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COMPANY REPRESENTATIVES

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Henri de Sauvage Nolting - CEO and President

Frans Rydén - CFO

PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Cloetta, Interim report Q2 2022 Conference Call. I am Moira the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode and the Conference is being recorded. The presentation will be followed by a Q&A Session. You can register for questions at any time by pressing * and 1 on your telephone. For operator assistance, please press * and 0. The conference must not be recorded for publication or broadcast. You will now be joined into the conference room.

Nathalie Redmo

Good morning and thank you for joining us on the Q2 conference call for Cloetta. My name is Nathalie Redmo, and I'm head of Investor Relations. I'm here today with Henri de Sauvage, CEO of Cloetta and Frans Rydén and CFO. Henri and Frans will take you through our results for the second quarter and we will then move on to a Q and A session and I will now hand over to Henri.

Henri de Sauvage Nolting

Thank you Nathalie. So first of all I want to say that I'm really pleased with the quarter with the double digit growth and also the step up in profitability that was really pleasing to see in very uncertain and turbulent times, I would say. So a few highlights I would like to share with you. So the communicated pricing became effective in quarter two, which you can also see in our results. But we do not see a flattening yet and new pricing has been announced for the second half of the year to compensate for further inflation.

We also see many global supply chain challenges but so far we've managed them in a good way without material disruptions, a lot of good work from our own people, also with suppliers looking for alternatives, et cetera. So a quite big achievement. Then we have now the six quarter of growth in Branded. Really pleasing to see that our further actions are focusing to grow our market shares and pastels and come get the grease because that's still a weak spot. Our actions taken in the past within the Pick and Mix segment continue to support our profitable growth over there, which is also really good to see.

And then where does the higher profit come from? Well that's from volume and from Mix. So that's really important that we have volume growth in this business. I don't think there's that many who can say that, but volume growth and Mix both contributing to the operating profits.

All our loan facilities have been extended by one year to 24 - 26 with our banking group and we got our science based targets approved. I'll talk a little bit more about that at the end of this presentation. In May we announced a plan to invest in a new greenfield facility in the Netherlands. The plan has generated questions and comments within the investor community and as a result we have decided to host an investor event on September 27.

This event will allow enough time to share further information on the investment and its benefits to Cloetta and our sharehouses, including details on timing, costs, financing and future potential of the investment. Already now I wish to clarify a few things related to the greenfield investment. That said, most of the discussion will then be on September 27. So Cloetta has an overall aim to deliver long term shareholder value on its path to becoming a leading food tech company through margin expansion from profitable growth and lowering our total cost base.

Over the last couple of years, we've seen solid volume growth in our candy category in the branded segment, as well as a robust recovery of pick and mix volumes. And this is leading to a lot of extra need for capacity in our production facilities. In order to meet this huge amount of capacity, we plan to consolidate our three current candy manufacturing facilities in Belgium and the Netherlands into one new modern greenfield facility. Serving our markets in Central Europe and international markets by consolidating three production sites will also enable significant cost savings through consolidation and automation. As earlier presented, the project will strengthen our EBIT with around 260 and 280 million SEC by the time of its completion.

And then thirdly, since we have the opportunity to build a new plant based on the latest technology, we can also make a major step towards our science based targets and build a truly sustainable plant with less energy consumption and waste. Indeed, this is a very big decision and a considerable investment for Cloetta, where we within four years will have an efficient production unit supporting our core markets. Hence, I wish to make a few clarification, but we realized that the investment is significant.

It includes headroom for the current uncertainties on interest rates and inflation and will not be fully incremental to current investment levels. Furthermore, the investment will add another 150 tons of capacity within the Kennedy category, whereas less than a third has been included in the estimated EBIT upside. Finally, the Board reiterates the policy with a payout ratio of 40% to 60% of profit after tax remains intact. The project is progressing according to plan, and during the quarter, consultations with the European Works Council and local unions were initiated and are expected to be finalized during the third quarter.

During the quarter, we also concluded on the perimeter of the building in order to initiate the permit process. With regards to financing of the investment, we have several options and are working closely with our banking group to determine the optimal solution. Our ambition is to provide ongoing information on the project on a quarterly basis, as well as to host a digital investor event on September 27, when we'll be presenting details on timing, costs, financing and the future potential of the investment. With that said, I want to hand over to Frans.

Frans Rydén

Thank you, Henri. So, as usual, I will start with net sales, which in total is up over 200 million kroner and where we are again reporting strong organic growth with sales up by 11.9%. And you may actually recall that we had a double digit growth in Q One but then that was aided by the foreign currency translation. And this quarter it is true, double digit growth from organic sales and excluding currency upside. So the strong sales are also again driven by both the branded package products and by picking mix.

The branded package sales grew 8% in the quarter on the basis of pricing and a good product mix including through last year's strong innovation and again supported by strong marketing. And there is a good mix here despite, as Henri mentioned, refreshment still trading the growth in candy and chocolate on the growth driven by pricing with our way of working with our customers. Where pricing is taken based on actual world market input cost changes in absolute terms there will always be a bit of a lag between change, input cost and the commensurate pricing coming into effect. I thought about this and I think the best way to actually illustrate it it's a bit like a game of Whack a Mole that you find at amusement parks where when the mole pokes its head up, you have to whack it down and some delay is inevitable.

And the rules of the game are such that you really can't whack the mold before it pops up. So as you recall in Q One we had pricing coming into effect largely to offset the input cost inflation carried over from 2021 while we also flagged that we would take more pricing in Q Two to offset the continued inflation seen early 2022. As Henri said, that pricing has been done. However, inflation has continued even further during Q Two and to offset that we have announced to our customers even further pricing that further pricing will come into effect in the second half of the year. And so the lag between increases in input cost and the change in pricing will continue until cost stops.

Pricing, on the other hand, if or when, rather cost at some point starts to come down there will be a similar lag between the decline in input cost and our commensurate price rollbacks.

Now, similar to Q One, this solid branded package growth was again achieved in parallel with pick and mix growing 24% in the quarter, which is phenomenal. The growth in pick and mix is driven by volume and also by pricing.

Although rather than an established way of working our ability to price in pick and mix is dictated by the contract terms which vary between customers. That said, I do want to call out that these picnic sales again delivered profit and despite extreme input cost inflation something which would have been actually difficult to imagine not long ago. And this is the direct result of the diligent focus and effort the last few years on ensuring profitable growth and pick a mix. So more about profit later.

Let's first look at segments over time, starting with the branded packaged segment accounting for the majority of our sales. This is the 6th quarter of growth. We did have eight quarters of consecutive growth prior to the Pandemic. That was a record at the time. So it is great to see that we are continuing to inch closer and closer to that record. Then on the lower half of the slide and the pick and mix business at over 24% growth, that is again great. And it is fifth quarter of consecutive growth and also the fifth quarter of that growth being doubled, double digit or over 20%. And these sales mean we are at an index constant currency of 92% to the prepandemic sales of 2019.

And it's another step up from where we were index wise in Q One. Now, this growth is also helped by Easter coming a bit later in 2022 than it did in 2021, but it doesn't change the overall picture. Moving to operating profit for the quarter, operating profit adjusted is also up versus last year from 127 million to 162 million, so growing at about twice the rate of the top line being up almost 28%. Likewise, operating profit margin is up by over 100 bips from 8.9% of net sales to 10%. Let me explain this strong result and help put into perspective of what we've said before and what we're seeing in the market.

Firstly, I already spoke of the fair pricing for our products and the continued inflation. So while pricing to offset cost is not giving a profit, the sales are underpinned by strong volume growth and better fixed cost absorption and a favorable mix that together drive the growth in profits. The top line growth is also driven by continued strong investment behind our brands, while in total, our sales general and admin costs are quite flat versus last year, and I'm going to cover that on a separate slide. With respect to pricing, I want to emphasize that as we are reporting the quarter's results, costs are continuing to go up. And while our new pricing will also come into effect in the second half, there is no clear end insight for this inflation.

I also want to add, even though everyone on this call knows it, that it is not only for raw and packaging material that costs are going up, but also for things such as energy and labor. That said, we're committed to ensure a fair pricing for our products. In addition, we'll continue this cycle of driving volume growth, investing behind margin enhancing products, and for a favorable mix, and with a keen eye on keeping our own cost down, basically using all the tools at our disposal. And thereby we still expect to, on the whole, to manage the input cost increases within this year.

Now, our gross margin, excluding greenfield, is down versus last year, which is a reflection of the timing of pricing. But also the dilutive effect of input cost driven pricing. Simply put, a product with €50 in input cost sold for 100 euro means 50 euro in gross profit and a 50% gross margin.

If cost goes up by 20 euro and you can only increase the price by the same amount, then you will still make 50 euro in profit, but now only 42% gross margin and that is also affecting us now and you can see it in the results. Then moving on to operating profit by segment for the branded package business on the top row, operating profit adjusted and margin is up versus last year adding 150 beats to get to 12.7% holding firm on the Q One operating profit margin despite the diluting effect of the pricing. Now the still lower share of our sales that come from refreshment sales also still suppresses the operating profit and each year of sales we can close back.

There is an important opportunity for us, but despite that we have a favorable mix in the quarter versus last year driven by our focus on higher margin products and more efficient promotional spend and a mix between countries. I also want to call out here that again the quality of the profit is high as we continue to invest in marketing of our brands at the same level as in quarter one, even up slightly and similarly to quarter 2021 despite the step up last year to support new product launches such as food based candy.

On a year to date basis we are higher invested in marketing this year than last year. With respect to pick a mix. As mentioned, this is the fifth quarter back in profit, again showing that the recovery has been sustainable beyond keeping it stable, it does look quite modest, but then you must note that pick and mix is also impacted by cost inflation and that with the different pricing model our ability to price has been more limited. And the reason you nonetheless do not see a dilution of margin nor profit is due to continued margin enhancing initiatives and savings, including keeping merchandising costs down despite the growing volume. Had it not been for the input cost we would be looking at an even stronger margin step up in the quarter, looking down at selling and general and admin cost with the top line growth there is a significant drop in spend as a percent of sales, but also in absolute spend is very flat, up 7 million on a base of 401.

I already mentioned that our marketing spend on the branded package segment is close to last year's stepped up spend and during the quarter we have also continued to invest in our organization and capabilities such as for net revenue management in ecommerce and to support international market sales.

However, this increased spending is largely offset by our cost efficiencies, including as mentioned on lower spend on campaigns for pick and mix. Keeping merchandising costs down despite the volume growth, the full effect of the reorganization of our sales force in Sweden and by continuing to largely hold back on spend that were all but frozen during the Pandemic. Looking then at cash. As you know, our business cash generation is skewed towards the back half of the year with inventories normally being built early on and receivables coming down two weeks after the selling for Christmas.

This year is not expected to be different for Q Two. Our discretionary free cash flow for the quarter was negative 136 million with 57 million in Capex investments which is roughly what we tend to spend on Capex each quarter. Now the key driver is the working capital whereas usual we are building inventories but with the input cost inflation those inventories are also valued a lot higher. In addition, given supply volatility where we have an opportunity are building safety stock, higher input costs also drives higher payables and higher pricing drives to higher receivables. Although also on the receivables we are up versus last year on account of the strong growth.

So that is arguably worth it. Which brings me to our net debt and leverage with the inventory build and growing receivables. Net debt is of course up versus our lowest ever level in quarter one. But with the dividend payment in quarter two I think it is more like for like to compare to quarter two in 2021 when we also pay dividend. So versus a year ago our net debt is unchanged at 2.2 billion Swedish Croners and that is despite both the extra 72 million in higher dividend paid this year and a revaluation effect of 77 million on account of the weaker Swedish Norwegian Croners and British pound versus the Euro. This improvement is also more evident in the leverage which is at 2.4 and that is down versus last year's 2.9% and also below our long term target of 2.5 during the quarter.

We also extend that, as Henri mentioned all our loan facilities for another year to 2024 2026 with our banking group. And as we closed Q Two are unutilized credit facilities and commercial papers and cash on hand were 1.7 billion, up from 1.6 billion last year. As Henri mentioned, we are also working with our banks to find the optimal financing for the greenfield and I will provide an update on that in the dedicated September event.

So for my final slide, I want to briefly touch on the one time cost in Q Two. Related to the Greenfield in the quarter are items affecting comparability related to the greenfield totaled 225 million Swedish corners which break down as follows impairments totaling 126 million. And I can confirm that while there will be a slight favorable effect on our depreciation going forward, the reduction will not be material as we will continue to depreciate the assets until they are taken out of commission.

The impairment represents the reduced value of those assets that will be sold or scrapped. Given the factory closures rather than continue to be used for production. The other 99 million relates primarily to provisions. As a result of the intended greenfield. We have done a review of Severances honorous contracts, site clean up, etc. And the cost reflects the outcome of that review as of today.

So after crossing the T's and dotting the I's, that 225 million is within the estimated approximately 250 million we had earlier communicated. So, before I head back to Henri, I do want to mention that in the presentation that will be available on our web page, I have also included a simple slide showing our report number, the numbers related to the green field, et cetera, as available in the report and then our results excluded in the green field.

So you have it in one place and in a simple to read format. And with that, back to you, Henri.

Henri de Sauvage Nolting

Thank you, Frans. So, a big thanks to all the work, Frans. And now we go to the strategic update to see what is happening during all this hard work to keep the business running with supply chain disturbances and a lot of pricing, that's very good progress as well on our strategic agenda. As you know, we have three strategic areas. The first one is the growth in the branded business, three categories with three focus areas. I will go a little bit deeper into the first two. Worthwhile mentioning is that we're still expanding our capabilities in ecommerce, even though the sales of most of our customers is down versus the height in the pandemic period.

But our capabilities are really improving a lot and also very pleased to see the progress in the international markets on the particular branded portfolio, the strategic branded portfolio, and that it is really showing now as one brand as well towards the consumers. So Nathalie, let's go into the next slide. Premium innovations and also innovations which are really playing into the naturalness trend of consumers. The cotton Blunder act of looked at this culture made from 50% real fruit. We're the first ones in Europe to have that.

So that's really very positive to see launched across all our main core markets. And what we see over there is that the target group is much more younger. So you can see both in the 18 to 24 group, but also the 25 to 34 age group that they really like these kind of products. We're only at the very early start of this. Is it a success? Well, I think we can see that, for example, from Norway, where this business is already 20% of the total cotton blond brand. So that is a really nice progress and showing that there is a strong consumer appetite for naturalness also in these kind of categories and that we are able to charge a premium price for that.

Then a little bit of an update on the refreshment category with both pastels and income. We're having sales growth in pastels, but we're not everywhere, gaining market share, yet that is a challenge. We are full onto that. We can see also over there that we need to rejuvenate in particular the buyers, the shoppers of this. So we're launching lateral lemon at the moment, which has a very strong performance in the market, which you can see in the top left how big this already is and it is very big within the younger target group.

So again very positive to see also the cooperation we do with Lacqueral Yup for the Pride festivals in the Nordic market is also being seen as very positive and again addressing the younger target group. Then on the right you can see all the work we're doing on penetration because arguably with the lower movement of people towards work or schools we have lost shoppers in both of these categories. So now that you can see on the people are moving back, not fully but back into out of home, we need to find those people again and address that and that is all the actions we are taking over there with these brands that is working really well, but we're not completely back to 2019 levels.

Then we have the third focus area which is cost and efficiency. So very good to see the progress on the net revenue management project. So that is all the costs which are there between list price and the net price we're getting from our customers. So that is fixed prices, promo investments etc. For so we're working there together with the renowned consultants company Simon and Cooker who are helping us in the main markets to do the analysis but also to get the skill and competence level up to a sufficient level which top FMCG companies would have.

And we're implementing a Promo planning and evaluation tool based on AI which is coming from Visual Fabric. We're going live in the Netherlands first and then we roll it out into all the markets so that we have a much better forward looking plan when it is about planning and evaluating promotions. On the cost side, we're working very much with portfolio optimization. As I already told you, we have a lot of growth in the candy category.

So it's also a fantastic time to start looking at the portfolio, take out smaller SKUs, take out less profitable SKUs in order to create capacity for higher margin products.

So that's a lot of work we are doing over there both on SQS and also looking at our brand portfolio and then of course the perfect factory program next to all the reformulations which are happening. We're doing a lot of work on waste reduction within the plant, raw material harmonization and also core versus non core compact. So really looking at all the production facilities we have within our factories, whether there are really core important production lines going forward in the future because they support our core brands with high profitability or whether we could make or buy those kind of products.

And then of course the Greenfield development where we will come back in September. And then last but not least, of course in the middle, the sustainability drive. So we've now got an approval of our target of 46%, which is linked to the reduction versus 2019 based on the science based Targets initiative. So this is how this works, that the science based Target has as a goal to stay within the one and a half degree climate change and then they calculate together with the businesses, okay, what do we have to do as Croatia in order to contribute to that one and a half percent reduction?

And that is where the 46% reduction versus 2019 comes from. And then on the right you can see the three different scopes one and two is the stuff we have more under our control. And scope three is all the raw materials we are buying and the impact on greenhouse gas they have. So you can clearly see where our biggest challenge lies is in the raw materials that is working of course together than with other companies to impact was the production of those raw materials. But we can also do a bit ourselves with reformulation to moving away from high impact raw materials to lower impact raw materials.

And scope one and scope two, of course, is what we are already driving ourselves. And also the Greenfield will make a step forward in that area. So that was it. Now we go back to questions around the quarter too. And of course we can clarify some things, but I would already like to say that all the detailed questions for the Greenfield, I would really like to get them in September so that you have a lot of time for them. Everybody can listen. And at the same time, because it's holidays and there's a lot of quarterly reports coming out today and that we address them there in all detail and with ample time available for everybody.

QUESTION & ANSWER

Operator

We will now begin the Question & Answer Session. Anyone who wishes to ask a question may press * and 1 on their touch-tone telephone. You will hear a tone to confirm that you have entered the queue. If you wish to remove yourself from the question queue, you may press * and 2. Participants are requested to use only handsets while asking a question. Anyone who has a question may press * and 1 at this time.

The first question is from Nicklas Skogman from Handelsbanken. Please go ahead.

Nicklas Skogman

Thank you. Good morning. I apologize if I ask something you already talked about. I just joined from another call. So first of all on the maybe the outlook, if you will, for Q Three, I mean compared to the Q One report. I note in this report that there is no comments about mismatches between input costs and price hikes. There are no such comments for Q Three in this report. So should we interpret that as you are now sort of aligned with your input costs and your price hikes for the gross margin in Q three and Q four. That's the first question, please.

Frans Rydén

Yeah, thanks a lot, Nicklas, let me take that question. So I sort of gave a bit of a visual example of how this works. If you imagine that you have at an amusement fair the game of Whack a Mole, where the mole pops up and you have to hit it with the club and then it goes down again. And of course, inevitably there is a bit of delay before you can hit the mold, so it goes down. And the rule of the game is such that there is no point in trying to hit it before it goes up. That doesn't make any difference. And it's the same thing for us with the pricing that given that our set up, is that we take pricing based on actual cost increases seen in the market.

So of course the cost has to go up first and then we can initiate the pricing negotiations and then the pricing comes into effect. So there will always be a lag there until cost stops going up because then we will catch up. Now, what we've seen is that we took the pricing we said we're going to take, but costs have also continued to go up during the quarter.

And so we have said we will take even more pricing now in the second half of the year. But let's say the lag will continue until those cost stops rising. So that's how it works. But it basically means the lag is already in the numbers you see in the quarter here.

Nicklas Skogman

Okay, yeah, I mean, it was 150 basis point adjusted gross margin decline in Q two year on year. Is it something similar for Q three or is it sort of the effect of the lag smaller?

Frans Rydén

Yes, a couple of things. One is the margin and the other one is the absolute. And what you saw from the presentation there, we say that the cost net of price impacts on an adjusted basis is 42 million. And then I share that 17 million of that is coming from the SG and E. So that leaves 25 million. But then what drives that's? A combination, of course, increased cost for which pricing had not or hadn't fully kicked in yet, but also higher cost in conversion due to some of the challenges in global supply chain and the normal cost increases just as costs are coming back a bit from last year, partially offset by savings.

So exactly how much is the lag? I can't quite give you, but you see it's part of that 25 million. Now then, as a margin, of course, there's another couple of components to think about here. One is the mix between the branded package business and the pick and mix with pick and mix glowing a lot faster. But at the lower gross margin. And the other one is the dilution as a result of US. Pricing for the absolute increase.

That, of course, always means there's a dilutive effect as a result of that. So that is also impacting this.

Nicklas Skogman

Yeah, that's true. And in terms of capacity utilization, are you new now basically back to levels like peak levels that you previously saw before the Pandemic? In terms of production?

Henri de Sauvage Nolting

Yeah, in general, I would say that is true for our candy business, which is a nice problem to have, I would say, because it also gives us an ability in the previous question to be really firm on the pricing because we can do without some volume sometimes and then move volumes around towards more profitable areas. Which means that also in this pricing discussions with customers, we sometimes have situations where for one or two months we are not delivering to a customer because they do not want to engage in giving us a fair price increase covering only the absolute level. So that is the situation. But it was, of course, also one of the background drivers for the Greenfield decision, which we'll discuss in September.

Nicklas Skogman

Okay, very good. And then finally, on the refreshment category, are you moving in the right direction there, would you say, in terms of.

Henri de Sauvage Nolting

Yeah, we're absolutely going in the right direction. If you dissect it a little bit, it's pastels and gum because it's two different categories. We see growth NSF or top line growth in the pastels categories.

So that's positive. But we're not winning market share everywhere because we can see mainly that cuff and cold that is called. So people who are now having a flu again after the corona that that segment is growing. We can also see that with our mint on brand in Finland that we have really good growth. That is basically the only brand we have which is very much into cuff and cold.

So we just need to become more competitive. And that's why I showed as well in the presentation, which you can see that we're focusing, for example, on the younger target group with like, lacquer lemon or the pride. So I would say that that's one of the areas where we can do more. And then on the gum, the Dutch business is really growing well and then the finished business, we still have more work to do to get that back into growth. It has our full attention.

Nicklas Skogman

Nicklaus all right, thank you very much.

Operator

For any further questions, please press * and 1 on your telephone. There are no more questions at this time.

Henri de Sauvage Nolting

Good, well, then I would like to thank you concluding really pleased with the results both on the top line and the step up in profit based on the volume and a mix. A lot of work to meet on a daily basis, the global supply chain challenges as well as the continued pricing. And that has not gone away.

It's also not easy. We see continued input cost step ups, which we are compensating with pricing. That is the focus for the coming at least two quarters, I would say. So thank you very much and see you hopefully in September.

Operator

Ladies and Gentlemen the Conference is now over. Thank you for choosing Chorus Call and thank you for participating in the Conference. You may now disconnect your lines. Good-bye.

- END -