they go into the store that perhaps has a shorter line, is not quite as crowded as some of the smaller discount stores. And they're not shopping around: many of our customers would go to multiple banners, and now they're doing one shop and they're choosing a market division store. So we are seeing that, and as I said, they're looking for the higher assortment and the shorter lines, as well as, I would say, they're probably a little bit less conscious of price at this point in time, and they're also taking up more of the spend from restaurants and other offers that they could have that are now closed. So, that's what we're seeing.

In terms of what's in the store, we're definitely seeing high growth in areas for people cooking from scratch, which we also would have said prior to this COVID time would have been a declining area, not as many people cooking at home, and now there's a big resurgence, so lots of flour and cooking, baking supplies, we're still seeing a lot of that, and of course you've heard about people stocking on paper. Meat would be another area. So, definitely produce. We're seeing strength in all of our key food categories. As you know, we've closed some of our HMRs, our Home Meal Replacements, so any of the hot categories, those are closed, so that would have an impact on sales. So, an interesting dynamic happening. Then, of course, our discount division is also more heavily skewed to having the right-hand side, general merchandise, more beauty, and of course the apparel, that we talked about. So, interesting dynamic there.

Irene Nattel – Analyst, RBC Capital Markets

Very, absolutely. And just a point of clarification, a couple points of clarification, please. When you talk about sales being up 10 percent—because I'm thinking, for example, about here in Quebec, where grocery stores are closed on Sundays—that is a total weekly spend number?

Sarah Davis – President, Loblaw Companies Limited

Yes.

Irene Nattel – Analyst, RBC Capital Markets

Okay, and the 6 percent decline at Shoppers, is that full store or is that just… could you clarify what that 6 percent is?

Sarah Davis – President, Loblaw Companies Limited

That's full store, full store.

Irene Nattel – Analyst, RBC Capital Markets

That's the full store, okay. Because, presumably, we're also seeing some normalization of Rx, because we saw some of the forward buys. So, it's both Rx and front then, correct?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Yes (inaudible).

Sarah Davis – President, Loblaw Companies Limited

That's right, yes, full store.

Irene Nattel – Analyst, RBC Capital Markets

Then, final question. I noticed that there was no dividend increase announcement today, and also no commentary around the NCIB, and I was wondering if you could just walk us through your current thinking on both of those.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Absolutely. First of all, we remain committed to returning capital to shareholders. It's part of our value-creation model and we're certainly still committed to that.

On the dividend, we are, I think, it's eight years now in a row of doing annual increases, and our intent is still to do an annual increase. We just didn't announce one this quarter. Just in light of the current environment, we just didn't think now was the right time to announce that. It's something we'll continue to look at.

On the buybacks, we have a very strong balance sheet. Our goal is to continue to return, again, capital to shareholders. I think, in the short term, we will take a pause on buybacks, as we see this play out, but our intention is to continue to do buybacks, which is the reason you would have seen the Normal Course Issuer Bid announced today.

Irene Nattel – Analyst, RBC Capital Markets

That's great, thank you.

Operator

Your next question comes from Michael Van Aelst from TD Securities. Your line is open.

Michael Van Aelst – Analyst, TD Securities

Hi, good morning. I just have a few follow-ups, because most of it's been covered, but when you talked about the 10 percent increase in food and the 6 percent drop in drug for the first five weeks, can you give us a little bit of colour how that's trended over that five weeks, because we know it was really strong at the end of Q1. Did it start stronger at the beginning of Q2 and then fade, and are we starting to see any signs of pantry destocking yet?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Hi, Mike. It was almost as we flipped the quarter, we saw the very quick change, and I think it came from all the different tactics put in by government, and all the isolation that's needed, so we saw the drop very, very quickly.

I would say that some of the trends… certainly, we saw beauty sales getting higher declines through this period of five weeks. We're starting to see a little bit of pickup in that area, but it's still negative. So, a little bit of sign of optimism there, that we might see some improvement. Also, as people you know, they get their earlier fills and they get them for longer periods of time, they're going to eventually need to come back and get their fills on their medication, so we think that should drive some demand. Then, on the food side, I think we saw very large drops in apparel as the first weeks of this started. We're starting to see a little bit of improvement there, as well, but still pretty significant negatives in those numbers.

Michael Van Aelst – Analyst, TD Securities

So, overall, it sounds like it was relatively stable throughout the five weeks, but maybe a little bit better in the last period, over the last week?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Yes, I think that's probably the right way to think about it right now, and, you know, it changes every day we look, which is why we're giving you what we know and not trying to predict where it goes, because it just changes so quickly right now.

Sarah Davis – President, Loblaw Companies Limited

Even though the total numbers show steady over the five weeks, the category within them is moving around. To Darren's point, we've seen apparel down and then not as far down, and so we've seen movement within it, but, overall, it's been pretty steady.

Michael Van Aelst – Analyst, TD Securities

Okay, great, and then I wanted to try and get you to clarify the e-commerce penetration comments that you made, because you said that your e-commerce has tripled and the general thought out there is that e-commerce for the industry has been closer to one, but yours is probably higher. But you also said that in the stores where you operate many of them are seeing double-digit penetration. So we don't assume that you're close to double-digits in penetration, can you give us a little bit more clarity as to where your e-commerce penetration is on food?

Sarah Davis – President, Loblaw Companies Limited

Yes, that's a good question. I think the way that we look at it is, the E-Com Team looks at it based on their base, so where they offer e-commerce, in which stores across it, and so I think we talked about having about 75 percent penetration in stores, and then it would have gone from around 3.5 percent of that to above 10, into double-digits in some stores. That's sort of the roundabout math of how we get to triple. In some stores, GTA, for example, we're penetrating higher than that. So, those are national numbers, when I say the tripling. We would have seen higher demand in the GTA.

Michael Van Aelst – Analyst, TD Securities

So, that would mean 75 percent times over 10 percent, you're talking about close to 8 percent penetration.

Sarah Davis – President, Loblaw Companies Limited

I think Roy was trying to figure out the specific math, so maybe he can go through it with you, but that's the way that we look at it.

Michael Van Aelst – Analyst, TD Securities

So, if you were to… you said you were a few years ahead of schedule, or ahead of expectations, but if you were to look out now, I assume you expect a pullback, based on your earlier comments, but where do you think it'll settle now in the next two to three years?

Sarah Davis – President, Loblaw Companies Limited

Actually, I don't know. We don't really know. We know that we have a lot of demand right now and we have had, obviously, wait times have been longer than we would have liked, which is why we've had to scale up our capacity in an incredible amount of time, and have that flexibility, but we've been adding slots, we've been picking at night, we've been seizing the opportunity on Sundays in Quebec, in order to be able to do some picking, so adding the capacity, and so we have it, so we know that going forward we can deal with it, if it stays, but we do think that as the economy opens up and people are allowed out, people will like to still go back to the stores, is our guess. So, I don't know what exactly the penetration is going to be, but whatever way, I feel like we've got a good model, where we can scale up and we can scale down, depending on what the consumer is looking for.

Michael Van Aelst – Analyst, TD Securities

Okay, great. Then, on your strategies and around the costs side, you've waived the pick fees, at least during COVID. Is there any intention to put those back in place post-COVID, or are those more likely to be more permanent, and then what are you doing on the… like, what do you see in terms of home delivery? It seems like you're ramping up your home delivery efforts in different parts of the country. Can you talk a bit more about what your intentions are there?

Sarah Davis – President, Loblaw Companies Limited

Yes. So, we did drop the fees, because we felt that was the right thing to do for Canadians during the pandemic, and give them the opportunity, for those that might have underlying health issues, the opportunity to not have to go into stores. So, definitely, that would be why we dropped the fees. We're looking at the right time to perhaps bring back the fee, but we haven't made a firm decision one way or another yet. We're really just trying to make our way through this pandemic.

In terms of delivery, yes, we have both offerings, and we do have a white label offering, in order so that you can go onto the Loblaw's, or whatever store that you shop at, site and you can choose whether you pick up or you want to have delivery. We have been partnering with Instacart, but we also have our own white label delivery option, as well, now.

Michael Van Aelst – Analyst, TD Securities

How extensive is that white label delivery option, and is this a permanent (multiple speakers)?

Sarah Davis – President, Loblaw Companies Limited

Right now, there's no fee, and what it will be going forward is yet to be determined.

Michael Van Aelst – Analyst, TD Securities

Okay, thank you.

Operator

Your next question comes from Chris Li from Desjardins. Your line is open.

Chris Li – Analyst, Desjardins Securities Research

Hi, good morning. I just want to start maybe with a couple questions for Darren, and then a couple for Sarah.

Darren, I wanted to just to clarify, on your comments about the cost of many millions additional cost for the full week, just on a high level basis, if I were to try to model out what the costs look like for Q2, can I just go 90 times three and that's sort of, roughly, the number year-over-year increase in costs that you're expecting to incur for Q2?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

You'll have to make the assumption on how long you think the costs will go for, because they are tied to things being isolated. If everything opens up, you know, it depends on, you know, we've got to put the right precautions in place, depending on what the government is telling us to do and what's happening out there, but, as a proxy for today, I think it's your best bet, just to take that number.

Chris Li – Analyst, Desjardins Securities Research

Okay, that's helpful. Then, just on the 6 percent decline at Shoppers, I'm not sure if you gave a breakdown between what was pharmacy and front store.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

We did not give a breakdown of that.

Chris Li – Analyst, Desjardins Securities Research

Okay, and are you able to share that?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Not more than the colour that we gave, which is things like cosmetics has been down, our beauty's been down more since the quarter. We tried to give you some directional comment, but we're not going to give the absolutes today.

Chris Li – Analyst, Desjardins Securities Research

Okay, and just lastly, on the number question, on EPS growth, as you alluded in the press release, if we exclude that $0.14 from COVID, your EPS would have been up about 6 percent year-over-year, but if I also exclude the higher credit losses in PC Financial, which was a fairly meaningful drag, that shows sort of a nice double-digit EPS growth for the Company. Am I missing something there? It seems like your underlying trend was actually quite strong, if you excluded the direct and indirect impacts of COVID during the quarter?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

The $0.14 included the bank, so you're right, just over 6 percent would have been the number, and it would have been right on plan. We were quite pleased with our performance going into COVID, we were making a lot of improvements in the business, but, yes, it would have been 6 percent, and it's an all-in number.

Chris Li – Analyst, Desjardins Securities Research

Okay, perfect. Then, Sarah, maybe first a question on loyalty. Since all the travel-related loyalty programs are not very popular these days, with people refraining from flying, it just seems to me there's a great opportunity for the company to really leverage the PC Optimum card to bring even more people into your ecosystem. I guess my first question is do you agree with this view, and, secondly, what are the plans in the works to achieve that?

Sarah Davis – President, Loblaw Companies Limited

Well, that's a good question. I would say we absolutely believe that our loyalty program is a great one, and if there is the opportunity to bring more people in as other loyalty programs are focused on travel and other things that they won't be doing for a little while, so we do think that there is the opportunity. We did mention that, both Galen and I, seeing that as a great opportunity for us going forward. The one-to-one connection has a couple of benefits to it. One, if the industry stays with fewer flyers, it does give us the ability to talk to our customers one-to-one. I also think it's a very compelling offer, so we should be able to get more people to sign up for it, as well. We already have a lot of customers who have signed up, but we're always happy to have more, for sure.

Chris Li – Analyst, Desjardins Securities Research

Got you, okay, and then maybe just one on online, the grocery side. I think, was it you, or maybe your peers, had talked about the high incremental nature of online business, with a large part of your sales coming at the expense of your competitors, and I can only imagine this has been emphasized with the outbreak. So, my questions are, number one, are you able to track what percentage of your online customers, say, in the last couple of months are new Loblaw customers, and then number two is what steps are you taking to ensure that you keep those new customers once things return to normal?

Sarah Davis – President, Loblaw Companies Limited

We have been able to track the number of new customers we have, and we've also been able to track the number of customers we did have that are now choosing to go online, so we do have some interesting data. We absolutely would like to keep these customers. We'd also love to keep them as conventional or market division customers, as well. So, we are looking at tactics to make sure that we keep as many as we can.

Chris Li – Analyst, Desjardins Securities Research

Great. All the best to you and your colleagues in these challenging times.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Thanks, Chris.

Sarah Davis – President, Loblaw Companies Limited

Thank you.

Operator

Your next question comes from Vishal Shreedhar from National Bank. Your line is open.

Vishal Shreedhar – Analyst, National Bank Financial

Hi, and thanks for taking my questions. I got dropped off the call earlier, so I might have missed it, and I apologize if I'm re-asking. With the change in the exchange rate and the higher costs, which have been noted, and heightened demand for certain food products, potential shortages in others, do you see inflation creeping back into the system in a larger way, maybe not next quarter, but call it two, three quarters out?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Hey, Vishal. Yes, I mean, I made some comments before: we are seeing increased costs from our supply chain. Of course, there's just a lot more costs in the whole supply chain system today, and we do expect that to put pressure as we go forward on costs, which therefore will put pressure on price. Our goal is obviously to keep prices as low as we possibly can for Canadians, but I do think it's reasonable to expect to see some inflation as we go into the back half. I'm not going to try to predict the number, though, of course.

Sarah Davis – President, Loblaw Companies Limited

I would say, on the U.S. exchange, it's fortunate timing, in the sense that we're going into the summer growing season in Canada, so we will buy more of our produce, will come from Canada, so it won't be as big an impact, but, to Darren's point, we are seeing some inflation across the board.

Vishal Shreedhar – Analyst, National Bank Financial

Okay, and just moving back to this e-commerce topic a little bit here. Obviously, Loblaw's view in the past was that click-and-collect will be the favoured way for consumers to shop within digital, but you offer a multitude of options for the consumer. So, I'm just wondering if what you're seeing has quicker growth—and I know it's off a smaller base—for ship-to-home, has that changed your view on click-and-collect in any way, or do you still think what you said in the past stands?

Sarah Davis – President, Loblaw Companies Limited

I don't think it changes our view. I think our strategy has always been to be flexible and open, and to understand what consumers want, and to make sure that we have an offering that is appealing to them. Right now, the vast majority of our online business, food business is click-and-collect, but as you mentioned, and as I said, the delivery part has increased more, but I don't think it changes our view, really. It's just a higher demand in total, overall.

Vishal Shreedhar – National Bank Financial

Okay, and you mentioned a white label offering for delivery to home. Can you just explain what that means?

Sarah Davis – President, Loblaw Companies Limited

Yes. So, right now, in the partnership with Instacart, the way that it works is you would go on to Instacart's website and you would order what you want and you would choose Loblaw as the store that you wanted to order from. Now, you can go onto a Loblaw's website and order delivery, and it will be fulfilled through Instacart, but it allows you to go into ours. We think that is a good offering for us to offer our customers.

Vishal Shreedhar – Analyst, National Bank Financial

Okay, and is the cost and revenue model different for the two offers for Loblaw?

Sarah Davis – President, Loblaw Companies Limited

No, it's just where you go, where the customers go to pick their order, to choose their order online. It's just that's where the differentiation is.

Vishal Shreedhar – Analyst, National Bank Financial

Okay, and in the disclosure documents, Management noted that they reduced CAPEX a little bit, while focusing on the process and efficiency initiatives. I'm just wondering if that CAPEX reduction is just an effort to be prudent or it's because Management is changing its views on certain investments. Is it because construction is difficult at this moment in time and you can't build stores or retrofit stores that you'd like? Any help there?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Yes, it's a bit of everything. I mean, really, we're focused on maintaining operations, we're going through this difficult time, so we're trying not to do anything that would be disruptive to the stores, and then there's also challenges in the construction side, just given what that whole industry is going through, as well. So, you're just seeing a bit of all of those things that will lead to a slightly lower CAPEX, certainly, during this period of time.

Vishal Shreedhar – Analyst, National Bank Financial

Okay, and on the costs that you mentioned, so the sales moderating—you did a very helpful job of explaining the trends that you're seeing early in Q2—so sales moderating costs creeping up, and I may not have got this, but did you make any reference to whether the increased sales will offset the heightened costs, or was the comment that we'll just have to wait and see?

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Well, I'm going to let you do the math, but if you look at the increase in sales and the decrease in shopping, the drug side, with the costs, it's obviously a pressure to the numbers. It wouldn't be that they would normally offset, so the answer to that is no, but I'll let you guys do the modeling as to where you think things could come out. That's just a period of time, as well, but at this point, from what we've seen, no, would not offset the costs.

Vishal Shreedhar – Analyst, National Bank Financial

Okay, wonderful, thanks for the colour.

Darren Myers – Chief Financial Officer, Loblaw Companies Limited

Okay, thanks, Vishal.

Operator

Your next question comes from Patricia Baker from Scotiabank. Your line is open.

Patricia Baker – Analyst, Scotiabank

Thank you very much. A couple of follow-ups. With respect to the white label delivery, is that only in the Loblaw banner?

Sarah Davis – President, Loblaw Companies Limited

No. It might have been just piloted in the Loblaw, but the idea would be that it would be across all of them.

Patricia Baker – Analyst, Scotiabank

Okay. So, it's available across the country?

Sarah Davis – President, Loblaw Companies Limited

It either is or it will be. I think it is in various ones, perhaps not all of them, but I'll get back to you. Roy can get back to you on specifically which ones.

Patricia Baker – Analyst, Scotiabank

Super, okay, and then just one more online question. What's the customer experience currently with respect to wait times and slot availability, delays?

Sarah Davis – President, Loblaw Companies Limited

Of course, with all the demand, we did have delays, particularly in some of the major centres, but we're down to six days, on average, and we have plans to get down back to the daily, being able to do it within the day. That's obviously our ultimate model for customers, to order in the morning and be able to pick up in the afternoon, and so we've been adding capacity as fast as we can in order to get back to that, but we're around six days right now, and it depends across the country and it depends exactly on the day, but around six.

Patricia Baker – Analyst, Scotiabank

Okay, excellent. Thanks, Sarah.

Sarah Davis – President, Loblaw Companies Limited

But I would say, if I can make a little bit of a pitch for it, is that I think customers understand the pressure, and also understand that this is a pressure not just to us, but to others who offer online, as well, and so, despite the wait times, they're overall satisfaction is above 80, and it's been steadily increasing every week, so we are happy to see that.

Operator

We have no further questions in queue. I turn the call back over to the presenters for closing remarks.

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

Great. Thank you, everybody, for your time this morning. Please give me a shout if you have any follow-up questions, and you can mark your calendar for July 23, when we will be back online discussing our Q2 results. Thanks very much. Have a great day.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.