Management's Prepared Remarks

Q1 2020 Earnings Call

May 7th, 2020

Operator

Ladies and gentlemen,

Good morning and welcome to the analyst conference call on the first quarter 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, first quarter 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, Head of Investor Relations. Please, go ahead.

Alvin Concepcion

Vice President, Head of Investor Relations

Thank you and good morning everyone.

Welcome to our first 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, Alvin. Good morning everyone.
Before I go into the Q1 presentation, I'd first like to mention a few things.

The first quarter of 2020 was unlike any we have ever seen before. The COVID-19 crisis has affected all of us, and I truly hope that all of our stakeholders, and particularly the people who are out on the front line, are managing through this crisis as well as they can. I am honored to represent the leadership and brands of Ahold Delhaize who are doing their utmost best to provide the essential service of helping to feed our local communities. I recognize and am very impressed by the hardworking and dedicated associates across our brands and geographies, including the people in the stores, distribution centers, and supporting functions who have stepped up to serve their local communities in the face of immense challenges. We have been, and will continue to be, committed to protecting the health and safety of associates and customers as our first and foremost priority. We must continue to operate well, and ensure that we are Leading Together with our business partners, vendors, and service providers, in order to provide customers better availability of food and supplies during this time. We must be able to adapt to new paradigm shifts in consumer behavior that emerge…and invest as necessary, particularly in digital and omnichannel capabilities, and in ways that allow us to serve our communities well during this crisis…and ultimately, serve them even better, well after this crisis subsides.

On a separate note, I'd like to welcome Natalie Knight, who was appointed as our CFO on April 8. This is her first earnings call with us, and I'm delighted to have her here. I'm excited about what she can bring to the table.

Now on to Q1 results.

Clearly, our Q1 performance across all our geographies were impacted by the unprecedented demand created by the COVID-19 outbreak. Natalie will go into more detail on the performance, but keep in mind that the margin reported in Q1 is mainly a function of timing, and is not a fair representation of the cost pressures we will experience relating to COVID-19. Instead, it largely reflects the timing of unexpectedly higher sales, which preceded the timing of significant investments related to COVID-19 at the end of the quarter. The margin rate you see in Q1 is not sustainable and not likely to be seen in subsequent quarters. Nevertheless, we maintain our full-year outlook that our group underlying operating margin in 2020 will be broadly in line with 2019.

On slide 5, you will see some examples of how we are deploying over €170 million to prioritize safety, relief, and support efforts during the COVID-19 crisis. This €170 million figure is by no means the full amount, and in fact, it will ultimately cost more than this. This is just what we are currently deploying.

For our associates, we have implemented additional safety and protective measures, which also benefits our customers. This includes plexiglass shields at registers and new flow patterns in the stores to maintain social distancing. We have enhanced associate pay and benefits, and are hiring more than 40,000 associates who can play a huge role in providing the essential service of helping to feed our local communities. We also provided contactless delivery options, to the benefit of both associates and customers.

For our customers, we are working with local governments and agencies to provide a safe shopping environment, which also helps our associates. We have enhanced already stringent cleaning and hygiene measures like shopping cart cleaning before and after use. We have invested in security personnel and optimized customer traffic flow at our stores. We have provided special grocery delivery service for healthcare workers and were the first in our markets to offer special opening hours for the elderly.

And for our communities, we are collaborating with our business partners, vendors and service providers to ensure food and supplies are available. We have also made charitable donations to local food banks, national and private health systems, the Red Cross, and various medical facilities.

While we are doing our part to prioritize safety, relief, and support during the COVID-19 crisis, we also know it is not enough.

In the nearer term, our priority is to continue to run operations safely and smoothly, and offer our customers more convenience so we can serve them better in their time of need. This means there are a higher level of investments needed in the upcoming quarters to make this happen.

I would categorize these nearer-term priorities into three buckets: improving in-stock levels, adapting store operations, and accelerating digital and omnichannel capabilities.

I'll start with improving in-stock levels. It will be no surprise for you to hear that we, along with the broader food retail industry, have had challenges with in-stock levels in categories such as paper, sanitation, frozen, proteins, and in some cooking supplies such as flour. We are therefore proactively working with suppliers to provide better availability of products to our customers, including prioritizing SKU offerings to meet current levels of demand. We are using our scale to ensure that we are provided our fair share of allocation for these products. We are also leaning upon idle capacity in the labor force and foodservice distribution providers in order to overcome capacity bottlenecks.

We are also adapting our store operations to changes in consumer behavior, preferences, and safety needs. We are working with local governments and agencies on health and safety measures for stores and distribution centers.

Our leaders know it's more important than ever to push for higher levels of customer service through exemplary associate efforts.

And we are adjusting our systems and processes, such as inventory ordering and labor scheduling to better match the new demand patterns caused by community lockdowns and health and safety concerns. For example, weekends have historically been some of our highest traffic days, and customers have shifted towards more weekday and shopping during off-peak hours.

We also know that for many reasons, including more recently, safety concerns, and always for convenience, that customers…both new and existing…younger and older…are preferring to engage us more online. Our near-term, and long-term plans always involved investing more in digital and omnichannel capabilities even prior to COVID-19, but we know we need to invest in accelerating these capabilities even further this year.

This is a significant focus in both the U.S. and Europe, and we are accelerating our online sales. In the US, we initially targeted over 30% growth this year, but we now expect it to be even higher at over 50%. In Europe, we expect to accelerate net online consumer sales growth this year.

In the US, we will be able to generate this higher level of online sales growth by investing in incremental associates and supplemental infrastructure, such as through more storage units, picking devices, and stepping up the pace on the number of click & collect locations we plan to open this year in the U.S. We are upping our target to over 1,000 locations in 2020 versus our initial target of roughly 1,000.

In Europe, higher levels of net consumer online sales growth will be achieved by accelerating the timing of 2 new home delivery fulfillment centers in the Netherlands, with one opening this Summer (August) and the other in the Fall (October). Albert Heijn will also begin to offer Sunday home deliveries this month, which is new.

At bol.com, we will continue to press hard to increase the number of marketplace partners, where we added another 1,700 merchants in Q1, bringing the total to nearly 21,000 now. This is key because these partners can help us flex up capacity faster.

These are just some of the ways we will expand our same-day and next day offerings and capabilities, in order to drive the higher levels of growth I mentioned.

While we are highly focused on our nearer-term performance, we will not lose sight of the long-term priorities and investments needed to drive our growth after the initial COVID-19 crisis subsides.

It's currently unclear what long-term paradigm shifts in consumer behaviour occur due to COVID-19, but we will monitor these, learn from them, and quickly adapt to them. Regardless of what these shifts ultimately are, there are things we can already do to accelerate growth over the longer-term and retain our #1 and #2 market positions across our brands.

There are 3 areas of focus I'd like to highlight that will be relevant in a post COVID-19 world, which we think will increase our share of wallet. These are:

One: Enhancing associate and customer well-being by continuing to take appropriate health & safety measures, and offering competitive associate pay and benefits, and progressing on our health & sustainable retailing targets through 2025, which we already unveiled on February 25th. These 2025 targets revolve around ensuring customers have healthier choices and see more product transparency, and also that we are doing our part to eliminate food and plastic waste. We will have more news to announce in this area later this year, as we are in the process of setting long-term, science-based targets to reduce our impact on climate change.

On offering competitive associate pay and benefits, we continue to focus on offering attractive and competitive packages with plenty of employee opportunities for advancement. On March 5th, we signed a 4-year collective bargaining agreements for Giant Food and will continuously work with our union partners and, others, on solutions to improve the position of our employee pension plans.

Two: We need to continue operating brands and supply chains smoothly in order to continue serving local communities well, and we need to do it more efficiently. There are many ways we are focused on improving efficiency, which can help us to keep pace with evolving customer needs, while also improving our bottomline. A very good example of this, is the 3-year strategy we embarked upon this year, to move the US supply chain to a self-distribution model. This not only reduces our costs which can be passed on to our customers, but it will also improve speed to shelf and improve product availability and freshness for customers.

We also continue to explore technology to improve the efficiency of our operations, whether that is online with our microfulfillment center pilot and innovation centers, such as Peapod Digital labs in the US…or artificial intelligence labs in the Netherlands, which aim to enhance the digital and omnichannel journey for our customers and improve our operations. Our stores are increasingly implementing electronic shelf labelling and various frictionless checkout options which provides savings and a better customer experience.

Three: You first heard us talk about this at our November 2018 capital markets day, but we remain committed to investing capex at around 3% of sales annually in order to accelerate our digital and omnichannel capabilities, some of which I described a moment ago…also it will be used to improve our store fleet through remodel programs such as Reimagine Stop & Shop… and we will improve meal solution capacity and private label offerings to further differentiate our offerings and help us gain more share of stomach. This is especially important if the consumer decides to eat more at home than in the past.

Although our capex investment excludes M&A by definition, we will continue to explore partnerships and M&A opportunities.

Slides 8 and 9 highlight some of our advancements and progress in the US and Europe. I've touched upon some of these highlights already, and for the interest of time, I won't go over them in detail, but I strongly encourage you to take a look.

Now let me hand it over to Natalie.

Natalie Knight

Chief Financial Officer

Good morning and thank you Frans. I'm pleased to here for my first quarterly results call with Ahold Delhaize, and I am looking forward to meeting many of the analysts and investors on this call in the near future… hopefully in person…and hopefully sooner, rather than later, when conditions permit.

Our first quarter was shaped by unprecedented levels of demand due to COVID-19. As a result, net sales grew 12.7% at constant exchange rates to €18.2 billion and operating income increased 40.0% at constant rates, to €964 million. Net sales were driven primarily by 12.2% group comparable sales growth excluding gasoline. Net consumer online sales grew 37.7% at constant rates.

Underlying operating income increased 35.7% at constant rates, to €961 million, with underlying operating margin up 90 basis points to 5.3% largely due to the timing of COVID-19 related sales. These higher sales preceded the timing of significant investments that only started to become material at quarter-end. This effect was more pronounced in the U.S. relative to Europe, as Europe experienced earlier customer stockpiling in late February, and therefore made earlier investments related to COVID-19, whereas the U.S. COVID-19 impact really didn't begin until early March.

Net income was €645 million, up 45.1% at constant rates. We repurchased €336 million of shares in the quarter. Diluted EPS was €0.59, an increase of 51.8% at constant rates. Diluted underlying earnings per share, were also €0.59, up 46.5% at constant rates.

Moving on to looking at the first quarter performance by segment, net sales in the US grew by 13.7% at constant rates, to €12.5 billion.

U.S. comparable sales increased 13.8%, driven by double-digit growth due largely to COVID-19 at all brands. Food Lion and Giant Food led the way and we believe we gained overall market share in the quarter as well, so we're proud of the performance across the board.

In the US, online sales grew 42.3% and this growth comes despite considerable product availability issues early in the Corona crisis, which caused the U.S. to close Click & Collect operations under most banners for some portion of March. As Frans mentioned, we are now accelerating investments in our online business in order to rapidly expand our capacity.

Underlying operating margins in the US were 6.7%, up 180 basis points from the prior year, driven largely by the timing benefit from higher sales preceding material COVID-19 investments. Also, we continued progress in our Save for Our Customers program. Product sales were strong across the board, and while it tilted modestly towards lower margin items during the customer stockpiling period, it had little influence on our margin, as customers bought more products that are not typically on promotion, and product availability issues prevented us from running certain promotions. This was partially offset by higher shrink and lower vendor allowances.

In Europe, net sales in the first quarter grew by 11.0% to €6.9 billion. This development is strong, but a bit more muted than the US growth due to a higher level of consumer lockdown restrictions, such as limitations on curfew and traffic levels allowed in the store. Also, the
wallet share of food away from home is lower in European countries, so the shift to food at home was less pronounced.

Europe's comparable sales increased 9.8%, and while all countries experienced higher than normal demand, Central and Southeastern European countries grew slightly faster than the overall segment. We gained share in the Netherlands and Belgium, and maintained overall share in Central and Southeastern Europe.

Net consumer online sales in Europe grew 36.3% despite capacity constraints. At bol.com, our online retail platform in the Benelux which is included within the Europe segment results, net consumer sales grew by 39.5%. Bol.com's third party sales grew 66% in the quarter with nearly 21,000 merchant partners on the platform.

Europe underlying operating margin was 4.1%, up 10 basis points from the prior year. The timing benefit from higher sales preceding material COVID-19 investments was less pronounced in Europe versus the U.S., and was partly offset by higher pension expense in the Netherlands amounting to €11 million in the quarter, as well as additional planned investments in digital and omnichannel capabilities.

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While COVID-19 was clearly the main driver of sales growth in the quarter, I think it's worth mentioning that our business was quite strong prior to the stockpiling period.

What you'll see on the chart on slide 13, which is also disclosed in our press release, is that group comparable sales growth excluding gasoline in January and February were stronger than the level of growth we generated in the full year 2019.

And more importantly, on an adjusted basis, where we exclude gasoline, weather, and calendar effects, as well as our estimate of the COVID-19 related stockpiling in Europe which occurred at the end of February, sales growth was strong at 3.7% in January and February, which showed clear momentum versus the 2.5% adjusted sales growth we had in the full year 2019. This trend is also visible in both the U.S. and Europe segments as well, which speaks to the underlying strength of both businesses during the period.

Moving on to free cash flow. The cash position of Ahold Delhaize remains strong. Free cash flow in Q1 was €1.23 billon, which compares with negative €136 million last year, mainly driven by the COVID-19 impact on the profit and working capital balances at the end of the quarter, which resulted in dramatically lower inventories and higher accounts payable balances. These will return to more normal levels in subsequent quarters.

Capital expenditure grew to €708 million, up €256 million from last year, as we acquired three C&S warehouses. As we progress into Q2, capital expenditures should be lower than the level seen in Q1 as the effect of the warehouse acquisitions diminishes.

Moving on the outlook for 2020, I'd like to mention that despite the uncertainty generated by COVID-19, we are reiterating the financial outlook we provided on April 7th.

Due to the significant quarterly fluctuation caused by COVID-19, we feel some commentary on Q2 is warranted, but commentary on quarterly trends or expectations should not be expected for any future periods.

We generated sales in April that were above normal baseline levels in both the US and Europe, but not as strong as those of March. We have also accelerated online sales growth across both segments, relative to what we delivered in Q1, reflecting increased capacity and the better in-stock positions we now have in the system. We believe these higher sales levels are occurring due to continued gains in share of stomach, particularly in the U.S., due to continued shopping restrictions. Going forward, it is very difficult to project how sales will develop as COVID-19 restrictions are reduced and recessionary trends take hold. Therefore, we won't be providing any topline guidance, inline with our standard practice.

What is important to emphasize, however, is that investments related to COVID-19 , which became material at the end of Q1, will become significantly more visible in subsequent quarters. Therefore, it's important to understand that the margin level you saw in Q1 will not be sustainable into Q2. Please see the footnotes in the outlook table we provided, which describe other minor factors to consider for 2020, which we have already previously flagged for you and have not changed.

In our April 7th update, we raised our free cash flow guidance at a level above €1.5 billion, which was our initial target for the year. And we have not changed this expectation. We are, however, modifying our view on what is driving that upside for the full year. The upside is mainly related to the strong levels of free cash flow generated in Q1, rather than our previous indication that it would be mainly related to delays in capital projects. While some capital projects will inevitably be delayed versus our pre-COVID-19 plans, Frans provided detail about how we will accelerate investments in digital and omnichannel capabilities to expedite our efforts to better service changing customer needs and demands. And we will continue to focus resources on operating our brands and supply chains smoothly, with associate and customer health and safety as our first and foremost priority.
Therefore, we expect capital expenditures at around €2.5 billion this year, loaded more towards the back half of the year.

As you all know, at Ahold Delhaize, we are committed to maintaining a strong cash and liquidity position, as evidenced by our recently placed €500 million fixed rate bond due in 2027. We intend to maintain our dividend policy, which calls for a 40-50% payout ratio and repurchase €1 billion in shares this year. So our shareholder return policies remain in place, however, like all responsible companies these days, will continue to monitor macroeconomic developments.

Thank you and now I will now hand it back to Frans.

Frans Muller
President, Chief Executive Officer

Thank you Natalie.

So let me wrap up.

We had strong Q1 performance which was impacted by the unprecedented demand from COVID-19, but even prior to the COVID-19 demand, the underlying business performed solidly.

Although there is uncertainty caused by COVID-19 and we are making significant investments in the near-term to continue to run operations safely and smoothly, we are maintaining our 2020 outlook and shareholder return policy, but we'll continue to monitor the macroeconomic conditions like all responsible companies.

Longer-term, we will adapt to shifts in consumer behavior and our focus is to continue to invest in omnichannel growth to maintain #1 and #2 market positions.

We have a strong cash flow and liquidity position that will provide us the means to make the near and long-term investments necessary to drive growth, while at the same time returning capital to shareholders.

I'd also like to thank the teams across our brands again for their hard work in Q1.

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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 will, continue, to be, committed, operate, ensure, leading, adapt, invest, during, after, subsequent quarters, maintain, full-year, outlook, will be, will see, deploying, provide, nearer term, upcoming quarters, would, overcome, push for, engage, plans, further, this year, expect, begin to, expand, offering and capabilities, focus, longer-term, continuing, 2025, targets, later, in the process, opportunities, continuously, evolving, improving, remain, explore, near future, trend, throughout, period, growth, progress into, Q2, expected, future periods, ongoing, going forward, project, develop, take hold, expectation, view. due, 2027, intend 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 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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