Ahold Delhaize NV

A Discounted Grocer

The Business:

Ahold Delhaize (Ahold) is a best-in-class food retailer with leading market positions in its home base of The Netherlands and Belgium, with a growing footprint in the Czech Republic and other Eastern European markets. Additionally, Ahold is the 4th largest grocer in the United States, its largest market. The group has been operating within the U.S. for close to 50 years, and commands #1 or #2 positions in the markets they serve along the Eastern Seaboard from Maine down to Georgia. Operating under such banners as Stop & Shop, Food Lion, Giant and Hannaford, the U.S. represents over 60% of group sales.

The origins of the company date back to 1867 when the Delhaize brothers opened their first grocery wholesale business in Belgium; shortly thereafter Albert Heijn and his wife opened a small grocery store in The Netherlands, which would form the roots of Ahold. These banners still command dominant market shares in their home countries, with the Albert Heijn banner being the most successful under the Ahold umbrella with approximately 37% market share within The Netherlands.

Sales and earnings at the company have compounded at roughly 8.5% and 7.5% respectively over the past 15 years, while producing stable, top tier margins along the way. Ongoing robust cash flow generation and conservative balance sheet management have been hallmarks of the business over the long term and have provided funds for internal growth, stock buybacks and select tuck-in type acquisitions. This financial discipline has also allowed for the payment of dividends over time. Over the past 15 years, dividends paid to shareholders have grown at an annual rate of approximately 11.5%.

Food retailing can be somewhat competitive, with certain markets more intense than others. Ahold's U.S. markets, for example, are typically more price competitive than its home European markets. Ahold manages this dynamic through annual ongoing cost disciplines, which have supported its above industry-average margins over the years. Cost saving initiatives are typically invested in price, but additionally have also been reinvested back into the business to help drive new initiatives, such as a growing online and omni-channel presence.

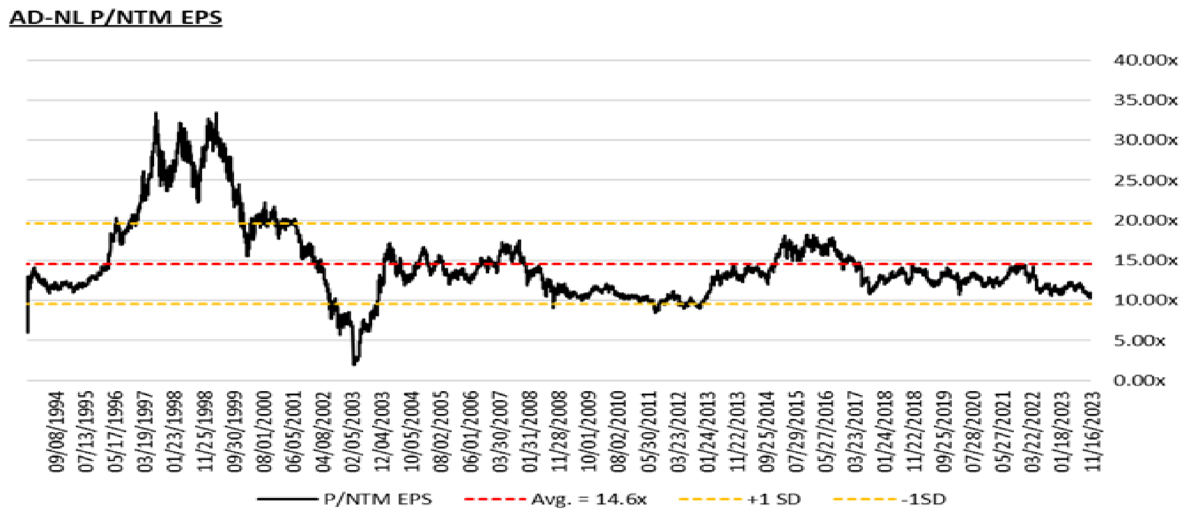
Ahold was early in developing an online presence, particularly within its European markets. This early move to invest in the online space has provided Ahold with strong leadership positions in all its markets, and provided an important head start in competing against larger, digitally enabled grocers and on-line only retailers.

The Stock

Ahold's current market value, as represented by its stock price, does not properly reflect the quality attributes of its underlying business. To borrow a phrase from the grocery trade, the shares are currently on the discount rack, but thankfully with no signs of damage, shrink or staleness.

A few factors are contributing to the discounted stock valuation. The COVID-19 pandemic and follow-on inflationary pressures were strong tailwinds for the food retail business globally. Both sales and margins received a strong boost during this period. There has been concern that the robust earnings of the last couple of years will normalize lower, which we would agree with, but we feel the market has been overly concerned. With a focus on the long-term capabilities of the underlying business, we see a very attractive opportunity to invest in Ahold at the current share price. Additionally, given the current pressures within the economy, and in particular, the consumer wallet, fears of customer trade-down have weighed on shares of grocery retailers. Ahold, like other grocers, is seeing some trade-down away from the often pricier national brands, but Ahold has a very strong offering within its own brand and private label products, which represent approximately 40% of sales in its U.S. division. These own brand categories, while often carrying lower ticket prices relative to the national brands, tend to offer higher margins for the company. We view any trade-down concerns as manageable and transitory.

Ahold's stock is currently being valued at close to 10x expected earnings – cheap on an absolute level for a business with such admirable investment qualities, and cheap relative to its history. Over the past 20 years or so, the average multiple to expected earnings was closer to 13x, with highs often in the 15x range.



Source: FactSet & Sionna Estimates, 2023.

We believe Ahold should be able to deliver similar results in the years ahead as it has in the past when it comes to sales growth, margin maintenance, robust cash flow generation and on-going expansion of the dividend. If so, its stock price should revert to more normalized long-term valuation levels.

With a three-year view, we see close to 50% upside in Ahold's stock price from current levels, driven by ongoing growth in the underlying business and a return to long-term normalized valuation levels (13x). Additionally, with the current share price weakness, the dividend is offering a yield just north of 4%, making for an attractive all-in total return.

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