Management's Prepared Remarks

Q3 2022 Earnings Call

November 9, 2022

JP O'Meara

Senior Vice President, Head of Investor Relations

Thank you operator, and good morning everyone.

I am delighted to welcome you to our Q3 2022 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, which also provides extra disclosures and details for your convenience.

To ensure everyone has the opportunity to get their questions answered today, I ask that you initially limit yourself to 2 questions. If you have further questions then feel free to re-enter the queue.

To ensure ease of speaking, all growth rates mentioned in today's prepared remarks will be at constant exchange rates unless otherwise stated.

I'll now turn the call over to Frans.

Frans Muller

President, Chief Executive Officer

Thank you JP.

Good morning everyone.

Empowering customer choice by providing great value and easy access to affordable and healthy food options has always been at the center of the customer value proposition of Ahold Delhaize's nineteen great local brands.

All year, and particularly now as we head into the holiday season, we are leaving no stone unturned to support customers and associates in our own unique way. With a deep understanding of commodity prices, built through our extensive experience with own-brand products, our teams play an important role in the value chain and work hard on behalf of customers to ensure realistic pricing. In the face of increasing price pressures, it is everyone's job, across the value chain, to keep prices as low as possible for customers. To this end, we continue to engage diligently and proactively with partners, making clear choices on assortment when necessary.

Our resilient financial performance and positive market share development in Q3 again highlights the loyalty and trust customers continue to place in our brands, and is the biggest vote of confidence that we are doing the right things.

With accelerating sales growth rates in both the U.S. and Europe driven by increasing inflation rates, comparable store sales ex gas increased 7.9%. The Group underlying operating margin of 4.4% was in line with the prior year, as a strong U.S. performance helped to compensate for a more challenging environment in Europe. And diluted underlying earnings per share was up 31.6%.

Succeeding as a retailer in this dynamic economic and geopolitical environment, as you well know, is a delicate balancing act of managing the price / volume equation. Therefore, and as you can see with the many initiatives on slide 8, I am very proud of these results and of our associates who consistently rise to meet the demands of these challenging times.

Despite all the important transformations going on throughout our organization – be it in digital and omnichannel, the pivot to self-distribution, modernizing our IT and technology infrastructure, the drive to a more sustainable and healthy food system – our teams never lose sight and stay true to doing the basics of good retail.

This is only possible with a strong foundation, and also in our case our unique position given the global diversity and scale of our business.

Here, and as evidenced on slide 9, there are three elements in particular that I believe really set us apart competitively.

- Firstly, dense networks which provide a close proximity to the customer which is also critical for enabling reliable omnichannel services. This is increasingly important as customers shift from bigger baskets to more frequent shopping.
- Secondly, a high focus on great value products plus deep assortments that discounters can't match, with our high quality own brands being a key differentiator. This helps us retain existing customers, by easily helping them find opportunities between price levels. And it also helps us win new customers looking for better value destinations.
- And thirdly, a relentless focus on the hygiene factors, keeping stores vibrant and modern, adding new digital features and functions, and investing in our associates and culture.

This tried and trusted model works, and is evident in the numbers. In Q3, we see the number of transactions, and that means number of shoppers and shopping trips rising across our brands. And within online we have seen a marked uptick in the ratio of new customers to our platforms during the quarter.

Our two biggest brands are great examples and case in point.

First, I'd like to highlight a special achievement of the Group's biggest brand: Food Lion. Q3 marks a remarkable milestone that any type of retailer or consumer company would be extremely proud of – A decade of continuous quarterly comparable store sales growth. And based on Q4 sales so far, it's also looking good for a strong start into the next decade.

With their Easy, Fresh and Affordable positioning, Food Lion exemplifies what it means to be sharp around the edges. Driven by it "Count on Me" promise, Food Lion has a clear value proposition to the customer – an excellent fresh offering, a dense and well maintained store network, and a fierce commitment from the top down to its brand, strategy and culture.

Albert Heijn is another great example of how the formula works. With a particular strength in innovation, technology and analytics, the brand continues to win market share, with fast reaction times in an increasingly challenging macro-environment. This quarter, included a new traffic generating '100 items under 1 euro' campaign as well as an expansion to 1,600 'Prijsfavorieten' (Price Favorites), which include top quality own brand daily products at affordable prices. In addition, Albert Heijn Premium passed the 600,000 member subscription mark this quarter, having just being launched this time last year.

I am pleased we are also making good progress with some of our more challenged brands.

For example, at Stop & Shop, we continue to advance on our remodeling program, with around 40% of the store fleet now remodeled since 2018. An important focus area for Stop & Shop is New York City, where we announced a multi-year $140 million investment earlier this year. With the first five store remodels completed, we are encouraged to see all stores trending ahead of plan with the double-digit comp sales lift driven by increased units and new customer transactions.

In addition, the introduction of Stop & Shop's new Deal Lock savings program, which helps customers capture value by locking in a specific sales price for multiple weeks on both national and private brands, is delivering strong early chain-wide results.

Delhaize Belgium also saw a material improvement in comparable store sales supported by the first full quarter of its Little Lions everyday low price program and enhancements to its health-orientated SuperPlus loyalty program.

In addition to these customer facing initiatives, we are laser-focused on saving cost and operating smarter every day. This quarter, we've made good headway on combining purchasing. In fresh sourcing, we are moving more volumes to our strategic partners able to service both Belgium and the Netherlands. We have implemented new processes which are helping reduce shrink and we are increasing digital communication to become more relevant with younger consumers and optimize marketing cost.

At bol.com, net consumer online sales were up 5.6% in Q3, and market share gaining over one percentage point year to date. This was driven by double-digit growth in third-party partner network sales. And while the market is still challenging, the brand is well positioned to serve customers and maximize the holiday season opportunity, supported by 'The Big Toy Book' and the logistical strength of its new distribution facility, which doubles our capacity as it ramps up following the official opening earlier this summer.

Ahold Delhaize

Taking a step back and looking at the big picture, I am equally encouraged about our progress on the four key priorities within our Leading Together strategy.

Starting with our Customer priority. Here we are focused on unlocking the creativity and innovation of our teams to cement deeper and more digital customer relationships. Our omnichannel transformation is central to this strategy, driven by customers' desire to shop whenever and wherever they want. In Q3, net consumer online sales increased by 11.5%. Our online grocery sales were up 16.9% with strong growth in both regions.

Here, our digital loyalty programs continue to fuel growth and opportunities for our brands. For example, our ADUSA loyalty programs have generated over $1.5b in incremental sales YTD. Moreover, we are seeing all-time highs with increased engagement in our loyalty participation with a double-digit increase in new loyalty customers year-over-year. Furthermore, in this quarter our CRM campaigns reached over 28 million households and delivered 8 billion personalized offers compared to 5.3 billion personalized offers last quarter.

Moving on to our Operational priority, which is the key enabler of our omnichannel transformation and is geared to drive long-term operational efficiency.

Looking at slide 17, we again accomplished a lot in the quarter.

- Our Save for Our Customers cost savings program remains on track to produce savings of more than €850 million in 2022.
- We are also making good progress on our plans to generate €1 billion in complementary revenues by 2025. For example, Albert Hejin and bol.com's digital media businesses grew ca. 60% in Q3 versus last year thanks to continuous investment in their digital advertising capabilities for example in sponsored products.
- In addition, we acquired a minority stake in Belgium adtech company Adhese, which will provide an important part of the tech stack and third-party integration to help scale our capabilities and services for advertisers and publishers in Europe, starting in the Netherlands.
- In the U.S., Peapod Digital Labs announced plans to build an end-to-end, in-house retail media business, building on the existing AD Retail Media network. And while we may not be the first retailer to make this important move, we will be the first one to go live with an end-to-end solution making it much easier for suppliers and other content providers to find a one-stop way to work with us instore, online and across all our brands and channels. In times where speed and ease of doing business matter, this is an industry first!

Moving on to our next priority, Healthy and Sustainable. We believe it is important to continue to make progress on elevating our Healthy and Sustainable strategy, also during these challenging times.

We believe that every step counts. And I'm proud of how our brands continue to show that it is not just about the numbers, but that there is real customer benefit in our efforts here as well. Let's take food waste for example.

- Albert Heijn recently introduced its 'Overblijvers' or leftovers program and Delhaize Belgium its 'Waste less, pay less' initiative. Both aim to reduce food waste and provide value to customers by enabling them to buy products close-to-the-expiry-date at lower prices.

- The Giant Company now has 106 zero waste stores, successfully diverting 90% or more of total waste from landfills or incineration.

- And Albert became the first retailer in the Czech Republic to test a hydroponic system that grows herbs and leafy vegetables on the sales floor, and introduced a zero waste kitchen, turning remaining food from three stores into meals for over 100 associates.

In conclusion, despite increasing macro-economic and geopolitical challenges, we continue to make important progress on delivering our strategy.

Operational excellence, tight cost control and disciplined capital allocation continue to be important in these times. As such, we are working hard on a variety of initiatives across the company to maintain our industry-leading position of consistent and reliable performance, dependable cash flows and shareholder returns.

As always, striking the appropriate balance between supporting our associates, investing in our customers and local communities, prioritizing our digital and omnichannel transformation and playing our part in the transition to a healthy and sustainable food system will guide our decision making.

Our proactive culture, plus our scale and our agility, position us well – a testament to the strength we continue to see in our company and our business model.

With that, let me hand you over to Natalie, to talk more about the numbers and the outlook for the remainder of the year.

Natalie Knight

Chief Financial Officer

Thank you Frans and good morning everyone.

I'm proud to say that in Q3 our business again proved resilient in what are clearly challenging market conditions.

Looking at the numbers:

- Net sales grew 9.1 percent, or plus 20.8 percent at actual rates to 22.4 billion euro.

- Q3 Group comparable sales increased 7.9 percent, with increasing momentum in both regions. Although it's also fair to mention that inflation is playing a big role in these numbers.

- Group underlying operating margin was 4.4 percent for Q3, which is unchanged versus Q3 2021. Strong underlying U.S. margins and continued insurance-provision benefits from rising interest rates offset lower Europe margins which were impacted by rising energy costs and the challenging economic environment. I will come back to this later.

- Diluted underlying earnings per share was 70 cents, up 31.6 percent, driven by strong underlying operating performance as well as positive U.S. dollar exchange rate effects. Our EPS growth rate also benefitted from our ongoing share buyback program. We purchased 7.5 million own shares in the quarter for 204 million euro. This brings the total amount to 711 million euro for the first nine months of the year.

Slide 22 shows our results on an IFRS-reported basis for Q3.

On an IFRS-reported basis, our operating margin was 4.0%. There were three main impacts that led to the bigger-than-usual divergence in these results versus our underlying figures.

- First, we took an impairment charge of 187 million euro on FreshDirect, which negatively impacted the reported IFRS U.S. operating margin. This was driven by broad based sector re-valuations as well as the reduced scope of that business, which is now predominantly focused on the New York Tri-State area.

- Second, on an IFRS-reported basis, our European operating margin benefited from the release of a wage tax provision in Belgium amounting to 62 million euro.

- And third, in Q3 a 27 million dollar benefit was recorded due to a further reduction of the FELRA excess benefit obligation under the final rule of the American Rescue Plan Act of August 8, 2022.

Let’s turn now to our regional performance.

On to slide 23, you see comparable sales growth by region including and excluding weather and calendar effects. These results were very similar in the quarter, with the inclusion of the 4th of July holiday and Hurricane Ian, both in the United States, being primary differentiators.

Our comp sales accelerated in both regions again this quarter. We delivered growth at every single brand and as Frans already mentioned, this growth has been price driven.

In the U.S., sales grew by 8.8 percent, and comparable sales growth was 8.2 percent.

Net consumer online sales were up by 20.8 percent, with eCommerce penetration rates increasing 80 basis points to 7.5 percent, as we continue to scale up our operations and roll out new omnichannel opportunities for our customers. With our hyper-local and flexible omnichannel toolkit, we are clearly out performing our major competitors, and I fully expect this trend to continue.

Underlying operating margin in the U.S. was 5%, keeping pace with the extraordinary high bar set in the prior year with the support of Food at Home trends due to Covid. This includes a 30 basis points gain from the release of a provision on our self-insurance program. We had a similar gain last year in Q4, so note the timing is different this year. This primarily resulted from many years of continued improvements in workplace safety.

With the consumer well supported by government stimulus and other support, and strong execution at all our brands, the U.S. has performed consistently well throughout the year. We are well-prepared for the holiday season, and we expect more of the same robust performance to carry through to year end.

Turning now to Europe, net sales increased 10.1 percent in the quarter. This was supported by market share gains at Albert Heijn, bol.com and Central Europe as well as 273 net new stores across the region compared to a year ago.

Comparable sales grew 7.4 percent. As price inflation increased in the region, our teams did an excellent job adapting their CVP's by

- Being fast and agile in introducing more entry-priced product solutions in stores and online
- Expanding our high-quality, healthy and better value own-brand assortments, which now represent close to 50% of sales in the region
- And deepening our engagement with customers through numerous upgrades and roll outs to our omnichannel loyalty programs.

In Q3, net consumer online sales in the segment increased by 6.1%, following 20.1% growth in the same period last year, also showing a nice acceleration compared to the first half of the year. A large part of this improvement came from bol.com which grew 5.6% compared to the prior year.

In Europe, our Q3 underlying operating margin showed a slight improvement compared to Q2, despite a more pronounced impact from rising energy and utility costs, which we estimate at roughly 70 basis points in the quarter.

Since we last communicated in August, we have seen further significant increases in energy prices throughout the year, which will continue to weigh on our European margins in the coming quarters.

In addition to proactive steps our brands are taking to reduce energy consumption across our operations, this continues to highlight the importance of our ongoing Save for our Customer cost saving program and the additional levers we announced in Q2 to help mitigate these and other inflationary headwinds. And expect more from us on this front going forward.

We continue to work diligently on things that are under our control, and here as you would expect, we are also laser focused on cash flow generation.

In Q3 free cash flow was 133 million euro. Operating cash flow was 204 million euro higher this year, which was not fully reflected through to free cash flow due to ongoing optimization of our netting processes in the US associated with the SAP/4S go-live during the quarter. This timing effect is expected to be fully normalized by the end of Q4.

As a result, we remain fully confident to achieve our goal of around 2 billion euro in free cash flow for the full year.

In dynamic and challenging times like these, we are proud that 2022 will again be another very good year for our company. Better-than-expected underlying U.S. results, foreign exchange benefits, and continued insurance gains from rising interest rates allow us to raise our full year diluted underlying EPS guidance to low-double-digit growth.

The rest of our targets for the year remain unchanged, including our expectations of an operating margin of at least 4% and net capital expenditures of approximately 2.5 billion euro and free cash flow of around 2 billion euro.

In light of our continued expectations of strong free cash flow generation going forward, we are announcing the continuation of our annual share buyback program in 2023.

While the environment is not getting any easier, we are committed to operational excellence, tight cost control and disciplined capital allocation that help us continue to succeed going forward.

I am confident that this recipe for success, which is about leveraging our strengths and focusing on those things under our own control will again pay off for us – allowing us to maintain our industry-leading position of consistent and reliable performance, dependable cash flows and shareholder returns.

With that, thank you for your continued interest in our company and Operator, please open the lines for questions.

END

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 continue, will, accelerating, growth, succeeding, position, more, retain, progress, to date, priority, challenging, remainder, ongoing 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; political developments, natural disasters and pandemics; 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 environmental, social and governance matters (including performance) 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.*

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