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Cloetta Interim Report Q4 2022 Conference Call

2023-01-27 at 11:00 AM CET

Duration: 32 minutes

COMPANY REPRESENTATIVES

Henri de Sauvage Nolting, Chief Executive Officer

Frans Rydén, Chief Financial Officer

Nathalie Redmo, Investor Relations

PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Cloetta Interim Report Q4 2022 Conference Call. I am George, 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

So, welcome and thank you for joining us on the Q4 Conference call for Cloetta. My name is Nathalie Redmo, and I am Head of Investor Relations. I am here today with Henri de Sauvage, CEO of Cloetta and Frans Rydén, CFO. Henri and Frans will take you through our fourth quarter and year end results, and we will then move on to a Q&A session.

I will now hand over to Henri.

Henri de Sauvage Nolting

Thank you, Natalie. So, if we look at the Quarter 4 results, I would say it is all best described by strong sales and an improved profitability, while the circumstances were challenging. And it's very good to see that we now are back to 8 quarters of growth on the branded business. Remember that before the pandemic, we left it at 8 quarters of growth and Frans will show you a bit how that is being put in perspective, a lot of the growth of course coming from pricing, which is a general thing. But also Pick & Mix 7 quarters of volume growth and profitability despite the higher input cost. We do see the input cost rising, and we have been able to offset that in Quarter 4, primarily through pricing and good cost control, good.

Further pricing will gradually become a factor throughout Quarter 1, 2023, given the continued inflation and the inflation of course is starting to change a bit in nature, because we now also see that our raw material suppliers are pricing-in their energy cost and labor and transportation cost, so not purely only the raw material itself which is going up. And then of course we see our cost going up as well.

The Greenfield facility project proceeded the union process is partly still ongoing.

We already delivered a strong cash flow and a net debt over EBITDA, which remained well below the targeted 2.5, actually very low, so that's something which Frans can talk about. The Board is proposing a dividend of 1 SEK per share to the AGM. So with that said, Frans, can you take us into a few more details?

Frans Rydén
Yes, thank you. So as usual, I will start with the net sales, where we are then for the 7th consecutive quarter reporting organic growth for the total company, and this quarter it's just shy of double-digit at 9.5%, and including currency upside, sales increased by 14.6%.

So I want to call out already at that point something to help you understand this currency effect on our reported results. So there is 3 pieces. The first, it helps our reported topline, as I just mentioned. Secondly, and you will see that in the presentation, there is actually, only limited upside at the operating profit level. So the gross profit upside is modestly offset by the translation of cost that we have incurred in Euro to Swedish Kroners on sales, general and administration, which makes it look as if those cost are up when they are actually not up. And thirdly, while the operating profit is not significantly affected, the FOREX does affect net financial items through revaluation of cash in our cash pool, and thereby also the net profit, but that impact is non-cash and it's unrealized. So the suppression of the net profit is also non-cash and unrealized, and importantly, it doesn't affect our ability to pay the dividends, as Henri mentioned. And I will come back to this.

Then starting with the sales though, they are again driven by both branded package products, growing at just over 6% and Pick & Mix growing at 21%, so we will look at that in more detail.

And starting with the branded packaged on the top row, so that's for 3 quarters of our sales, and this is the 8th quarter of growth, as Henri mentioned, and we are now matching our pre-pandemic record of 8 consecutive quarters of growth. And the... at 6.1% growth, that is a little bit less than what we had in Quarter 3, but then if you scan across, you can see that in this quarter we are meeting a much, tougher competitor as Q4 2021 was up over 9% as we were still growing very strongly after the pandemic.

I also want to comment on the volumes. As you know, we have stepped away from some volumes, where customers have not been willing to meet us on the need for pricing, and that remains a bit of a factor in the quarter. But we are also seeing a hopeful mix in branded, where pastels and gum volumes are growing faster than the rest of the branded, and faster than what had been in Quarter 3 and in Quarter 3 year-to-date.

And then on the lower half of the slide for Pick & Mix growing at 29%, that is the 7th quarter of consecutive growth, and comes on top of the solid 32% growth we had in Quarter 4 in 2021. And the sales growth is again underpinned by both pricing and volume.

So let's look at the profitability. So on the operating profit, we have again this quarter been able to manage the rising input cost, and we have offset that through strong pricing and other activities to keep costs down. And operating profit adjusted is growing faster than our organic sales with or without the FOREX upside. And we are delivering a step-up in operating profit margin versus Quarter 4 last year.

On a full-year basis, our operating profit margin is also up versus last year, and just about 10%. That is despite the compression effect of the higher pricing that we have discussed in prior quarters. I also think as we look at Q4 and the full year here, it is fair to say that we've done what we said that we would do, which was to offset the input cost during the year, leveraging all the tools to our disposal. That said, and Henri mentioned this, input costs have also continued to go up. And while you may not always see it in the market data, surely everyone can see it, you know, when they check their own prices, basically, energy is up, everyone has felt that. Labor costs are also going up, largely due to those earlier increases and this is now affecting much more our suppliers conversion cost. And as a result, we have announced further pricing which has and will gradually become effective during Quarter 1.

I can also confirm that what we shared in Q3, which is that we have increased our investment behind our brands this quarter, although not to the level that we did in Quarter 4 last year. So while marketing spend is down year-on-year, we have spent more in this quarter than we did in any of the 3 preceding quarters.

And then, looking at the segments side-by-side here with the branded packaged segment on the top, the absolute profit is up and so is the margin, both for the quarter and the full year. Again, this is driven by pricing, there's a favorable mix with the gum and pastilles that I mentioned doing better than the average. And also the marketing spend increased, not reaching last year's level. Excluding the lower marketing, absolute profit is still up, whereas the reported margin percent would be more similar to last year. But then also taking into account the compression effect on the margin from the high pricing, we're doing quite well.

Now for Pick & Mix, you do not see the same development in the quarter as you do in the full year.

Then here it makes sense to recall, that this quarter is the 7th consecutive quarter for Pick & Mix where we have also stayed in profit, not just growth, but stayed in profit. And that is despite the very high increased input cost. So a few years ago that would probably not have been possible. And I'd like to think of this as the hard work on building profitability is evident from the ability to avoid making a loss in the current environment, rather than seeing it as stagnation on the journey or that we are not focusing enough on this.

I would also say that, of course, this is not where we want to be. And we actually have a slide here just to zoom in a little bit closer on Pick & Mix. And the ambition that we have expressed to reach 5% to 7% of operating profit adjusted for this segment and what we will continue to work towards. So when we started this journey on the very left, we were making about 1% to 2% EBIT margin for Pick & Mix, despite a 60 million loss in Swedish Kroners we were making in Sweden, so the other countries Pick & Mix was compensating for that.

And we had previously shown that we brought Sweden back to breakeven and interestingly, that alone would have been enough to bring the segment to about 5% EBIT margin and basically into the range that we are seeking. So we're not talking about something that is impossible here. But then... and this is not quite chronological, but we've had 2 big hits. First, it was the volume losses due to COVID, and now we have the increased input cost. And we had through pricing and other efforts, kept the margin above zero, as I mentioned, the last 7 quarters, but not much more.

Now, I also want to mention that this result does include Pick & Mix having first absorbed its fair share of the common cost. So the profit seen on this slide is not fully representative of the favorable contribution that we have from Pick & Mix.

Nonetheless, given the contract structure of Pick & Mix and I think, I've shared this as well earlier, we have so far been able to manage the input cost increase and partially through pricing and partially through other means. Meaning that and here you should look at the striped arrows that should sort of be seen together. There is still an upside to come from having completed the pricing in full. And the question would be, so when will that happen? Well, given that there is a bit of a lag, there... that will happen when costs stop going up and we can catch up.

Now, in addition to that, we will continue to drive the margin-enhancing initiatives and there are further volume gains to be had in addition to other levers. And of course, the reversal of the compression on the margins is very important and this explains then our ambition. But as mentioned in a way the key to get to mid-single-digit was always turning around Sweden's losses.

That has been done. So, for the rest of the business, it's more to rebuild to where we were and any upside on breakeven in Sweden, that also becomes accretive.

So, moving onto sales, general and admin. So, with the pricing raising the topline, there is of course a significant drop in the spend as a percent of sales from 27% down towards 24%, and that is despite the impact of the FOREX I mentioned initially. And that's adding 21 million to the reported SG&A. So, we should exclude the translation effect here. We are controlling cost not only with respect to the marketing that I mentioned earlier, but also offsetting increased costs such as in merchandising, given the continued growing volumes or increased employee salaries when comparing year-over-year.

On a full-year basis, there remains a... just a smallish 1% increase in SG&A also when you exclude FOREX, as about 20 million here against 1.6 billion spend, and that as marketing spend is held at similar levels while all the other increases in salaries, merchandising et cetera, we have been able to offset through cost savings. So, the earlier presented savings from our VIP plus cost savings program which has delivered about 1% EBIT net of reinvestment is still holding.

Looking then at cash. So, as is the case for our business, we tend to generate our cash in the back half of the year after investing in working capital in the first half. Q3 wasn't different and Q4 is not different as presented today. So, our discretionary free cash flow for the quarter was 241 million and that accounts for most of the full year free cash flow of 305 million.

Overall, cash flow holds to the normal seasonal patterns with the year ending with low receivables after the festive season, but also lower inventories and lower payables. What is, of course, still affecting us in all 3 is pricing and higher input costs. So, on the same number of cash conversion days, it ties up more working capital so the result is despite that.

On CAPEX, the spend is a bit lower than our normal run rate but do... we do expect that on a full-year basis, the spend will be on average 50 million to 60 million per quarter in line with what we normally do excluding spend on the green feed which wouldn't really materialize at least not in the first half of the year.

Now as we look at the cash, I also want to comment on and returning to the point that I made at the very start, something you do not see in this cash flow bridge and that is the effect of the very high net financial items in the quarter and for the full year, for the simple reason that is basically non cash.

So, for the net financial items and now looking at the full year, that includes a negative 143 million Kroners of unrealized exchange differences that a lot of negative and a lot more negative than where we have been before. I think the worst time prior was 2012 with about 19 million. That's important to understand because our profit after tax is affected, but not our ability to pay dividend which brings me to the last slide on net financial position.

So, as we close the year, our net debt at 1.9 billion is slightly up versus last year, but if you take into account the revaluation impact, we're actually on par with last year and our leverage is improved at 1.9x. It's down versus last year, but not only that it's actually the first time since 2012, maybe even before then since our net debt at year-end has been below 2 in terms of leverage. So, we're well below the 2.5 long-term target.

So as we close the quarter, our unutilized credit facilities and commercial papers and cash we're at 3.9 billion, that's more than last year, and that's driven by the newly agreed financing for the Greenfield, which we've also presented in more detail during the investor event earlier this fall, which is available on our website.

Consequently, with our strong growth and improving operating profit, as well as strong cash flow and solid financial position, the Board has proposed a dividend of 1 Krona per share in line with earlier expressed ambition. This is at the upper end or just above, they usually refer to 40% to 60% of profit after tax, now of course excluding the Greenfield. But then of course, that profit as I mentioned earlier, is very much suppressed by the non-cash unrealized revaluation effects on cash in our cash pool, and that does not reduce our ability to pay dividends.

So before I hand back to Henri, I want to mention that in the presentation towards the back, we have also included a simple couple of slides bridging our reported number to our pro forma numbers excluding the Greenfield, and then bridging that to our operating profit adjusted, as presented here. So, we provide this for the quarter and for the full year, of course, in the quarter there is no material movements. But that way you have it in one place and in a simple to read format.

And with that, thank you. Henri.

Henri de Sauvage Nolting
Good. Thank you, Frans. So 3 strategic updates. And we always talk a lot about what is happening in our core markets and in Europe.

But of course, as part of our strategy it's also to expand on the international positions which Cloetta has had for many years, and which we focused upon as from the new strategy implementation. And just to give you a feel of that, and we're looking at growth levels of 15%, 14% on top of the existing business, with a new team with a focused agenda on the top 5 brands we already have in those markets. And then also focused on the regions, as we call them, you can see them on the right where Cloetta is already present for many years.

So this is a clear growth strategy to contribute to the overall growth journey of Cloetta, and also to get more scale into our business through growth in those markets. So quite nice to see and if we keep on doing this, this will be an important pillar under our business.

The next is, I think, a external compliment you could say of... as the progress we've made within our Pick & Mix business that we are really able to claim now that we are the category captain in Pick & Mix customers coming to us. We can advise them on how to grow their business and how to attract shoppers to that category, how to promote, how to activate, et cetera, et cetera. And why are we so confident to say that, well, this is a piece of information from Norway, there are 3 customers over there or 3 main customers.

We are having our Candy King concept within Rema 1000, and here you can see an external piece of research which was published widely. What are the main categories shoppers go to these 3 retailers for? And you can see in Rema Pick & Mix from Candy King is on the 1 place and in itself it's already very nice to see. But you can also see that in the other 2 customers, their own Pick & Mix concepts are not even featuring in the top 10. So this is really a piece of proof, I would say that we now really know Pick & Mix can help our customers like we do with brands to grow the business, and do that in a very professional way.

Then as part of our CSR agenda, we're also looking at other areas than just the climate action, and one thing which is really important is the people part as the 3 legs of our CSR strategy, and what you can see over here is that Cloetta is a very active part in the pledge on kids marketing. We already had that. We updated that, we actually go beyond some of the things we want to steer, and we want to do. So, that is something which is, I think important for a responsible company, and also very good to see the enthusiasm and understanding of our commercial organizations that we do good business.

Yes, another one on the For You is the accidents we have in our factories, yes. We want people who walk into our factory to work there for 8 hours, to also live in a good way.

So there is a lot of focus on this. Our vision is to come to zero and then a strange word LTIR, that is Loss Time Incident Rate, so how many accidents do we have where people have to leave the factory to maybe seek doctor's consult based on the number of hours. And you can see that this gradually over the last couple of years has been going down. Of course, each accident is one too many, so we work to lot with people in particular on the safety structure and how to train people to always think safety before they act when they make changes to machine so where they are starting up et cetera, et cetera, really important for our safety first is an important message for our people.

So a bit of an update from a different angle in the CSR journey and that means that we can now open up for questions, and I will give it back to the operator to manage that.

QUESTION & ANSWER

Operator
I will now begin the question and answer session. Anyone who wishes to ask a question may press * and 1 on their touchtone telephone. You will hear a tone to confirm that you have entered the queue. If you wish to remove yourself from the queue, you may press * and 2. Participants are requested to use only headsets while asking a question. Anyone who has a question may press * and 1 at this time.

Henri de Sauvage Nolting
So we have a question on the web. Could you please comment on overall branded segment volume development versus the 6.1% organic growth? Was volume positive in index terms? Where are we on branded products volume relative to pre-pandemic, i.e., Quarter 4, 2019?

So overall, I would say that we have seen in the quarter, as Frans said, that in some categories like Pick & Mix, we see strong volume growth. We also are very pleased to see the volume growth we had on both the gum and pastilles business. We have good profitability over there. That is the category where we lost volume during the pandemic, so very important to bring that back. Then on overall on branded we are just shy of having stable volumes that is mostly driven for now from some customers who did not want to buy our products at the new higher prices and where we have been very firm that we say, well, you know, we are not in this business to shift our profit to our customers and that has had an impact. Then the exact relation to the pre-pandemic, Frans, you have that.

Frans Rydén

Well, I mean... so I mean, the big view of this of course is that also during the pandemic, we continued to grow on the branded side. I mean there was a bit of an effect just very, very initially but if you recall, the decline was not... and you see that on the slide as well with quarterly growth, it was nowhere near what happened on the Pick & Mix side. So we continue to you know, to basically to grow on the branded side and actually in totality, these 2 categories together we are above where we were in 2019 on top line whereas the Pick & Mix volume wise is still below. Part of is volume lost. Part of is volume that we walked away from, because we couldn't get the pricing through, but branded is doing well versus 2019.

Henri de Sauvage Nolting

There is a second question. Hi, can you discuss about competition from other players, please. Discussions also with big retailers customers really regarding price increases due to global inflation price can increase where is the limit update on the new facility?

So all the players is a little bit difficult to talk about. I mean that you should ask them but I would say in general, we see that in FMCG most companies are taking pricing since they are all faced with the same raw material input cost and we are now, of course, a year into this more or less, and I would say that everybody is getting these effect, even if you would have had some delayed effect.

Of course, discussions with retailers, it is difficult. I mean we are very open and transparent about showing them what our absolute price increases are on things like raw materials, energy transports, et cetera and we see compensation for the absolute level. I think we have got quite some praise, that we do it in that way so that is good, but of course there is some variation from market-to-market on how this is being done, and as I said before in some markets there are customers who are not willing to pay the price, which is completely transparent and fair as we see and then we walk away from that business, which I think is the only right thing to do in the current climate.

So, where is the limit? I mean, that is of course a good question. What we know from the past when we had the previous financial crisis we could see that the confectionary category in general was not so much affected yes, so that is a good thing to see. We already see that right now that given the fact that we have strong brands and also that we have been investing in those brands in the last couple of years, it also means that the consumer is willing to pay this higher price, but I would not be able to have a very strong view on how that is going to look in the future.

So, that's so far so good. Of course we see some channel shift of shoppers going into cheaper channels, but that also fits with our strategy, because we are present in the channels where the consumers are shopping. So, I think it's much more like we also said in the reports that we will try to adjust our offering to the consumers to also take this into account. Value packs or smaller purchase price packs is something we will do, yes.

And then an update on the new facility, I mean that is going along, I mean, we are negotiating with the unions. We are talking to the government in the city where we have one of the options of the land to get the permits. All that work is ongoing.

Frans Rydén

Yes, I guess on the question also you know on CAPEX. So, of course, when we have details around that, we will share that, but as we presented the FOREX, of course it doesn't come now in the first half of the year. We first have to get everything ready and we have to contract as well with what we are going to order building, machinery et cetera. So, there is of course no CAPEX spend in the first half of the year, at least that would come more towards later on.

Henri de Sauvage Nolting

Good, then we have the next question. You mentioned that cost inflation will continue during 2023 as your suppliers pass on energy and labor cost despite moderating raw material and freight. What is the magnitude of the cost inflation that you are preparing for in 2023?

That is, of course, a bit sensitive in the sense that yes, that is part of the discussions we have with our retailers. So, it would not be wise to share that, but of course the impact continues even though as you also mentioned, some of the things, raw materials are maybe not going up as fast and freight may be becoming more benign in some areas. But let's not forget that also energy is being used to refine sugar or to produce cartons and of course these costs are now also getting into the raw material or packaging material prices we are paying. But, I would say we have shown during 2022 that we can manage that, that we will price and that will just continue in 2023 in the same way.

Frans Rydén

Yes, maybe just share a little bit more on this piece, let's say why we don't want to give you specific number on this? It's a little bit similar to that. We don't want give you exact the price because what... how much the costs are increasing, it depends on what the products are that the customer is buying from us and it depends also what was the price the last time we had the price increase, because that also varies between the markets and the customer.

So, if we give you a number which is the average, than half of the customers will think they were over charged and half of them thought they got away with it. So, it's basically... I think the main point is, it is a lot of cost increases that we will continue to manage those as we have done in the last year.

Henri de Sauvage Nolting

I don't see any more questions on the screen, so then I think we come to the end of this call, very efficient I would say, in half an hour. So, thank you very much and have a good weekend.

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. Goodbye.

- END -