Cloetta

Transcription: Q4-report 2016

Title: Cloetta Q4 Report
Date: 01.02.2017
Speakers: Jacob Broberg and Danko Maras
Conference Ref. No: EV00051411
Duration: 31:24

Presentation

Operator
Ladies and gentlemen, welcome to the Cloetta Q4 Report 2016. Today I'm pleased to present Danko Maras, Interim President and CEO and Jacob Broberg, SVP Corporate Communications and Investor Relations. For the first part of this call all participants will be in a listen-only mode and afterwards there will be a question and answer session. Speakers, please begin your meeting.

Jacob Broberg
Thank you very much, operator, and welcome to Cloetta Q4 presentation. And as last time, I will immediately hand over to Danko Maras, our Interim CEO, to present the report. Please go ahead Danko.

Danko Maras
Thank you, Jacob. Good morning everyone. Let me get right into the results for Q4 and the full-year. So with that, some of the highlights on page 2. Our net sales for the quarter increased by 3.8% to SEK 1.684bn, meaning that in 2016 for full-year our sales increased by 3.1% meaning SEK 5.852bn. Our operating profit adjusted for the quarter increased to SEK 258m and in 2016 the full-year operating profit adjusted increased to SEK 758m versus SEK 690m last year, and that's an improvement of close to 10%. That margin result that is 13% versus 12.2%. Operating profit – loss amounted to SEK -548m, and this is mainly due to the previously announced impairment of Cloetta Italy that we made on 18th January, and that also means on a full-year basis that 2016 results amounted to SEK -82m. Our cash flow from operating activities increased to SEK 406m in the quarter, so slightly higher than last year and then in total you can see a cash flow generation of SEK 889m full-year compared to SEK 927m last year. And because of that cash flow, we managed to increase EBITDA and reduce our net debt and the ratio amounted to 2.44x. And I'm happy to announce that we have now reached one of our financial objectives of coming to a level of 2.5x. And because of that, the Board is proposing a dividend of SEK 0.75 versus SEK 0.5 last year, an increase of 50% for the dividend of 2016.

So moving on to the markets on page 3. Overall the confectionery market in our markets where we operate were basically unchanged to somewhat negative in all markets. I'll go more into Italy and Finland soon but in the Netherlands we actually saw some growth in the quarter. Our organic sales growth in the quarter was about 1% and we had good growth in Sweden, Denmark, Netherlands and in our export markets. We had a decline in Finland and Italy but also in Norway, Germany and the UK in the – in the quarter. However, note that on a full-year, the Nordic region had good growth on a – on full-year basis but also export market grew on a full-year basis. In Sweden sales was driven by pick-and-mix and seasonal products. Our all-time favourite Juleskum sold record levels. Many people like that product and that's great. Also in Holland chewing gum and sugar confectionery increased for us in that market. Finland, as we anticipated, there was impact due to the destocking and trade prior to the abolishment of the confectionery tax. We expect that to come back in 2017 but clearly we saw an impact in the December month that has been impacting our top line growth. And also in Italy we did manage to recover some volume due to the price increases – decreases that we've done, but we were not able to fully compensate that by higher volumes. So both Finland and Italy had an impact in the quarter for us, and keeping that in mind, I'm still very pleased to see that we managed to grow our business organically with 1%, considering that a component of our business with Italy has traditionally been so significant.

So that was top line. If we then move into the numbers a little bit more on results – bear with me, it's a lot of numbers here on this chart but I will try to walk you through it. The net sales of SEK 1.6bn, as you can see there, resulted in a gross profit of SEK 667m and that is gross margin of 39.6%, an improvement of 70bps versus last year. So nice delivery of gross profit. And also if you look at it on a full-year basis you can actually see, conveniently, the full-year gross margin is also 39.6% and shows an improvement of 60bps. Operating profit adjusted of SEK 258m represents a 15.3% EBIT margin versus a higher margin last year of 15.7%. But then again, if you look at full-year you'll see that we are increasing our EBIT margin to 13% from last year's 12.2%. It's a nice increase. You might think that a little bit more of the profit would come through given that we had such a nice gross profit, but I would say that the underlying reason for our profitability measure this quarter is Italy and Finland not delivering the same numbers as they normally do on average margin basis. This has been offset somewhat with translation benefits in our gross profit, and I'll come more into that when I talk about the currency impact. The operating profit – loss of SEK -548m relates to an impairment that we did on Italy on 18th January – announced SEK 771m of write-down on our Italian business. I'll come more into that later. But also SEK 35m restructuring charge where predominantly the cost was related to a dispute we've had with a warehouse claim in Norrköping, Sweden being that we were actually forced to take a charge for. This issue is still ongoing, but we made a reservation for a potential cost and that of course effects the full-year numbers significantly. And therefore you can see on the full-year basis we are at SEK -82m on a full-year basis.

Moving down, net financial items are coming in a little bit better than we anticipated. We keep on reducing our debt. The financing cost and the benefit of the refinancing that we did in the early summer is almost halving the interest cost and you can see that we are at SEK 25m versus SEK 48m. And that continues to be a benefit that you will see in 2017. So profit and loss before tax, SEK -573m. Profit – loss for the period, SEK -420m, somewhat negative in the fact that we are having a tax release between the profit before and after tax considering that we are reversing back the tax liability from the impairment. So the impact is not as big on the profit and loss for the period as before tax. Now, if we were to exclude the impairment implications on our results when looking at it from an underlying perspective, you can see that our profit for the period increased with SEK 17m in the quarter to SEK 174m. And also on a full-year basis, for which we have been calculating our dividend potential, increased to SEK 403m versus SEK 386m last year. And the earnings per share excluding the impact of the impairment loss is SEK 0.61 in the quarter, but more importantly on a full-year basis you can see SEK 1.41 versus SEK 1.35, which is an improvement of 4.4%. That was a lot of numbers, but you're welcome to have questions to this one as we come into the Q&A session.

Let me move into the sales again and you can see that our organic growth in the quarter was 1%. This means on a full-year basis that we have organic growth of about 0.5% compared to 1.5% in 2015. There's no M&A or structural growth items in the quarter, but on a full-year basis you still have 2.2% and that relates to the Lonka acquisition that we did in July last year. That represents, as I said, 2.2%. And then also changes in exchange rate. We did come in strong with the Euro, and therefore we have a 2.8% benefit in the fourth quarter. It does not impact us that much on a full-year basis. You can see that the translation effect there is quite small, 0.4%, but in the quarter it was a benefit on top line and gross profit, which is somewhat offsetting the impact of Finland and Italy. And obviously, also, then having an impact on our cost items. If we more visually depict the delivery over three years, you come to this chart that we are showing every now and then. By quarter you can see a stepwise improvement on both sales and profit in almost every quarter for three years. And this is something we feel good about in delivering and also continuously improving. And then also in the aggregate of the fourth quarter for 2016 results in the EBIT margin of 13% when you pull these ones together, versus the 12.2% that we had last year.

And then of course in the absence of cash items, please remember that the write-down of Italy is completely non-cash item, so the cash generation is very strong. And last year was a record year in delivering our working capital improvements, so the SEK 927m was a good year. But actually it's not that bad in 2016, either, with the SEK 889m. It represents free cash flow yield of 8.7%. You could also keep in mind the redemption that we had of the bond in Q3. It would be somewhat similar cash generation as last year. That also, if I go and show that on a table, you can see a little bit more on the next page, that if we look at the cash flow from operating activities before changes in working capital, it is SEK 324m in the quarter but also on a full-year basis it is SEK 813m compared to last year's SEK 697m. And we feel good about the ability of generating cash from our income statement. That increase feels solid and we can continue doing that. But then if you look at the changes in working capital, it is normal delivery, I would say, in the quarter of SEK 82m versus SEK 72m last year. But you can also see on a full-year basis that there was a significant delivery of improvement in our balance sheet from working capital last year, which is a bit more normal in 2016. And that results in the cash flow delivery that you can see in the – in the full-year and the quarter.

I'm not going to go through the other numbers there. We can talk about them if you would like to, but this also then results in the nice trend of page nine, where you can see that the journey has come to one goal post, at least, in being able to deliver the 2.5x target. That means that we're going to retain that leverage position. It's very nice to finally come to that point and because of that we also will propose the dividend of SEK 0.75.

Now, coming back to 18th January and the announcement that we did on Italy. We have been continuously looking at the performance of Italy, and I think we've been talking about it in numerous times in the quarters. We were hoping to get profitability from the fourth quarter from our Italian business by recovering volume in doing those price decreases of 10-15% in the marketplace. We did see some volume recovery. We also held our share in Italy in terms of seasonals. But in total, the market did not recover and because of that we had to do a review of our Italian business. And that's why we are now going to do a strategic review of Italy. It is aimed at improving growth and margins of Cloetta. It might include a potential divestment of the Italian business; it might not. It's too early to tell. We're in the middle of looking at that – those aspects at this point. And given the performance of Italy I just want to say we have a lot of respect for our Italian colleagues and they are part of our family. Even though if we do look at the business and look at the average EBIT margin that we are having at the moment, if there were to be a divestment there will be an accretive effect on Cloetta's EBIT margin, just to give you some guidance.

So with that we feel good despite the impairment which is not a low number. It's a significant number, but if we take out the non-cash item and look at the full-year Cloetta stands strong. We are growing our business. We are improving our EBIT margin adjusted and we are delivering strong cash flow. And the metrics of cash conversion and yield are very strong. The fact that we have reached a net debt/EBITDA target and actually low – even below the 2.5x makes us feel confident about our ability to pay out the dividend of SEK 0.75 per 2016 numbers, which is an increase of about 50%, obviously, from last year. Now with that, I should note that our ambition is to use future cash flows for dividends while at the same time provide financial flexibility for complementary positions. Amortisations are not on the table anymore. We think we have a good balance of debt and equity in our balance sheet.

With that in mind, our focus going forward for 2017 are obviously very important that we manage to find a good solution and a good work through of our business in Italy. We keep being very ambitious in implementing and driving initiatives within pick and-mix – it's part of our strategy to drive that pillar, so very important for us to do. At the same time, working with our factories and implementing the Lean 2020 initiative we believe can yield significant improvements in our margin and cost efficiencies. And not to forget that growing our business organically is one thing, also growing through acquisition is another and both are equally relevant for us. So finding the right opportunities are important for us going forward.

And with that, I show you some selections of really tasty product launches that we've done in the fourth quarter. And maybe I can leave you with that picture while we then start with the Q&A. And then maybe you can go out and buy some of those products.

Jacob Broberg
And with that we open up for questions. Operator, please go ahead.

Q&A

Operator
Thank you. Ladies and gentlemen, if you have a question please press 01 on your telephone keypad. Please hold until we have the first question.

We have a question from Magnus Bernet from Direkt News. Please go ahead, sir.

Magnus Bernet
Yes, hello. This is Magnus Bernet from Direkt News. I was wondering – I respect that you can't say very much if you will sell the – in Italy or not, but I was wonder for your time schedule. Your new CEO is coming in in February, so when can we expect the closure of the strategic review? Should we – should this take most part of 2017 or – yeah?

Danko Maras
Hi Magnus, it's Danko here. First of all, there's nothing interim in the activities that we've done with Italy so we don't see that there is any loss of momentum on the strategic review just because we have a new CEO coming in. This discussion has been ongoing, the Board is fully involved, so we don't feel that that in any way or form should cause any delays. And obviously we would like to do this as fast as possible, but I would like to refrain from giving you any timetables about when we could be doing that. We have also a big organisation in Italy that we want to be respectful to, and working fast but thoroughly is our key priority.

Magnus Bernet
Okay, thank you very much.

Operator
Thank you. We have a question from Nicklas Fhärm from SEB Equities. Please go ahead, sir.

Nicklas Fhärm
Yes, this is SEB Equities, good morning. Could I ask you to update us on paid taxes and potentially if you would care to give us some guidance for the tax rate expected in 2017, please?

Danko Maras
Yes, good morning Nicklas. The actual paid taxes that we have in our company is significantly lower than what we are – been showing throughout our running operation, which has been somewhere around 24-25%. In the quarter and full-year you see a tax credit of 26%, and that is because we are releasing the tax liability related to the impairment of Italy. So it becomes a bit distorted to look at the tax rate in 2016 given that we have this impact of the release of the tax liability. But I would refer back to the corporate tax rate in Sweden is about 22%. We have international rate differences in our Group adding it up to approximately 24%. We will do everything we can to come below that level but that would be the guiding principle for 2017.

Nicklas Fhärm
Thank you so much. Can I also ask you what's the – after the write-down of intangibles, what's the free equity in the parent company balance sheet, please?

Danko Maras
Sufficient to pay dividend for another 12 years.

Nicklas Fhärm
Well, that's fairly straightforward, thank you. Can I also ask – I'm a bit interested in educating myself a bit more on developments in Italy. You know, you lowered prices on some products maybe in

double-digit terms. What was the actual volume development? What's the price elasticity as you calculate it right now in the market?

Danko Maras
Unfortunately we didn't get that price elasticity that we were hoping for but we did recover volume. It was not enough for us to offset the price decrease. So overall if we look at the turnover in Italy we have negative sales in 2016 in the fourth quarter. And overall there is an expectation that seasonal products in Italy would recover from very high prices on hazelnuts and almonds because part of the very important raw material for seasonal products in Italy is nuts in nougat. I think all of us were a bit disappointed – not only us, but also our competitors – that the market didn't recover fully. What I can say, though, is that within the development of a declining market or less recovery than expected, we actually held share and the Italian team did a great job in trying to recover. But it was nowhere near the expectations and nowhere near where we have been in the past. And that's why we are coming to the conclusion that we have to impair and we have to do the strategic review.

Nicklas Fhärm
Thank you very much. Would you care to give us any update on sort of the destocking situation in Finland ahead of New Year's change in tax legislation and perhaps how that has proceeded in – at the start of this year?

Danko Maras
Yes, so I think it was not easy for our Finnish colleagues to manage this situation. It was a destocking very clearly happening in December. Some customers had opportunity to have a bonded warehouse but not everyone, and that caused a lot of triggering moments between suppliers and the customers in Finland. We could see quite a material impact in December and without saying too much I'm seeing some recovery in January. I'm not allowed to say more than that. I'm looking at Jacob here. But we are seeing some recovery, not solely and it's something that remains to be seen. And I think the more important point is that €0.97/kg has been taken out from the sugar confectionery or confectionery products in Finland. And we believe that that will be a positive impact in the longer-term for our sales in Finland. It will even out in the long run. We saw that also when we increased prices because of the introduction of the confectionery tax. Consumption is quite high in Finland. But I do think we will see a positive impact of this in 2017.

Nicklas Fhärm
Thank you for clearing that. Can I also ask you, if you look at the organic growth rate, 1% for the quarter and about 0.5pp for full year, how does that break down into price mix and volume, please?

Danko Maras
Predominantly volume growth. Let's not forget we have introduced ourselves into the pick-and-mix area and we are growing in that nicely. We have done some price but fragmented in the markets. We are now going to do another price increase in 2017. So if you go back and look at our business over ten years, what you see is established market positions. Market share gain is what is actually going on. You need to retain your position, so most of the growth you are seeing in this business is volume related. And any component of price over time tends to be inflationary adjustments. And you can do strategic pricing, like for instance with the Jelly Bean Factory. We acquired a very good product

which is a price premium that contributes to our EBIT margin. But that's more of a strategic pricing that we are doing on premium products. But overall it's volume.

Nicklas Fhärm
And final question. Do you see any particular reason for why gross margins would change in 2017 compared to the current level – up or down, for that matter?

Danko Maras
I mean, the gross margin is a component of many variable factors. We believe that the Lean 2020 programme will continue to yield benefits to us and all of that will essentially come through in our gross margin. And that's something that we have communicated. We need to do price increases to mitigate input costs and that should be fairly neutral, but there could be some lagging effects on that. And then more than that I would not – would refrain from saying more than that.

Nicklas Fhärm
All right. Thank you so much for taking all these questions.

Danko Maras
You're welcome, Nicklas.

Operator
I remind you that if you want to ask a question you will have to press 01 on your telephone keypad.

We have a question from Mikael Löfdahl from Carnegie. Please go ahead sir.

Mikael Löfdahl
Yes, hi guys. First could you – is it possible to get some more flavour on the spread between different countries regarding organic growth if you look at the worst and best performers?

Danko Maras
I – if I come back to the – essentially what I have communicated, which is we're a bit careful on giving too much detail for obvious reasons because in some countries we have very few customers. But the growth that we've seen has been in Sweden, Denmark, Netherlands and export in the quarter. We feel very good about the full-year because the whole Nordic region has grown, and as you are aware we are a European – we have a European coverage, but we also have a sort of a footprint in the Nordic markets. And there I feel very good about the delivery, even despite the effect we had in the fourth quarter of the confectionery tax in Finland. Finland actually showed some – some, very minor, but showed growth also in 2016. And then, obviously, the Italian business you are aware of, there we have a negative impact on full-year. So further than that you will see in the – in the Annual Report where we'll give you a little bit more details, but for now I want to refrain from saying more than just that.

Mikael Löfdahl
And it's not possible to get the actual impact from Italy? You gave that last year in Q4 2015. You gave the organic growth excluding Italy. Is it possible to get that now as well?

Danko Maras
The only thing I can say is that our organic growth would have been higher in Q4 and our EBIT margin would have been significantly higher. But despite that we are still managing on a full-year basis to improve our EBIT margin to 13% and show organic growth.

Mikael Löfdahl
Okay. And could you remind us regarding the sugar prices and the lag and when you hopefully will get some price increases through to compensate? I guess they're still up year-on-year even though they are declined from its peaks.

Danko Maras
So it – unfortunately it varies by market so we initiated price increases already in September/October in negotiating with our customers. It's not an easy task, as you know, and we have managed to get those price increases through in most markets. And some are still going on. And if you think about Finland we work with trimesters, so they have different periods and that will start in the middle of the year. Sorry on – in May month. In Sweden we have a different calendar window and so on. So it does have an implication for us on the lagging effect, but the success rate of our price increases, we feel very firm that at the end of the day the consumer should pay for any input cost changes and that should not affect our EBIT margin. And that principle we hold firm to and that also means that we're having one or two very tough discussions at the moment in certain markets that I want to also refrain from talking about, given that we are in the middle of those negotiations. But prices will come through.

Mikael Löfdahl
Are – are you – are you comfortable in that your competitors are doing the same thing so that you don't get the same kind of situation as in Italy last year in Q4?

Danko Maras
That's a good question, and in some markets we are market leaders and then people are following us when we're doing price increases, in other markets we are more following. So if you think about the UK, we are a bit more modest about price increases there because we are not market leader. We need to follow what the other markets are – or what the other players are doing. But overall we see that competitors in the core markets that we're in are doing somewhat the same as we are doing.

Mikael Löfdahl
Okay. Regarding Italy, the impairment, was that only because of your own sort of calculations and the outlook of the Italian business and that you came up with this impairment? Or was it driven by any indicative prices from potential buyers, or what they were actually willing to pay for the Italian business?

Danko Maras
No. No, we're – I – just a direct no on that. We do our impairment review together with the auditors. It's been a sensitive area to us, an important area to us, so we've been using two advisors to help us making sure that we make the right estimates here. As you know, all of this is judgemental. You need

to work on discount factors and judgemental parts and we hang in – we had the view that we could recover in Italy, but given the performance and relevance of the fourth quarter, in advice – with the advice and the calculations we've done it's entirely internally-based on the assessment we've done. It has nothing to do with the external world.

Mikael Löfdahl
And lastly on Italy is there – I mean, what kind of natural buyers are there for your business? That's one question. Secondly, is it possible to sell pieces of Italy or would you regard it as one unit – either you buy it all or nothing? And thirdly, what is plan B for Italy if you do not manage to find a buyer for the business? What could you do in terms of restructuring? I mean, the market is what it is.

Danko Maras
So let me just come back to my last statement there when I said it was internal. Our assessment that we have done on Italy is based on a business plan, of course, but we will do externally. But what I wanted to say is that there are no external parties putting bids into Italy and therefore deciding any amounts. We have done this exercise the way you should do it, on impairment. And then for any other questions related to Italy and the potential future of Italy I do not want to wish ourselves to go into any speculations on what will happen and what will not happen. And the fact that it is an important component of our business and respectfully to the people in Italy, I would like to avoid creating any speculation. Even though I understand that you have some interest in knowing more, please let me come back to that when we have more to say.

Mikael Löfdahl
Okay. And my last question regarding the M&A pipeline, could you comment on that, how it looks today compared to a year ago or so? Do you see more opportunities or – yeah, comment on that please?

Danko Maras
We have one person working on M&A in our team. There's no lack of work for this person. It's – the challenge is to find the right opportunities for us. There is a lot of consolidation opportunities in Europe, a lot of family-owned business. As you know, we've done four acquisitions in total and all of them were family-owned. So we have a lot of activities that are happening at the moment. We just have to make sure that they come to us with the right synergies, with the right price. I think multiples are a little bit high. They've come down a little bit, but they are still a little bit high so we have to be sure about what we are doing if we are finding those opportunities. And it is our hope that we will find value accretive opportunities to drive top-line growth and EBIT delivery in the future. There's no lack of opportunities. We just have to find the right one.

Mikael Löfdahl
Okay, thanks.

Operator
I remind you that if you want to ask a question you will have to press 01 on your telephone keypad now.

There are no further questions at this time. Please go ahead, speakers.

Danko Maras
Okay, thank you very much for listening in and asking questions. Speak to you next time and have a good day. Thank you and goodbye.

Jacob Broberg
Bye-bye.