Management's Prepared Remarks

Q2 2020 Earnings Call

August 5th, 2020

Operator

Ladies and gentlemen,

Good morning and welcome to the analyst conference call on the Second Quarter and Half year 2020 results of Ahold Delhaize. Please note that this call is being webcast and recorded.

Please note that in today's call forward-looking statements may be made. All statements other than statements of historical facts may be forward-looking statements. Such statements may involve known and unknown risks and uncertainties that could cause actual results, performance or events to differ materially from those included in the statements. Such risks and uncertainties are discussed in the Interim Report, Second Quarter and Half year 2020 and also in Ahold Delhaize's public filings and other disclosures. Ahold Delhaize disclosures are available on aholddelhaize.com.

Forward-looking statements reflect the current views of Ahold Delhaize's management and assumptions based on information currently available to Ahold Delhaize's management. Forward-looking statements speak only as of the date they are made, and Ahold Delhaize does not assume any obligation to update such statements, except as required by law.

The introduction will be followed by a Q&A session. Any views expressed by those asking questions are not necessarily the views of Ahold Delhaize.

At this time, I would like to hand the call over to Alvin Concepcion, Vice-President Investor Relations. Please, go ahead.

Alvin Concepcion

Vice President, Head of Investor Relations

Thank you operator, and good morning everyone.

Welcome to our second quarter 2020 results conference call.

On today's call are Frans Muller, our CEO and Natalie Knight, our CFO. After a brief presentation we will open the call for questions.

In case you haven't seen it, the earnings release and the accompanying presentation slides can be accessed through the Investors section of our website aholddelhaize.com.

I ask that you please limit yourself to 2 questions.
If you have further questions, then please re-enter the queue.

I'll now turn the call over to Frans.

Frans Muller

President, Chief Executive Officer

Thank you very much, Alvin and Good morning everyone.

First, I would like to thank associates across all our local brands and support offices for their outstanding service during this COVID-19 crisis. Their agility and dedication have ensured the safety of our stores and distribution centers, sustained the strength of our supply chains, and helped nourish families and local communities. The engagement and strong execution of our teams helped us translate the stronger-than-expected demand in both the U.S. and Europe, due to COVID-19, into outstanding results in the second quarter.

We are proud of our second quarter performance and proud of the associates who have helped deliver it. The strong performance has enabled us to further increase important investments in additional safety measures, enhance associate pay and benefits, and fund significant charitable donations to local communities, including to several local food banks. Our brands have also hired more than 45,000 associates globally in the second quarter.

Natalie will go into more detail on the financial performance in second quarterQ2. Before she does, I would like to take the moment to share a few key highlights:
We accelerated both comparable store sales growth and net consumer online sales growth; both were even better than the high levels of growth we saw in our record first results.

This sales development, along with the benefit of comparing against the same quarter last year, when we saw a negative impact from the strike at the Stop & Shop brand in the U.S., led to strong Group underlying operating margin performance in the quarter, and 88% diluted underlying EPS growth.

We're also accelerating investments to support customer demand and our increasing digital and omnichannel ambitions. And while COVID-19 continues to create a high level of market uncertainty, we are nonetheless raising our full year outlook for underlying operating margin, underlying EPS growth, and free cash flow due to our strong performance in the first half of the year.

We continue to adapt to the changes we are seeing in consumer shopping behavior. One of the changes we see is the increased demand for our online offerings, which combined with investments to increase capacity, has resulted in Group net consumer online sales growth of nearly 78% at constant rates. Our increased investments in digital and omnichannel capabilities, as well as a continued focus on maintaining our leadership position in the markets we operate in should lead to continued wallet share gains. As a result, we now expect greater than 55% growth in global net consumer online sales in 2020. This puts us on track to reach our goal of doubling global net consumer online sales from €3.5 billion in 2018 to €7 billion in 2020 which is one year earlier than we outlined at our November 2018 Capital Markets Day.

I am on slide 5. And there you will will see three areas with examples of how we are navigating through the COVID-19 crisis.

Our first priority, of course, is to continue to run operations safely and smoothly and offer our customers even more convenience, so we can serve them better in this time of need. Our continued emphasis on safety and convenience requires a high level of investment. We invested approximately €260 million in COVID-19 related mitigation efforts in the second quarter, which was a significant step up from the amount we invested in Q1. The total we have spent on COVID2019 less items to in the first half of the year is approximately €330 million.

These items include additional safety and protective measures, for our associates and customers, enhanced associate pay and benefits, and significant charitable donations to support local communities. As you heard me mention earlier, our brands have also hired more than 45,000 associates in this quarter and nearly 69,000 in the first half of the year. These associates have played an essential role in helping feed our local communities.

Second, we continue to enhance our omnichannel and digital capabilities to adapt to rapidly changing changes in customer behavior. For example:

- We will increase our US online grocery capacity by 70% in 2020,
- And we are growing it by 40% at Albert Heijn in the Netherlands.
- At Stop & Shop, later this year, we will open four new ware rooms, which are our online fulfillment centers.
- Bol.com will open a fulfillment center this year as well.
- And, have accelerated our same-day online offerings in the U.S. with additional Click & Collect locations.
- Offering of same day delivery at more than 600 additional Food Lion and Stop & Shop stores will be also a part of our offering.

And third, further improving in-stock levels to better serve our communities is of key importance. By working proactively with our suppliers, we are now back to normal in-stock levels in Europe and are improving in-stock levels in the U.S., where there continue to be industry constraints in certain categories. We will use the strength of our relationships, scale, supply chain, and leading local market positions to ensure we are getting ample allocation so we can continue to serve our communities in the best way possible.

On slide 6, you'll see some of the business highlights from the US. Our strong comparable sales performance was aided by 127% online sales growth, as we were able to convert higher demand from both new and existing customers. We expect the strength in online sales to continue, and we are now forecasting more than 75% US online sales growth in 2020, which is higher than our previous expectation of more than 50% and the initial expectation of more than 30% growth.

While we're benefiting from increased customer demand, we're also helping to drive this growth with investments to increase online capacity, which I mentioned earlier. In addition to adding same-day delivery at an additional 600 stores, we've also continued to focus on Click & Collect, which remains an important same-day channel for customers as well. We ended the second quarter with 765 locations and expect to have for the full year over 1,100 click & collect points in 2020.

Food Lion was our fastest growing brand and achieved its 31st consecutive quarter with positive comparable sales and is proving that a high density store network with its clear focus on fresh and affordable is hitting the sweet spot of what customers are looking for today.

We also agreed to acquire 62 stores from Southeastern Grocers, which will be converted to the Food Lion brand, and that should further help improve an already very strong market position at the brand in 2021 and beyond.

Finally, Stop & Shop was also one of our fastest growing brands in this quarter as well. In particular, the Reimagined Stop & Shop stores continue to outperform. We expect to open 20 more of these remodeled stores in the second half of the year.

Slide 7 shows some highlights from Europe. We also had strong performance here and gained market share in our largest European brands in the Netherlands and Belgium. Overall, the brands in Central and Southeastern Europe maintained share.

One particular standout, was the high level of net consumer online sales growth, which was nearly 64% in Europe. Online grocery growth was strong, and bol.com also performed extremely well, with 65% net consumers sales online. Bol.com delivered 107% growth in third party sales in the quarter and added more than 4,400 merchant partners to the platform in Q2, which now brings the total number of merchants on Bol's platform to 34,000 merchant in total.

We previously discussed accelerating the timing of two new home delivery fulfillment centers in the Netherlands in order to serve the higher levels of demand we expect to continue there. The first of these centers opened this week and has already increased capacity by 20%. The other will open in the second – in the third quarter, and combined, these two fulfillment centers will increase capacity by 40% in the Dutch market.

Albert Heijn also launched home delivery service in Belgium, and we will open our first home delivery fulfillment centers in Greece and Romania in the second half of the year in order to better accommodate the high levels of online sales growth in those markets.

In addition to our strong omnichannel performance I also think it's important to spend a moment on health and sustainability, another key growth driver in our strategy. On slide 8, you'll see that we've made some important strides on this topic.

During the second quarter, we published our first ever Human Rights Report, outlining the steps we are taking to safeguard human rights. The report is based on the UN Guiding Principles Reporting Framework and is the result of a global human rights due diligence process that began in 2018. This due diligence process was designed to increase engagement on human rights – both internally and externally – and to assess current human rights management policies, processes and governance. The Human Rights Report outlines the outcome of this due diligence and provides a roadmap for our future actions.

We also issued our first Sustainability Bond Report in June 2020, documenting how we used the €600 million bond financing from 2019 to support sustainable products, reduce climate impacts and promote healthier eating.

We have just recently announced our commitment to achieve long-term, science-based targets on climate, including our goal to reduce our own carbon emissions by 50% by 2030 and to reduce those same emissions from our overall value chain by 15%.

We also officially became a supporter of the Task Force on Climate-related Financial Disclosures (TCFD). We're now in the process of developing voluntary and consistent climate-related risk disclosures.

Food Lion was awarded its 19th consecutive Energy Star Partner of the Year award for its leadership in energy efficiency. They became the only U.S. company to receive ENERGY STAR Partner of the Year Award 19 years consecutively.

And all of our US brands adopted new sustainability policies to bolster GMO product labeling and animal welfare. Now let me hand it over to Natalie.

Natalie Knight

Chief Financial Officer

Good morning and thank you Frans.

Our second quarter was very strong and continues to be impacted by unprecedented levels of demand due to COVID-19. As a result, net sales grew 15.9% at constant exchange rates to €19.1 billion and Group comparable sales growth ex-gas was 16.4% . Group comp sales were impacted strongly by demand related to COVID-19 and, to a lesser extent, benefited from a positive comparison in Q2 2019, when the strike at Stop & Shop unfavorably impacted Group sales by 2.0 percentage points.

Net consumer online sales grew 77.6% at constant rates. This was driven by strong demand from both existing and new customers, as well as by accelerating investments in our online business in order to rapidly expand our capacity across the US and Europe.

Underlying operating income increased 68.8% at constant rates, to a little over €1 billion, with underlying operating margin up 170 basis points to 5.3% at constant rates. This was largely due to operating leverage from higher sales related to COVID-19, as well as that benefit of lapping the roughly €90 million operating profit headwind caused by the strike at Stop & Shop in the U.S. in the prior year's quarter. This was offset in part by significant costs related to COVID-19, which amounted to approximately €260 million in Q2, bringing our year-to-date spend to approximately €330 million.

Net income for the quarter was €693 million, up 106.4% at constant rates. And we repurchased €183 million worth of shares in the quarter, which brings that amount to €519 million in the first half of the year. Diluted EPS was €0.65, an increase of 114.3% at constant rates.

Moving on chart 11 and our second quarter performance by segment.

Net sales in the US grew by 18.7% at constant rates, to €11.9 billion.

U.S. comparable sales increased 20.6%, driven by double-digit growth at all brands. There was also a benefit from lapping last year's Stop & Shop strike, which unfavorably impacted Q2 2019 result in the U.S. by 3.2 percentage points. Another important call out on the US topline, is our online sales which increased 126.8%.

The underlying operating margin in the US was 6.1% in the second quarter, up 250 basis points from the prior year, driven largely by operating leverage from higher sales growth due to COVID-19. There was also a roughly 90 basis point benefit from lapping the Stop & Shop strike last year, which reduced underlying operating profit in the second quarter of last year by roughly €90 million. We also continued progress in our Save for Our Customers program. Lower shrink and labor efficiencies also helped this development.

In Europe, net sales in the second quarter grew by 11.4% to €7.2 billion. This was a strong development, but slower than the U.S. growth due in our view to the fact that COVID-19 outbreaks in Europe were less severe than it had been in the U.S. and that the wallet share of food eaten away from home is lower in European countries, so that the shift to food at home has been less pronounced.

Europe's comparable sales increased 10.2%. This improvement was led by our brands in the Benelux markets. Growth was a bit more muted in the Central and Southeastern European countries due to a higher level of consumer lockdown restrictions, reduced tourism and lower demand in urban centers where many of our stores are located. These developments translate to market share gains in the Netherlands and Belgium and stable share in our Central and Southeastern Europe.

Net consumer online sales in Europe grew 63.9%. At bol.com, our online retail platform in the Benelux which is included within the Europe segment results, net consumer sales grew by 65.4%. The big driver of this development was Bol.com's third party sales, which grew 107% in the quarter.

Europe's Q2 underlying operating margin was 4.5%, which is relatively stable compared to the prior year. Operating leverage from higher sales was largely offset by higher costs related to COVID-19 as well as €11 million of pension expense in the Netherlands in the quarter.

Now, moving to free cash flow. The cash position of Ahold Delhaize remains strong. Free cash flow in Q2 was €533 million, which compares with €486 million last year, driven mainly by the COVID-19 impact on profits, which drove an operating cash flow increase of €469 million. This was offset in large part by a €459 million unwind in working capital at the end of the quarter, as inventories in-store returned to more normalized levels after initial shortages experienced early in the COVID-19 crisis at the end of Q1.

Net capital expenditure was €466 million, down €64 million from last year despite increasing omnichannel investments due to fewer store remodels this year as a result of COVID-19. I'll now take a moment to discuss the announcement we made on July 21st regarding Stop & Shop's tentative withdrawal agreement with local unions on the UFCW International Union–Industry Pension Fund, which we refer to

In Europe, recall that we will be lapping a one-time benefit in the Netherlands from third quarter of last year, which was over €20 million, as well as making higher pension contributions in the Netherlands at a run rate of €11-€12 million per quarter. Combined, these effects will create an unfavorable underlying operating profit headwind of over €40 million in the second half of the year.

And in the US, we will continue incur transition expenses related to the US supply chain transformation efforts. Recall that these expenses we have told you would be around €45 million for 2020 and that the majority of this cost will flow through our results in the back half of the year.

Now, moving on to our EPS outlook for 2020, we are raising our guidance to low-to-mid-20% growth from mid-single-digit growth previously. This guidance reflects our strong performance in the first half of the year, and lower margin expectations in the back half of the year.

Our 2020 free cash flow outlook is also being raised to at least €1.7 billion compared to at least €1.5 billion previously announced. It's important to note that the underlying level is even higher as it also includes the effect of paying the majority of the €583 million pre-tax obligation related to our tentative agreement to withdraw from the National Plan and contribute to the transition reserve for the new variable annuity pension plan at Stop & Shop.

On capital expenditure for 2020, we are maintaining our guidance of ~€2.5 billion. Remodels were slower in the first half due to COVID-19 closures and labor availability. However, this is being offset by our decision to accelerate our digital and omnichannel investments significantly to support the step-change in growth that we believe is underway.

Our dividend policy sets the interim dividend payout at 40% of the first half underlying income per share. In this instance, a €0.50 per common share will be paid on August 27. This represents a 67% increase vs the previous interim dividend.

We are also now a little more than halfway through our €1 billion share buyback program in 2020 as well.

So, that end my comments for you. Thank you and now I will hand back to Frans.

Frans Muller

President, Chief Executive Officer

Thank you very much, Natalie.

So let me wrap up quickly.

We had strong Q2 performance which was impacted by the unprecedented demand from COVID-19, despite all the significant costs and uncertainty that come along with it.

Our online business grew significantly, and we believe we will continue to see high levels of growth. Therefore, we will reach our €7 billion net consumer online sales goal in 2020, which is a year ahead of plan.

Due to strong performance in the first half of the year, we're raising our 2020 outlook for underlying EPS and operating margin as Natalie already made very clear.

We're also raising our free cash flow target to at least €1.7 billion, even though we plan to pay a significant amount to withdraw from a US multi-employer pension plan, contingent upon ratification by Union Locals.

We announced a 2020 interim dividend of €0.50, which represents a 40% payout ratio, inline with our commitment there.

The health and safety of associates and customers, as well as continuing to make progress in sustainability initiatives, remain one of our top priorities.

Lastly, I'd once again like to thank the teams across our brands again for the great job they did in Q2, particularly in how they have stepped up to the challenges created by COVID-19, adapted to changing consumer preferences, and have had a relentless focus on health & safety.

Operator, we would like to move into the questions. Can you please proceed from your end, please?

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Cautionary notice

This communication includes forward-looking statements. All statements other than statements of historical facts may be forward-looking statements. Words and expressions such as increasing/increased, ambitions, continue(s)/(d)/(ing) (to), uncertainty, raising, full / this year, outlook, changes, should, lead to, expect(ation)/(ed), 2020, on track, reach, goal, are, through, enhance, to, will, growing, accelerated/accelerating, additional, further, ensure, forecasting, drive, remain(s), is, beyond, second half of the year, support, 2030, bolster, tentative, in the future, improve, reduce, upon, later this year, believe, likely to, be, guidance, the back half of the year, underway, reach, ahead of or contingent upon, or other similar words or expressions are typically used to identify forward-looking statements.

Forward-looking statements are subject to risks, uncertainties and other factors that are difficult to predict and that may cause the actual results of Koninklijke Ahold Delhaize N.V. (the "Company") to differ materially from future results expressed or implied by such forward-looking statements. Such factors include, but are not limited to, risks relating to the Company's inability to successfully implement its strategy, manage the growth of its business or realize the anticipated benefits of acquisitions; risks relating to competition and pressure on profit margins in the food retail industry; the impact of economic conditions on consumer spending; turbulence in the global capital markets; natural disasters, pandemics and geopolitical events; climate change; raw material scarcity and human rights developments in the supply chain; disruption of operations and other factors negatively affecting the Company's suppliers; the unsuccessful operation of the Company's franchised and affiliated stores; changes in supplier terms and the inability to pass on cost increases to prices; risks related to corporate responsibility and sustainable retailing; food safety issues resulting in product liability claims and adverse publicity; environmental liabilities associated with the properties that the Company owns or leases; competitive labor markets, changes in labor conditions and labor disruptions; increases in costs associated with the Company's defined benefit pension plans; the failure or breach of security of IT systems; the Company's inability to successfully complete divestitures and the effect of contingent liabilities arising from completed divestitures; antitrust and similar legislation; unexpected outcomes in the Company's legal proceedings; additional expenses or capital expenditures associated with compliance with federal, regional, state and local laws and regulations; unexpected outcomes with respect to tax audits; the impact of the Company's outstanding financial debt; the Company's ability to generate positive cash flows; fluctuation in interest rates; the change in reference interest rate; the impact of downgrades of the Company's credit ratings and the associated increase in the Company's cost of borrowing; exchange rate fluctuations; inherent limitations in the Company's control systems; changes in accounting standards; adverse results arising from the Company's claims against its self-insurance program; the Company's inability to locate appropriate real estate or enter into real estate leases on commercially acceptable terms; and other factors discussed in the Company's public filings and other disclosures.

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