FINAL TRANSCRIPT

Loblaw Companies Limited

First Quarter 2021 Earnings Call

Event Date/Time: May 5, 2020 — 10:00 a.m. E.T.

Length: 57 minutes

CORPORATE PARTICIPANTS

Roy MacDonald
Loblaw Companies Limited — Vice President Investor Relations

Darren Myers
Loblaw Companies Limited — Chief Financial Officer

Sarah Davis
Loblaw Companies Limited — President

Galen Weston
Loblaw Companies Limited — Chairman and Chief Executive Officer

CONFERENCE CALL PARTICIPANTS

Irene Nattel
RBC Capital Markets — Analyst

Mark Petrie
CIBC — Analyst

Karen Short
Barclays — Analyst

Vishal Shreedhar
National Bank — Analyst

Patricia Baker
Scotiabank — Analyst

Kenric Tyghe
ATB Capital Markets — Analyst

Chris Li
Desjardins — Analyst

Peter Sklar
BMO Capital Markets — Analyst

Michael Van Aelst
TD Securities — Analyst

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to Loblaw Companies Limited for first quarter 2021 earnings 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 *, 1 on your telephone keypad. If you require for any further assistance, please press *, 0.

I would now like to hand the conference over to your speaker today, Roy MacDonald. Please, go ahead, sir.

Roy MacDonald — Vice President Investor Relations, Loblaw Companies Limited

Great. Thank you very much, Jacqueline. Good morning, and welcome to Loblaw Companies Limited first quarter 2021 results call. I'm joined in the room this morning by Galen Weston, our Executive Chairman; Sarah Davis, our President; and Darren Myers, our Chief Financial Officer.

And as always, 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 level of anticipated future results and the impact of the COVID-19 pandemic.

These statements are based on assumptions and reflect management's current expectations. As such, they're 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 now turn the call over to Darren.

Darren Myers — Chief Financial Officer, Loblaw Companies Limited

Thank you, Roy, and good morning, everyone. First quarter generated strong financial results that reflected continued improvement in our business. As we report on our second year of the pandemic, comparable numbers do not tell the entire story. As such, I will include commentary on two-year average growth rates as applicable to provide further context on our operating performance.

On an adjusted consolidated basis, our reported revenue for the first quarter grew 0.6 percent, EBITDA increased 4.5 percent, net earnings increased 12.3 percent, and earnings per share grew by 16.5 percent.

Looking at Q1 on a two-year basis, we saw average growth in revenue of 5.5 percent, adjusted EBITDA of 8.2 percent, and adjusted earnings per share growth of 20.4 percent.

Our Food and Drug business has continued to perform well in a challenging and dynamic environment. As a reminder, retail revenue in Q1 last year included an estimated $750 million in incremental retail sales related to stockpiling. Additionally, because of the inclusion of a 53rd week in 2020, our 12-week same-store sales period in Q1 laps an extra week of elevated sales from last year. This resulted in the negative impact on our reported Q1 2021 same-store sales of approximately 100 basis points in Food and 170 basis points in Drugs.

Food retail same-store sales were relatively flat, up 0.1 percent in the quarter. Same-store sales continued its strong momentum from the fourth quarter before lapping the COVID-related pantry stocking from 2020, which drove same-store sales last year of 9.6 percent, including 44 percent in the final two weeks of the quarter.

Our average article price was 3.9 percent for the quarter and unchanged from Q4. The increase in average article price compared to last year was driven by sales mix, and we continue to see outsized basket growth and traffic declines in the quarter. On a two-year rate, Food same-store sales reflected average growth of 4.9 percent.

Same-store sales in Drug Retail declined 1.7 percent in the first quarter. Front store same-store sales were lower by 6.4 percent, while pharmacy same-store sales grew 3.5 percent. Front store same-sales continue to be impacted by sales mix. Front store sales lapped strong sales of 10.7 percent last year, including 42 percent growth in the final two weeks of the quarter.

Pharmacy performance was strong. However, against last year's COVID-related surge, we recorded a prescription count decline of 0.8 percent and an average prescription value increase of 2.4 percent. On a two-year average rate, drug same-store-sale sales have grown 4.5 percent, with front store plus 2.2 percent and Rx at 7.1 percent.

Retail gross margin was 30.3 percent, an improvement of 50 basis points compared to the first quarter of 2020. Gross margin improved in both Food and Drug as a result of underlying improvements we have been driving throughout the business. Compared to Q1 2019, gross margin has improved by 20 basis points.

Retail SG&A as a percentage of sales was 20.5 percent with the rate increasing 70 basis points compared to the first quarter of 2020. The increase was primarily due to lapping-cost leverage from stockpiling in 2020, incremental COVID-19-related costs, and higher e-commerce labour costs from increased sales penetration, which more than offset P&E improvements.

COVID costs came in at $48 million in the quarter, in line with our expectations. Our online business continued to generate strong top-line growth, and we demonstrated progress in driving sequential improvements in our operational metrics and profitability.

Compared to Q1 2019, our Retail SG&A rate was flat despite heightened COVID costs and headwinds from our online growth. Retail adjusted EBITDA declined by $12 million in the quarter. This compares to last year when we recorded year-over-year growth of 176 million, which was elevated primarily a result of stockpiling in the final two weeks of the quarter.

At PC Financial, revenue was down $13 million in the quarter driven by lower interchange income and credit card-related fees due to lower customer spending. Adjusted EBITDA at the bank increased $65 million year over year, primarily driven by changes in the expected credit loss provision.

In Q1 last year, at the beginning of the pandemic, we recorded a $50 million ECL provision. Based on improving economic factors, we released $20 million of the provision in Q1 this year.

On a consolidated basis, adjusted EBITDA margin was 10.3 percent in the quarter, up 40 basis points compared to last year.

In the quarter, IFRS net earnings available to common shareholders was $392 million, up 12.3 percent, and fully diluted earnings per share were $0.90, an increase of 36.4 percent.

Free cash flow was $288 million in the quarter, and we repurchased 5.4 million common shares at a cost of $350 million.

As we look ahead, there remains a great deal of uncertainty as, of course, with the pandemic-related lockdowns and the resulting impact on consumer behaviour remains dynamic. We are pleased with the strong financial performance of our first quarter, which exceeded our internal plan. We have seen that momentum continue into the second quarter, putting us in a position to exceed our full year EPS outlook.

Given the ongoing uncertainty and volatility related to the pandemic, we are not updating our outlook this early in the year. Our COVID-related costs remain elevated, and we expect costs in the second quarter to be in the $65 million to $75 million range.

This being my last quarter, and I'd like to say thank you to our investment community. I've enjoyed working with you and getting to know you over my time at Loblaw, and I wish you all continued success.

I will now turn the call over to Sarah.

Sarah Davis — President, Loblaw Companies Limited

Thank you, Darren, and good morning. We started the year with strong results, extending the steady and sequential improvements that we have delivered for three quarters now. Our core business is healthy, and we continue to actively leverage our assets to deliver value to our customers as the pandemic continues to impact the lives of Canadians.

As mentioned by Darren, in extraordinary times, it's helpful to look at a two-year average growth rate. Our consolidated Q1 2021 performance exceeded our financial framework on a two-year stacked basis with average revenue up 5.5 percent, EBITDA up 8.2 percent, and EPS up 20.4 percent.

In Q1, our Food businesses held strong with same-store sales up 10 basis points, lapping growth of 9.6 percent in Q1 of last year. This was driven in part by lockdown conditions and strong eat-at-home home trends.

Q1 delivered market share gains with continued strength in market and sequential share improvements in discount. Our grocery stores gained tonnage and dollar share, while our inflation remained flat to Q4. As was the case through 2020, we have managed margins carefully to keep prices in check for Canadians in ways that set us apart from the market.

In our Drug segment, same-store sales declined 1.7 percent, growing 3.5 percent in Rx and declining 6.4 percent in front store. There are two driving forces here. First, our drug stores are negatively impacted by lockdown, specifically in important areas like beauty. Second, we are lapping last year's inflated Rx and front store sales. Ultimately, we are pleased with the position and performance of our Drug business.

As I called out in Q4, we're seeing strong results in convenience and food. Our beauty sales are down, but our share is up, and our pharmacy business continues to grow as we play a bigger part in community care.

I want to highlight the great work of our pharmacists who have been key to the testing and vaccination efforts in most provinces. We have nearly a dozen different programs supporting COVID testing for travellers, workplaces, schools, and more, and we've already vaccinated over 700,000 Canadians to date, reaching people conveniently and close to home.

Just to give you a data point, in most markets our contribution to the vaccination effort is greater than our pharmacy market share. While the revenue impact of these testing and vaccination programs has not been material thus far, they certainly show the trust consumers have for our pharmacists and our place in community health.

Across our Food and Drug businesses, we continue to manage COVID costs, operating well under modified conditions and adapting to pandemic-related pressures on our mix. Best of all, our customers are adapting with us, and our satisfaction scores remain very high.

Let's take a moment on e-commerce, as I know people are keen to understand what is happening in digital retail as the pandemic conditions continue.

In Q1, we had three digital priorities: first, to improve customer service; second, to margin up through additional offerings; and third, to lower our cost to serve. We improved on all three priorities while serving more customers than ever.

Revenue increased 133 percent over last year, and as the business grew exponentially, we delivered our highest bill rates, lowest wait times, and the best satisfaction scores of all time.

Across the business, we're appealing more and more to those who transact online for the things that matter in life: in food and drugs; rapidly growing programs like the PC money account and the PC Health app; and loyalty, where we're primed to give Canadians more than $1 billion in PC Optimum rewards again this year. We have all the pieces assembled: an unmatched store network, unmatched loyalty, culture and satisfaction scores that have improved even as we face the challenges of the last year; and clear line of sight to process and efficiency and data programs that will continue to make our company run better.

As you know, starting May 6th, I'll be observing our company's teamwork and achievements in retirement, as an admirer and a customer of Loblaw. I'm extremely proud of the progress and accomplishments of the Company over the past 14 years and even more proud of my colleagues; great people with a strong culture. I can't thank them enough.

I'm pleased to be leaving the Company in a strong strategic position with operational and financial momentum and tremendous opportunity. To those of you on the call, the investment community, I've enjoyed working with you through my years as CFO and then as President. I wish you all continued success and happiness in your careers and in your lives.

I'll now turn the call over to Galen.

Galen Weston — Chairman and Chief Executive Officer, Loblaw Companies Limited

Thank you, Sarah, and good morning. I'd like to begin by acknowledging Sarah's retirement after a stellar 14-year career with Loblaw. As many of you will know, Sarah has been an essential part of the most transformative moments in our company's recent history. Throughout that time, she's been an exceptional leader and an invaluable strategic partner and a terrific person. Her unwavering commitment to colleagues and our customers has made Loblaw a better company. I know you join me in wishing her our best.

I'd also like to take a moment to recognize Darren's contribution over the last three years. During that time, he's been an excellent financial steward, advancing our capital discipline and process and efficiencies, and he's been a lively contributor to our executive management board. I know you've appreciated his style and candor, and that you join me in wishing him well.

As Sarah and Darren move on, Richard Dufresne and I return with considerable enthusiasm and a clear focus on the future. At Loblaw, we have a unique and complementary portfolio of market-leading assets. Together, they provide us with a powerful value proposition and unrivaled long-term potential.

We look forward to that future and to our ongoing engagement with the investment community when we are more firmly in our seats.

While we don't know what COVID-19 will hold in the near term, we are far enough into 2021 to know it will be a better year. I think that's true for society and for our business.

Here's what we know today. We're now on our fourth quarter sequential performance improvements. Our determination to lower prices to serve Canadians and our company well and trust in our brands has never been higher. As we look to deliver fantastic supermarket choices and industry-leading, pharmacy-based community care through the nation's best retail and e-commerce networks, our job is to build on this strong foundation and to seek more ways to make our networks hum and our assets shine.

As we enter into what we hope will be the home stretch of the pandemic, I want to express my admiration for our people. Our business and our team of 200,000 Canadians have set a high standard, hitting challenges head-on. Whatever the consumer demands, they kept Canadians fed and well through phases of panic buying, fear of public spaces, and efforts to put this pandemic behind us, including through our mental health services and nationwide vaccination effort. Loblaw is well positioned to create value over the long term.

I'd now like to open the call to questions.

Roy MacDonald

Thank you, Galen. Jacqueline, could I ask you to remind participants how to ask a question?

Q&A

Operator

Certainly. As a reminder, to ask a question, you will need to press *, 1 on your telephone keypad. To withdraw your question, press the # or hash key.

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

Irene Nattel — RBC Capital Markets

Thanks, and good morning, everyone. Before I ask my question, just want to express thanks and congratulations and best of luck to Sarah and Darren. It's been lovely having them. Just moving on to other stuff, very nice performance in Q1. Can you talk a little bit more about the momentum that you're seeing in discount and conventional how baskets are evolving? Whether there's any change? And also, the competitive intensity that we're seeing? Because I think Metro noted that they saw a bit of an uptick in promotional penetration during their quarter.

Sarah Davis

Okay. So maybe I'll start, and Darren can add something if he likes. So certainly what we're seeing is—well, during lockdown periods that we're experiencing in Ontario anyways, the market division performs better. So we would have seen that through any of the lockdown periods through Q1. But what we are seeing is a bigger momentum in discount as it starts to come back in terms of share performance. So the performance and share performance for discount was more substantial than it was in market in Q1.

So basically, we feel good about both sides of the business. They react differently as we go through different parts of the pandemic, but well positioned for the rest of this year.

Darren Myers

I would also just add to your other part of your question, Irene, I wouldn't say that we're seeing a more noted promotional intensity from before. I think it feels about the same as what it—it's staying consistently competitive. Nothing we would call out specifically.

Irene Nattel

That's great. Thank you. And if I might, a question around inflation. Obviously, extremely topical. Can you talk about what you're seeing and how it's playing through in both centre of store, but also in fresh? And whether you've yet seen any reaction in consumer behaviour?

Darren Myers

I mean, inflation's going to be, of course, a hard one to predict. I'd say so far things have been in check. I mean, I think you know the CPI was 0.9 percent for the quarter, so so far things have not raised. Our average article price was 3.9 percent, but that's really based on mix and people buying Club Pack sizes. And it was unchanged from Q4.

So so far, not seeing large increases. Certainly as the year goes on, there is more talk everywhere about inflation, but I would not want to try to take a guess at what inflation's going to do.

Irene Nattel

That's great. Thank you.

Operator

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

Mark Petrie — CIBC

Hey. Good morning. I wanted to ask about gross margins; really nice result. Nice rebound in Q1 after some pretty notable pressure, particularly in the Food business, but in retail overall Q2 to Q4 of last year. Could you just talk about the sort of different puts and takes there, be it sales mix, promo investment, leveraging data assets? And then how should we think about lapping Q2 to Q4 of last year where margin was under some pretty significant pressure?

Darren Myers

Yeah. Hi, Mark. Can you hear me, by the way? We're getting a little comments—you're okay? Okay.

Mark Petrie

Yeah. Yeah. All clear. Sorry, I'll mute.

Darren Myers

All right. So yeah, I mean, we're very pleased with the continued improvement. We saw increases in both Food and in Drug. I would say there's not kind of one specific item that's doing it. It's a series of things, a number of initiatives, including the ongoing pricing adjustments we were making through last year and continue to fine tune our pricing. We also have a number of sourcing initiatives and as well our strategic vendor program this year.

And another thing I would also add on the Drug side, we did see—we had front-store pressure still on the margin, but we saw a nice lift from all the services and the growth that we've seen in services. So both businesses doing well. And as we look forward, I mean, we do think these are sustainable improvements. Of course, depends what happens in the competitive environment, but we feel good about the fact that we can sustain these. And to your point, we'll be lapping in Q2 some pressure that was there last year. So the margin is in a decent place certainly going into this quarter.

Mark Petrie

Okay. And then I guess just specifically with regard to Q2, I think last year part of the issue was around the general merchandise and apparel parts of the business, or the right-hand side of the store. Should we expect better sort of stability from that in 2021, be it on sales or margin?

Darren Myers

I mean, it's certainly we're lapping a lot of challenges last year. So even in Q1, we didn't really see an impact from the right-hand side, which is good, given that we weren't really seeing the impacts in Q1 last year to the same extent. So it's still going to be volatile with lockdowns and different things happening to businesses like Joe right now. But all in all, to your point, we'll be lapping some poor performance last year, or a challenging performance last year. And so that should get better as we keep going through the year.

Sarah Davis

Yeah. And maybe I'll just add a little colour because you remember in Q2, we did have the negative impact on apparel and GM. GM actually picked up in Q3, so it was positive as we sort of sorted through that and were able to sell some more general merchandise. Margins in both apparel and GM have improved as well, so to Darren's point on Q1, it's across the board that we've seen some improvements.

The tricky thing to predict is whether we'll be able to sell it. So right now in Ontario, we're not allowed to sell any apparel in our stores. So that for sure is going to have a negative impact on the sales there in Q2. And some general merchandise that we're not allowed to sell either. So it's tricky to predict.

The rest of the country we can and, of course, we have a pretty dominant business in Western Canada when it comes to GM and apparel. So that's still—we're still able to sell there. But overall, you'll see some improvements in Q2.

Mark Petrie

Okay. Great. That's helpful commentary. And then just second on the SG&A side, again, in Q2 you're lapping some pretty big COVID costs. Q1 it looks like if you normalize out the COVID costs you had some pretty good cost control and had relatively normal level of inflation. I'm just wondering if that's the right way to think about it for Q2 is to basically normalize the COVID costs in line with what you've guided to and then kind of run that more typical level of cost inflation through? Or if there are some other puts and takes we should be considering?

Darren Myers

No. I think that, Mark, that's the right way. So Q1 pressure, obviously with the COVID costs and digital and what have you that I described, and then in Q2 there is a significant lower amount of COVID cost, so the SG&A will get better as a result of that.

And the other thing we obviously won't have, which we had last year, is the same SG&A pressure from digital. We won't have that same year-over-year impact that we would have had last year.

Mark Petrie

Okay. Very helpful, and wish you both all the best.

Darren Myers

Thanks, Mark.

Operator

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

Karen Short — Barclays

Hi. Thanks very much. Actually, just on that last comment on e-comm, you obviously gave us the dilution last year at $0.20. So wondering if you could maybe give a little colour in terms of how you're trending this year or thoughts into how that will look for the remainder of this year?

Darren Myers

Yeah. So we're not giving the number this quarter relative to the $100 million we said last quarter, but what I will say in both my remarks and Sarah's remarks is that the profitability rate improved from Q4 to Q1. So that's from a lot of the initiatives we have in place. And then if you think about Q2 digital with all the growth we had last year, it's going to be tougher to grow on top of that growth. So we won't have that same year-over-year pressure. So a little bit of improvement on digital profitability is probably the way to think about it.

Karen Short

Thanks.

Sarah Davis

And if you think of Q1, our digital business was up 133 percent. To Darren's point, you're not going to see that in Q2. So we would have had the incremental costs associated with that incremental digital penetration. And when you think about penetration, we actually increased penetration in digital from Q4 of 2020 to Q1 as well. So we're still seeing increases in our digital business.

Karen Short

Okay. That's helpful. And then actually just on the COVID cost guidance, the $65 million to $75 million, can you just parse out like the different components of that? And then on the SG&A, if we look at that, it's up slightly differently, the SG&A was up about 2 percent in the quarter, excluding COVID. So it sounds like that 2 percent is not—it won't be growing that much when we get into Q2 and beyond. But I mean, directional comments there would be helpful.

Darren Myers

Yeah. I think on your second question, again, some of that would be because of that digital growth, so fair amount of costs on that year-over-year growth that we will not have that same year-over-year impact in Q2 that we just had in Q1.

And then on your question, it's really not changed. I mean, it's really we're spending the money on safety, security, janitorial. There's also some amounts being spent further for colleagues. So it's the same kind of buckets that we've been talking about through last year.

Karen Short

Okay. Thank you.

Darren Myers

Thanks, Karen.

Operator

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

Vishal Shreedhar — National Bank

Hi. Thanks for taking my questions. I was hoping to could take a few steps back and maybe better understand where we are with respect to Loblaw's health care initiatives or the Connected Healthcare initiatives. And are they benefitting the Company yet? Or are we still in an investment phase? And maybe the same question for Loblaw Media and advertising?

Sarah Davis

Okay. So I'll start with health. I would say that our focus in health has very much been on working through the pandemic, serving Canadians, either through testing or through providing vaccinations. But at the same time, we did launch our PC Health app in the back half of 2020. And it's starting to get some good traction in 2021 as well.

And so in terms of our focus on having additional services, pharmacy services, I think we talked about it on the call last time that we are seeing tremendous growth in pharmacy services. They come with a higher margin. They would also be part of the gross margin mix that is mixing up in the pharmacy business. And so we are seeing it's positive in terms of what we're seeing on the health side of our business.

When we talk about Loblaw Media, I think I mentioned on the last call as well that what we should expect is that it was flat basically in 2020. So it didn't have—whatever we invested, we were able to get in revenue as well. And what we should expect in 2021 is for it to be marginally profitable, but not material at this point in time.

Darren Myers

And, Vishal, just to remind you, I think I said it at the last call that we were looking to spend about $20 million more on kind of that whole Connected Healthcare. So we tried to box that in for people so that they understood the magnitude of number we're talking about.

Vishal Shreedhar

Okay. Appreciate that. And with respect to Connected Healthcare, when you were saying that it is—are you including QHR and the variety of systems that Loblaw has in that comment as well? Or is that viewed separately internally?

Sarah Davis

No. It would all be included.

Vishal Shreedhar

Okay. And with respect to pharmacy market share and management's initiatives to grow that with e-prescribing and a variety of adherence initiatives, where is Loblaw? Have you increased market share in pharmacy from Rx delivery? Has that increased over the last few years? And maybe you can help us understand where pharmacy market share is?

Sarah Davis

Yes. We've seen an increase in our pharmacy market share over the last year. We've also seen, as I mentioned in my script, an increase in beauty market share as well. So despite the industry being down, we're actually seeing increases in share in both of those.

Vishal Shreedhar

Okay. And the increase in pharmacy market share, is that due to improved adherence initiatives? Or is that a variety of initiatives?

Sarah Davis

It's a variety, but I would say definitely adherence would be part of it. Offering different services would be part of it as well. As people come in for COVID testing or for COVID vaccines, there's always something else that comes with it. When you consider in Q1 we've done 700,000 COVID vaccines, but we also did 2.1 million flu vaccines. So all of that would be part of increasing our share.

Vishal Shreedhar

Okay. Okay. And then how about with respect to Project Delta (phon)? Are the benefits from that initiative, are they fully captured yet? Or should we still expect more?

Sarah Davis

I would say that the systems piece is pretty much behind us. We will continue to see some savings from that as we go forward. But it's not a thing that we're calling out in terms of a big number in terms of the savings we'll see.

Vishal Shreedhar

Okay. Thanks a lot. Appreciate it, and best of luck to you, Darren and Sarah, as you move onto your next step.

Sarah Davis

Thanks.

Darren Myers

Thanks, Vishal.

Operator

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

Patricia Baker — Scotiabank

Thank you very much, and good morning, everyone. I have a few questions. So just going back to the gross margin trend, which I have to say was a very welcome highlight of Q1. So you noted that you continue to see pressure in the front store on the gross margin, and presumably a large part of that reflects the shift in mix associated with not being able to sell as much beauty. I'm just curious whether or not if we walk away from the beauty impact on the gross margin, are you seeing relatively stable gross margin trends sequentially if we look at the rest of the business? I understand that overall gross margin would be down, but is there anything else impacting the gross margin? Or is it primarily that mix shift?

Darren Myers

It would be mostly that mix shift. Also, cold and flu would be an area that has been down. So that's another area that's a higher margin that would have hurt us. But again, the growth in services and pharmacy have certainly helped that and the other initiatives that I kind of walked through.

Sarah Davis

And in Q1, the overall margin for the Drug business was actually up.

Patricia Baker

Okay. Thank you. That's very helpful. And then just sticking with that, in your outlook you gave us the first four weeks what's happening with Food and also what's happening with the pharmacy and indicated that that consolidated pharmacy margin has actually turned positive in Q1. I'm just curious, can we interpret that to mean that the front-end trend has improved from that minus 6.4 that we saw in Q1?

Darren Myers

Yeah. I mean, yeah, we're lapping a little bit of decline last year. So that definitely changes things versus the lapping of the stockpiling from last year. So we're just in a different phase, I would say, of the pandemic. And as things open up, or as some of these lockdown conditions change, we should see some more improvements in front of store.

Patricia Baker

Okay. Thank you. And forgive me for this question because Sarah was speaking too fast for me to get it but, Sarah, you gave some really good improved metrics for digital. I think you gave three of them. Can you repeat those?

Sarah Davis

Okay. I'll think about what I gave. I gave that sales were up 133 percent Q1 2021 over Q1 2020. I think I said penetration was up from Q4 of 2020 to Q1 of 2021. And I'm trying to think of another one I might have given—

Patricia Baker

It was—no, Sarah. Sarah, it was the metrics around you had improved—

Sarah Davis

Oh, I see. I see. Oh, what were we working on? So our three priorities. I'm sorry. So our first one was on customer improvement, so definitely improving the customer service. So that would be in fulfillment rates, as well as wait times.

The second would be in margining up, so either through having a larger basket, which we have a substantially larger basket on our digital business than we do in store, so continuing to see that. Adding general merchandise items, we've been quite successful in that way as well, as well as incremental margin from having incremental customers. So that would all be in the margining up of that business.

And then the third was in reducing the cost to serve, so the actual cost of picking in the stores we had targets that were set to improve the actual cost to serve.

So we were pleased to see improvements in all three of those areas; at the same time having the highest customer satisfaction we've had in our digital business in the quarter.

Patricia Baker

Okay. Perfect. That's exactly what I was getting at. And then just a broader question. So it's so great to see that finally the pharmacies in Canada are able to help with the big issue and challenge around delivering the vaccines. You said you did, I think, 700,000 vaccines in the quarter. Can you just review for us across the country where you are able to give the vaccines? And then a bigger question, just looking at it strategically and I guess philosophically, do you really think that there's an absolutely bigger role that the pharmacies in this country could be playing and are capable of doing much more than you're already doing if you were given the leeway to do that and sort of really help with the bottleneck that we're seeing and the challenges across the various regions?

Sarah Davis

Okay. So we have been able to provide vaccines in the majority of provinces. And then I would say in terms of absolutely, we absolutely believe that there's a larger role for pharmacy to play in the health industry of Canada. We would love to be able to provide minor ailments in all provinces. We already are able to do that in Alberta. We should be able to do that, I think coming soon, in Ontario. But it is something that we believe is very good for our business, but also good for the health care system because it provides a less expensive way to provide some of these services. And it's also more convenient for consumers without having to go line up in emergency in some cases, or go and finding time to go to the doctor's offices; they can just stop by a pharmacy. So we think there's a bigger role, absolutely.

Patricia Baker

And just specifically, Sarah, do you think there's an even greater role you could be playing with vaccines if you could get greater access to the vaccines that you could be—that really that the vaccine administration should be narrowing their flu administration?

Sarah Davis

Yep. We could play a bigger role. We have the capacity to provide a million a week.

Patricia Baker

Okay.

Sarah Davis

In terms of vaccines.

Patricia Baker

Okay.

Sarah Davis

So we did 700,000 in the quarter, but we have the capacity to do a million a week across the country.

Patricia Baker

Okay. Thank you. And I hope you get close to being able to do that. Thank you.

Sarah Davis

Me too.

Operator

Your next question comes from Kenric Tyghe from ATB Capital Markets. Your line is open.

Kenric Tyghe — ATB Capital Markets

Thank you, and good morning. Just what's your share of pandemic costs? On a first quarter cost of $48 million, you're guiding to roughly $120 million in first half pandemic costs. That compares to your second half of 2020 of around $127 million. Could you help us better understand sort of the range of outcomes on pandemic costs how much of the step-up Q1 to Q2 is lockdown-related? And perhaps how we should potentially just be thinking about in the absence of lockdowns in the back half of this year how we could see that range of outcomes on pandemic-related costs?

Darren Myers

Yeah. Hi, Kenric. Predicting the future's a little bit tough. It's going to depend on the state of the economy and the lockdowns. The more things open up the, of course, the lower the costs are going to be. I think Q1 is a nice indicative kind of value in terms of ongoing costs. Q2 is a little bit higher as we spend in different parts of the business and some further amounts for our colleagues. So it's hard to predict the back half at this point in time. I'm not sure I can give much more details on that, to be honest.

Kenric Tyghe

No. Fair enough. I just wanted to try and just better handicap the progression through the year there, and so thank you for that. Sarah, just perhaps on beauty and specifically your comments with suspect of the share gains, could you perhaps help us understand how much more responsive or have consumers become that much more responsive to your pulling of levers in beauty when you do? Are there higher uptakes within the beauty business? Are people starting to look forward and look forward to a normalization with respect to their activities that would support higher spend in those categories? Any incremental colour you could provide there on the stickiness of what you're doing and the levers your pulling in beauty would also be appreciated. Thank you.

Sarah Davis

Okay. So I think definitely in beauty we've seen market share increases. It's a number of things as well. Part of it is related to some of our competitors who weren't able to be open during times as well, so that was an advantage for us. But I would also say that we've been doing a lot of work digitally as well. So trying to appeal to younger consumers. Consumers in the 18-to-34 range would be a specific target that we're going through. And we've been seeing some nice traction in that area.

In terms of what consumers are spending on, we did see an uptick in perfumes and some of those types of items that we hadn't seen since the beginning pre-pandemic. So we're starting to see that. Of course, our trends in skin care are continuing, hair care, all of those would be trending positive as well.

So it's the main cosmetics which are down, prestige cosmetics which are down, but seeing some improvements in some of the other areas.

Kenric Tyghe

Thank you. Just on that with respect to the share gains, if I'm hearing you correctly, is it more concentrated against your pharmacy competitors perhaps than your prestige-type competitors in department stores and sort of your luxury competitor? Is that a fair characterization?

Sarah Davis

No. The market share would be gains across the entire—all the beauty categories against all competitors.

Kenric Tyghe

Okay. Thank you. Thank you, and best wishes to you and to Darren, Sarah. Thanks very much.

Sarah Davis

Thank you.

Darren Myers

Thanks, Kenric.

Operator

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

Chris Li — Desjardins

Oh, hi. Good morning. I know there are lots of moving parts, but just on a very high-level basis, when we exclude the favourable impact from lower COVID-related costs, do you expect the underlying profitability of the food and drug business to be higher this year versus last year?

Darren Myers

Yes. I mean, there's been a number of improvements we've been putting in place since the second quarter of last year and they're taking hold. And so, yes.

Chris Li

Okay. That's helpful. Thanks for that. And then just on digital, Sarah, you mentioned you've been able to reduce your costs this year. I'm just curious to see if you can provide us maybe with a couple examples on exactly what you're doing to achieve that?

Sarah Davis

Oh, it's pretty block and tackling in the store, so making sure that the forecast is as good as it can be because putting the right number of people in terms of labour into the store to serve the number of orders would be a key point; making sure that their pick routes are the most efficient that they can be. Any of those types of tactics. Making sure that the whole store is involved in the efficiency of Click & Collect and it's not just left to the digital team. So I would say that we looked at the whole process from end to end and looked at ways that we can improve it. And we're pretty pleased with the results we've seen so far.

Chris Li

Okay. That's helpful. And any update you can provide us on your partnership with Takeoff so far? When do you expect a decision to be made on whether to expand that deployment?

Sarah Davis

Oh, that's a good question. I would say there's no update on that. So basically, we're continuing to work with Takeoff on the one that we've got. And we don't have any other announcements to make on anything going further yet.

Chris Li

Okay. And my last question, just maybe switching on to Shoppers. For the stores where the vaccines are being administered right now, are you seeing any notable lifts in terms of merchandise sales as a result of the additional traffic?

Sarah Davis

We have seen some, but we've got 1,100 stores now participating, so like it really is right across the base. So it started out as small, but it's quite a lot now.

Chris Li

Perfect. And I also want to wish you and Darren all the best in your future endeavours. Thanks for all your help.

Darren Myers

Thanks, Chris.

Sarah Davis

Thank you.

Operator

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

Peter Sklar — BMO Capital Markets

Okay. Thank you. Just first had a question on your discount banners. There have been periods over the last couple of years where you just didn't have your price volume, price promotion balance correct. And I know you've been working on correcting that. Do you think you're in a good space now in terms of your discount format?

Sarah Davis

I think we're in a good place in terms of our discount format. I think part of it is the impact of COVID and the lockdowns on that business. What we do see is that when we're in lockdown, there is a bit more of an attraction for customers to go to the market stores. And that's an industry thing, not just in our business.

But to answer your question, yes, I feel like we're in a good position in terms of where we are with discount.

Peter Sklar

Okay. And just changing topics. During your presentation and, Sarah, I can't remember if it was you or Galen said that you anticipate that you'll be paying out $1 billion of rewards in the PC Optimum loyalty program, which is a big number. Can you talk a little bit about who pays for that? Like how much does Loblaw pay and how much do your CPG and other suppliers players pay? Like I don't believe that's a drag of $1 billion on your earnings. And can you also talk about just review the accounting for all of this? When will the expense accrue relative to these rewards that will be paid?

Sarah Davis

Okay. So I can start with how—I'm not going to give you the specifics, but it's basically funded by a few different pieces. Some of it is funded by the business, some of it's funded by the credit card, and some it's funded by suppliers. And in terms of the accounting, I'm going to leave that to Roy to follow up with you after the call on how we do the accounting.

Peter Sklar

Okay. And when you say funded by the credit card, I'm not too sure what you mean. Like you own the credit card.

Sarah Davis

It's the interchange.

Darren Myers

As people spend and the interchange that is generated, that funds a large part of the points. And then people are spending it in the stores.

Peter Sklar

Okay. And then lastly, I just wanted one quick question on e-commerce. In terms of very high-level strategy, can you apprise us of your latest thinking on home delivery? Like we all know you have the Instacart offering, but obviously a big slice of the Canadian market is ultimately going to be home delivery. And what are your latest thoughts there?

Sarah Davis

Okay. Maybe I'll start and Darren can add in. So basically we are—predominantly it is still Click & Collect that we see in our business, but we do think that delivery is important in some parts of the country. And we do have a delivery offering. And obviously, we have a partnership with Instacart as well. But we've also started our own delivery options, and so we do believe that both matter. But right now, Click & Collect is the predominant what we're seeing in terms of what customers are choosing.

Darren Myers

Peter, I'm just adding, I think it's going to continue to evolve as technology evolves. I think the answer's going to be all of the above. It's going to be people going to stores, it's going to be people doing Click & Collect, and it's going to be delivery. And in addition to what we've already piloted, there will be three other ways I am sure that we will be exploring and seeing what takes off at the end of the day. So I think it's going to continue to evolve.

Peter Sklar

Okay. Okay. Thanks very much for your answers and all your help.

Operator

If you would like to ask a question, please press *, 1 on your telephone keypad.

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

Irene Nattel

Thanks. And just a couple of housekeeping-y type of items. First of all, can you remind us in 2020 when you were waiving the cost for e-commerce and when you stopped waiving them? Like how long did that last?

Darren Myers

Roy would have to get back to you with all the details. It was definitely waived in Q2. I just can't remember if it started right back up and which part of Q3 it started back up in, but Roy can provide that.

Sarah Davis

We would have to get you the exact dates. But my memory's the same as Darren's that we stopped it through all of Q2 and we started back up in Q3. Just not sure of the exact date.

Irene Nattel

Yeah. So I mean, presumably that should be quite—now that you're charging the normal fees again, that should be helpful to Q2 SG&A rates.

Sarah Davis

Yes.

Darren Myers

On a year over year, yes.

Irene Nattel

Yeah. Okay.

Darren Myers

Not on a SG&A rate, but—

Sarah Davis

It goes into margin. It would go into margin.

Irene Nattel

Okay. So it would go—okay. Perfect. Thank you. And just following up on the whole conversation about pharmacy services, what percentage of your revenues overall would come from pharmacy services at this point?

Darren Myers

I don't think we're going to disclose that one today. It's a material business, but relative to the total size of our company, it's still not a high percentage.

Irene Nattel

Okay. And then just finally, when I calculated your market shares, it looked like you went up from about 24.5 percent of Rx dollars in 2019 to about 26 percent in 2020. I know you talked about it here and said a couple of other things, but are my calculations correct on that one?

Darren Myers

Roy can check with that one as well. I don't have that in front of me right now.

Irene Nattel

Okay.

Darren Myers

So I don't want to misquote a number, Irene.

Irene Nattel

Okay. Thank you.

Operator

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

Michael Van Aelst — TD Securities

Thank you. On the e-commerce side, have you already started to see the business slow in April and May? And are you actually expecting it to decrease relative to kind of the pandemic peaks of last year?

Sarah Davis

That's an interesting question. In period four, it actually increased. So what we saw was an increase. But I think it's a reasonable expectation that it's going to start to flatten out. And certainly to Darren's earlier point, Q2, we're not going to see the high growth that we saw last year, so. But we did see an increase from Q4 to Q1, and we have seen an increase in period four, the first period of the second quarter as well.

Michael Van Aelst

Okay. Great. And then you talked about inflation, and I know that you don't want to try to forecast it, but do you believe that the Canadian dollar, or to what extent the stronger Canadian dollar help fight off that inflation? And if we do see inflation pick up, do you expect to be able to pass it through? Or are the conditions not conducive to that?

Darren Myers

Yeah. I think the Canadian dollar will help. And then the second part of your question is hard to predict. I think I don't want to make a prediction on that. I mean, generally, in times of inflation people have done better. But time will tell how that is in this environment.

Michael Van Aelst

Okay. And then just lastly—

Sarah Davis

And I think a little bit—maybe I'll add that just in general when there's a little bit of inflation it's positive generally for the retailer. If it starts to get higher, it affects what customers buy. So I think in that dynamic it's hard to predict, to Darren's point.

Michael Van Aelst

Right. Okay. Great. And then on the financial services side, there was that meaningful reversal in Q1 of $20 million, but how much were the PC reserves in all of 2020? How much did they increase? And how much of that do you think could reverse this year?

Darren Myers

I don't have the exact number in front of me in terms of how much it increased. We are still somewhere in like—well, no, we'll get you the right number for sure, Mike. But we are not to where we were pre-pandemic in terms of the reserve. And so if the economy continues to improve and the shape of the Canadian consumer continues to stay strong, you could expect to see some releases on that. But of course, time will tell on how that goes.

Michael Van Aelst

I guess I was just wondering how much does that play in to your guidance of at least 10 percent to 15 percent earnings growth?

Darren Myers

Nothing from here that would be into that.

Michael Van Aelst

Yeah. Perfect. Thank you. And then, Darren and Sarah, I do want to wish you best wishes in whatever you plan to do next.

Sarah Davis

Thanks.

Darren Myers

Thanks, Mike.

Operator

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

Mark Petrie

Yeah. I just wanted to ask about the PC Insiders program. I know it's small, but it does seem to have some strategic value. It hasn't been something that you've particularly emphasize or promoted, but you also do have more things that you could potentially layer into that. And I'm just wondering if you could talk about kind of how you view that program and if it is a sort of future lever? Or if you kind of determined that it kind of is what it is at this point?

Sarah Davis

Yeah. I would say that we piloted it one way, and then we changed it to be a bit more universal and more, I would say, appealing to more consumers. We're pretty pleased with the performance of it, but it hasn't been a major focus over the last bit as we've been dealing with all the other things that have been going on in our business.

But I actually agree with you. I think there are a lot of things that we could layer onto it. I do think that it could have some more strategic merit than what it's getting today. But it just hasn't been the thing that we've been focused on over the last, I would say, six months.

Mark Petrie

Yeah. Understood. Okay. Thanks a lot.

Operator

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

Vishal Shreedhar

Hi. With respect to distribution centre capacity, how does Loblaw feel about its capacity at this moment? And will there be any future investment required?

Sarah Davis

I think we feel we're in a pretty good position. We've been doing a bit of automation. So we had a new automated DC that is operating now in Milton for our pharmacy business. We've been expanding a DC that we have in Cornwall that is also is partially automated today. It's going to have even more automation as we go through this year, which should be operating by the end of this year. And I think we announced that that was replacing two older facilities that we have that we're closing down. So there is some investment going on in our distribution centres as well. And those are just two that are the current ones that are happening right now.

Vishal Shreedhar

Okay. And is the technology that is being installed, will that help facilitate e-commerce from the warehouse as well? Or is that a separate issue?

Sarah Davis

It is going to help. It will help. And depending on whether it's pharmacy or food, we've got different types of technology. We have each picks (phon) in the pharmacy, which will help with it. And then we've got K-6 happening in the food DC in Cornwall. But the strategy is an all-encompassing strategy.

Vishal Shreedhar

Thank you.

Operator

There are no further questions. I'll turn the call back over to the presenters.

Roy MacDonald

Great. Thanks, everybody, for your time this morning. Give me a shout. I know a few of you have some follow-up questions. And mark your calendars for July 28th when we'll be discussing our Q2 results. Thanks, and have a great day.

Operator

This concludes today's conference call. Thank you for participating. You may now disconnect.