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Presentation

Jacob Broberg
Welcome to Cloetta Q1 Conference Call. My name is Jacob Broberg, Head of Investor Relations and Corporate Communications, as last quarter, I have Henri de Sauvage-Nolting, CEO, and Frans Rydén, CFO, with me here today. And, Henri, you can start. Please, go ahead.

Henri de Sauvage-Nolting
Yes, thank you, Jacob. Q1 highlights, of course, very happy to see the fifth quarter of organic growth in the branded business. And that we have a stable operating profit. Net sales declined organic-wise with 3% – a lot to do with Pick & Mix; we'll talk about that later. Operating profit adjusted 166 and the cash flow doing well at 154 and the net debt/EBITDA is still at the target level. If we then look a little bit more at the markets, we can see that the packaged confectionary markets, or candies, it is what is measured by the Nielsen numbers in our main markets, so excluding Pick & Mix, declined in most of the markets. We can clearly see that March month was much lower than last year which is all to do with Easter. So, the market, a bit down, but no big change. Our estimate of the Pick & Mix market is that it grew somewhat in all markets, except from Sweden, but these are estimates, of course, because there are no market data really available on Pick & Mix. Our organic growth was -3%, all coming from Pick & Mix, and then mainly from Easter timing and also the last quarter of the lost contract in Sweden. Those are the two main contributors to -11% on Pick & Mix. And the branded part grew with 0.6%. Last year, we had a strong start in Q1 with brands that Frans will allude to. So, I'm pleased to see another quarter with growth. Even more pleased to see that we're growing market shares on an overall level and also in our main categories. So, that's really important, competitive-wise.

If I look at the update on the Q1 progress on our core strategy: as said, market shares are growing, it's a signal that brands are becoming stronger which is important. Further progress on the working media, so the money we spent on getting our messages across to consumers, so another 10% up, which is really good because that means that the money we have is being used more efficiently and also continued strong traction on some of the recent big launches like the Plopp tablets and also all the low and no sugar candies et cetera. So, that is good. If you look at the facilitate growth, we can see that the "One Cloetta" programme is getting traction, both in cooperation across the markets, commercially, but also some more tech things. So, we're now live with an HR system across Cloetta where all the people, FTE salaries, et cetera are in a cloud-based system, which will facilitate also virtual teams, and with more and more managers who have people in different locations.

Candyking UK is ready to go live on the Cloetta ERP system as from the 1st of May – we gave a go-decision on that. The capacity investments we announced last time have been approved and initiated into two big moulding sites, and on the international markets we now also have the Dubai Hub for the

Middle East opened to get more traction on the brands we have in that region. Then, if I look at the funding growth, we have the Value Improvement Programme initiated together with Accenture. We're getting the first results, the first cost buckets, first ideas of the potential over there. Very good, positive feedback from the 'Perfect Factory' in two of our biggest plants where we did this assessment on what we can do to improve things like efficiency, waste, et cetera. Really inspiring to hear also operators and technicians talk about that. The insourcing is continuing and, last, but not least, the price increases we have announced in March in Sweden on Pick & Mix to get out of the loss-making situation over there are progressing. Frans, over to you.

Frans Rydén
Thank you. So, first let me say that this is a quarter where I think it's appropriate to use the word 'despite'. And, as you start to familiarise yourself with the results, the gross profit and operating profit, I think you would join me in saying that this is a very stable business and that's despite fairly tough comparator that we have with Easter shifting by one quarter. Nonetheless, to dig a little bit closer into the net sales, so obviously we're down 0.2%, primarily due to this Easter effect, but recall also that we lost the Coop contract in Q1 last year and it was only by end of March we had exited the stores, and, of course, March was still a pretty strong month with Easter that year. Pick & Mix, as such, was down 11.4%, but then the branded packaged products continued to grow, as Henri said, for the fifth quarter by 0.6%. Now, on the next slide we're going to look at that in a bit more detail, but before we go there, I just want to call out, of course, the forex upside here. So, we did have a 2.8% gain on forex this quarter. Fairly similar to what we had in quarter four and, overall, for last year, which of course, then, brings us back to pretty flat net sales. The flip side of this, and that we will see when we look at the P&L, is of course where we get the benefits of forex on our sales, we have a negative effect on our sales G&A.

So, moving, then, to a little bit of a zoom in on branded and Pick & Mix. So, the packaged products accounted for 73% of our sales in the quarter, and what is worth calling out here, on the very right-hand side – the 0.6% – which then on top of the 2.4% that we grew in quarter one last year which, in turn, was on top of the 1.3% that we grew in the first quarter of 2017, which was the only quarter in 2017 where we had organic growth in the branded business. Now, on the Pick & Mix side, given the Candyking acquisition and the reliance on gaining or losing big contracts rather than winning every day with the consumer, we can't quite make the same comparator. Of course, it's not nice to see an 11.4% drop, but if I'm looking for a silver lining here, at least these bars are approaching towards zero here. So, the reduction is getting smaller and smaller.

So, moving, then, to our profits: If I start with the gross profit, it improved by 6 million versus last year. Obviously, the shortfall in organic growth was offset by the currency translation effect on the sales that then came through. Where we have a stronger ability to influence, though, I think is on the gross margin and it's great to see it's up by 0.4% – largely driven by the favourable mix in the portfolio. Of course, given that the forex impacts both sales and the profit, you don't really get an upside on that in gross margin, so this is really driven by the mix in the portfolio.

On sales and general and admin, you have an increase of 8 million, which is probably similar to what many of you expected with increased spending on advertisement. We have increased the spending, but not as much as we originally envisaged because we were able to utilise the available money better than what we had done before. So, our working media, that which is seen by the consumer is up by 10%, whereas we could then reduce what we're spending on agencies and on production and so forth. Now, the other piece which is very important here, as I mentioned, we get the upside on forex on net sales. And here we see the downside, so it's about 11 million if the hits on this line on account of forex alone. So, our cost saving programme is working well and is delivering, but it gets obscured here by the forex impact. Operating profit: favourable by 2 million. Obviously, the net of the two previous lines, and very much in line with last year.

So, moving over to cash flow. So, we have slightly better cash flow from operating activities before changes in working capital, and here I want to call out that we do have an effect as a result of implementing IFRS 16. It's only about SEK 1 million on the operating profit line, but here we see a shift from this line down towards cash flow from financing activities by 19 million. Towards the back of this deck, in the appendix, there is a summary that highlights all the changes which I think describes it actually better than the official interim report does and I invite you to have a look at that. However, it doesn't really influence our leverage or any other big changes. Now, the working capital in the quarter increased by 50 million. This is driven by increased inventories heading into Easter while we also have increased receivables, largely on account of Norway, and as some of the retailers were holding back purchases towards the end of December. Now, this is offset by favourable payables which have increased, given that we exited with very low payables last year. We then had the big movement, as you can see, the 146 million, as part of cash flow from investing activities. This is the payment for Candyking; so, the earn out. It's the only payment we're doing now; there is no more payment after this, so that is settled.

And, then, cash flow from financing activities: As I mentioned, there is a reallocation on account of IFRS 16, but these are also commercial papers that we entered into, given the fact that at the end of the month we needed to manage the cash, also, for the payment of the dividends, early April. Now, we use commercial papers, because it's actually less costly than using our credit facilities which we still have about 1.2 billion unutilised. So, in conclusion, before I hand back to Henri here, I would say it's a stable financial performance despite a difficult comparator.

Henri de Sauvage-Nolting
So, summarising for those of you who were at the Capital Markets Day on the three main areas: so, again the branded growth, really important because it has the over 14% EBIT contribution to the business. It's 71% of Cloetta; we had 0.6% growth, fifth quarter, it starts to become a trend, for sure, it has all the focus in the company to deliver quarter after quarter growth in our branded business and making our brands stronger. That, and the second bucket is, of course, how do we get Pick & Mix to sustainable value creation. Very important is that we get out of the -60 million loss we made last year in Sweden on Pick & Mix. We have announced price increases. We've taken cost-cutting exercises; assortment rationalisations – that's all in progress. Also, in Norway, we have a new model for Pick & Mix implemented as from Q1, which is able to operate at lower cost which is important, again, for profitability. Candyking UK is going onto the ERP platform of Cloetta which will, also, enable us, then, to create one company in the UK, not only doing the Candyking Pick & Mix business, but also the Cloetta brands in the UK, mainly Chewits and the Jelly Bean Factory will be managed now from the UK with English people knowing the customers better than our export international organisation. And, of course, the insourcing synergy is really important and that is going in line with our plans. And, then, the third bucket is the reducing of the cost and to drive the efficiency up in the factory. The value improvement programme has started. Actually, this afternoon we will see the first results from all the transparency we are getting through Accenture and looking at different cost buckets to look at the kind of savings we are going to make in each of those cost buckets. The cost savings which are coming out of the programme we announced at the end of 2017 are coming through. Of course, exchange rate is not showing that in the external results, but it's good to see the Q1 progress we are making and, then, the 'Perfect Factory', really important to drive the efficiency and the wayside of it, but in particular the efficiency-side, to create more capacity in our factories to also be able to grow more and to insource more. So, a lot of progress over there, as well. And, with that, we open up for questions.

Q&A

Operator

Thank you, sir. Ladies and gentlemen, if you have a question for the speakers, please press 01 on your telephone keypad. Please hold until we have the first question. The first question we have is from the line of Nicklas Skogman from Handelsbanken. Please, go ahead, sir.

Nicklas Skogman
Yes, hello. Thank you for taking the question. Could you say something on the timing of your expected-- the 60 million in losses in Pick & Mix in Sweden; the improvements there over the coming quarters. I think at the Capital Market Day you said it will take 18 to 24 months to remove this, but when do you think we should start seeing the improvement? And, roughly, what rate do you expect?

Henri de Sauvage-Nolting
Yes. The improvements we should start to see as from second half this year, right? With the pricing we are doing, but also the efficiency in the merchandises and some assortment rationalisations. So, of course, that is going to come. It's normal in these situations that you have to – I don't want to say 'educate' – but you have to take your customers and your consumers with you on this journey so it cannot be a big shock. We might lose too much of the business, so it will be several steps we have to take. So, I still stand by the timing that it will take us this year and next year to bring it into black figures. And, that is the plan we're executing right now.

Nicklas Skogman
But do you think it's going to be gradual improvements, or will it be–?

Henri de Sauvage-Nolting
Yes.

Nicklas Skogman
Heavy. 2020 heavy–?

Henri de Sauvage-Nolting
No. It will be steps. So, on the matter of pricing you also have to take consumers with you to a new price point and that is something you better do gradually, not to completely lose them.

Nicklas Skogman
And, do you think you have lost any business in this quarter, because of the announced price increases or tougher terms for your customers? Or, is that–?

Henri de Sauvage-Nolting
Not yet in a big way, but there are some contracts which we have ended which were low or negative margin and no possibility to increase prices also for other reasons we are not able to insource these products. So, there has been a small effect, but it's not the– it doesn't play a major part of the -11% Pick & Mix development in Q1. And, then, how customers are going to take this going forward is speculation; we don't know yet.

Nicklas Skogman
OK, perfect. And was there a negative impact from extra shifts that we saw in Q4 and in Q1, as well?

Henri de Sauvage-Nolting
Yes.

Nicklas Skogman
But it was less than in Q4?

Henri de Sauvage-Nolting

That’s very difficult to say. But, of course, it’s pleasant to see that, in particular on the branded side, that we keep on growing. The growth, also, if you look at the market shares, is very much in candy and on chocolate. And, that means also that there is a volume shift towards the moulded products and, to a certain extent, also, towards some chocolate products. We have the lines. I rather run them more shifts than coming with an investment proposal to build a new line, but, of course, these extra shifts – particularly if they are not planned months and months in advance – then you pay overtime and that is normally a bit more expensive than the regular, let’s say, seven days a week, 24 hours a day shift pattern. But that’s something which we are developing and taking decisions on how we’re going to go forward, also hand-in-hand with the extra drying capacity we have been talking about last time.

Nicklas Skogman
OK, perfect. Thank you very much.

Operator
Thank you. The next question we have is from the line of Nicklas Fhärm from SEB. Please, go ahead, sir.

Nicklas Fhärm
Thanks, operator, and good morning to all. I would just like to ask you– Obviously, now, you’re running a positive like-for-like in the packaged branded goods. This is-- which, by the end of the day, is most of your revenue. Now, going into this quarter, there should be some substantial calendar effects, of course, impacting in a positive way, but without you – because you probably won’t guide us on organic growth with this current trading – but my question is: could you elaborate a little bit on what are the risk for you not to deliver positive organic growth? And, that’s on a basis in this quarter, please.

Henri de Sauvage-Nolting
What quarter do you mean? Q2 or Q1?

Nickla Fährm
Q2.

Henri de Sauvage-Nolting
Q2. Of course, there’s an Easter effect in Q2. I think everybody understands - right? - that last year, Easter was to a large extent in Q1, although the refilling was probably partly in Q2, and now there’s a bit of preselling in Q1, but it’s largely a Q2 effect. That’s very broad, very overall. It doesn’t satisfy the answer that, of course, within Easter, Pick & Mix is very much impacted, mainly in Sweden; also, in the other markets there is some Easter effect, but not as much as in Pick & Mix. Then, there is also, within the categories, there is, of course, a difference, where chocolate is much more Easter-sensitive than, let’s say, candy. And, you know that we have a lot of chocolate business in Sweden, some chocolate business in Norway and Denmark, less so in the other markets. And, then, the third factor you need to take in is the fact that Coop is now out. So, out of the -11%, less than half of it was the Coop effect of last year that we don’t have with us now going forward. So, that is, of course, a positive in the comparator. And, then, of course, there are a lot of other effects that have nothing to do with Easter – of course, we have a good Q1 in Norway due to the abolition of the sugar tax, but, then, we can see in the UK that one of our customers wants to do less promotions because that’s where they think they lose too much money on the promotion, so there’s several other things. And, then, of course, we’re having the previous question – we’re doing serious price increases in Sweden on the Pick & Mix because we want to get rid of the loss-making situation. We’re judging, of course – there is a risk that we might lose some of these negative margin contracts, but we still think this is the right thing to do. But, overall, of course, Q2 with Easter should give us a good lift.

Nicklas Fhärm

Agree. Thank you. That's very clear, Henri. Also, the follow-up question, then, will be– So, in Q1 you had basically zero sales growth, right? From a combination of FX and organic developments while your cost growth adjusted for the small items of a non-recurring nature is up 1.8% year-on-year, which I think reflects good cost-management. But my question is, how should we think about operating leverage now that you're likely – I say – going into quarter with positive organic growth? Should we expect the current cost run rate to be a good proxy for current trading in the rest of 2019? Or, should we expect even positive operating leverage? Could you give us an idea of–?

Henri de Sauvage-Nolting
There's, of course, a few things. The first one, which is really important, is the branded business. The branded business has above average growth margin; also, above average EBIT, as we showed – so, more than 14%. So, every quarter we get positive branded growth. Of course, there are differences between the countries, between the brands, but branded growth is helping us to get a full P&L effect – you could say – from growth to growth margin to EBIT. You also point out that, of course, there is an Easter effect, so Q2 will be more Pick & Mix. And, Pick & Mix is having a lower gross margin, but also a higher cost base because you have the merchandising costs over there. Of course, part of that is fixed, part of that is variable, and we know that, apart from Sweden, we make a margin in the other countries and not in Sweden. So, you have to – when you think about it – you have to balance those two things. Then, we're working on the underlying cost. And, if I strip out – let me say it like that – if I strip out the currency effects, I'm happy to see that our indirect costs, which, of course, are only part of the SG&As, because that is excluding the advertising part, indirect costs are going down in Q1. And, that, of course, is good because we also are embarking on the next programme with the Value Improvement Plus. So, there is traction on that and we want to get more out of that. So, that should also help and, like we put in the report, good cost control has helped us also in Q1. And, of course, that is not something we want to immediately throw out, but, of course, you need to dissect that because, as I already pointed out, if you sell a lot more Pick & Mix, you will also attract more variable merchandising cost, and they are also going into the SG&A line. So, in order to get a real good picture, you need to look at those separately.

Nicklas Fhärm
Yes. But would it be – I appreciate your answer – and would it be a fair conclusion, though, that– because Pick & Mix is also a smaller part of your business, that it doesn't necessarily have to end up as negative operating leverage in Q2. Maybe cost doesn't have to increase as much as sales in Q2.

Henri de Sauvage-Nolting
No. I don't think we should necessarily– It's difficult to answer it like this if we don't have the P&L and your understanding of the total P&L. But, of course, if we sell more, we get more top line, we get more gross margin out of Pick & Mix, but, as you also know, Pick & Mix is not contributing yet a lot to the EBIT level, and Sweden is actually negative; in the other markets it's positive. So, there's also a big relation between how much is Sweden going to grow and how much are we going to grow in the other markets before you're able to really judge the EBIT impact of Pick & Mix. Which brings me back to– it is so damn important to keep on growing the branded business because that's where we make the profit right now.

Nicklas Fhärm
All right. Thanks so much. Final question: Did you say, at any time, how much you actually increased your pricing with, as an average, say, on an annualised basis? What are we talking about?

Henri de Sauvage-Nolting
No. That is something which, for several reasons, is not smart to communicate. Both, I don't want my competitors to know what kind of price increases we are negotiating with our customers, and there's actually also a competition law issue with this because that could be seen as price signalling, right? If I'm telling you and it comes into the– this is a public call and so the competition authorities might

think that by saying a figure that our competitors would then hear that and would think, ‘Oh, well, then we will also follow’, because in those markets where we are market leader that is not allowed.

Nicklas Fhärm
Sure. All right. Thank you so much for your time and taking all of these questions.

Henri de Sauvage-Nolting
You’re more than welcome.

Operator
Thank you. We have a follow-up question from Nicklas Skogman from Handelsbanken. Please go ahead, sir.

Nicklas Skogman
Yes. To follow up: Marketing spend was lower than, maybe, you had planned for in Q1. How do you see that going forward?

Frans Rydén
I think we’ve said previously that we would increase the spend, and, obviously, we will invest behind getting the branded products to continue to grow, but we’re also looking for an opportunity to spend what we have more wisely. So, similar to what we did in Q1 – to increase the working media at the expense, if you will, of the non-working media.

Nicklas Skogman
OK. So, the Q1 level is a fair level for Q2 and Q3, as well, then?

Henri de Sauvage-Nolting
We have a few big launches – I won’t tell you which ones they are – but there’s a few strategic launches coming up in Q2/Q3. And, it is something that we’re looking at all the time, and if we manage to get more working media, then we don’t need to increase the absolute numbers. But, of course, that becomes more and more difficult – let’s say it like that – we will start to look at all our media contracts and renegotiate it, so there’s a bit more scope here and there. Then, when these business cases are being presented, of course, we have attractive business cases which are delivering good gross margin. If we’re growing more high-margin products then we will invest also in absolute terms more in advertising. And, it goes hand-in-hand with the savings programme – that’s also very clear for both the markets – well, for everybody – that we have to find the money ourselves through savings.

Nicklas Skogman
OK. Thank you. And, one on inventory: Are you happy with the levels and the status of the inventory?

Frans Rydén
If you’re thinking on the cash side, obviously, we have some unfavourable working capital on account of increased inventories, but that’s to be expected as we’re heading into Easter. Of course, I would say, I would be very happy if we could have some more candy inventories because we’re constrained.

Nicklas Skogman
OK, great. Thank you.

Operator
Thank you, Nicklas. The next question we have is from Mikael Löfdahl from Carnegie. Please, go ahead, sir.

Mikael Löfdahl
Yes. Hi. I was just wondering on Candyking and the synergies. If, now that you have summarised 2018 and also now you have the plan of further investments to achieve the last half of the synergies that you communicated earlier. But is it possible to say something more on: first, 2018, how the synergies actually came through in 2018, how much was actually already in place in the first half versus the second half, and how much impacted the gross margin versus the EBIT margin? And, going forward then, the second half – if you could say something more on the timing, now that you have put the investment plans into realisation?

Frans Rydén
Maybe just on the Candyking synergies: we have shared that number also during the Capital Market Day, that's cumulative 2018, we're at 55 million out of the 100. And, then, we're looking to getting up towards 80 this year, and, obviously, that also requires some of the further insourcing. It's most of what we've been able to do on the sales and G&A we have – there's still a few pockets where we can do a bit more, but 55, end of last year, and going for 80 this year.

Mikael Löfdahl
Yes. But the 55, how much of that impacted the gross margin versus the EBIT margin?

Frans Rydén
I don't actually have–

Henri de Sauvage-Nolting
The majority is the insourcing, which of course is in the gross margin. I think we've said 60/40 or 70/30-ish on that–

Jacob Broberg
No, but yes. Our only focus has been to communicate EBIT uplift 100 million, we have never split that into gross margin or something else.

Henri de Sauvage-Nolting
But the majority is from the insourcing.

Jacob Broberg
The majority is insourcing. Absolutely.

Mikael Löfdahl
Yes. But I think you communicated earlier, or last year, that the first synergies were more on the SG&A side. And, then, the insourcing takes some time, obviously. First, you had to end the contracts with other sub-suppliers, and, then, now, obviously, you have more capacity. So, my question is, again, the remaining part then, going from 55 to 100, I guess that will show in the gross margin, and what we saw in 2018 perhaps was more on the SG&A side?

Henri de Sauvage-Nolting
Yes, that's right. There's a little bit more to do on the UK and a few further SG&A indirect, but not so much. And, the majority is the insourcing. You are right.

Frans Rydén
Just one thing to add to that, if I may, Mikael. We had part of the savings that we achieved up until end of last year was also insourcing. We've shared some numbers on this in the Capital Market Day. Because, obviously, we went ahead and insourced pending the new capacity, using existing, available capacity. So, there's already insourcing outside in the P&L today.

Mikael Löfdahl
OK. And, in terms of the investments that you will be doing now. The 100 million, when will that start to show in CapEx?

Frans Rydén
Yes, 2020. There will be something maybe towards the end of this year already.

Mikael Löfdahl
OK. And, to further specify, then, the remaining synergies of the remaining 45. You say 80, 2019, and 100, 2020. But is that a run rate? So, you will be up on the run rate in 2019, and by the end of 2020 you will have the run rate of 100? Or, will it be for the full year?

Frans Rydén
No. Run rate. The 2018 number is cumulative. Then, we talk about the run rate.

Mikael Löfdahl
OK. So, maybe we shouldn't expect too much in the next couple of quarters, then, until you have built this new capacity?

Frans Rydén
And, what makes it a bit tricky as well is, obviously, because when packaged products are doing very well, we also have to consider what we should insource, and at what point. So, obviously, we're always going to make a decision which is best overall for the company, but it could be possible that we will allow our available capacity to manufacture for the branded business instead of insourcing something, if that's more beneficial. So, that could change the timing a little bit on that.

Mikael Löfdahl
OK. Thanks. The other question from me is regarding Easter and if you could say anything about the Easter period, now occurring, obviously, in Q2. And, first of all, and I know it's mostly a Swedish thing, but in Norway with the sugar taxes coming back to 2017 level and– has there been any promotions and so on in Norway, now, which was not the case last year? And, in Sweden has there been a normal Easter impact?

Henri de Sauvage-Nolting
Yes, I would say so. In Norway, of course, there are a number of factors. The first one, of course, was that, with the sugar tax abolition, customers stopped buying in December and, then, started buying again in January. So, of course, that's a positive effect for Q1. And, then, we can also see that our new set-up for Pick & Mix, our two main elements over there is the consumer price and the way we communicate that, but also the fact that we're back with, call it secondary display units, that has a very positive impact on the Pick & Mix sales. The customers so far are not price promoting, so that is not back like it was in 2017, but I think we've adopted well to that situation by still communicating price in a good way and with those extra display balance. Then in Sweden, Easter is – Easter is Easter, I would say. And, it's a big season for Pick & Mix.

Mikael Löfdahl
OK. Thank you.

Operator
Thank you, sir. As a reminder, ladies and gentlemen, if you wish to ask a question, please press 01 on your telephone keypad. As a final reminder, ladies and gentlemen, if you wish to ask a question, please press zero then one on your telephone keypad. At this time, we have no further questions in the queue. I'd like to hand back to the speakers for any closing comments.

Jacob Broberg
Thank you very much for listening in on this call and speak to you next time. Have a good afternoon and weekend. Thank you and good bye.

Operator
Thank you, ladies and gentlemen. That concludes the call for today. We thank you for joining and ask that you disconnect your lines. Have a great day ahead.