Management's Prepared Remarks

Q4 2020 Earnings Call

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Alvin Concepcion

Senior Vice President, Head of Investor Relations

Thank you operator, and good morning everyone.

Welcome to our fourth 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.

In 2020, the effects of COVID-19 and social unrest deeply impacted the communities we serve, and created unprecedented challenges for our brands. I'm pleased with how the hundreds of thousands of associates across all our brands, distribution centers, and support offices demonstrated courage and care in protecting the safety of our stores and distribution centers, while providing great customer service and community support. I would like to once again thank each and every one of them for their tremendous efforts.

In support of these efforts, we made significant investments in additional safety measures, enhanced associate pay and benefits, and substantial charitable donations, which resulted in approximately €680 million in COVID-19-related costs in 2020.

We also committed to contribute over €1.4 billion to improve the security of pension benefits for associates and reduce financial risk for Giant Food and Stop & Shop.

When we started to see consumers shift their purchases more online at the onset of COVID-19, we acted quickly to shift capital expenditure spending in 2020 to accelerate investments in digital and omnichannel capabilities.

As a result of these combined efforts, we ended 2020 in a strategically stronger position than before the COVID-19 pandemic began.

Now I'll focus a little bit on the financial results:

Natalie will go into more detail on the financial performance in Q4 as well as our outlook for 2021. For now, you can see in our press release and on slide 4 some of the highlights.

We are pleased with the underlying Q4 performance in both the U.S. and Europe. Comp sales growth excluding gas was strong in both the U.S. and Europe. Our leading local omnichannel platform generated nearly 130% net consumer online sales growth in the U.S. and nearly 75% growth in Europe in the quarter, at constant exchanges rates.

The strong Q4 performance allowed us to exceed our full year outlook. Underlying EPS growth was 33% in full year 2020 versus our guidance of high-20% growth. We were able to produce €2.2 billion in free cash flow in 2020, which compares to our guidance of above €1.7 billion. We were proud of this high level of cash flow given the significant payments we made to withdraw, settle, and improve the security of pension plans in the U.S. and the Netherlands, as well as our accelerated investments in digital and omnichannel capabilities.

We strive to benefit all of our stakeholders and aim to strike the appropriate balance between investing in the health and safety of associates and customers, supporting our local communities, prioritizing environmental, social, and governance initiatives. Therefore, we are also proposing a €0.90 dividend for 2020, which represents 18% growth from the prior year.

Moving to slide 5. You heard me mention that we were entering 2021 in a strategically stronger position versus pre-COVID-19. I'll elaborate more on that now.

In 2020, we were able to significantly improve our strategic position:

- We are exceeding the multi-year Capital Markets Day 2018 financial targets.

- We grew overall market share in both the U.S. and Europe, which has further strengthened our #1 and #2 market share positions.

- We exceeded our 3 year group net consumer online sales goal of €7 billion a year early, by achieving €7.6 billion in 2020. Online now represents about 10% of our sales and we are positioned for additional growth given our significant capacity increases in 2020 and 2021.

- And we significantly de-risked our U.S. multi-employer pension plan liabilities, by withdrawing from and securing plans that comprised about 90% of the year-end 2019 net deficit.

Exiting 2020 in this position makes us feel even more confident about our prospects in 2021 and beyond.

While no doubt that COVID-19 helped our results last year, we also know that the future for Ahold Delhaize is very promising.

Many consumers have found a new love for eating at home and found new ways to engage with our brands both online and in-store, which are behaviors which we think will have a lot of stickiness.

As a result, we are now setting more ambitious targets in several key areas of our business, which you can see on the right side of slide 5:

- With increased capacity and continued momentum, we expect Group net consumer online sales to continue to grow strongly in 2021, to grow strongly in 2021, particularly in the U.S. both organically, and aided by the recent acquisition of Fresh Direct.

- We are raising our cumulative cost savings target for 2019-2021. These cost savings efforts will enable our brands to invest in providing more value and convenience to customers, and help us mitigate cost pressures in the business. This will lead to a solid Group underlying operating margin in 2021, which is expected to be at least 4% and will drive EPS growth versus 2019.

- It will be another strong year for free cash flow, and we are now on track to reach €5.6 billion in cumulative free cash flow from 2019-2021, which exceeds the Capital Markets Day 2018 target of €5.4 billion.

Natalie will provide more color on this outlook in a few moments, but underpinning this financial guidance is our ability to further capitalize on our strong relationship with our customers and communities, who will continue to reward us for our efforts to innovate, provide convenience, and offer a healthy and fresh assortment at a good value.

This guidance also reflects the consistent financial discipline and operational excellence which you have come to expect from Ahold Delhaize. This is particularly important as we lap a year where COVID-19 has created a lot of distortion in the financial results, as well as new challenges in 2021.

Slide 6 and 7 summarize how we exceeded our key targets in 2020 as well as our new targets in 2021 beyond the financial targets I just discussed. We hold ourselves accountable when we set targets and believe in being transparent about them.

In the spirit of transparency, slides 8 and 9 show our progress versus the initial 2018 Capital Markets Day promises. And I won't go through them all, but clearly, we have exceeded or are on track of exceeding all of our financial goals through 2021. We are happy with our track record here, which I recall was also a very good pre-COVID-19. I am confident in our ability to achieve our more ambitious targets in the year to come.

The last quarter on slide 10, we spent a bit of time discussing some of our early initiatives to solidify our position as an industry-leading, local omnichannel retailer and increase our share of the customer wallet in 2021 and beyond, even more confident about our efforts to make this happen.

On slide 10, you can see that we increased share in 2020 in our key markets in the US and the Benelux and maintained share in the Central and Southeastern European markets. This widened in a positive sense our already leading one and two position market share, and our aim is to retain this leading position in 2021 and beyond. So, I think it's worth giving you an idea how we plan to do that.

On slide 11, we described some of the reasons we think additional wallet share opportunities remain. Well, no doubt, COVID-19 creates challenging sales comparisons in 2021. We are confident that our two-year stacked comp sales growth rates will be better than they were pre-COVID-19. One of the reasons we believe this is because of our ability to capitalize on changes in customer behavior. We have shown in 2020 our ability to adjust our operations and shift investments in the short amount of time, and we will continue to remain nimble. Even as COVID-19 subsides, we think customers will work more from home than they did before COVID-19 and, therefore, eat more at home than before. We think the preference for healthy and fresh product will step up even further, and we think online demand will continue to grow strongly.

These behaviors portend well for our future as a company because they are the areas we have been highly focused on and already play well into our strengths. In fact, with our investments in increased capacity and continued innovations, we expect over 30% growth in net consumer online sales for the group in 2021, and we expect the US to outperform that rate with over 60% growth. In Europe, bol.com has exceeded their net consumer online sales target a year early, reaching €4.3 billion in 2020 versus our target of €3.5 billion in 2021. We expect growth to continue and are upping our forecasts for bol.com to €5 billion in net consumer sales by 2021.

There are a few other reasons we think incremental sales opportunities exist.

- Our recent acquisitions of FreshDirect and stores from Southeastern Grocers, as well as yesterday's announcements regarding DEEN supermarkets in the Netherlands will drive incremental sales. We think there is organic growth opportunities here as well.

- The store remodels we are doing across the US and Europe should also continue to drive sales uplifts, and many of these are focused on some of our largest brands in Stop & Shop and Albert Heijn which you have heard us talk about before.

- There are also new opportunities for increased sales in general merchandise and own-brands products in the US as well as improved meal solutions offerings in both the US and Europe.

On slide 12, you can see some highlights of ways we are bringing to life our goal of being a leading local omnichannel retailer. Building upon key initiatives which we announced last quarter, our activity center around several areas:

- First of all, significantly stepping up our online capacity, supply chain, and technological capabilities. In 2021, we have plans for increased online capacity in both the US and Europe on top of a significant increase in 2020. We will also continue to make progress in our US supply chain transformation efforts which are absolutely on schedule.

- Two, advancing our omnichannel offerings to consumers, we will roll out AH, Albert Heijn, Compact, which is a no-fee home delivery service targeting smaller households to more markets in 2021. GIANT Company launched Choice Pass in January, which offers unlimited free grocery delivery and pickup with an annual membership fee of $98 as a sort of subscription system.

- And last quarter, under three, we mentioned that improving online productivity across all our brands is one of our highest priorities for 2021 and beyond. It remains a key focus for us, and we have some new things to share with you on this front.

- We plan to accelerate US online grocery fulfillment productivity growth through an end-to-end improvement of processes, systems, operating practices, and innovation beginning in 2021 and continuing through the end of 2022, which will lower the cost to serve.

- To improve efficiency even further, we will open an additional micro-fulfillment center with Autostore and Swisslog inside of a new omnichannel fulfillment center in Philadelphia in the fourth quarter of 2021. In both the US and Europe, we will utilize technology to improve route optimization in order to reduce last mile costs. We're also working on ways to optimize the numbers of orders per trip and leveraging new fulfillment centers to reduce distance traveled. And at bol.com, we are pleased with the team's ability to drive positive operating profits and double-digit return on capital in 2020, and we expect this to continue in 2021.

You also remember that we want to continue to address the call to action in ESG. Slide 13 show our recent actions. It's great to see that our substantial efforts in the past have been recognized as well. We were the top ranked food retailer in the US and Europe and number two globally in a 2020 S&P Global Corporate Sustainability Index. And therefore recognized as a member of the Dow Jones Sustainability World Index and in Europe. Going forward, we continue to push our online efforts on – our efforts on the ESG and announced that:

- In January, Albert Heijn halved the CO2 emissions per store and switched to 100% wind energy.
- The US partnered with HowGood on an easy-to-use environmental and social impacting – impact rating system.
- The US brands pledged support to the CEO Action for Diversity & Inclusion Program, which is the largest CEO-driven business commitment to advance D&I within the workplace.
- And our US brands were recognized as best places to work for LGBTQ and Equality, receiving a perfect score on the Human Rights Campaign Foundation's 2021 Corporate Equality Index.
- We also announced a €1 billion sustainability-linked revolving credit facility, all elements to underline the importance of ESG and our efforts to make it even more important for ourselves, our associates, and our customers.

On slide 14 and 15, we highlight some of the key achievements in Q4 for the US and Europe.

In the interest of time, I won't cover all of these. But in the US, we saw high levels of online growth continue. Also the Stop & Shop remodeled stores continue to perform in line and we will accelerate the number of remodels in 2021. In Europe, we were also pleased with the high level of net consumer online sales growth, particularly at bol.com, which started the year with 26,000 sellers on the platform the year of 2020 and ended the year with over 41,000 of sellers on the platform. And it continues to grow in 2021.

Natalie Knight
Chief Financial Officer

Good morning and thank you, Frans.

Our underlying performance in the fourth quarter was again strong and continues to be impacted by high levels of demand due to COVID-19. As a result, net sales grew 18% at constant exchange rates to €19.6 billion and group comp sales ex-gas were 11%.

Net consumer online sales grew 84.2% 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 to rapidly expand our capacity in both the US and Europe.

Underlying operating income increased by 10.8% at constant rates to €811 million with underlying operating margin down 30 basis points to 4.1% at constant rates. This was primarily due to significant cost related to COVID-19, which amounted to €210 million in Q4. That's a significant step-up versus Q3's €140 million, due to a resurgence in COVID-19, as well as lower margins in the US, which I'll elaborate on more in a moment. These factors were partly offset by a margin benefit of 0.2 percentage points from the calendar effect of a 14-week quarter compared to a 13-week quarter in 2019.

Underlying income from continuing operations for the quarter was €561 million, up 3.4% at constant rates. On a reported IFRS basis, however, there was a loss from continuing operations of €9 million, reflecting the €841 million pre-tax provision for the previously announced withdrawals and settlement from US multiemployer pension plans. We also repurchased €296 million of stock in the quarter, which brings our full-year share buyback to €1 billion in 2020.

Diluted underlying EPS in the quarter was €0.53, an increase of 7.3% at constant rates.

Now slides 18, 19, and 20 show our results on an IFRS reported basis, as well as for the full-year 2020. Moving on to our fourth quarter performance by segment, let's look at chart 21.

Here you see that net sales in the US grew by 18.7% at constant rates to €11.4 billion. Comp sales ex-gas increased 11.2%. Brand performance was strong across the board with the highest growth rate again coming from Food Lion.

Another important callout on the US top line was our online sales which increased by 128.5% in the quarter. This led to 105% online sales growth for the year exceeding our already upgraded 90% growth target. Click-and-collect was a significant driver of this growth, and we ended the quarter with 1,116 locations, up from 692 at the beginning of the year.

The underlying operating margin in the US was 3.9%, down 40 basis points from the prior year. Q4 comp sales moderated relative to the growth rate we delivered in Q3, and at the same time, costs related to COVID-19 in Q4 also increased relative to what we'd seen in Q3. This drove a different margin profile relative to what we've seen in the other quarters of the year. In addition, one-time items and the previously announced transition expenses related to the US supply chain transformation initiative, unfavorably impacted margins by 0.5 percentage points.

In Europe, net sales in the fourth quarter grew by 17.1% to €8.2 billion and comp sales increased 10.6%. This improvement was led by our brands in the Benelux markets. Growth was mixed in the Central and Southeastern Europe due to higher level of consumer lockdown restrictions, reduced tourism, and lower demand in urban centers where many of our stores are located.

Net consumer online sales in Europe grew 73.4%. At bol.com, our online retail platform in the Benelux, which is included within the Europe segment results, net consumer sales grew by 69.6%. The big driver of this development was Bol.com's third party sales, which grew 110% in the quarter.

Europe's Q3 underlying operating margin was 5.1%, up 10 basis points from the prior year at constant rates. Operating leverage from the higher sales growth was offset in part by higher costs related to COVID-19, as well as €11 million of pension expense in the Netherlands during the quarter, which had been flagged in previous earnings calls.

Moving on to slide 22 where you see the underlying segment performance for the full year and 2020.

Now, a look at what you've seen in terms of all of the announcements we've made on pensions in recent months. Up on chart 23, you see a summary of our activities on this important front. We committed to contribute over €1.4 billion in the U.S. to improve the security of pension benefits and reduce financial risks. This relates to withdrawing from and settling our largest U.S. multi-employer pension plans. We took the full charge for these liabilities in our P&L in the second half of 2020, of which €841 million was taken in the fourth quarter, and was excluded from underlying operating income. In terms of cash impacts, we paid out €487 million in 2020, of which €470 million was paid out in the fourth quarter.

Together, these plans represented about 90% of the year-end 2019 deficit for all of our US multi-employer pension plans as disclosed in our 2019 Annual Report. We'll disclose an update on the 2020 report, which will be released on March 3. But suffice it to say, you'll be see a significantly improved profile here.

We also paid out an additional €122 million in cash to the Netherlands Pension plan based on an existing agreement to improve the funding position in the fourth quarter.

In sum, the cash payouts in the U.S. and Netherlands related to these activities totaled €609 million for the full year 2020, of which €592 million was in the fourth quarter.

Moving on to free cash flow in the fourth quarter, which is the top chart on slide 24. Free cash flow in Q4 was €262 million, which compares with about €1 billion last year. This was largely impacted by €592 million in pension plan withdrawals and incremental pension funding payments, which I just discussed. There was also an increase in net capital expenditure of €238 million as we accelerated and increased omnichannel investments in the quarter. Taxes increased by €69 million due to higher income, as well as the timing of tax payments in the Netherlands. As you recall, taxes in the Netherlands were paid in full in Q1 2019, but have been paid out more evenly throughout the year in 2020.

At the bottom of chart 24, you'll see that our free cash flow for the full year was really something that was a very strong result. Free cash flow was €2.2 billion, which compares to about €1.8 billion last year. And this would have been even higher had we not paid that €609 million for pension plan withdrawals and incremental pension funding payments. We also spent €476 million more in 2019 on CapEx than we had in 2019 for a total of €2.6 billion for the year, as we accelerated and increased our omnichannel investments and acquired several C&S wholesale distribution centers and made other investments into our US supply chain transformation totaling over $300 million.

Now on to chart 25. Here, we're proposing a cash dividend of €0.90 for the financial year 2020, an increase of 18.4% compared to 2019, which is the highest increase since the merger.

This represents a payout ratio of 40% based on the expected dividend payment on underlying income from continuing operations on a comparable 52-week period, which is right in line with our dividend policy. This means our compounded annual growth rate is 12% since 2016 with this proposal.

Moving on to our outlook for 2021 on slide 26, as you know, COVID-19 continues to drive a significant amount of uncertainty for our business, and this is an important factor in all of our guidance for 2021. While operating – while higher demand drove unprecedented sales growth and operating leverage in 2020, this development and, to a lesser extent, the absence of the 53rd retail week, will challenge comparisons significantly this year. Let's start with operating margin where I'm pleased to announce that we are expecting at least 4% in 2021. We believe this return to historical levels is realistic compared to the unsustainably high margins we experienced in 2020 due to the very strong sales related to COVID-19.

It also reflects our ongoing commitment to drive cost savings, and we'll need to do that in 2021 to offset cost pressures including the continued costs associated with COVID-19. I'll share a few items to consider when you think about this year's outlook.

- First, we expect comp sales trajectory to be better on a two-year basis in 2021 compared to pre-COVID-19. While it doesn't affect our comp store sales, our recent acquisitions of FreshDirect, as well as the stores of Southeastern Grocers and DEEN Supermarkets will provide us with incremental sales which will be modestly dilutive to earnings as we integrate them.

- It may, however, still be challenging to overcome the abnormally high growth comparisons from 2020 overall. Therefore, compared to 2020, we expect sales to deleverage as we lap the strong results given by – driven by COVID-19. We expect costs related to COVID-19 to continue, albeit at a much lower level than what we experienced in 2020.

- And you've heard this from us before, but as a reminder, US supply chain transformation costs are still expected to have a $50 million impact in 2021.

On our key – one of our key priorities is to improve online productivity as our guidance suggests and we are finding new ways to balance the impact from increased online sales penetration that we expect to come into our numbers in 2021.

And lastly, one of the big ways we're balancing all the pressures I've mentioned is through significant cost savings of over €750 million in 2021, which is higher than our previous expectation of about €600 million. So underlying EPS is expected to grow mid to high single digits relative to 2019. Free cash flow is expected to be approximately €1.6 billion inclusive of our CapEx of around €2.2 billion. This puts us on track to reach €5.6 billion in cumulative free cash flow from 2019 to 2021, averaging €1.9 billion annually, exceeding the Capital Day – Capital Markets Day 2018 target of €5.4 billion that was €1.8 billion annually.

As a reminder, our free cash flow guidance has always excluded M&A. And we have made that pretty clear consistently. If we were to exclude investments needed to improve the operations and capabilities of the aforementioned M&A deals, as well as the ongoing CapEx related to our three-year supply chain transformation, free cash flow for this year would actually be on track to the €1.8 billion number.

When we look at slide 27, this outlines the increased outlook for the Save for Our Customers plan, and this is something that you see us over-delivering, and it really gives us confidence that we will continue to do over-deliver against that initial plan for 2021.

So I'll now hand back to Frans.

Frans Muller

President, Chief Executive Officer

Thank you very much, Natalie. So, let me wrap-up. While our 2020 results were impacted by increased demands from COVID-19, we made significant moves to enter 2021 in a strategically stronger position when compared to pre-COVID-19. For that, we thank the associates across our organization for their contributions during these unprecedented times. We had a strong 2020 performance, which exceeded our guidance. We also are exceeding our key multi-year financial targets established at the 2018 Capital Markets Day.

Our significant efforts in ESG were recognized as the number one ranked Food and Staples company in the US and Europe by the S&P Global CSA, which led to being selected as a member of the Dow Jones Sustainability World Index as well as the Dow Jones Sustainability World Index in Europe in 2020. We are now able to propose a cash dividend of €0.90 for 2020, an increase of 18%. Our recent acquisitions should add incremental sales and market opportunities in 2021 and beyond. And this leads to our confidence in providing a 2021 outlook, which reflects a balanced approach to margins and another year of strong free cash flow.

We will now be happy to take your questions. And, operator, could you help us here and could you please proceed?

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Cautionary notice

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