Management's Prepared Remarks

Q3 2020 Earnings Call

November 4th, 2020

Alvin Concepcion

Vice President, Head of Investor Relations

Thank you operator, and good morning everyone.

Welcome to our third 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.

I would like to start off by thanking the associates across all our local brands and support offices for their hard work during this challenging time. I am increasingly proud of our teams' performance. Their focus on the safety of our stores and distribution centers, as well as their service to our local communities are commendable. In the third quarter, we enabled our teams by continuing to make important investments in additional safety measures and enhanced associate pay and benefits. For our communities, we also continued to make significant charitable donations. In total, we have spent €470 million on these efforts in the year to date.

But despite the challenges we have all faced during COVID-19, we were able to produce another strong quarter of results.

Natalie will go into more detail on the financial performance in Q3 as well as our outlook for 2020. For now, you can see in our press release and on slide 4 some of the highlights. Overall, I'm pleased with the results. While the high growth in comp sales and net consumer online sales were aided by demand related to COVID-19, it wouldn't have been possible if not for our ability to leverage our leading local digital and omnichannel platforms, which we continue to significantly invest in. And despite the high level of costs related to COVID-19, we were able to expand underlying operating margin, and grow diluted underlying EPS by 16% at constant exchange rates. The strong performance in the quarter allowed us to raise our full year underlying EPS outlook for 2020 to growth in the high-20% range.

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 announcing a new share repurchase program of €1 billion in 2021, which is a testament to the strength we expect to continue to see in our business model.

Speaking of 2021, we know a lot of you are wondering what the future holds for Ahold Delhaize. In short, we think the future is bright, and many consumers have found a new love for eating at home. Many households, including my own, discovered cooking skills they never knew they had, and they enjoy it. Others, who are more challenged with time and haven't quite yet developed their cooking skills, discovered many delicious and convenient meal solutions we offer. Many households also discovered the strength of our assortment, particularly in fresh and healthy items. They have found ways to save money and extract even more value, such as through our loyalty programs, our competitive price points, and through our exclusive own brand offerings.

They have found new ways to engage with us, whether that is in-store with contactless payment option or through our convenient click & collect and delivery options. We think a lot of these attitudes and behaviors will be sticky in the future, and we will continue to adapt as new behaviors develop.

While 2020 will be a record year by nearly any financial measure, we know it's also a time we have to lean into our strengths to continue driving our business forward in the future. And despite the undoubtedly tough comparisons starting next Spring, we see continued strength in our business model, and are able commit to another €1 buyback program in 2021.

You heard me say lean into our strengths. This means we need to continue to innovate and continue to please our customers to retain our title as #1 or 2 market share across all our markets. Importantly, we need to maintain the consistent financial discipline and operational excellence which you have come to expect from Ahold Delhaize.

I want to spend a bit of time today to discuss 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.

On slide 6, you can see that our initiatives center around three areas:

1) Significantly stepping up our online capacity, supply chain, and technological capabilities.

2) Advancing our omnichannel offerings to consumers

3) Addressing the call to action in ESG

I'll dive into each of these points in a little more detail, but keep in mind, the initiatives we highlight today are by no means a complete list. It's just a preview of some of the things that we're up to and the direction we're headed.

On slide 7, you'll see some of the investments we're making to step-up online capacity, supply chain, and technological capabilities, as many of these areas were challenged during the demand spikes of COVID-19.

Today, I'm proud to say that our U.S. business reaches approximately 90% of households in our markets with home delivery and Click & Collect, and around 70% with same-day options.

In 2020 and 2021 cumulatively, we are increasing our online capacity by nearly 100% in the U.S. This includes the expansion to nearly 1,400 Click & Collect locations by 2021, which will double the number of locations we had at the beginning of 2020.

In Europe, our online capacity is increasing by nearly 50%. And this includes an over 50% increase in capacity in bol.com in 2020 and 2021.

To better serve customers, recall that in December 2019, we announced that we are improving the U.S. supply chain capabilities by moving to a fully integrated, self-distributing model beginning in 2023. So far, we are progressing on our deliverables ahead of schedule and the first integrated distribution center of the transformation initiative will go live in 2021.

In Europe, we will improve our technology capabilities by doubling electronic shelf labels to over 50% of our grocery stores in 2021, versus 2020. Nearly all Albert Heijn and Delhaize owned stores will have this by the end of 2020. Electronic shelf labeling will help improve productivity and save costs. As an example, it allows us to offer dynamic markdowns to improve turnover on aging fresh items which reduces shrink, allows for faster price changes, and improves labor efficiency ofcourse. In our To Go format at Albert Heijn, we are enabling a Tap & Go solution for customers which means there's a self-checkout component to this as well.

Finding cost savings and enhancing productivity with solutions such as this are part of our culture at Ahold Delhaize, and helps us to stay on track to achieve at least €1.9 billion cumulative cost savings target by 2021.

On slide 8, we have a lot of exciting advancements for omnichannel consumers in the U.S., with many many more to come.

As many of you know, our brands have offered subscription plans for years and they have quite a loyal following by consumers. But we always look to improve our offerings. Therefore, The GIANT Company will test a new subscription offer in Q1 2021, with an annual membership fee under $100, improved value proposition and preferential delivery time slots. We believe this improved subscription offering should lead to both increased loyalty and engagement.

The U.S. will also offer an "endless aisle" solution with an additional 80,000-100,000 general merchandise and food items in the first half next year, utilizing the Mirakl platform.

We are also focused on offering even more value to consumers, and to do so, our U.S. brands will launch 1,500-2,000 more own-brand items in 2021, growing from the existing base of 15,000 items.

The Stop & Shop remodeling program in the U.S. will be accelerated in 2021, with approximately 60 additional stores vs. the 30 or so expected in 2020. The remodeled stores are performing well, with sales lifts in line with our expectations.

On slide 9, you see that the European brands are staying on the leading edge of innovation, with some exciting launches that will be rolled out more broadly.

In July, Albert Heijn launched a home delivery service in the Antwerp region of Belgium, which is off to a very promising start.

In August, bol.com expanded to French-speaking Belgium in Brussels and Wallonia. This allows us reach even more customers, and the brand has already managed to attract a thousands of Belgian third-party sellers.

Mega Image in Romania launched a 90-minute home delivery offering in the capital of Bucharest in September.

Also in September, Albert Heijn initiated a no-fee home delivery service in its first market in the Netherlands. The program targets smaller households, and will expand to additional geographies in next year.

To date, Albert Heijn has remodeled over 200 stores to its new fresh and technology-focused format and plans to remodel 170 more in 2020 and 2021, cumulatively. The stores are performing well and are providing an uplift in sales and customers relatively to the control group.

The COVID pandemic has highlighted the importance of our commitments to enable healthier and more sustainable diets, as well as in supporting our local communities. There is increasing customer demand for healthy and sustainable products and services, and they want to engage with companies with strong values.

We have many initiatives to enable healthier eating, drive down waste, increase the transparency on the products we sell and reduce our carbon emissions. We strive towards improvements in diversity & inclusion, and do our part to better protect human rights.

On slide 10, you'll see a list of our longer term ESG targets as it relates to many of the key issues for us. You may have seen many of these over the past year, so I won't cover it again, but please do take a look and also look at our website and annual report, where more details are available.

On slide 11, you can see some of the recent initiatives in ESG, but one I would highlight is an interesting program in Belgium, where Delhaize has taken steps to make eating healthy easier, by ramping up permanent price reductions for so called Nutriscore A and B products, which led to the launch of the SuperPlus loyalty program in October. We look forward to share more details about this program in subsequent quarters.

Slides 12 and 13 highlight some of the key achievements in Q3 for the U.S. and Europe.

In the interest of time, I won't cover all of these, but would note that after seeing 115% growth in U.S. online sales in Q3, we now expect over 90% growth in US online sales for the full year 2020. This is another upgrade from our previous target of over 75% growth.

Also, the Stop & Shop remodeled stores continue to perform well.

Let's move over to Europe, we were pleased with the market share gains in both The Netherlands and Belgium in third quarter, which shows the continued strength of our Benelux ecosystem. CSE continues to hold its strong share as well.

Bol.com continues to perform very strongly, with 46% net consumer online sales growth, including 73% growth in sales from third-party sellers and there are now about 37,000 sellers on our platform, and it continues to grow. I'll now hand it over to Natalie.

Natalie Knight
Chief Financial Officer

Good morning and thank you Frans.

Our third quarter was very strong and continues to be impacted by high levels of demand due to COVID-19, albeit less than what we saw in Q2 as hoarding behavior subsided and lockdown measures generally became more relaxed during third quarter, allowing consumers to eat away from home a little more. As a result, net sales grew 10.1% at constant exchange rates to €17.8 billion and Group comp sales growth ex-gas was 10.5%. Group comparable sales were impacted significantly by demand related to COVID-19.

Net consumer online sales grew 62.6% 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 to rapidly expand our capacity in both the US and Europe.

Underlying operating income increased 15.9% at constant rates, to €813 million, with underlying operating margin up 20 basis points to 4.6% at constant rates. This was largely due to operating leverage from higher sales related to COVID-19. This was offset partly by ongoing costs related to COVID-19, which amounted to approximately €140 million in Q3, bringing our year-to-date spend to approximately €470 million.

Underlying income from continuing operations for the quarter was €530 million, up 12.0% at constant rates. On a reported IFRS basis, however, income from continuing operations was €68 million, largely impacted by a €577 million pre-tax provision for the previously announced withdrawal from the National pension plan. As we repurchased €186 million of shares in the quarter, which brings that amount to €705 million year to date. We saw a diluted underlying EPS in the quarter was €0.50, an increase of 15.9% at constant rates.

Moving on to our third quarter performance looking by segment.

Net sales in the US grew by 11.3% at constant rates, to €10.9 billion. U.S. comparable sales ex-gas increased 12.4%. Brand performance was strong across the board, with highest growth rates coming from Food Lion and Giant Food. Stop & Shop had also strong results.

Another important call out on the US topline, was our online sales which increased 114.7%. Click & collect was a significant driver of growth, and we ended the quarter at 883 points, up from around 700 at the start of the year.

The underlying operating margin in the US was 5.0%, up 0.6 basis points from the prior year, driven largely by operating leverage from higher sales growth due to COVID-19. Lower shrink and labor efficiencies also helped this development, offset in part by significant costs related to COVID-19.

In Europe, net sales in the third quarter grew by 8.3% to nearly €7 billion. This was a strong development, but continues to be slower than the U.S. growth due in part to a lower shift to eating at home, since wallet share of food eaten away from home was generally lower in Europe to begin with.

Europe's comparable sales increased by 7.5%. This improvement was led by our brands in the Benelux markets. Growth was more muted in Central and Southeastern Europe due to a higher level of consumer lockdown restrictions, reduced tourism and lower demand in urban centers where many of our stores are located. All of these developments translated to market share gains in the Netherlands and Belgium and stable share in Central and Southeastern Europe.

Net consumer online sales in Europe grew 48.6%. At bol.com, our online retail platform in the Benelux which is included within the Europe segment results, net consumer sales grew by 45.6%. The big driver of this development was Bol's third party sales, which grew 73% in the quarter.

Europe's Q3 underlying operating margin was 4.3%, down 50 basis points from the prior year. Operating leverage from higher sales growth was largely offset by higher costs related to COVID-19 as well as €11-€12 million of pension expense in the Netherlands during the quarter, as well as the lapping one-time items that benefited margins in the Netherlands from the prior year's quarter. Both of these items were flagged in the last earnings call.

Moving on to free cash flow. The cash position of Ahold Delhaize remains strong. Free cash flow in Q3 was €176 million, which compares to €484 million last year. The COVID-19 impact on profits drove a significant operating cash flow increase. This was offset in part by a €134 million unwind in working capital at the end of the quarter, as inventories in-store continued to return to more normalized levels after initial shortages experienced in the earlier stages of the COVID-19 crisis, particularly in the U.S. In Europe, the increase in inventory is mainly caused by Bol.com as we prepare for the high season in Q4. Taxes had an unfavorable impact of €145 million due to higher income from COVID-19 impacts, as well as tax payments in the Netherlands. If you recall, in the Netherlands were paid in full in Q1 2019, but have been paid out more evenly throughout the year in 2020.

Net capital expenditure was €601 million, up €78 million from last year as we accelerated and increased omnichannel investments in the quarters.

Moving on the outlook for 2020, I'd like to mention that despite the uncertainty generated by COVID-19, we are again raising our outlook on underlying EPS growth due to strong year-to-date performance.

Let's start with underlying operating margin for 2020, which is still expected to be higher than it was in 2019.

There is still a lot of uncertainty in the remainder of the year, but embedded in this margin outlook is a lower margin rate in Q4 compared to what we have seen so far this year. This is due to our expectation that comparable sales growth will moderate further relative to Q3. Although Q4 comp sales are expected to moderate relative to Q3, we do not expect a moderation in the costs related to COVID-19 relative to what we saw in Q3. This creates an operating deleveraging effect. We will also be making additional investments to further accelerate our digital and omnichannel capabilities, and will be impacted by an increase in the online sales mix.

There are a few smaller items to remind you of, which is also unfavorably impact margins for the remainder of the year.

In Europe, recall that there are higher pension contributions in the Netherlands at a run rate of €11 - €12 million per quarter.

In the US, there are €45 million in U.S. supply chain transformation costs in 2020, which are more back-end loaded.

While we do have a 53rd week which benefits our Q4 results, the pressures I discussed will outpace these benefits.

Moving on to our EPS outlook for 2020, we are raising our guidance to high-20% growth from low-to-mid-20% growth announced last quarter. This guidance reflects our strong performance year-to-date despite lower margins in Q4.

Our 2020 free cash flow outlook is also being maintained at a least €1.7 billion. It's important to note that the underlying level is even higher as it also includes the effect of paying the majority of the €577 million pre-tax obligation related to our withdrawal from the National Plan that we announced over the summer.

On CAPEX for 2020, we are maintaining our guidance of ~€2.5 billion. Remodels were slower in the earlier part of the year due to COVID-19 closures and labor availability. However, this is being quickly offset by our decision to accelerate digital and omnichannel investments to support the step-change in growth that is clearly underway.

Our dividend policy sets the dividend payout at 40-50% of underlying income per share.

And as of today, we are now a little more than 80% through our 2020 €1 billion share buyback program, and as Frans mentioned, we are planning a new €1 billion share buyback program in 2021 due to the strength and cash flows we expect to continue to see in our business model going forward.

While I'm sure many of you would like to hear what our broader financial outlook is for 2021, our normal practice is to provide this during our Q4 results in February. And with the high level of uncertainty caused by COVID-19, it is more challenging than usual to forecast. We will provide an update in due course, with our Q4 results next year.

That said, the uncertainty in the marketplace won't stop us from moving forward and finding new ways to adapt to the changes we are seeing in consumer shopping behavior.

Thank you and now let me hand over to Frans.

Frans Muller

President, Chief Executive Officer

Thank you Natalie.

So let me wrap up.

We had strong Q3 performance which was impacted by increased demand from COVID-19, despite all the significant costs that come along with it.

Our online business grew significantly, and should continue to grow solidly. Therefore, we expect to reach our €7 billion net consumer online sales in 2020 which is in fact a year ahead of plan.

Due to strong performance in Q3, we're again raising our 2020 outlook for underlying EPS growth in the high-20% range.

We're reiterating 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 and spend €2.5 billion in capex this year.

We announced initiatives to solidify our position as an industry-leading local omnichannel retailer in 2021 and beyond: including a significant step-up in online capacity and supply chain capabilities, increased use of technology to enhance productivity, advancements in omnichannel offerings to consumers, and addressing the call to action in ESG.

Lastly, we're authorizing a new €1b share buyback program for 2021, which is a testament to the strength we expect to continue to see in our business model.

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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 continued, will, outlook, continue (to), grow, full year, strive, aim, expect, 2021, future, we think, offer, adapt, develop, forward, commit, maintain, consistent, would, in due course, Q4, beyond, preview, direction we're headed, more to announce, progressing, enhance, should, lead, focus, expected, expectations, want to, development, remains, remainder of the year, can change, 53rd week, underway, goal, ahead of plan, or other similar words or expressions are typically used to identify forward-looking statements.

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