FINAL TRANSCRIPT

Loblaw Companies Limited

First Quarter 2022 Results Conference Call

Event Date/Time: May 4, 2022 — 10:00 a.m. E.T.

Length: 50 minutes

CORPORATE PARTICIPANTS

Roy MacDonald
Loblaw Companies Limited — Vice President Investor Relations

Richard Dufresne
Loblaw Companies Limited — Chief Financial Officer

Galen Weston
Loblaw Companies Limited — Chairman and Chief Executive Officer

CONFERENCE CALL PARTICIPANTS

Michael Van Aelst
TD Securities — Analyst

Irene Nattel
RBC Capital Markets — Analyst

Mark Petrie
CIBC — Analyst

Patricia Baker
Scotiabank — Analyst

Chris Li
Desjardins Securities — Analyst

Kenric Tyghe
ATB Capital Markets — Analyst

Vishal Shreedhar
National Bank — Analyst

Peter Sklar
BMO — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Loblaw Companies Limited First Quarter 2022 Results Conference Call. At this time, all lines are in a listen-only mode.

And following the presentation, we will conduct a question-and-answer session. If you have previously pressed *, 1 to ask a question prior to this announcement, please press *, 1 again.

If at any time during this call you require immediate assistance, please press *, 0 for the Operator.

This call is being recorded today, Wednesday, May the 4, 2022. And I would now like to turn the conference over to Mr. Roy MacDonald, Vice President of Investor Relations.

Please go ahead, sir.

Roy MacDonald — Vice President Investor Relations, Loblaw Companies Limited

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

As usual, I'm joined here this morning by Galen Weston, our Chairman and President; and by Richard Dufresne, our Chief Financial Officer.

And before we begin the call, I want to remind you that today's discussion will include forward-looking statements, which may include, but are not limited to, statements with respect to Loblaw's anticipated future results and the impact of the COVID-19 pandemic.

These statements are based on assumptions and reflect management's current expectations; as such, are subject to a number of risks and uncertainties that could cause actual results or events to differ materially from our expectations. These risks and uncertainties are discussed in the Company's materials filed with the Canadian securities regulators. And any forward-looking statements speak only as of the date they're made.

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

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

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

Richard Dufresne — Chief Financial Officer, Loblaw Companies Limited

Thank you, Roy, and good morning, everyone. The first quarter of 2022 saw continued strong performance across our business, continuing on our momentum from 2021.

We delivered solid sales performance, coupled with stability in our gross margin. We continued to focus on market share and our pricing position and carefully manage our expenses, all part of our focus on retail excellence.

We started the quarter in lockdown. Then, as restrictions eased, consumer behaviour shifted as people began to gather, return to the office, and travel again. Inflation accelerated in the quarter, which accelerated the shift to discounts in Food Retail.

Our mix of assets across Food and Drug Retail, along with our strong e-commerce and loyalty offerings, helped us deliver strong results in this evolving environment.

Given that we are now cycling two years of the pandemic, we will focus on comparisons to prior year in providing insight to our performance and will no longer share two-year average data points as comparisons.

We're pleased to report strong and steady results in the first quarter. On a consolidated basis, revenue grew by 3.3 percent, adjusted EBITDA increased by 10.3 percent, and adjusted earnings per share grew by 20.4 percent to $1.36 a share.

In the quarter, both our Food and Drug Retail businesses contributed to our performance.

In Drug Retail, absolute sales increased 5.4 percent while same-store sales increased by 5.2 percent, lapping a decline of 1.7 percent. Frontstore same-store sales grew by 3.6 percent.

As we moved past the initial lockdowns early in the quarter, we began to experience acceleration in sales growth in our higher-margin categories led by OTC and cosmetics. Pharmacy same-store sales grew 6.8 percent, once again driven by our COVID vaccine and testing services, which were not material in Q1 last year.

In Food Retail, absolute sales increased 2.4 percent and same-store sales grew 2.1 percent. Performance in our Discount banner strengthened, and for the first time since the pandemic began we saw the sales mix between our Discount and Market businesses return to pre-pandemic levels as we exited the quarter.

Although customer buying patterns shifted as restrictions loosened and inflation continued, our Market banners remained strong and continued to perform well against our conventional grocery peers.

In Q3 last year, we announced our network optimization initiative. Over the last few weeks, three converted stores have been completed. We are pleased with their sales performance, which is running ahead of expectations. More conversions are on the way.

Our omni-channel performance remained strong. Online sales decreased by 9.8 percent, lapping last year's 133 percent growth rate during a period with more stringent lockdown measures. We see volumes now levelling off after a peak of activity experienced in January this year through the latest series of lockdowns.

Our digital businesses delivered $3 billion in sales over the last 12 months, continuing to run well above pre-COVID levels.

Our omni-channel network is well positioned. We continued to enhance our customer shopping experience through our digital platform, while offsetting its cost through optimizing operational efficiencies, deploying new technology, and refined our delivery offering.

In the quarter, we further expanded our local store-based offering, expanding PC Express Delivery same-day service to over 300 stores.

Retail gross margin in Q1 was 31.1 percent, up 80 basis points compared to last year. Drug Retail led our margin expansion in the quarter. With its higher gross margin rates, growth in pharmacy services category contributed to this expansion. COVID vaccines and testing led this growth, while we also saw traction in medication reviews and prescribing services.

Higher margin categories within frontstore, such as OTC and cosmetics, continued their momentum, benefitting from customers who returned to socializing and office-based work.

Gross margin performance in Food Retail also improved slightly, reflecting our pricing and promotion strategies, which leverage our unique data set. We now feel confident in our ability to scale up some of these strategies, allowing us to benefit both sales and margin.

We are pleased with our growth performance for Q1 and our competitive positioning in the market. As the year unfolds, we are focused on delivering consistency in our gross margin performance and are confident in our ability to do so.

Retail SG&A as a percentage of sales was 20.4 percent, an improvement of 10 basis points compared to last year. We lapped higher COVID costs in the prior year and continued to benefit from sales leverage and operating efficiencies. This was partially offset by higher labour costs across the network, including the higher cost associated with the growth in pharmacy services.

Adjusted Retail EBITDA increased by $140 million, or 12.2 percent in the quarter, yielding a margin of 10.7 percent.

We were pleased with PC Financial's performance in the first quarter. Revenue was up $21 million, driven by higher interchange and interest income with a broad-based increase in customer spending. Contribution to adjusted EBITDA from the bank was strong, but decreased $15 million year over year as we lapped last year's gain related to reversal in expected credit loss reserves.

On a consolidated basis, adjusted EBITDA margin was 11 percent in the quarter, up 70 basis points compared to last year.

In Q1, we repurchased $148 million worth of common shares representing 1.3 million shares.

Maintaining our cadence of annual dividend increases, today we announced our 11th consecutive annual increase, raising our quarterly dividend by 11 percent.

Looking ahead, macro factors continue to make forecasting challenging. In Q2, we expect eat-at-home trends to continue to taper. We expect inflation to remain elevated in the short term. However, inflation may moderate in second half of the year as we begin to lap higher levels from the second half of 2021 and see the impact of actions taken by central banks.

That said, there are broader macro and geopolitical factors that are outside of our control that impact the inflation landscape.

While we continue to experience challenges within our supply chain, our in-stock position has improved and we remain confident in our ability to navigate the situation. Our full year outlook remains unchanged.

I will now turn the call over to Galen.

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

Thank you, Richard, and good morning. I'm pleased with our performance in the quarter. And with a backdrop of high inflation globally and the return of normal routines here at home, the breadth of our business and its range of well-defined value in services are resonating with consumers into 2022.

Our Drug segment stood out this quarter, driving a significant portion of our sales and gross margin growth. As consumer behaviour normalized, customers returned to our Shoppers beauty counters, generating excellent results in our higher-margin categories like cosmetics.

Cough and cold has strengthen significantly, prescription counts increased, and pharmacy services continued their multiyear expansion, a strong indication of the relationships patients continue to build with their pharmacists as convenient and trusted healthcare partners. A recent Leger survey named Shoppers Drug Mart the country's most reputable company, a great position when you're in the business of care.

Our Food business continued to face global supply chain challenges and cost increases across the board, including for fuel, shipping, ingredients, and packaging. We're watching these structural pressures closely. At the moment, as Richard said, we see signs that inflation is moderating. However, external forces are significant and complex, making accurate predictions difficult.

Within the current environment, all divisions are performing well. I'm particularly encouraged by our Discount division, which represents 60 percent of our grocery sale. Our hard discount, No Frills and Maxi stores, are a bellwether for customers seeking value, and Q1 sales growth was strong.

This is an indication of the Canadian consumer's steadily increasing focus on value. We see similar signs in the performance of our market-leading private label program. After President's Choice, our No Name brand is the second largest in the country and through the promise of excellent product at incredibly low prices, sales are at all-time highs.

When combined with the over $1 billion of savings we are on track to deliver to Canadians through our PC Optimum program, our consumers know they can count on us for the best value.

Delivering value is core to our customers' purpose: our company's purpose of helping Canadians live life well. But equally important is our commitment to make a positive impact in the communities we serve.

With that in mind, I'm delighted to announce the release of our 2021 ESG report, now online at loblaw.ca. The report shares the details of our progress to date and our ambitious goals for the future on a wide range of environmental, social, and governance topics, with a particular focus on our two biggest internal priorities of advancing social equity and fighting climate change.

This is an increasingly essential part of the shareholder value creation model for Loblaw as we work to marry strong financial performance with excellent ESG credential.

Thank you. I'll now open the call for questions.

Roy MacDonald

Thank you, Galen. Michelle, if you'd please remind us how to line up for a question.

Q&A

Operator

Thank you, sir. Ladies and gentlemen, we will now begin the question-and-answer session. If you would like to ask a question, please press *, followed by the 1 on your touch-tone phone. If you would like to withdraw your question, please press *, followed by the 2. Please standby one moment for your first question.

Your first question comes from Michael Van Aelst of TD Securities. Please go ahead.

Michael Van Aelst — TD Securities

Hi. Good morning. Very good quarter. And overall, looks like you're—I would have thought you're ahead of plans in Q1 after a strong result and the way you guys talked about your outlook for the year last quarter.

So I'm just curious as to why you felt that you couldn't increase your guidance for the year? Is this just cautious because of the uncertainty? Or is there anything that's changed in the fundamentals that may also be slowing down the back part of the year?

Richard Dufresne

Good morning, Michael. Yeah. Uncertainty, yes, through the second half is definitely a factor. But when you look at our performance last year, we delivered increasingly improving result as the year progresses.

So when we look at where we are now versus our plan, we feel that our current outlook is correct. We will update it as the year progresses, but for now we feel good with what we have out there.

Michael Van Aelst

Okay. When we look at the gross margin improvement it was quite impressive, and are you able to separate what was coming from mix improvement in your business and what was coming from retail excellence initiatives?

Richard Dufresne

Tough to do that. So what we can easily separate is where like Food versus Drug. And as we mentioned in our remarks, in this quarter it was predominantly Drug and driven mostly by pharmacy services, which last year were just beginning and whereas this year we're running strong.

So those services have a significantly higher margin than the rest of the business. And that was the big driver of our gross margin rate improvement.

We did see some slight improvement on Food Retail, but it was small compared to the overall increase.

Michael Van Aelst

Okay. And when do you expect to start lapping the higher level of pharmacy services?

Richard Dufresne

The best way to describe it, Michael, is that pharmacy services were increasing throughout last year. So every quarter we saw an increase. So it's going to be an increasing trend that we'll face as the year progresses, but the team has put together some good plans for that portion of the business for 2022.

Michael Van Aelst

Okay. Great.

And then just finally, you talked about, or we've seen prices, obviously, significant cost inflation and price inflation being passed through. But aside from your actual food and true cost of goods sold from your suppliers, how are you dealing with the higher cost of labour, of plastic bags, of things like that? Are you able to pass that along at all?

Richard Dufresne

Those costs are obviously throughout the business, but they pale in comparison to the cost increase coming from on goods for resale. And so those are the ones we focus more on. And the rest we're just managing.

So supply chain, as Galen was mentioning, is a good example where we've been doing a decent job in sort of trying to offset those internally.

Michael Van Aelst

Okay. All right. Thank you.

Operator

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

Irene Nattel — RBC Capital Markets

Thanks, and good morning, everyone. Before I get to my question, just a quick follow-up from Mike's question.

On the gross margin, the absolute level of gross margin in Q1 is higher than the average over 2021. Do you think that 31 percent level is sustainable?

Richard Dufresne

Yes.

Irene Nattel

Thank you. That's very clear.

Just so now, if we could just talk a little bit about consumer behaviour. I think you said discount is now back. Private label is now back. What are you seeing in terms of promotional sensitivity and ability to pass on? And I will say that on the Maple Leaf call earlier this morning, Michael McCain noted that they are not seeing consumer resistance to price increases in the form of lower volumes when they do raise prices.

Galen Weston

Yeah. So I sort of picked my words carefully. We are seeing a steady shift towards consumer sensitivity around value as opposed to a dramatic left turn. It's been building now for a number of quarters. And we see the strong signals, as we mentioned in our Discount business. And then also even within our Market division business increased interest in things like No Name private label.

So that translates also into increased promotional sensitivity. And I think what Richard tried to get at is we're kind of back to normal or, call it, back to pre-COVID price sensitivity, promotional sensitivity. We're not yet seeing that expected shift that comes when you have plus 6 percent inflation for month after month.

We think that's an indication of the consumer having more money in their wallets still than they would have had pre-COVID levels. But we're watching it very carefully because prices are continuing to grow. Consumer behaviour is shifting. It's the usual things: smaller pack sizes, sensitivity to higher price points, all of that stuff. And it's an indication that if inflation doesn't begin to moderate because of some of these external forces that we've been talking about, it's going to increasingly become a concern.

But the reason that we emphasize the strength of our Discount business is a reminder that during COVID it was a headwind for us. During an inflationary period, we see it as a tailwind. And No Name is the unsung control brand that we have inside our portfolio. And we've done a lot of work on that over the last number of years and are really encouraged by what we're seeing from the customer in terms of their enthusiasm for that product.

Irene Nattel

Thanks. That's very helpful. And I guess we're all shopping like mothers now.

Actually, just following up on that, you've got a lot of data in PC Financial around broader consumer spending. Any colour that you can share with us from that perspective in terms of just what you're seeing?

Galen Weston

Well, we look at it very carefully. I want to be careful here. It gives us an extra sort of layer of visibility into consumer behaviour. It's one of the data sources that gives us some incremental degree of confidence around the strength of the consumer balance sheet. The strength of the PC Optimum balance sheet—or the PC Financial balance sheet is very good. And that suggests that the consumer is in reasonably good shape. But you can see that in what you're hearing from the big banks as well.

Irene Nattel

That's great. And finally, last one from me.

You guys mentioned improving sales of cosmetics. Do you have a sense of in aggregate where cosmetic sales are today relative to pre-pandemic?

Galen Weston

Oh, that's a good question. And they're still growing fast. And so I don't know if they're all the way back to pre-pandemic levels. But if they're not there yet, they will be very soon based on the rates of growth, of course, subject to a change in consumer behaviour.

I don’t want to understate either the strength that we are seeing in OTC. I think there’ve been a few headlines in the paper over the last few weeks about the flu being back. That certainly seems to be the case when we look at OTC. And also, people who are managing COVID on the milder side are also diving back into all of the cold medicines as well.

So those are really the two places that we’ve seen a very marked shift in sales growth in the last quarter.

Irene Nattel

That’s great. Thank you.

Operator

Your next question comes from Mark Petrie, CIBC. Please go ahead.

Mark Petrie — CIBC

Yeah. Thanks. Good morning. Just with regards to your efforts on promo optimization, I think you basically said it’s now imbedded in the organization and you’re sort of at a run rate on that. Is that a fair summary?

Galen Weston

Well, so call it the first phase, which is a very small number of tools that we developed during the pandemic and have now been deploying at scale; one of those internally we call the hero engine, which is a promotional algorithm that drives incremental sales through loyalty. And then there are a set of tools that are being used to pick items and to pick promotional prices with the same kinds of incremental objectives.

So that’s ramping up. I’d say that those tools are being deployed at scale now. But we have a world-class analytics team who is working on the next two or three tools at the moment. And those tools are primarily focused around increasingly intelligent audience building. So imagine identifying particular audiences with particular propensity to want to buy certain things, or to be responsive to certain kinds of messages or promotions. That is kind of the next phase.

So when you ask Richard the question, what do we see in terms of margin expansion potential over time, one of the reasons for our optimism is the depth of opportunity that we're scratching the surface on in terms of that analytical database.

Mark Petrie

Okay. That's helpful. Thank you. And then, I guess, on a related topic just with regards to margins, I wanted to ask about sort of procurement more broadly. I know this is an area of focus for Robert and you've made some changes.

So can you just talk about that work? What's the impact of it today? What are your sort of expectations? Or how does this play out in terms of second half of the year and into 2023?

Galen Weston

Yeah. So the principal adjustment that we've made is we now have a central procurement team that consolidates the buy and the negotiation with our vendors. It's a small team, but it's also a very capable team.

And I think we spoke last quarter about the way that that team evaluates the impact of cost inflation on the cost of a good. And it allows us to negotiate with our vendor base, we believe, with an elevated level of precision. And we've talked about this before about putting through real justifiable cost increases, but being very careful about accepting cost increases that are not truly justified. So that is one of the big areas of focus of the team right now.

The second is developing really intelligent strategies by category to make sure that we have the right cost across the board in key items. And there are techniques that we're using. We're probably through two or three of the big categories right now, and we're encouraged by the results that we're seeing.

Mark Petrie

Okay. And then just switching to e-commerce.

I just wanted to ask about sort of the margin impact of that business. And as sales come off or sort of normalize in a more normal sort of shopping environment, are you rightsizing capacity specifically in Food? And are you able to scale costs to the slower demand?

Galen Weston

Yes. Absolutely. I mean, we have a certain fixed cost base inside our picking network across all of our stores. And I think Richard has commented before, at peak sales we do get a certain amount of leverage on those fixed costs. And as the sales come down, that leverage compresses a little bit. But that's being offset by all the incremental work that we're doing on pick efficiency, on pick-up efficiency, and then ultimately on the efficiency of the relationship that we have with our delivery partners.

So these things are mixing out in the short term. And then I think we've also shared that over time we expect to see potentially incremental investments in different forms of automation. We see an increasing opportunity to offset that kind of diluted margin through our media business and monetizing eyeballs on our digital properties.

So we see the heavy investment period and, therefore, the heavy impact on our gross margin is largely behind us.

Richard Dufresne

Yeah. Mark, we know very well the net drag or the impact of fixed costs on the infrastructure we have. That's a number we track very carefully. And year over year now, the incremental impact is not that material. So it's something that we can manage quite effectively.

Mark Petrie

Thanks for that. I'll pass the line.

Operator

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

Patricia Baker — Scotiabank

Yeah. Thank you very much for taking my questions.

First, just a follow-up to an earlier discussion on the gross margin and the impact of Shoppers on the frontstore. In the way that you've discussed it, would it be fair to assume that the OTC, the order of magnitude of impact is that OTC was a greater contributor than cosmetics to the improvements in frontstore gross margin in Q1?

Richard Dufresne

I actually don't know the answer to that question to be honest, Patricia.

Patricia Baker

Okay.

Richard Dufresne

I think that the biggest driver on gross margin is essentially COVID services. That is the biggest contributor.

Patricia Baker

Okay. And then my actual question is in Q4 and again in Q1 you indicated that your basket inflation was greater than CPI, and the CPI in both cases was quite high, 7.5 percent in Q1.

Can you just talk about the dynamic there why your basket is higher? And how much of the inflation, of product cost inflation, are you passing through?

Richard Dufresne

Yeah. Patricia, for us what's most important is our pricing position versus our peers. That's what we track very well.

As to how it affects inflation and how others talk about inflation, it's very tough for us to compare. And so, but if we feel good about our pricing position, if we feel good about our share position, that's how we manage our business.

Patricia Baker

Okay. I'm not sure that I really understood your answer.

Richard Dufresne

Well, I think we're not trying to manage our business to an inflation number. We're trying to manage our business as to where we are priced versus our competition. And so if we have a good pricing level versus our peers and everybody is living the same inflation as us, everybody's dealing with these cost increases, so if we can maintain good pricing position, that's how we satisfy ourselves that we're well positioned versus our peers.

Patricia Baker

Okay. Thank you.

Galen Weston

And, Patricia, maybe just if we go back a few quarters, one of the things that we talked about as part of the retail excellence program was we got in here and we saw what looked very much to us like overinvestments in certain regions, in certain categories, in certain types of programs. And so part of what's happening right now is that we're adjusting that base. I think one of the terms—

Patricia Baker

Okay.

Galen Weston

—that's used often around the merchant table is we're getting out of what we call low-calorie sales, things that just were simply not giving us value for money.

So it would stand to reason that there might be a temporary difference between us and others in terms of the relative growth of the basket.

Having said that, Richard's point is the most important one, which is we're managing our competitive position not through inflation, but through our relative price position and the effectiveness of our program and, ultimately, our market share performance.

Patricia Baker

Okay. That makes sense. So what you're talking about, Galen, here is kind of recovery from a past bad pricing position?

Galen Weston

Yeah. That's certainly one of the forces out there. I wouldn't want you to think it was the only one because—

Patricia Baker

No. No.

Galen Weston

—as you optimize your promotional effectiveness, you're essentially spending less to get the equivalent value in the minds of the consumer. That will also lead to potentially incremental inflation in your measure without deteriorating your customer value prop, if that makes sense.

Patricia Baker

No. It makes a lot of sense. Thank you for that.

Operator

Your next question comes from Chris Li of Desjardins Securities. Please go ahead.

Chris Li — Desjardins Securities

Hi. Good morning. I was wondering if you can give us a sense of the magnitude of the out-performance for the Discount banner versus Market during the quarter?

Richard Dufresne

One is accelerating and the other one is slowing a bit, so sorry, Chris.

Chris Li

No worries. I tried. But maybe can I just ask was the same-store sales at the Market division at least positive during the quarter?

Richard Dufresne

For which one?

Chris Li

For the Market division?

Richard Dufresne

Market position was slightly negative.

Chris Li

Was slightly negative. Okay. Okay. That's helpful. And then in terms of just maybe a quick one on the Food gross margin. I was wondering specifically if you see an acceleration from Market to Discount? And my sense is and I could be wrong that gross margin for the Market division is generally higher than Discount. Is there a bit of a negative shift impact on margin as Discount grows faster?

Richard Dufresne

Yes. Mathematically, yes. But the shift is not material. So all in all, it's not a material impact.

Chris Li

Okay. And maybe a quick one on private label. I know in the past, I think you've disclosed that your own brand penetration was around sort of 30 percent in the Food segment. I was wondering, has that percentage gone up in recent months?

And then maybe secondly, how is Loblaw capitalizing on the strong demand for private label to drive growth but, more importantly, to try to further improve the margin profile over the longer term for the private label portfolio?

Galen Weston

Yes. So yes, private label penetration is up. It is growing notably faster than our non-private label products and programs. And of course, the design of a private label product takes into account deliberately the margin structure.

And so it's about penny profit. You want to earn more penny profit when you sell a controlled brand product than you earn when you sell a national brand product. And that means the margin needs to be significantly higher. And that's how the program is engineered.

Chris Li

Okay. And your penetration, is it still around 30 percent?

Galen Weston

Well, it's grown, but it's not 40 percent.

Chris Li

Okay. Okay. That's helpful.

Maybe just a couple of quick ones just on the frontstore for Shoppers. So yeah, it's helpful that Omicron obviously had bit of impact in the early part of the quarter. I guess my question is within your categories were there maybe more sensitive to for the inflation, like the food products that you sell at Shoppers, is that particular category, are you seeing more sensitivity in terms of maybe people not buying as much because of high inflation? Or is the convenience proposition of Shoppers more than offsetting that trade-down?

Galen Weston

Yeah. I mean, look, the starting point is that the Shoppers Drug Mart food proposition is not price led. It's convenience led. The assortment is designed that way, the promotional programs are designed that way, and the pricing is designed that way.

Having said that, you certainly have to keep a watchful eye on what could be perceived as insult pricing on the shelf. And that's something that the merchandising teams in Shoppers Drug Mart are very focused on. But it's not the primary driver of business there.

Chris Li

Okay. That's helpful. My last question, maybe just a quick one on financial services.

The allowance rate has been relatively stable. I was wondering, what is your outlook for the second half of the year if we do get into a slowdown situation?

Richard Dufresne

I think that business should continue to do well. The noise that we've been experiencing has to do with the movements and the expected credit loss reserves. But if you look at the core performance of the business, we're starting to see spend go up again, which is very good for us.

But interestingly, and Galen was touching on that earlier, payment rate, which is the rate at which people pay down their balance on their credit card, continues to be exceedingly high, which is an indicator to us that people still have money in their pockets. So we're monitoring this very carefully as an indicator of the health of the Canadian consumer.

Chris Li

Okay. That makes sense. Thanks very much, and all the best.

Richard Dufresne

Thank you.

Operator

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

Kenric Tyghe — ATB Capital Markets

Thank you, and good morning. Could you speak to how the online business performs perhaps relative to your expectations?

And secondly, how has sort of the changing play for the consumer, the changing pressures that consumers are perhaps facing impacting consumer behaviour around online?

Is there a marked shift in how consumers are shopping online? And any insight there would be really useful.

Galen Weston

No marked shift that is a function of inflation, if that's really at the heart of your question. We are seeing opportunity to drive online grocery penetration in our Discount businesses, but largely because there's been a shift of consumers in general to that space. And we want to make sure that for customers who want to buy Discount online that they have the best possible access to that solution.

But otherwise, it's still by and large a less price-sensitive shopper. I think we've commented in the past that the margin mix is better online. That contributes as part of the offset for the incremental cost.

We are still seeing significant growth in our proprietary delivery channel, which Richard mentioned we've been rolling out, which has a fee associated with it, which again suggests people are prepared to pay for that convenience. And when it comes to a market like the GTA, we would have penetration levels that are running well above the numbers that we reported today on average for the country.

Kenric Tyghe

Thank you, Galen.

And then if I could just switch to capital allocation and capital allocation priorities in the context of the changed world in which we live and perhaps some of those changes proving a little more permanent than some might have expected a couple of years ago.

Has any of this impacted your thinking by way of capital allocation priorities or perhaps necessitating a rebalancing of those priorities? And any insight you could provide there as well would be appreciated.

Galen Weston

I think the insight is no, no fundamental change. We're still aggressively investing in upgrading our supply chain distribution systems, adding automation. These were all decisions that were part of our strategy over the last couple of years and we're beginning to do more of that.

And then, yes, we've seen a bit of a pullback in e-commerce and we've seen lots of robust strength in our store networks. But this is all within the framework that we laid out 12 months ago. So no meaningful change in capital allocation approach.

Kenric Tyghe

Great. Thank you. I'll leave it there.

Operator

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

Vishal Shreedhar — National Bank

Hi. Thanks for taking my question.

With regard to pharmacy services, I was hoping you could give us some perspective on the size of that business. Once upon a time, I understood it was a pretty small business, but now it seemingly has a meaningful impact on gross margin.

Richard Dufresne

Yeah. I won't tell you the exact size, but yes, it grew significantly during COVID. And it's now an important part of our strategy going forward. And last year was a record performance for that business.

And so Shoppers worked hard last year to put together plans to be able to continue to maintain and, ultimately, continue growing that business. But there's definitely portions of it that'll be cyclical and that'll go away. But we do feel good about the plans that is put in place this year to be able to continue to have that business perform well going forward.

Galen Weston

Just to add to that, Vishal, I think what COVID has done both for the Canadian consumer and then also for the public healthcare system is it's really helped everybody understand the complementary role that the pharmacist and the pharmacy can play on kind of basic healthcare delivery. And so vaccinations and COVID tests are just examples. Med reviews, hypertension, prescription, all these things are growing and important parts of the whole healthcare network.

And so we see medium term the opportunity to grow services through our pharmacies well in excess of the peak that we had in COVID this year.

Vishal Shreedhar

Okay. That's helpful.

And in your plan when you anticipate growing that services business, do you see legislation—do you see the requirement for legislation change? Or that's within the existing framework?

Galen Weston

Yeah. It's within the existing framework, first and foremost, but there is not—the regulatory framework in each of the provinces is different. And in certain provinces where we can do more we're certainly building the evidentiary case for why some of these services should be expanded or allowed in other provinces.

But it's part of the normal course. We don't need some wide-ranging change to take place in order for us to fulfill our objective. But we'd certainly like to be able to do more in certain provinces.

Vishal Shreedhar

Okay. In your remarks I believe you mentioned, and I may have got this wrong, $1 billion in savings associated with Optimum for the consumer.

Was that a 2021 figure? And if so, do you have a year-over-year number that you could share with us?

Galen Weston

That was a 2021 number. And no, I don’t have a year-over-year number to share with you.

Vishal Shreedhar

Okay. And just on frontend for Shoppers, a bit lighter than I would have expected, despite annualizing the negative 6 percent same-store sales growth last year. Wondering if that was an aberration just related to the ups and downs associated with COVID-19? Or is there something else in there that I should consider?

Richard Dufresne

So I think you’re right. When we started the year in lockdown, Shoppers businesses was negatively affected. And so it doesn’t perform well under restrictions. So as we go back to normal, we’re starting to recover that. And we see that trend continuing going forward.

Vishal Shreedhar

Thanks for the colour.

Operator

Your next question comes from Peter Sklar of BMO. Please go ahead.

Peter Sklar — BMO

Good morning. Just a couple of questions here.

One, with your e-commerce revenues down almost 10 percent, Richard, what’s your thought bottom, bottom line? Is that good for profitability? I would think it is because your margins are much better on an in-store sale versus a click-and-collect sale.

And I guess it assumes that you're capturing that customer as the customer leaves e-commerce and goes in-store. I think there has to be an assumption that you're capturing the customer rather than the customer going to a competitor.

But if that's the case, bottom line, has this been a profitable trend for you? And did that noticeably contribute to your grocery gross margin in the quarter?

Richard Dufresne

What you say makes a lot of sense. But the impact of all of this is pretty marginal on our numbers because what happens is the biggest contributor to our cost in online is labour to pick in-store. So that gets adjusted with the sale performance. So net-net, it's not a big driver of our gross margin performance the fact that penetration levels went from X to Y in the last two quarters.

Peter Sklar

Okay. And then just lastly, this is just kind of anecdotal, but as I look at your flyers, there just seems to be more promotions in terms of PC Optimum rewards offered on these various promotions in the flyer. Am I just imagining things? Or has there been a bit of change in strategy during the quarter?

Galen Weston

So you're right. You are seeing in certain places, I think maybe this week in particular, a particular emphasis on PC Optimum.

Think about this as not a fundamental strategic shift, but more a series of experiments to understand exactly how to optimize the use of PC Optimum across all of the various channels of delivering value to the consumer.

And the fact that you're seeing a bit more of it in our flyers is an indication of success and trying to test how far we can take it. But at this point, what you're seeing is—some of what you're seeing are experiments.

Peter Sklar

Yeah. So and the way you measure success, I assume, is you make an investment, which is the reward, and then you look at the incremental sales and the margins it generates and what's the return on that investment. Is that how you look at it, Galen?

Galen Weston

That's right. We have a very effective measure, which we call ROS, which is a return on sales metric. And we measure every single promotion that way particularly when it comes to those items that are part of the PC Optimum program, whether it's in store, in flyer, or through the app.

Peter Sklar

Okay. Thank you.

Operator

Ladies and gentlemen, as a reminder if you would like to ask a question, please press *, 1 now.

There are no further questions from the phone lines. I will turn the conference back over to Mr. MacDonald for closing remarks.

Roy MacDonald

Great. Thanks very much for your time, everybody. As always, if you have any follow-up questions, give me a shout, drop me an email. And mark your calendars for July 27th when we will be releasing our Q2 results.

Thanks, and have a great day.

Operator

Ladies and gentlemen, this does conclude your conference for this morning. We would like to thank you for participating, and ask that you please disconnect your lines.