

## **Loblaw Companies Limited**

### **Q2 2020 Earnings Conference Call**

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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by and welcome to the Loblaw Companies Limited Q2 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode.

After the speakers' remarks, there will be a question-and-answer session. To ask a question during the session, you will need to press \*, 1 on your telephone. If you require further assistance, please press \*, 0.

I would now like to hand the call over to your speaker today, Roy MacDonald. Thank you. Please go ahead.

### **Roy MacDonald** — VP Investor Relations, Loblaw Companies Limited

Thank you, Megan, and good morning, everybody. Welcome to the Loblaw Companies Limited second quarter 2020 results conference call. Joining me this morning is Galen Weston, our Executive Chairman; Sarah Davis, our President; and Darren Myers, our Chief Financial Officer.

Now before we begin the call, I would like 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 expectations. These risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulators.

Any forward-looking statements speak only of the date they are made. The Company disclaims any intention or obligation to update or revise any forward-looking statements, whether as the 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 security regulators for a reconciliation of each these measures to the most directly comparable GAAP financial measure.

And 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. I'd like to start again by thanking our front-line teams and the broader organization, who continue to ensure we deliver the services Canadians rely on in a safe and secure environment.

For the quarter, we continued to see elevated sales, with a continued shift in Food's conventional format, and significant growth in our e-commerce platforms. The pandemic has changed consumer behaviour, impacting our mix of sales which, combined with our elevated investments and COVID-related costs, has put pressure on our financial model in the second quarter.

On an adjusted consolidated basis, our reported revenue grew by 7.4 percent, adjusted EBITDA declined 13.5 percent, adjusted net earnings decreased by 28.7 percent, and adjusted earnings per share decreased by 26.7 percent. Our same-store sales and drug retail decreased 1.1 percent, front store same-store sales grew 3.3 percent, while pharmacy same-store sales were negative, declining by 6.2 percent.

For the front store, the mix of sales changed as we delivered strong growth in food and HABA, while we experienced pressure in cosmetics and OTC.

In pharmacy, revenue was impacted by stockpiling in the first quarter and certain COVID-related changes that negatively impacted sales.

Food retail same-store sales grew 10 percent in the quarter. Food sales growth included significant changes within the category mix and the benefit from strong demand for essential food categories. Consumers purchased fewer nonessential products, and demand shifted towards conventional formats, with our market division delivering strong same-store sales growth of 18.8 percent and our discount division growing 4.9 percent.

Our average article price was 4.6 percent for the quarter. The average article price increase reflected a change in sales mix in the quarter related to the pandemic. Food retail basket size continued to show an increase during the quarter, while traffic continued to be negative.

Total gross margin was 29.6 percent in the quarter. Excluding the consolidation of franchises, Retail gross margin declined 90 basis points compared to last year. Our margins were negatively impacted by the change in our mix of food and drug sales and declines in both our food and drug rate.

In Food, our grocery trading margins were flat, while our rate was negatively impacted by lower sales in right-hand-side categories. Drug gross margins were impacted primarily by front store mix, driven by lower cosmetics and OTC sales.

Retail SG&A as a percentage of sales was 21.3 percent. Excluding the benefit from franchise consolidation, our Retail SG&A rate increased 90 basis points, primarily driven by higher operating costs related to COVID, and costs to support the accelerated growth in e-commerce, partially offset by the sales lift in Food, benefits from our ongoing Process and Efficiency initiatives, and certain timing of expenditures.

During the quarter, COVID-related costs increased our spending by an estimated \$282 million. The significant and accelerated growth in our e-commerce business has led to an increase in costs to support the rapid scaling of our capacity to meet demand. We continue to focus on meeting the demands of our customers and have a number of initiatives in place to improve the productivity of the model over time.

Retail EBITDA decreased \$151 million, and EBITDA margin came in at 8.3 percent, a decrease of 200 basis points compared to last year.

Moving to PC Financial. Revenue was \$233 million, down \$51 million in the quarter as credit card spending was lower, with less interchange income and credit-related fees, as well as lower sales within Mobile due to the partial closure of kiosks.

Adjusted EBITDA contributions declined \$8 million year over year, driven by the revenue decline.

Adjusted consolidated EBITDA margin was 8.5 percent in the quarter. Normalized for the consolidation of the franchises, EBITDA margin declined 190 basis points compared to last year.

In the quarter, IFRS net earnings available to common shareholders was \$169 million, a decrease of 40.9 percent, and fully diluted earnings per share were \$0.74, a decrease of 26.7 percent.

Free cash flow was strong with \$334 million generated in the quarter, in line with the previous year. Our liquidity remains strong, supported by a strong balance sheet and the ability to generate significant cash flow from our operations. As of Q2, Loblaw's consolidated cash and short-term investments balance was \$2.6 billion.

Note that subsequent to quarter-end, we repaid the \$350 million note that we had refinanced in the second quarter. The Company did not repurchase any common shares during the quarter.

Looking ahead, 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 evolve, as does the demand for the types of products and services we provide.

In the four weeks following the end of the second quarter, sales growth and mix continued to evolve as restaurants began to reopen. Food retail sales have continued at elevated levels but have experienced a modest tapering of groceries, and Drug retail has experienced continued improvement compared to the second quarter same-store sales growth rates.

As we continue to navigate through the COVID crisis, our focus is on doing the right things to protect our colleagues and our customers. In the first four weeks of the third quarter, we saw approximately \$20 million in incremental costs related to safety and security in our stores and DCs. Both our Process and Efficiency initiatives and our CapEx program continue, and we are investing in our long-term strategic initiatives, which in large part have been validated through the pandemic.

In conclusion, this remains a challenging and dynamic time. We are confident we are doing the right things to protect our colleagues and customers and to position our business to meet the future 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 the 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.

If you think back to the start of the second quarter, we were just getting past unbelievably high volumes of panic shopping and, of course, the early stages of a global pandemic. We were implementing

safety protocols, introducing pay premiums, changing operating procedures, and we were beginning to close departments in our stores. We were seeing very inconsistent buying patterns.

The quarter ended with a gradual easing of restrictions, and a general sense that we were establishing a new normal. We fared well, with strong underlying performance in the face of unexpected challenges. More importantly, the quarter was a major confidence-builder, underlying the strength of our strategy. In digital retail, on a strong base, we nearly tripled e-commerce sales. I'll come back to that.

In Connected Health, we ramped up virtual care and pharmacy assets, experiencing great uptake and doubling digital pharmacy volumes. And through our Payments & Rewards initiative, we delivered personalized connections and value when they were needed the most. We've been building these initiatives for years and it was rewarding to see them gain such meaningful momentum in such a short period of time.

As you've heard, our revenue growth was substantial but uneven. The impact of COVID on our business mix resulted in inconsistent growth in Food and negative pressure on the Drug business. In Drug, we saw a decline of 1.1 percent, with front store growing 3.3 percent and Rx down 6.2 percent.

There's no question that our usual strengths in these areas were dampened by COVID. More specifically, people were doing far less convenience shopping and not buying cosmetics, in part because we restricted our beauty boutique business, choosing to focus on our core essential services.

In pharmacy, prescription sales declined as people worked through some stockpiling from Q1, visited doctors and hospitals less, and as fill days were temporarily reduced from 90 days to 30. We've begun to see strength in convenience, beauty, and scripts, and we believe the Shoppers business is primed to regain its momentum.



In Food, we saw strong same-store sales growth of 10 percent, with distinctly different performance between our discount and market divisions. Since the onset of COVID, discount stores have been challenged by a swing in shopping habits towards full-shop conventional stores. Customers are making that choice, even at a cost. Further, there was an overall lag in non-food categories, which are an important part of our larger format discount mix.

Like our Drug business, we have complete confidence in the strength of our discount food network, which accounts for about 60 percent of our supermarket business. Given this sales mix, we are disproportionately exposed to a shift from discount, but we are also uniquely poised for a swing back.

By choice or necessity, discount shoppers will return to discount banners, and we will be there for them when they do. We are already seeing the start of a return to discount, and we expect that to quicken if the economy tightens in any meaningful way. Our competitors are investing in the discount sector, and we intend to maintain our share.

Moving to conventional. Our market division was a clear winner in the quarter, showing consistent strength across the country. It was not only our strongest performer internally; it took considerable share from the market. At the same time, it hit record high levels of customer satisfaction.

As Darren mentioned, market division was also a standout in the shift to e-commerce, which was another bright light for us company wide. In the quarter, our e-commerce business grew 280 percent and, year-to-date, we have reached \$1.2 billion in e-commerce sales, surpassing our 2019 full year achievement of \$1 billion.

We are on a run rate of sales that we did not expect for years. Our national platform has proven to be flexible and scalable, providing our customers same-day service and a choice of pickup or delivery, because we know that one size does not suit all.

Tripling e-commerce sales years ahead of plan brought incremental costs for the business. We scaled every aspect of our PC Express offering, from labour to technology to micro-fulfillment centres. All of these costs were anticipated; they just weren't expected so soon. This creates a short-term headwind with long-term promise. These are costs that we are willing to bear, as we know this is and will continue to be an area of competitive advantage.

COVID dynamics, from investments and safety, to the cost of building e-commerce, to changing shopping patterns, mean we need to keep our hands on the financial and operating levers. We need to let tighten and loosen our grip as we see risk and opportunity. We are doing just that.

Fundamentally, this whole experience has given me a great deal of confidence in our underlying business, the strength of our people, the mix of our businesses, the discipline of our Process and Efficiency commitments, and our exciting investments in e-commerce, Connected Health, and Payments & Rewards. Our strategy remains relevant and promising.

I'll close by saying that there has never been a period of time where we have received more feedback from our colleagues and our customers than we have over the past three months. Our customers have given our colleagues huge and well-deserved credit for all we have done. In turn, our colleagues have appreciated the support they receive. As a result, we are getting record results in our customer service and our colleague engagement scores.

Thank you. 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.

Conditions in the second quarter were unusual and challenging, and I want to begin by thanking the 200,000 colleagues and the leadership at all levels that carried us through. The team's performance was nothing short of remarkable.

The quarter confirmed the fundamental importance of a strong core business. There were consumer shifts that favoured our market stores, and COVID conditions that slowed discount and Shoppers. But at the peak of the crisis, more Canadians turned to us to stay healthy and well fed than any other grocer.

We believe this was a function of strong fundamentals, a no-compromise approach to colleague and customer safety, and the strength of our forward-looking strategy. The last four months confirmed that the commitments and investments we've made over the last few years will deliver a long-term competitive advantage.

On a \$1 billion run rate, our e-commerce business nearly tripled. Patients and provinces turned more and more to Shoppers virtual care and pharmacy services, and customers are clearly leaning towards digital promotions and value generation that only PC Optimum can provide. These trends will not reverse.

As Sarah mentioned, maintaining the strength of our core business while simultaneously pressing our strategic advantages will require continued thoughtful investment. We remain resolute in our commitment to do so, with long-term value creation as our primary objective.

**Roy MacDonald**

Thank you, Galen.

Megan, could you now open the lines for questions, please?

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**Q&A**

## **Operator**

Certainly.

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

## **Karen Short — Barclays**

—very much. Wanted to ask a couple questions about e-comm. So I guess, just thinking about as we maybe get into a slightly more normal environment, where do you think e-comm will shake out as a percent of sales?

And then how are you thinking about your strategy in e-comm in terms of click-and-collect versus delivery, from a penetration perspective?

## **Sarah Davis**

Hi, Karen. It's Sarah. So I'll give you a couple of stats that we have, that everybody should also have.

So basically, in 2019, if we look at our \$1 billion that we have said on e-commerce, on a \$48 billion enterprise—so total enterprise, everything, all included—the percentage is about 2.1 percent. If you consider \$1.2 billion was what we said we had for the first half of this year, and if you consider our entire enterprise revenue of \$23.7 billion for that same time period, it's about 5 percent. And when you consider that, coming into the year, the first quarter would have been much lower than the second quarter, where we said it was triple.

So we now are at a reasonable run rate. We think it will taper a little bit from that place, so 5 percent so far year-to-date, with a mix obviously much higher in Q2, and it will fall back a little bit in Q3 but will continue much higher than what we would have seen in Q1. And so that would be sort of the overall on it, and that's total enterprise.

So you can imagine within the Food business, the penetration would be higher than the overall enterprise number. And if you consider our discount and our market divisions, they're fairly equivalent in terms of PCX penetration. But what happened in Q2 was the conventional or the market division saw a larger growth in penetration. Prior to that, discount would have been a bit higher in terms of penetration. So those are sort of the stats, some of the stats anyway.

When you think of going forward in terms of how do we think about our strategy between click-and-collect and delivery, we like offering both. We think both matter to consumers, and that is what we're here to do—serve the demand of our consumers.

We saw an increase in delivery, the offer of delivery during COVID, which was higher than the increase in PCX, but it's still on a much lower base. So for our business, the largest proportion of our e-commerce in grocery would still continue to be done through click-and-collect. We expect that will continue as we go further but, as we said, we're open to demand in either spot in terms of making sure our customers get what they want.

### **Karen Short**

Okay. That's very helpful. Thank you.

And then looking at margins and overall—so obviously, you've given us the \$19 million or \$20 million, I guess, in COVID costs for the four-week period into 3Q. So I'm assuming that's what we need to embed for all three periods in 3Q on the SG&A front?

So then, the question is really gross margin, which seems to be more of a wild card. How should we think about gross margin pressures going forward? Should we start to see gross margins improve sequentially, just as there's a little bit more discretionary and beauty and things like that in the mix?

And then I would tie that into your comment on discount where, Sarah, I think you said you intend to maintain share. Is that a comment intended to indicate that maybe that division, it will get a little bit more promotional in order to maintain share?

**Darren Myers**

Yeah. Let me touch on the first part, Karen. So from a gross margin perspective, you've got it exactly right in terms of the key variables, which is really around the mix and, assuming we see some increases in Shoppers, in cosmetics, and things like that, we should start to see an improvement.

I'm not going to give a forecast on it. And part of it will be, if you think about it from a year-over-year basis, is it growing, is it not growing, how's the right-hand side doing? So there's a lot of question marks out there, and it will depend how the economy opens up. But we are seeing some improvements. I wouldn't say we're going to see dramatic changes.

**Sarah Davis**

And then I'll just say, on the share comment, I would say that's our goal. It's no different than our strategy has always been. We intend to maintain our share. We just have seen some heightened activity in the discount sector. And so my point is just that we intend to maintain our share in that space.

**Karen Short**

Okay. And just to clarify, in the SG&A, that \$19 million is just for the four-week period, and that's the run rate we should think about for all three months, right, in the quarter?

**Darren Myers**

Okay. We have four months in this quarter.

**Karen Short**

Oh. Four months. Okay.

**Darren Myers**

We're not giving guidance for the quarter, but I think it's a good representation of the spend level, what we should continue to have.

**Karen Short**

Okay. Thanks very much.

**Sarah Davis**

And wait. I think what Darren's doing is trying to give you what we know. It's hard to predict exactly how the pandemic will continue. If everything goes as it is, it will maintain, but it's possible that you could have a resurgence somewhere, in which case, we might have to spend more.

**Karen Short**

Okay. That's helpful. Thanks.

**Operator**

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

**Irene Nattel** — RBC Capital Markets

Thanks and good morning, everyone. Just want to tie up something on SG&A. I think that during the quarter, you cut back on some discretionary SG&A. Just kind of wondering what your thinking is for Q3 around promotional and, thus, maybe some of the other discretionary spend that you eased back on.

**Darren Myers**

Yeah. Irene, I mean, we definitely—and I mentioned that in my prepared remarks—we did do a nice job cutting back on discretionary spend, especially with everything being closed down. We do expect that to increase in the third quarter. So think about things like marketing spend will be back closer to

normal levels versus much more reduced amounts in the second quarter. So we will see a bit of a headwind on a relative basis to Q2 from discretionary spend. It still gives us both—

**Irene Nattel**

Thanks.

**Darren Myers**

—though and all of the things that we're doing still to manage costs.

**Irene Nattel**

Yeah. That's great. Thank you. Obviously—just moving onto e-commerce—you did a fabulous job of scaling up the business in short order. Just kind of wondering, now that we're moving past a little bit sort of the most acute phase of the crunch, how you're viewing the economics of e-commerce and where you see areas that you really need to improve. Or where you see areas that it would be easy for—well, nothing's easy—but easier for you to improve there?

**Darren Myers**

Yeah. Let me start by giving a bit of colour, and Sarah can certainly jump in with her comments.

First thing I'd say, on a variable basis, the business is profitable. But we recognize it's a more expensive channel. And certainly, as Sarah mentioned, as we accelerated multiple years, really, within a quarter, there's been a lot of costs and effort thrown into that, including multiple MFCs and lots of changes within the business. So right now, we are still focusing on meeting the customer demand on improving the service. But over time, we see those things maturing and getting the model more economic. And that, again, will happen over time.

And the other thing just to recognize is part of the model, as we've talked about many times, is within the brick-and-mortar, we continue to apply process efficiencies to make that channel more



efficient, which in part funds the e-commerce channel. And just given the accelerated pace of this increase, obviously, that hasn't happened yet because this is multiple years within a quarter. So we'll be pushing on both the efficiency of e-commerce and on the continued efficiency within the brick-and-mortar business over time.

**Irene Nattel**

That's great. Thank you. And then just one final one for me, please. We did have an announcement from Walmart earlier this week around significant investments to scale their e-commerce capabilities, but also on store renovations. And so just kind of wondering what your view is of your discount footprint, and whether you need to accelerate any investments in store renovations. Or coming back to Sarah's—or the commentary around, you will invest to hold onto your share.

**Sarah Davis**

Okay. Good morning. So I think, from our perspective, we spend about \$1.1 billion every year in terms of our capital expenditures. In terms of what we spend it on, part of that would be renovation. So we actually feel that we're in fairly good shape in terms of our renovation cycle. There might be some areas that we think we need to spend some extra money. But I wouldn't think about it as being a big additional CapEx spend for us, in terms of making sure that our assets are ready. We feel like they're in pretty good shape.

And I think what Walmart was doing in their announcement was grouping a few years together to get to the \$3.5 billion that they were announcing as well. So when you think about our \$1.1 billion a year, that's part of our normal course. Renovations would be part of it. Our e-commerce—any expansions in e-commerce would be part of it as well.

**Irene Nattel**

That's great. Thank you.

**Operator**

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

**Michael Van Aelst** — TD Securities

Yes. Thanks. I just want to touch back on the e-commerce side. And I know you touched on the economics, but there was a report out recently that said that the MFCs are the more efficient economic model when it comes to e-commerce and groceries. And I'm wondering if you have any early insights that you can tell us from your testing of the MFC, and if you have made any decisions yet as to your long-term use of them.

**Sarah Davis**

Hi, Michael. It's Sarah. So I would say we have—so as I mentioned, we did actually do—opened one automated micro-fulfillment, and then we actually added four manual ones in order to amp up our capacity. So together, they now pick orders for 20 high-volume locations in the GTA, and they are operating at greater efficiency and speed than what we're seeing in store.

So we like what we're seeing, but it's still pretty early days. They haven't all—they were very quickly put together. Well, the automated one was more planned, but the four manual ones were very quickly put together, so still some early days. We feel like there's lots of opportunity to enhance that. So I think it would be part of our strategy, but no specifics on a rollout yet.

**Michael Van Aelst**

And the automated versus manual economics?

**Sarah Davis**

Right now, the automated is performing picks quicker than the manual, but it comes with a capital cost. So it's just figuring out the all-in. Can we get the manual to be as efficient as the automated? Is it worth the spend? It might be worth it in a few very high-dense areas in Canada, to have the automated fulfillment centre—micro-fulfillment centre, but it wouldn't be something that we would have widespread across the country. At least, that's what we're thinking right now.

**Darren Myers**

And, Mike, I'd just add, we'd also expect the cost of the automated fulfillment centres to come down over time, and that will improve the economics. So we continue to look at all of these different options.

**Michael Van Aelst**

Okay. Great. And then you also touched on the right-hand side of the store. Can you give us an idea of how much of a drag-down might have been on the discount same-store sales? And how you're seeing that improve so far this quarter?

**Darren Myers**

I don't have the number specific just to discount but, overall, it impacted our same-store sales by about 140 basis points. And you can think about a discount would have a higher proportion of that.

And I think it is important to note, within that, we did see improvements in the GM side of the business. I know we've talked about that a lot in the past. Apparel was still down. Pharmacy was a big drag this quarter in terms of the in-store pharmacies. So I think as things open up, we would expect to start seeing improvements on the right-hand side. We'll have to see how apparel plays out, though, as the year goes on.

**Michael Van Aelst**

Okay. And on the Drug, I didn't quite hear what you said. I don't know if you said there was a significant increase so far in Q3 or just an increase. But can you clarify that? And can you also touch on, I guess, how much of an impact the going back to 90-day scripts will have?

**Darren Myers**

We have seen—and I don't think we were going to quantify the increase—but we have seen an increase in the first period. So it's not declining in the first period. So we're seeing some growth there. And I don't think we're going to give you the script number for this quarter, but it did impact maybe about a third of the softness last quarter in terms of our number.

**Sarah Davis**

We think it will even out. The trouble with the 30-day and the 90-day, it just causes very lumpy performance. So we saw an impact negatively in Q2. We will see a positive impact in Q3 but, over the four periods of the quarter, it will probably even itself out. So it does have an impact.

But overall, we would like to see the script counts—we do think they'll go up. We are starting to see that in terms of people being out and about a little bit more, more visits to doctors and hospitals—all of those things that result in script count growth.

**Michael Van Aelst**

All right and thanks. And just a last, short one. I see that you renewed your NCIB. Can you talk about what your intentions are for that, for the year, given how you didn't buy anything so far?

**Darren Myers**

Yeah, Mike. As we've said in the last call, we had positive—we didn't do any buybacks this quarter. Our intent—not exactly going to call out when we're going to start it—but our intent is to start them in the second half.

**Michael Van Aelst**

Okay. Thank you.

**Operator**

Your next question is from Mark Petrie with CIBC Capital Markets. Your line is open.

**Mark Petrie — CIBC Capital Markets**

Hey. Good morning. Obviously appreciate that the sales mix is pretty volatile and has had a pretty material impact on gross margin. But separate from the mix, could you just talk about the margin performance within some of the major buckets of your business, within both Food and Drug, please?

**Darren Myers**

I think, Mark, the only thing I would call out, which I said is within Food, it's really been stable. So if you look at the core margin, it's actually been stable year over year. So it's more these other areas that have caused the headwind to us. And there's nothing I would specifically call out more than just the mix of sales in some of those higher-margin items, just less. Other examples to give you is the in-store food our prepared food, we shut those down during the quarter. So you've seen a lot of mix in the past month from just the change within the quarter.

**Sarah Davis**

And I'd say on the Drug side, on Shopper's side, no—same answer—no specific change in margin in terms of margin on food, or margin on beauty, or margin on the Rx. It's just that the mix was so different, in that front store was up but beauty was down and drug was down, and so has an overall negative impact on margin, with Food being a lower margin than either Rx or beauty.

**Mark Petrie**

Okay. Thanks. Thanks for all the comments, too, on the e-commerce business. That's really helpful.

I guess, somewhat different but related, I'm just curious how all of that growth in the digital part of the business affects how you think about your promotions and marketing strategies. And obviously, you've shifted some of your fliers to digital. The loyalty program gives you flexibility in terms of reaching customers. How has all of this affected how you think about sort of marketing and promotions?

**Sarah Davis**

Well, I think how we feel is that the fact that we've invested this money in sort of our Payments & Rewards part of our strategy, we feel very good about it because during the pandemic, it did give us a voice to be able to talk to all of our customers through the loyalty program.

It allowed us to, in some parts of the country, where paper fliers were not allowed for periods of time, it allowed us to continue with digital fliers. We have continued in places where it worked unbelievably well to be able to have that direct relationship with customers, customized personal offers for customers to come into our stores. So we are trying it and a few parts of our business not going back to the paper flier. So we'll see how that goes.

But right now, we feel quite confident in that it does give us a voice to be able to reach our customers in a different way, tell them a different story. So it will have an impact on our marketing going forward, as you highlighted. It does give us a new avenue, so we're quite pleased with that and how it worked through Q2 and through the pandemic.

**Mark Petrie**

Thanks for that. The other thing I wanted to ask about, I guess—well, there's two other things but one—the first is Loblaw Media. And just wondering—we haven't really heard too much about it—I'm

just wondering if you can give us an update about how that has evolved over the course of the year so far as it's began to roll out?

**Sarah Davis**

Yeah. I would say we haven't provided it because it really wasn't a highlight in the quarter. As you can imagine, it wasn't our focus area or the focus area of any of the CPG companies that we partner with. So I would say more to come on that. We'll give you a better update in Q3, but it really wasn't a focus area for us as we went through the pandemic in Q2.

**Mark Petrie**

But are you in a position now where it can become a bit more of a focus for the second half of the year, and then into next year?

**Sarah Davis**

Yes. Absolutely. So Media is absolutely part of our strategy; just wasn't the area we worked on in the quarter so, absolutely.

**Mark Petrie**

Yeah. Understood. Thanks. And then just last, with regards to Connected Healthcare, I mean, it's obviously been a huge focus for you guys over the course of the last number of years. Clearly, the pandemic has put digital health care sort of at the forefront. Just wondering if the economic model—

**Sarah Davis**

Mm-hmm.

**Mark Petrie**

—has become more clear at all? Or if you've had sort of tangible steps forward within that segment as it relates to sort of government support or sort of government pushing in that direction?

**Sarah Davis**

Okay. So a couple points there. So first off, I would just highlight that digital health is still a relatively small part of our business. But what we are looking at is large increases in demand. So that's what we saw in Q2 and, of course, that gives us confidence. And when you think of our digital pharmacy volumes doubling, we also saw an increase in patient-physician video services that we offered were up 10 times what we would have seen pre-COVID.

We also entered into two partnership offerings with primary care and mental health services digitally, so with SilverCloud and Maple. And those resulted in more than half a million Canadians who actually went on to see those services. So we're definitely seeing demand for some of these areas in health.

And then the other thing we're seeing are two trends. So, one, consumers who are willing to pay for some of these health services, which is clearly a positive trend. Second, the regulatory trend, so provinces that are making scope changes for doctors and pharmacists in meaningful ways, more meaningful than we've seen in the past decade in terms of allowing for more expanded scope of practice for pharmacists.

So we would say the huge consumer demand and the change in terms of trends with consumers being willing to pay and regulatory changes being—now seeing are all positive towards our Connected Health strategy. But having said that, it's still a relatively small part of our business, but we are looking for some growth there for sure.

**Mark Petrie**

Okay. Appreciate all the comments. Thanks.

**Operator**



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

**Peter Sklar** — BMO Capital Markets

Okay. Thank you. First question on the grocery business, this shift you saw during the quarter from discount to conventional during the COVID period. Although expected, I would have thought that shift was more dramatic than you anticipated. And so can you talk a little bit how you coped with that? Was there interruption to your logistics or operations? And how would that have had an impact on your financial results for the second quarter?

**Sarah Davis**

Well, I would say I don't know that we knew that it was expected, the move to conventional. I think in hindsight, you think of it and it does make sense.

I would say I'm not sure I totally know what you mean in terms of how it had an impact on our supply chain through it. I think we have a centralized supply chain, so it would have—based on demand and what comes out of the stores—so it would have adjusted immediately to make sure that the demand was fulfilled in the market stores as opposed to the discount stores. So from a service-level perspective, the switch wouldn't have had an impact on our sales.

I would say the difference in assortment in terms of what's offered in a conventional store or a market store would have had an impact versus a discount store. So when you consider a No Frills with limited assortment and in each item only a couple of offers, versus a conventional store that would have more offers within each item or within each group of items, that would have had an impact in the switch as well.

Because if you had service-level issues from vendors in a couple of items in a No Frills, it would have a bigger impact than in the conventional store, where you just have more assortment. So that would have had an impact. I'm not sure if I answered your question, though.

**Darren Myers**

And Peter, I would—

**Peter Sklar**

No. That was a good—that was what I was looking for. And on the—

**Sarah Davis**

Okay.

**Peter Sklar**

—financial impact, I believe conventional carries higher margins than discount, so the financial model would have changed a little bit?

**Sarah Davis**

That's right.

**Peter Sklar**

Okay. The other thing I've wanted to ask you about, just in terms of consumer behaviour—and during the COVID period, I think there was a period where you eliminated pickup fees, and then the fees are back in place now for your click-and-collect model. So I'm just wondering what kind of consumer reaction you've received with them going through a period where they were not paying fees and then the fees have been implemented again. Are you getting any feedback or pushback from your consumer on that?

**Sarah Davis**

I would say, what we can see is that our OSAP (phon) scores have continued to increase, so our customer satisfaction scores within. And that's a key metric for us to make sure that our customers are happy. So we have seen that.

I think our customers understood that we temporarily reduced the fees or eliminated the fees as we went through the pandemic. We have also offered different offerings, so that if you go on certain days of the week, the fee is waived. So for those who care a lot about the fee, there is a way to manage their shop in order to get a day without a fee. So we're doing that to manage volumes by day.

But customers are reacting to it and seem—they just change their shopping habits if it matters to them, so no, not a lot, no. From our stats, it would say that we are just seeing positive improvements in terms of our customer satisfaction.

**Peter Sklar**

Okay. And lastly, Sarah, I wanted to ask you, this experience that happened where the CEOs of the various grocers were summoned to Ottawa, I believe you testified before—

**Sarah Davis**

Yes. I did.

**Peter Sklar**

—a parliamentary committee. There was kind of a flurry in the press then it's all gone quiet. And I'm just wondering what you're aware of is next. Is it possible that this committee could convene again and recall you? Or I'm just wondering how it was all left with the companies.

**Sarah Davis**

I think what you would have seen in the parliamentary committee is what I know as well. I would say, I don't know if they have the option to call us back. There's nothing to make me or others believe that

we will be called back in any way. I think they made their—they asked their questions; we answered them. And as far as I'm concerned, it's done. But I wouldn't say that—I mean, anything's possible. They could ask us to come back. But that's not part of—they haven't notified us, if they intend to.

**Peter Sklar**

And has there been any reaction that you're aware of from regulators, like antitrust regulators?

Have you had any interactions as a result of that?

**Sarah Davis**

No. No, none whatsoever.

**Peter Sklar**

Yeah. Okay. Thank you.

**Operator**

Our next question is from Chris Li with Desjardins. Your line is open.

**Chris Li — Desjardins**

Hi. Good morning and hope everyone's keeping well. Just on the Shoppers front store business, as consumers continue to place high value on convenience in the new world, are there opportunities to accelerate some of the changes within the product assortment, like great emphasis on food or grocery, to try to capitalize on that behavioural shift?

**Sarah Davis**

Yeah. That's a great question. So, absolutely. I think that as an enterprise, solving meals for Canadians is definitely what we want to do. And that comes in a whole bunch of different ways. But definitely, using Shoppers as a way to provide convenient food for Canadians, especially in the urban centres, is definitely part of that strategy. And it was always part of our strategy but we did see a little bit

of an emphasis on that as we went through COVID as well. So once again, another piece of our strategy that we got a little bit of confidence as we went through COVID. So it's a good question.

**Chris Li**

Okay. That's helpful. And then maybe just related to that is, in addition to having more self-checkout kiosks at Shoppers, are there other customer-facing technologies that you guys are looking at to try to speed up the process as traffic picks up again, as people gravitate towards more of the convenience channel?

**Sarah Davis**

Well, that's a good question. I don't think we have anything specific in terms of it. I would say that it could be store specific. I would say, in general, we wouldn't say that we would have a speed-of-checkout issue in Shoppers. There might be a few stores where we would need to add a few more self-checkouts, certainly, for peak times. But there's not an overall strategy in order to change the layout or checkout, other than adding more self-checkouts.

As it's turned out, I don't know if people remember, but it was actually 2016 when we put our first self-checkout into a Shoppers, so really not that long ago. And the penetration is almost at 40 percent—it certainly was during COVID—of using it. So people, customers have adjusted and do like the self-checkouts. So there might be an opportunity to add some more, but that's the only thing I can think of.

**Chris Li**

Okay. That's helpful. And while we're on that, how many stores have the self-checkout now?

**Sarah Davis**

In Shoppers?

**Chris Li**

Yes.

**Sarah Davis**

I'm going to guess, but it's going to be in the 400s, something like that. But I can get a—Roy, maybe, can get back to you with the exact number.

**Chris Li**

Okay. That's great. And then maybe just a couple ones on online. As competition for online intensifies, how sophisticated is the system to retain or win back customers? And so, for example, if a regular Pizza Express customer hasn't shopped with you for awhile, does your system have the ability to detect her actions and then send out target offers to try to win her back?

**Sarah Davis**

Yes. It does. So telling all of our secrets, it would know. The system—

**Chris Li**

Okay.

**Sarah Davis**

—would absolutely know if a customer who normally shops, wasn't.

**Chris Li**

Okay. And then I know in Montreal and I think parts of Toronto, you're trialling a model where you have your Loblaw employees pick up products but then you outsource the home delivery part to third-party transportation companies. I know it's still a pilot but it seems like it is a longer-term part of your strategy. Just wondering if you can elaborate on that, how is the experience so far and et cetera.

**Sarah Davis**

Still pretty early, I would say. And definitely, we are going through such a crazy time. So we'll have to try it out for a bit longer, but definitely trying a few different things.

So we like the deliveries to the home as well, as I said earlier. We like to have a mix of delivery. Instacart has been a very good partner to us, so we'll continue in that partnership. And then we are trying, in a couple of the urban centres, our own delivery, outsourced to a third party but picked by us. Yes. So far so good, I would say.

### **Chris Li**

Perfect. And then my last question is, I know over the years the industry has invested a lot of capital in trying to enhance the shopping experience inside the store, and one area is definitely a replacement program. What do you see as some of the opportunities and, perhaps, challenges going forward with home meal replacement?

### **Sarah Davis**

Well, I think part of it is just making sure that you understand what customers want and need, in terms of what they're going into a store for, or what they would like delivered to their home. So when you think of a meal that would be delivered to their home, would they want—there's all different types that it could be. It could be that they want to make it themselves like a meal kit, or it could be that they just want a hot dinner served to their home in the same way that they would order restaurant food and have it Uber-delivered to them.

So I think in store, it's a different experience because you're walking into a store. And so I think having this—I think the key is to have different opportunities for different things that they can have. But it is a different circumstance than having it delivered to your home, or even picked up and brought home to eat right away.

So I would think just understanding exactly what customers are doing in each space is the key. And we've been spending quite a bit of time working on that to make sure that our offering suits the demands of our customers.

**Chris Li**

Great. Thanks very much.

**Operator**

Our final question comes from Vishal Shreedhar with National Bank. Your line is open.

**Vishal Shreedhar** — National Bank

Hi. Thanks for taking my questions. I might be a bit early here and I'm jumping on the e-commerce question line again. But regarding micro-fulfillment centres, when you install one, are there any considerations for the real estate and the landlords in terms of if you can split and install the DC? Are there considerations with zoning and perhaps unions and safety laws? I'm hoping to get perspective on that.

**Sarah Davis**

So, absolutely, there would be a lot of considerations that would go into picking the site. But I think, generally, it would be the size of the store would be a key factor. It would be the volume, so the density of the area for the store that it would be serving because we want to be as close as we possibly can to our customers. And then, yes, there would be some zoning.

And there would be—there's not—not really, from a union perspective, we wouldn't see that. It wouldn't be taking work away in any way, as long as they're—so we haven't had that as an issue. But there would be a few factors like the size of store and the density of the stores it would serve.

**Vishal Shreedhar**



Okay. And with respect to the online number that you provided, thanks for that. Would that penetration rate go down if you exclude Joe Fresh? And would it be meaningful?

**Darren Myers**

No. But—

**Sarah Davis**

No. It wouldn't go down, I would say. I would say it's about the same, what we're seeing on Joe Fresh. And it would be a small part of our business.

**Vishal Shreedhar**

Okay. And I appreciate that COVID has caused a lot of consumer trend changes all at once. And I understand that Shoppers—the kind of beauty business is one of the more coveted businesses for Shoppers, and. But would work-from-home, do you perceive that impacting, maybe, some trends of the beauty business going home? Or is it too early to say at this point?

**Sarah Davis**

That's a good question. I would say that what we've seen is—I think it changes what consumers buy. I think the focus is more on skincare and derm, which is a big part of the business and maybe a little bit away from some of the pure cosmetics. But it's a bit early to tell yet. I think people will go out again and will still want to look beautiful. So I think it will come back.

**Vishal Shreedhar**

Okay. And regarding the e-commerce and Shoppers and delivery of scripts and, obviously, the pharmacy in the back of a Shoppers is a traffic driver, and as people walk through the stores. So wondering as this accelerates, or if it does accelerate, do you have intelligence on how it impacts associated front store sales? And do you have tactics to replace maybe those lost front store sales as you deliver Rx?

**Sarah Davis**

Well, I think the key for Shoppers and having the—a lot of it is still pickup in-store as well so that would be a major part of it. It's just that you digitally are aware of when it's going to be ready so you could come in. So the traffic would still be there.

But, yes, if there was a big switch to everything being delivered to the home, we would have to come up with different things to attract people into our stores. But I think convenience and location has always been something that is important to the Shoppers business, and that will continue to be there. It'll be driven by front store sales, food, all of those convenience items that people will continue to walk into those Shoppers for.

**Vishal Shreedhar**

Okay. And I was hoping you could give us maybe some perspective on basket size or maybe basket difference between the click-and-collect and delivery? Are there meaningful differences there?

**Sarah Davis**

I would say click-and-collect is generally a bigger basket than the delivery is. On average, it would be a bigger basket. And of course, through COVID, it would be an even bigger basket, as people really did consolidate their shops. And we would have seen an increase in the size of delivery baskets as we went through COVID as well. But I would still say click-and-collect is a larger basket than delivery.

**Vishal Shreedhar**

Okay. Thanks a lot.

**Operator**

We have no further questions at this time. I turn the call back to presenters for closing remarks.

**Roy MacDonald**

Great. Thanks, everybody. If you have any follow-up questions, please give me a shout. And circle November 12th on your calendars for the release of our Q3 results. Have a great day.

**Operator**

This concludes today's conference call. You may now disconnect.