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# Ahold chooses a prudent growth path, but remains vague about targets

Dear Ahold shareholder,

Ahold had a decent 2011. In particular, higher identical sales growth (sales from the same number of shops) in the Netherlands and US boosted Ahold's market share. Ahold realises some two-thirds of its turnover and more than half of its operating profit in the US.

At the same time, the supermarket group managed to improve underlying operational profit fractionally in the third quarter compared with the proceeding periods - to 6.4 percent in the Netherlands and 4.2 percent in the US. It should be pointed out however that in the Netherlands this was below the same period in 2010, when underlying operational profitability reached 7 percent. At the same time, chief executive Dick Boer announced he wants to increase the dividend and pay-out ratio to between 40 percent and 50 percent of normalised net earnings. The dividend in 2011 is likely to be higher than the 29 eurocents per share (pay-out ratio 40 percent) in 2010.

**Continuing pressure on volumes and margins**
The question now is whether Ahold can come up with a good follow-up in times of recession. The increase in revenue last year was largely due to price rises being passed on to the consumer, while sales volumes fell. Growth in the Netherlands in the fourth quarter levelled off to 2.9 percent. Competition remains cut-throat, which will lead to continued price wars and a further erosion of the margins. In the Netherlands, Ahold remains market leader with 34 percent, with Jumbo now on 23 percent following its takeover of C1000. But the battle for market share will be mainly fought out on price. Discounters such as Aldi and Lidl (together 13 percent) and Walmart in the US remain a threat. At the same time, consumers have changed their shopping habits, due to the economic downturn. The pressure on Ahold will continue to come from two sides: a potential reduction in volumes and lower margins.

**Vague about targets in the new strategic plan**
In November 2011, Boer presented a five-year plan to accelerate Ahold's growth. Ahold appeared to opt for a prudent growth path, but no specific financial targets where shared with investors.

There are growth plans for Belgium, Germany, the US and the online activities. In Belgium, Ahold wants to roll out 10 Albert Heijn shops this year. There are currently two. By 2016, there should be more than 50. In Germany the company is busy rolling out the *AH to go* format. By 2016, Boer says over 200 of these convenience stores should be located throughout the EU. There are already 53 in the Netherlands. In the US, Ahold wants to expand its retail network step by step. This will come on top of the 25 Ukrop supermarkets acquired in early 2010 which only returned to profitability in the final quarter of 2011, and 16 outlets recently taken over in Philadelphia. Food and non-food online sales (albert.nl in the Netherlands and Peapod in the US) currently break even on sales of €450 million. By 2016, this should have risen to €1.5 billion and the web shops should be profitable.

In previous years, Ahold set itself a mid-term target of reaching sustainable sales growth of five percent combined with margin growth of five percent. This target has been tricky to achieve over the past few years. Given the current growth initiatives, it is notable that Boer recently refused to reconfirm this target. This could point to the fact that Ahold foresees ongoing difficult market circumstances and/or may be forced to make considerable investments. The VEB would ask Ahold to give its shareholders more clarity on this.

It is also relevant in terms of the company's risk profile to know whether Ahold is planning to open its own shops in Belgium or take over a number of outlets in a single transaction – buying part of the struggling Carrefour group, for example.

And finally, Ahold remains vague on the financial criteria potential takeover targets should meet. The recent acquisition of Bol.com marked a significant expansion of Ahold's online activities. However, on the basis of the limited financial information that Ahold disclosed, the deal appears to have been concluded at a relatively high price. The fact that Ahold stated that the acquisition would be earnings per share accretive from day one does not matter in that respect. For example, in terms of operating result Ahold pays significantly more for Bol.com than its own market capitalization relative to operating result. This is only justified if Ahold manages in increasing the profitability of the online retail store. The VEB askes Ahold therefore to clearly state within what term the acquisition will really enhance shareholders' value.

**Questions with regard to the balance sheet**

With net debt of over €1 billion (as of the third quarter of 2011) and a cash position of €2.3 billion, Ahold has a fairly solid balance sheet. However, the VEB would like to raise two points. Firstly, Ahold has relatively high financial lease liabilities, as CFO Jeff Carr recently acknowledged. In 2010, the interest rate burden on these liabilities (€1 billion at end 2010) was over €100 million. The VEB expects Ahold to make clear how it intends to tackle this unfavourable situation in the short term.

In addition, for years Ahold has been confronted with pension liabilities in the US which cannot be accurately calculated and therefore do not appear on the balance sheet. Ahold and other employers participate in 'defined benefit multi-employer plans'. However, because Ahold has not been supplied sufficient details to calculate its share of the communal obligations (by end 2010, Ahold's share of the shortfall was €648 million), these pensions have had to be labelled 'defined contribution' plans. This means the pension premiums are only put through the profit and loss accounts, with the present value of these liabilities not appearing on the balance sheet. In other words, the pension liabilities are under-estimated. This is why the VEB asks Ahold to state whether this can be rectified in the short term and what the financial impact would be in a worst-case scenario.

On behalf of the Dutch investors' association VEB NCVB

Jan Maarten Slagter, director

Would you like to reply to this letter. Please email info@veb.net

NB: This letter was written before the publication of the annual report and the definitive agenda for the AGM.