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Presentation

Nathalie Redmo
Good morning and welcome to the Q4 conference call for Cloetta. My name is Nathalie Redmo and I am the new Head of Investor Relations since beginning of January this year and I will be your main point of contact here at Cloetta going forward. With me here today are Henri de Sauvage, CEO, and Frans Ryden, CFO of Cloetta. Henri and Frans will take you through our fourth quarter results sales and we will then move on to a Q&A session. And I will now hand over to Henri.

Henri de Sauvage
Good. Thank you, Natalie. Very happy to have you on board and being in contact with all our analysts. Looking at the Q4 results. Starting off, I'm happy with the result; in particular, the eighth quarter of branded growth which is really good and also that we see progress on the pick & mix business in particular in Sweden on the profits, that we continue our journey with the costs going down and our investment in the brands going up and our efficiencies in the factories also improving.
If we do look at the outcome, we can see that the organic growth was 2.6% and it was not that many quarters or years ago that this was the really number one problem for Cloetta, so it's good to see that we are now delivering another quarter of growth. Also, the operating profit is going up and then the adjusted operating profit at SEK 209 is I think a good achievement in the quarter. Profit for the period at 172.
Cash flow, Frans will go a bit more into the detail, at 318 and the net debt EBITDA at 2.2, I think is also going in the right direction and well below our target of 2.5. And then we have a proposed dividend of SEK 1, which was discussed yesterday in the board of directors, and they also decided that we will not go outside of our policy to have a dividend which lies between 40% and 60% and that's why we come to the SEK 1 again.
If we then look a little bit more into the markets, as already said, organic growth at 2.6%. For the full year, the 2.3% is really based in the European context that we are getting organic growth and we will unpeel that a little bit more in the next slides. It was all due to the branded growth in this quarter, 3.6%, which of course also helps us with mix and is also a good signal that our branded agenda is starting to pay off. On pick & mix we are flat. Growth in most of the markets, but in Sweden we lost a bit of volume mainly due to the pricing, which we need to do in order to get into a profitable situation at the end of this year. We can see from Nielsen that there is growth in the package confectionery market, even though Nielsen is only measuring a limited amount, about half I would guess, of the business and pick and pick & mix also grew in most of the markets, or was stable.
And then we can see that we are growing market shares again in Nielsen in four out of the 16 categories. That is not good enough, but of course, we need to remember again that Nielsen is not measuring the big out-of-home market before impulse is very important also that we are focusing very much on making our big brands stronger or bigger and we are also deliberately then letting some

smaller less profitable or unprofitable positions slip and then there's a lot of category dynamics as well, where we might play. If we would take a Swedish example, the Kexchoklad we play in that segment is then premium, bar chocs is growing a lot; that doesn't mean that cakes is not growing or winning share in the segment of count lines, but that the total market is growing faster. So I think it's mostly important that we focus on the key brands and get them stronger.

If we then look at the strategy and what are we doing over there. What is the update on the strategy.. The focus on brands and customers is of course very important, so brands keep on growing. The marketing visible to consumers; we're now on the 60%, so 60% of the investment are actually being seen by the consumer, so that is a big step up. I mean, it was only like one-and-a-half years ago where it was only 40%. So that of course is helping. Fewer but bigger: We can also see that our bigger brands are growing much faster than the average of Cloetta, so that also starts to pay to pay off. We can see pick & mix in most of the countries really growing. That is very positive and in Sweden we also see a step up, a real step up, in profitability towards the goal, which we have set ourselves, that we want to be at breakeven at the end of Q4 2020.

And one of the things we're doing is we're relaunching the Candyking brands. Extensive work has been going in in the last 12 months to really understand consumer and shopper behaviour and how we can make Candyking differentiated versus all the other offers and also being able, then, to demand a price premium towards consumers and then ultimately as well customers. And that is going to be rolled out so that's also very interesting to follow for us.

On the facilitate growth, with the perfect factory programme. Remember that it is to increase the efficiencies of our line, so how many hours are they producing without stopping and also waste. How much raw material waste do we have. That is going well. Eleven out of the 17 most important lines for Cloetta are now being touched by the programme. That means that we have started over there; it doesn't mean that the programme is finished. It will be a multi-year journey. We can see efficiencies going up. So it's also very good to see them. Of course, sometimes you see the other bottlenecks starting to pop up and we need to address those but that's part of the programme and also very pleased to see that quality is improving – so the way we measure quality. We can see that we're producing better quality and that of course is also very important because that is ultimately why we are here, right? It's the millisecond when people are putting the piece of candy or chocolate into their mouth.

We're also working hard on taking out complexities on the global IT solutions. We are implementing in Q4, the first marketing sales organisation on the new planning tool. It's a planning tool which will go end to end. So from the demand planning in the markets all the way down to the production planning in the factories. It will replace three existing systems, which are not communicating very well with each other, so we always have a lack of information. So three will go out and then we'll replace it with one new and over the year we will start to implement that in all factories and all the marketing sales units.

And also in Germany, we're now working on getting our enterprise system installed and if that is finished mid-year 2020, then all the units will be on the same ERP platform, which will greatly facilitate, of course, further synergies. And as you also could have read, we have signed a media agreement for total Cloetta with one company rather than each country doing it on their own. One company helping us both in negotiations, so that we get better bang for our bucks, but also to get a much better professionalism in media and I don't think I need to tell you how quickly the media landscape is changing and how important it is to plan media in the right way if you want to get your message on your brand across to consumers.

Then when we want to invest either in brands or in our factories, we will need to find that money, the value improvement programme to find cost is really going very well. Also, the Q4 results are proving that we are able, step by step, to address our underlying indirect cost. There's not a reorganisation taking place, and we take that step by step over the years we have taken to deliver that.

And on pick & mix Sweden, very important, and its continued pricing. We did a lot of pricing last year due to forex and raw materials, but also to get to a better profitability on the pick & mix business in Sweden. And now, also in the beginning of this year, we have announced further price increases, not only on the concept but also on the bulk sales we sell to other parties who are buying pick & mix articles for us because we need to get out of that lossmaking situation in Sweden and we are also then willing to jeopardise a bit of volume by taking the right pricing measures needed to bring it back into black. I don't see any other way to do that.

Also on the merchandising we have further cost initiatives and then we're going to move from two warehouses and pick & mix to one. So in the end, we will have one warehouse for the Scandic region, which will do both the pick & mix and the branded products which will deliver us again lower cost, but also less complexity, less stock. So there's a lot of benefits coming in from that.

So having said that, I hand over to Frans who will take us a bit more on the sales and profit. Frans?

Frans Ryden

Thank you, Henri. So as usual, I will start with net sales and as we close 2019, as Henri mentioned, we are really happy to report a full year of organic growth of 2.3%, which is ahead of our target to grow 1% to 2% per year. And coincidentally, on a full year basis, organic growth in the branded business was also 2.3% and for pick & mix it was 2.3%. So not only strong but also easy to remember. Now, including forex, full year reported top line grew 4.4%, including then the impact from mainly the weaker Swedish krona.

And looking at Q4 specifically, we continue to deliver strong growth in the quarter with organic growth at 2.6%, so above the full year average. And with that in mind, let's look closer at quarterly phasing.

So our branded business grew, as I mentioned, 3.6%. That makes Q4 our eighth consecutive quarter of year-on-year organic growth. And as you see at the top right, in Q3 this year we also grew 3.6%, which at the time had been our strongest growth to date. And it's great to see we were able to match that in Q4, but please don't mark this as a new normal. You know that in Q3 growth was very strong, including on the back of a step up in marketing support, which we detailed in our press release and we also discussed it previously. And in Q4 we did benefit from a soft Q4 2018 in Norway when retailers had held back orders, waiting for sugar taxes to normalise at the beginning of 2019, but also from a very strong finish in Sweden and in Germany. And as an example, Germany, retailers put in early orders in December as they anticipated the price increases that we had announced would be effective from January 2020. Now that said, overall we are very pleased with this quarter of branded growth.

Meanwhile, at the lower half of this slide in the pick & mix business. As you know, it was back to growth since Q2 2019. And as mentioned, we ended the year at growth, but we were flat for the quarter after a very strong Q3. And while we don't disclose growth rates by country, holding to prior year NSV in pick & mix is despite a volume and sales decline in Sweden following the price increases that Henri mentioned.

And here I would actually like to pause little bit and reiterate what we've said since the start of last year, which is that we’re willing to walk away from unprofitable volumes as we turn around the lossmaking pick & mix business in Sweden.

Also, since July 2019, we have now taken pricing on the full pick & mix business in Sweden and with most recent price increases having been announced actually last week and coming into effect in quarter two. That said, we are taking pricing to increase in commodities and weakening Swedish krona as well as to turn around the loss and we will have to continue to take more pricing in 2020, also at the risk of continued volume losses. However, as also previously shared and as Henri mentioned when he went through the strategy slide, pricing is not the only lever to turn around the losses; we’re also taking action on assortment, on merchandising cost and in the supply chain. So price increases alone is not sufficient and we are in no way expecting our customers to somehow carry the burden on their own; only that we build a business which is profitable for growth and thereby sustainable.

Now, as I said, pick & mix is flat, so despite the volume loss in Sweden, in total across other markets, pick & mix is continuing to grow and across all of Cloetta, Sweden included, we'll continue to build a great consumer-focused business in pick & mix and we look forward to sharing more about that going forward.

Now, looking then at the profit and loss gross profit in quarter four improved by 43 million versus last year, driven by the strong sales including pricing as well as favourable mix with the branded business growing faster than pick & mix and as the gross profit was up, gross margins also improved in quarter four by almost a full per cent and this margin improvement is driven by the pricing, favourable product mix, but partially offset by higher conversion costs and negative forex. As always, the currency that helps boost our NSV growth in the quarter from 2.6% to 4.6% reported hurts us on the margins.

Now, full year gross profit is favorable by 97 million, while gross margins, which we reported were down quarter three year to date ends the year pretty much flat. And these margins are flat on a full year basis as the margins from sales growth is primarily driven by volume and favourable mix than within branded products. And full year pricing is offset by higher costs, including the unstable forex that we mentioned.

For sales, general and admin: As previously, I will show you separate slides on this to make it clearer that excluding the impacts of items affecting comparability in the forex, SG&A is flat for the quarter and full year, as the cost savings that we are delivering or offsetting investments required to drive the growth. Key point on this slide though, is that full year and even more so for quarter four, spend, as the per cent of NSV, is down versus last year.

But before we go to the SG&A details, the last point on this slide: operating profit adjusted up 42 million versus 2018 in the quarter, and year to date up 66 million. And the result in both quarter four and the full year is really driven, again, primarily by the strong sales and favourable mix and it's pretty much flowing through to the bottom line.

We're also pleased to report that this improved operating profits, adjusted, also converts to improved operating profit margin as a per cent of NSV. So full year we're up half a point to 11.4%. And if you recall, after the acquisition of Candyking, our margin had dropped 10.4%. We brought that up to 10.9% in 2018 and now to 11.4.

If you look at quarter 4, that's usually our strongest quarter, largely because of more profitable seasonal sales and you can also see that here, with a margin of 12.5%, that is improved by 1.9% versus last year.

Moving then to the details of sales and general and admin, and you see that there at the top, the reduction as a per cent of NSV both for the quarter and full year. You can also see that in quarter four we have big item affecting comparability and what that is, being a green column here, is that we have a lot less such items in Q4 this year than in Q4 last year, when of course the Candyking integration was still ongoing.

And the following is quite important. Also when I strip out those items, both for the quarter and the full year, SG&A as a per cent of NSV is still significantly down. Other than that, both for the quarter and the full year, you can see that forex, the translation of costs that we incur in European countries to Swedish krona, is really the only driver of the increase in SG&A. And for completeness, this forex number is not official IFRS, but it's our best estimate as we have done before.

At the end of today, our programme for cost efficiencies is delivering and is able to offset all the investments that we're doing. Whether that is in marketing spend or the organisation for ecommerce or the organisation to expand in the international business, salary increases to employees – all other ins and outs. And we mentioned here cost efficiencies as an example, key changes that we did in restructuring Norway and Sweden affecting this year and also now in Holland, where we increased our strong sales capabilities as customers demanded that, while reducing our field sales force and thereby we could deliver both savings and effectiveness.

So I would then move to the cash flow. And for the quarter we are delivering, if I guide you to the bottom left of this slide, a stable 269 million in free cash flow and that's against an EBIT from the prior pages of 209 million. So it's a stable delivery, also versus the 240 million that we had in quarter four 2018. And this variance is on account of the operating profit that we see coming through at higher cash flow before changes in working capital. It includes a favourability from IFRS 16 reclassification. It's offset by somewhat softer improvement of working capital this year than in quarter four last year, while capex, as you see, remains in line there at 49 million this quarter versus 48 million quarter four last year. Likewise, for the full year, free cash flow of 538 million is improved versus 2018. Also factoring in IFRS 16 impact. And similar to quarter four, this is driven by the strong operating profit offset by higher working capital investment while capex investments remains largely the same.

And on working capital: the reduction in Q4 versus Q3 of 64 million follows the same trends as in quarter four and that's after the sell-in of seasonal sales, inventories receivables and tables usually will come down a bit by end of Q4. In 2018 that was, as you saw, 74 million.
Also, in the full year under other investing activities, the 144 million, just to remind you, was for the final settlement of the earnout consideration for Candyking. And on cash flow from financing activities in the quarter, 18 million is due to IFRS 16 reclassification, whereas on the full year, of course, there is IFRS 16 reclassification there as well, but I think that the most interesting part is the SEK 1 dividend that we paid in 2019, which was up from 75 öre in 2018.
And on that positive note on dividend, I hand back to Henri.

Henri de Sauvage
So we go to a bit of a summary, which is maybe boringly consistent, but if we want to get to the 14% there are three important areas. The first one, of course, is to keep growing with our brands that have a margin on average, which is already at the 14%. So how do we do that? More marketing visible to consumers; we continue with that. The media agency is very good to bring our fixed costs down and use that money again towards the consumers. But also, we should not forget about the pricing because there's a lot of raw material cost going up: sugar prices, cocoa prices, and a few other ones; gelatine. And we have the Swedish krona. Of course, we continuously need to cover for the weakness of that. So there's a lot of pricing coming towards us and, of course, we cannot predict what's going to happen, but there is of course an underlying volume risk both in the negotiations with the customers as well as with the consumer behaviour. So that’s still number one.
Number two is then pick & mix. We have set ourselves a stiff target to turn around this minus 60 million from 2018 into neutral, and of course, the fact that both the forex and the raw materials are also going in the wrong direction means that we need to do even more pricing than we were thinking when we had the capital markets day. That’s now all in execution and that is, of course, a big task and, again, we are dealing with that with our customers. That is a price negotiation, which is going on at the moment. At the same time, we are coming with a good relaunch of the brand. We will also then invest in the brand, making it also more attractive to customers to work with Cloetta. And also, we are addressing the pricing on our bulk articles. So the articles from the Cloetta portfolio we are selling to other pick & mix suppliers in the Swedish market.
And then last, but not least, is the cost and efficiencies. We talked about the value improvement of five lines. We did quite some increase on capacity through opening hours, but also through capex; the drying chamber project in our two moulding sites is on time, so that will come into operation towards the end of quarter two. That is very good because of the lines are getting more efficient, more outputs and then we need to reduce the bottleneck in the drying. And we have also now a much better view on our capacity and capacity constraints on the top lines within Cloetta and a good five-year road map on how to address some of these capacity constraints, either through the perfect factory focusing on getting higher efficiencies or taking out or replacing, let's call it obsolete equipment and investing in higher speed, modern lower cost machines.
Then, of course, we are in the business of candy and in the end the money comes in when consumers are buying our products in the shelf and paying our customers who are paying us. So I always like to focus on where the money is coming into Cloetta. So a few seasonal highlights on the left, you can see fantastic execution of pick & mix during Halloween where we had less trick, more treat with a lot of Halloween activity and that's one of the examples where we as Cloetta, I think, can make a difference because we can execute it across all the markets, where we are; so use our scale, use the consumer insights, which we are developing, building and utilising and then also helping our customers with consumer behaviour to be more successful on pick & mix. But what we also quite often see is pick & mix can be one of those categories where consumers, in particular on Friday and Saturday, take a decision on which store to go to because they like the pick & mix over there – so very important. Also, the so-called Juleskum, so that is a big seasonal article in Sweden, we have increased the capacity or the opening hours of producing that and was very nice to see that we sold even more this year than last year. It’s a really good product for us.

And then the exclusive, or the one year only, which is the Polka, there on the right, was also very positively received and very positive sales figures. So that is really, really good. We're now translating this into an Easter-skum, so Påskeskum, also being rolled out over the Scandic markets to capture more in this important segment. So very, very positive, I must say.
And then, we also did a really good campaign in Sweden with something called Mustasch Kampen – so that's the Prostate Cancer Association and we donated in the end, something like two SEK 200,00 to SEK 300,000 to them, based on the sales of the Mustascher, as you can see again, a very nice liquorice foam product and very well received both internally, but of course, also externally with customers, and I think that's also the way to go, to give your brands a purpose, within the category.
And then on right – it's not something we talk that much about – but at the international division, and we have very good sales of RedBand in the Middle East. We have not touched those products for many, many years and now with the establishment of a separate division under the leadership of a very experienced international guy, we built up a whole team over there, also with both marketing and sales people and we start to address and rejuvenate our product portfolio. So these are boxes – a bit like Läkerol – but a bit cheaper, tuck-in boxes and we're launching at the moment very popular SKUs, a product format under RedBand in those regions.
Polar and Gummy Bear is next to the portfolio we already have and make it really look modern, one range, ability to raise prices, but of course, also sales. So I think that's very nice to see that also that division starts to deliver on the ambition to double it and build another strong leg under Cloetta with good growth potential.
And I think that was it for presentation and now we open up for questions.

Q&A

Operator
Thank you. Ladies and gentlemen, if you do wish to ask a question please press 01 on your telephone keypad. If you wish to withdraw your question you may do so by pressing 02 to cancel. Once again that is 01 on your telephone keypad.
Our first question comes from the line of Nicklas Skogman from Handelsbanken. Please go ahead. The line is open.

Nicklas Skogman
Yes, hi. I'm trying to reconcile your strong organic growth in the packaged business with the market share development. So obviously you mentioned that Nielsen doesn't cover the whole market, but I was thinking Nielsen is also measuring market shares in the retail segment and you mentioned that you had seen some pre-buying ahead of your upcoming price increases. Is that explaining some of the difference as well?

Henri de Sauvage
Yeah, it could be some of the difference, I mean, it is not huge but of course it – we can see, as Frans mentioned, we can see in Norway the fact that we had the sugar tax going back to the previous levels last year, so that meant that in December 2018 customers stopped buying and then they bought a lot more in January and now it was normal, so we had better sales in December and that, of course, will come back then as a negative in 2020 in the first quarter, but we know that so we're planning against it and trying to compensate for that.
We have in Germany, which is actually our number one market if you look at RedBand as a brand position in Germany is the biggest brand in a country. So if you were to compare, let's say, let say, Gott & Blandat Sweden, we're not making enough profit over there. We have cost price also going up with sugar and gelatine. So we're taking quite a big price increase in Germany to cover for that and we could see that some customers were buying earlier in December. And that will also have an effect and then it is always the question during the year end, are customers going to buy the promotions from January in January, or are they going to buy them in December. And there were a few of that as well,

but it doesn't explain the growth. And you can also see that in the consistency if you look at the underlying quarters. It is quarter after quarter that we're going up.
Then, I really like to report market shares, also because it helps me, internally, to put people on the notion that in the end, it is not about scoring goals, it's about who is winning the match. But there's always a danger in understanding the underlying drivers in market shares because in the end it's the sales out from store, as I talked about the cakes example, but we are also looking, when we're looking at mix, we're trying to sell more expensive products and less of the bulk articles. Of course, we have a price towards the customers and they determine the price to consumer and if we reduce the amount of promotions, like we are doing in certain markets, we reduce promotions or make them more affective, that means that we are selling more bass volume; so more regular volume out from shelves and why do we do that? Because we earn more money on that because when we invest more in media, we get more baseline volume. That could be that we then lose a bit of market share, but actually our NSV, or our turnover, is going up because each unit we sell is then not at promotion conditions but at full price. So there's a lot of details in there.
Nevertheless, we are working hard, in particular on our big brands getting into market share growth because that is important because it would make the big brands bigger. It helps us with our EBIT journey, but it also helps us with our complexity reduction journey we are taking. So it's a bit of a mixed bag, I would say, in the market shares. It has our full attention and it also needs, logically, it needs to go up that we get more categories growing – like we had in the beginning of last year.

Nicklas Skogman
So I guess the competitors have become a bit more on the ball, so to speak. So what are they doing to claw back market share? Are they increasing their promotions?

Henri de Sauvage
Yes, so it's again a bit of a mixed bag. We can see in Denmark, I think we we're also quite open about that at the beginning of last year, one of our bigger competitors had a conflict with one or two of the major customers, so they did not get promotions, they got limited assortment. They were out for a year and now they're back in that retailer and then I see the whole market is growing and Cloetta took a lot of market shares when they were absent and now we can see that our market share over there is going back, although we are still higher than before, when they were out. So that's a good example that we can see in other countries that we have been extremely successful with our candy brands and we can see reactions, either they come with copies, and we can see that also in Sweden, for example, that other competitors are coming with copies of things we have launched very successfully. But hey, that is competition right, I mean, we need to be on our toes. We need to expect that; we need to plan for that. That's the whole commercial focus, which we're trying to bring into Cloetta. That in the end it's about brands and customers and that is where the money comes in, and that's how we improve the profitability of the company. And we have good plans and I'm confident that we'll get more categories, and in particular, more of our bigger brands into share growth. We have good programmes, good analytic tools for that, so that will happen.

Nicklas Skogman
Are you able to provide a number on the estimated impact from the pre-buying on organic growth for packaged?

Frans Ryden
What I would say is that even if we took away – and, again, we shouldn't exaggerate the pre-buying – but even if we took that out, let's say, in Germany and elsewhere where we saw there was a strong push, we would still be growing the branded business well above our targets of up to 2%. So it's still a very strong quarter. Maybe what I would add to what Henri said, just to help you with that reconciliation, it's a very specific example. So the early purchase is happening in Germany, on account of retailers wanting to avoid the price increase, in Germany our focus is on improving the profitability of this RedBand. So when we talk about 16 country category combinations that we track for share

purposes, we're not looking primarily to grow the share in Germany. So it's not one of the 16. There, the focus is on rebuilding profitability and I'd be happy to keep the revenue where they are if profitability went up significantly.
So there will be a disconnect—

Henri de Sauvage
Actually, we don't buy the Nielsen shares in Germany, just to clarify, for cost reasons because it's expensive and we think we can do without them for the time being, so we report the categories and the countries where we are buying their data. And that's big and small and it's mainly the Scandinavian, Dutch and Finnish markets and then the categories where we operate in. Also smaller categories like nuts are in there, even though the nuts business is not so big.

Nicklas Skogman
OK, thank you. My last question would be on the 60 million profit improvement target for pick & mix. Where are you roughly now at the end of Q4?

Frans Ryden
We are where we basically, in the positioning we are where we have been before, which is that we want to make sure that that business breaks even by end of 2020. And it's going to require both pricing as well as improvement on merchandising and assortments and the supply chain, but also, as Henri mentioned, a lot of the pricing that we've taken this year is not only because of profitability, but it's also to offset increasing commodity costs and the weakening forex.
So I would say, in terms of our commitment, it is unchanged and exactly how far we've progressed, that's not something that we want to—

Henri de Sauvage
–not in the middle of the price negotiations we have with our customers on multiple levels. That I don't think is good.

Nicklas Skogman
OK, thank you very much.

Operator
Thank you. Once again as a reminder if we do have any more questions it's 01 on your telephone keypad.
And the next question comes from the line of Mikael Löfdahl from Carnegie. Please go ahead. Your line is open.

Mikael Löfdahl
Yes, thank you. So first on the pick & mix side and in Sweden, you are mentioning some lost volumes, or reduced volumes, because of the price hikes. Is this that existing customers are buying less from you and more from potentially others or is it lost contracts? And if it's lost contracts, is there any big ones that we should be aware of?

Henri de Sauvage
So what is predominantly – if you think about the Swedish business, there is basically three types of contracts, you could say, or three types of segments. One is with a retailer who has contracts on an individual store basis. So where we have contracts on an individual store or group of stores basis, then there are contracts which are central, where then one customer makes a contract with Cloetta centrally for all their stores – that's number two. And the third one are then what we call the bulk sales. I think we should try to find a better word for that, but that is where Cloetta sells items to pick & mix players in the market and that can be direct competitors, but also our customers, again, like Coop, who are doing this themselves, as you know.

We have been touching prices on all of them and where we have lost so far is in the individual store segment and a little bit on the bulk sales. We are now addressing again in 2020 all three of those areas because raw materials are going up and forex is going down and there's also renegotiations happening on the central contracts. And that is all happening in the first two quarters of this year.
But I think the question is valid because we were making SEK 16 million loss and we cannot continue with that. And if we are having contracts central or on a store basis which are not profitable, and reminded we're not only selling Cloetta products, we're also selling third-party products or other people's brands. I cannot justify towards the owners of this company that we're buying products from other candy manufacturers and then we're selling them at a loss. You could argue that for our own products, we are having also benefits, of course, in the supply chain, having the scale. But that we have to turn around even if that would mean we would lose a contract or we would lose a number of stores.

Mikael Löfdahl
In terms of, again, on the process here of reaching break even in Sweden, we know that roughly half of the volumes were renegotiated already ahead of Q3, in terms of prices and then the rest is now more or less complete. But the other measures, also the assortment optimisation and so on – where are you and how much of any positive effects did we see in Q4 and when should we expect sort of a full effect?

Henri de Sauvage
Of course, I think, the most important thing: We have a plan, a well thought through plan to bring us to break even at the end of this year. It's not an easy plan, let me say that, maybe it is not an easy plan. Then, is the plan linear? No, it's not completely linear, but it's not banking that everything will be done in 2020. So we've seen very good progress already in 2019 on our journey towards break even at the end of 2020.
The bulk of the problems is lying in the pricing, but also of course, our internal cost, be it warehouse, be it merchandising, be it organisation, are being addressed. The current plan will bring us to a break even at the end of this year. But then also, of course, it is a bit 'all other things being equal'. Because if the Swedish krona would suddenly weaken again significantly or raw material prices would explode even more than what we know at the moment, then of course, some of that progress is going to be eaten up by other external factors and then we would need to plan another price increase to compensate for raw material and forex. But given the facts we know, given the plans we have now, we will be at breakeven at the end of this year and I can only add that I'm pleased with the progress we made in 2019.

Mikael Löfdahl
Yeah. I was just trying to figure out what more – when you say by the end of the year it feels like some of the measures you're doing now will take a while and I'm trying to figure out what is it that will take two/three quarters to implement and what has already been implemented?

Henri de Sauvage
Of course, when you announce a price increase, it is at least three months to implement that, right? So if we said we've been just now announcing price increases, that round of price increases will come to the books, you could say, in Q2. And we talked about the warehouse move that will also happen in Q2. So before that is all settled and we have aligned systems and organisation, results of that will start to come into place in Q3.
Then on the merchandising efficiency, there will be things happening throughout the year to make routes better and also of course, when contracts are clear we can see how do we then get the efficiency going. I also talked about the relaunch of the Candyking brand, which will then add more value to the pick & mix category. That is something we will do in the middle of this year and that will also have an impact on price.
So there's – because you work with customers and you work also with consumers, it's not like one big bang where it's OK, in January, we just 'bang!' we blow everything out of the water and change

pricing and then a month later it is done. No, it's continuous work and from a consumer and customer perspective there's a logical sequence in how we do this to both get to black, but also not lose the total business. And that's why we plan it like we plan it and why we say very committed at the end of this year, we will be at breakeven.

Mikael Löfdahl
On FX, could you please just update us on what is the lag from purchases to sales in terms of the FX movements, if you just look on year-on-year or quarter-on-quarter FX movements. When will that translate into better gross margins all else equal?

Henri de Sauvage
So the way we work – and it's a bit different market by market. So let's say in the middle European countries, so we take UK, Holland, Germany, you more or less always have a yearly agreement. So once a year you negotiate price and you take everything into account. Those are the euro countries, you could say, apart of course from the UK, and there it is more like once a year the price negotiations are taking place. And if you look in these Scandinavian and Finnish markets it's happening more often. There is a genuine willingness of the trade to listen to the forex, but not on a spot market move. So you first need to basically have a new forex exchange rate for, let's say at least two months, before you can arguably go to the trader and say I have a price increase because forex has moved in the wrong direction. And then there is in all these markets a three month negotiation period. So you could say there's always a five month delay when the krona would suddenly weaken or the Danish krona, the Norwegian krona. It's two months to see OK, is it a spot price or does it stay at this new weaker level two months, and then we go out with the price increase and it takes then three months to negotiate that. So that also with the weakening of the SEK last year, that is also why it takes us a bit more time to get that out in our prices towards the customers.

Mikael Löfdahl
OK, so it is about a quarter or two from FX rates?

Henri de Sauvage
Yes. And that is the simple answer. Of course, then there are also all sorts of considerations because the currency goes up and it also can go down of course. So what is the right timing for us then to go out. And we always work with an average of course, and like just last week it went up to this exchange rate, and now we want to move. So it is a constant parameter in the business and I would also say that we're quite on our toes on that. It's something which in every business review we have with the markets and every monthly performance call, it is there and people have good information and good ways to put this pricing out in the market.

Mikael Lövfahl
Another question on SG&A and on marketing. First of all, marketing in Q4, there's a lot of competition for advertising space and so on, so I guess it's not that clever maybe to launch campaigns in Q4. You did step up last year with marketing, but I guess in Q4 you did less marketing and that is one explanation for SG&A being basically flat year-on-year and definitely down in percentage of sales. Is that a reasonable explanation?

Frans Ryden
Yeah. I would say marketing is not the driver of SG&A as you said. We did step up and we had already improved the ratio between working and non-working in Q4 last year. Actually, maybe anecdotally, but if you recall at the capital markets day, we said that this year we wanted to get on a full year basis to that 60% of the spend would be on the working, so seen by the consumers and 40 non-working, which was a reversal versus what we used to do and actually now when we closed Q4, we've hit that number on a full year basis. But yes, we did not step up any spending Q4.

Mikael Löfdahl
So, if anything, the year-on-year SG&A drop as a percentage of sales that we saw in Q4, maybe it's not representative for the coming two quarters or so where you will probably step up marketing again?

Frans Ryden
Yes. Again, depending on the quarter, and also a little bit coming back to the share discussion, we have implemented over this year, or over the last year, also a process to really dig into the share and the variances and depending on what action we need to take that could be of course, it could be packaging format, but it could also be that we're under-spending. So we will use that as one of the tools in the toolkit.

Henri de Sauvage
But of course, we continue with our VIP journey to look at cost savings and that's also pleased to see that we have really concrete plans to deliver the cost savings we have set ourselves in order to be able to pay for these investments. So it's just not only a target, it is also concrete plants and actions on how to take those cost out from the business.

Mikael Löfdahl
And another question on the marketing. The big campaign or relaunch of Läkerol that you had in Q3, what are the effects from that? Was it – I guess initially you have an immediate effect from it but has it been in more long lived and has it been as expected and successful?

Henri de Sauvage
Yes, it depends a little bit by market. First of all, of course, if you do a media campaign there is a short-term effect, I agree with you. But you don't do it for the short-term effect; you do it for the long- or mid-term effect because you want to build a stronger brand. So one burst is not enough and that's why we will continue with the Läkerol campaigns and positioning also in 2020 and 2021. That's normally the kind of timelines you're looking at to start rebuilding a brand stronger and stronger.
On the result, we are pleased overall. We can see from market research, when we're asking consumers that they are playing back the kind of position messages we are aiming for, so that is very positive. Then of course, you're always in a dynamic landscape and we can see that in some markets we're really growing market share.
And then of course, the question is OK, is that because of this? In other markets we can see that there are, for example, a competitor is launching a completely new brand in the market and putting pressure on our share. Then of course, you could say shit, that's not what we were planning for, but you can also say well if we would not have invested in our brand, what would then have been the market share results. So initially I would say yes, we are pleased but it's a first step out of a five-step journey or something like that.

Mikael Löfdahl
On the gross margin also, the bottlenecks that you've had in production and also the capacity that you need to add to insource the last portion, I guess, of the Candyking assortment. Is it still up and running by Q3 or when do you expect that new capacity to be available?

Henri de Sauvage
So when we talk about the bottleneck, we talk very much about the moulded products, so let's say the wine gums, the Gott & Blandat, etc. where we are very big; that's basically our old candy assortment, but also the pick & mix articles. So those cabinets, or drying cabinets as we call them, they are being installed in Q2 and they will be up and running by the end of Q2 and that's all going towards plan. About the building and the construction, so the civil works and also the suppliers delivering those cabinets on time.
It is also good to see that the machines, which are standing in front of those drying cabinets – the mogul lines as we call them – those are really important lines to us and that's also where the perfect

factory work is focusing on them. We just reviewed it yesterday, also in the board. We can see on the line where we started, we can see real efficiencies increasing. And what's the efficiency? Well if you have eight hours in a shift are you then producing seven hours or six hours and if you produce six hours, why are you not producing eight? Is it because you're changing over or because the machine has broken down or you’re waiting for product to come or the drying chamber was still full from the previous production run. So we see that those efficiencies are coming up and that's very good because that means we also can fully utilise the drying capacity. So we have had a lot of focus on that, but there are other bottlenecks that we are addressing.
And I think we mentioned also the opening hours on the foam line – the Juleskum – that we are now working on the foam line 24/7 so always on is probably the right word. But there are some other bottlenecks still, but I don't think it's good to mention that over here because my competitors might be listening as well. And that is part of the capex plan, but that will take a little bit more time. So we are making good progress because it's bottleneck after bottleneck after bottleneck we are taking out.
And then it remains the same message as before. If we keep on growing organically that will then mean we will delay a little bit more the insourcing but if we are not growing organically, or if we lose some volumes in Sweden because of the pick & mix pricing, then we can gear up the insourcing again. So I would say that is quite a good position to be in.

Mikael Löfdahl
And you can insource quite rapidly? There is no contract that runs for a year or so that you need to terminate in order to--

Henri de Sauvage
No. We've been smart enough to think that with these contracts we can be fairly flexible.

Mikael Lövdahl
Final question from me – sorry for all the questions by the way – but you have an EBIT margin target of 14% still. From now and onwards, how would you say to reach that? Is it mainly a gross margin case or is it equally divided from SG&A and more scale on that; some savings and scale on SG&A as well?

Henri de Sauvage
If you look at the big elements, and remember the chart which Frans was showing you, so I would say most of it is coming from gross margin. That is on the branded growth and, of course, then the branded growth in those categories and countries where we are already at 14% and you can see that as well the effect of that in quarter four. If you have more branded growth the mix improves a lot. So that is definitely bucket number one. Then, of course, the pick & mix Sweden – remember the minus 60 million in 2018. That is nearly 1% EBIT margin on total Cloetta.
So there's still a lot to be gained over there to get that part in. And then the perfect factory, as we call it, we have a net productivity target. So how do we bring the cost per unit down in the factories? Both by producing more but also producing more efficient. And again, if we have those lines running for eight hours then we pay people for eight hours. We have the heating for eight hours. And if we can only produce six hours, we basically throw two hours of opportunity out of the window, right? So if we can claw back one hour and produce, then of course we only have the raw material and packaging cost to pay for but the rest is already paid for in our current P&L. And that's the same with raw material loss. If we use 1 or 2 or 3 or 4% too much to produce a pack of Läkerol or a Tupla bar then all that money comes back, not easy, but it is good money.
So the perfect factory, I also remember Frans in the capital markets day doing a back of an envelope for you, but there's also about a percent margin in there. And then, of course, the SG&A one, we have a lot of plans over there, but we also have plans to reinvest into the marketing and that's also a constant evaluation what do we do over there, and only invest of course when it makes sense. And as we also said before, we only want to invest in absolute terms more in the brands where we have a more healthy working/non-working relationship and a more professional organisation.

And I would say we started to come close to that point – Q3 was a good example, but also with the new media agency. It's a whole new ball game, I would say, in how we think about media, how we plan it, how we buy it and how we also are very sure that we're investing in the right thing. And yes, it’s the shareholders’ money and we only can spend it once, hence we need to be really sure when we step up the absolute investments that we're doing it in the right way.

Mikael Löfdahl
Okay, thanks a lot.

Operator
Thank you. And as we have no more questions registered, I’ll now hand back to our speakers for any closing comments.

Frans Ryden
Thank you, Mikael, for all of those questions. We do have a question from Stefan Stjernholm as well that we have received here in writing. And part of that really ties into the last question from Mikael and that was about an opportunity to improve margins also on the branded part of the business and as Henri pointed out obviously just growing that business is good for us, where we already have an EBIT margin north of 14%.
But on top of that I would say, of course, as we're looking at introducing new products and overall in the innovation, whether that is 30% less sugar or sugar free or vegan, we want to make sure that those innovations are never diluted to the margin and wherever it's possible and strategically right that they will be margin accretive. But our road map to get to 14% EBIT margin does not require it.
Now the other piece is just on the capex, which I think also ties in well with the questions from Mikael about what's going to be up and running in terms of debottlenecking and getting more capacity. So we’ve previously given a guidance, as you know, since then we did our first five years strategy plan, including on capex and we're working through those assumptions basically as we speak. Henri mentioned that there was a review actually as late as yesterday.
And when we have that, we will have a new guidance. But today, we stand by what we've said previously.

Nathalie Redmo
OK, thank you very much for calling in. We wish you all a continued nice Wednesday and look forward to seeing you in various meetings. Thank you and goodbye.