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Interim Report Q2 2023 Conference Call

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COMPANY REPRESENTATIVES

Henri de Sauvage-Nolting, Chief Executive Officer
Frans Rydén, Chief Financial Officer
Nathalie Redmo, Head of Investor Relations

PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Cloetta Interim Report Q2 2023 Conference Call. I am Alice, 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.

At this time, it's my pleasure to hand over to Nathalie Redmo, Head of Investor Relations. You will now be joined into the Conference room.

Nathalie Redmo

Hello, 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 am here today with Henri de Sauvage, CEO of Cloetta and Frans Rydén, CFO. Henri and Frans will take you through our results for the second quarter, and we will then move on to a Q&A session.

And I will now handover to Henri.

Henri de Sauvage-Nolting

Thank you Nathalie. So this is the normal agenda. We start with the quarterly update from me, so what are the key messages, that we had a lot of growth as I think we all expected, so high organic growth and also continued profits improvement that makes us proud of these results.

So strong growth in the branded business of 14.8% organic, and also favorable mix from higher margin products that's also quite important. Pick & mix having volume growth, which is really good and on top of that, of course, 22.4% organic growth in total, so really positive to see. I will show you a few initiatives we are doing on Pick & mix when we come to the strategic update.

The higher adjusted operating profit reflected last year, our pricing was only partially offsetting the cost inflation. Remember that we always have this lag in pricing after input cost are going up, last year we were lagging, now we are on top of that. So that's quite an important one if you adjust the results.

We are also looking and executing a lot of things in the factories and one of the things is that we are stepping up the efforts in the portfolio rationalization. We were actually doing that before, but we are doing this now faster also to contribute to lower cost in order to compensate for our own internal cost which are going up, and that is difficult to price through to the customers. So we were taking out cost of growth at the same time, than creating capacity for further growth.

On the Greenfield project will come a little more specific, but the big loss union negotiation outstanding in Belgium was finalized, and also the City Council in Roosendaal has published the intent to sell this piece of land to Cloetta. Net debt remains below our target, and Frans will also talk a bit more about the loan facilities which are now extended in order to finance the Greenfield project.

So Frans, if you allude a little bit more in detail on the financials.

Frans Rydén
Yes, thank you. So as Henri mentioned, we are again pleased to report strong, double-digit organic net sales growth of 16.7% and when including the effect of currencies growth is 22.9% and it takes us the closest we have been to report 2 billion Swedish Kroners in sales in a single quarter at really just shy at 1.998 billion Swedish Kroners, and so that milestone is still out there ahead of us, and let's see when we will get there. Now, the 16.7% growth is a bit lower than the growth we reported in Q1, but of course as we progress in the year, we will face a tougher and tougher comparable given the ramp up that we had in pricing last year.

Now, I will come back to a couple of things more than once in this presentation. One of those is the strong organic growth in an environment where consumers are increasingly under pressure from rising inflation. Our fair pricing to offset our home, rising input cost and also the stronger Euros effect on our sales and the profit generated outside of Sweden and Norway, but also that it leads to a challenge when materials for the Swedish and Norwegian markets are purchased outside.

Firstly, though I wouldn't say... and you've heard me say this before. Unlike energy and food et cetera, the consumer is completely free to decide if they want to buy our products or not. And despite the inflationary environment, many are continuing to buy Cloetta products. We are of course very happy with this, but we are also proud because needed a customers or the customers... customers as in the consumers, except higher prices by default. And that our products have this pricing power is the result of many years of effort to strengthen the quality of the product, the quality of our brands and also the organization that actually carries out the work across functions and markets.

So, moving then over to net sales by segments, and started with the branded package sales on the top, accounts for close to 3 quarters of our sales, and it's growing organically by 14.8%. And this is the 10th quarter of growth so we continue the streak post-pandemic, and we extend the lead of our pre-pandemic record of 8 consecutive quarters of growth. This is also the highest sales we've had of branded package products, since we started with segment reporting, and likely also before that, with the prior record actually being Q1 earlier this year.

Now, the growth, as mentioned, is driven by pricing, but also some favorable mix within the portfolio and between markets, including, as we have ramped-up, and Henri mentioned this, the effort on product portfolio rationalization to create space for more profitable and more strategic growth, as well as, we've had to step away from sales when our fair pricing has not been accepted.

Now, despite this, with respect to the branded package volume, I would argue, and I also did this in Q1, that our underlying branded package volume, and by that I mean the consumers' willingness to buy our product, are just about holding versus last year. Here, I'm talking about volumes. If I, however, include volumes where we've had to walk away from when customers are not willing to accept our fair pricing, then our volumes for branded package products are down somewhat and that is in line with the overall market.

In the Pick & mix segment, however, which is also growing top line organically 22.4%, that is primarily driven by pricing. But there we also have volume growth, as Henri mentioned. Now, Q2 2023 is now the 9th consecutive quarter of growth with profit in Pick & mix. And this is despite a tougher comparator than what we had in Q1, including as a result of that there is more Easter sales that happened in Q1 this year than what it was in the last year.

So, let's then move on to the profit. So, we are pleased to report a very strong quarter where our pricing has offset the higher input cost in line with our stated ambition. Now, on this slide, what really stands out is also that for the first time, can we see a net favorability comparing price versus cost. So, in 2022 we were lagging in our pricing versus the steep increase in cost, and now in Q2 2023, we have caught up. And I've even added a small insert here from the presentation last year to sort of help illustrate this.

Now, at the same time, and also since last year, and we have shared that we would work on all the other tools at our disposal to manage the increase in cost, including premiumization, mix, efficiencies, cost control, and as such, the favorable balance of pricing net of cost in Q2 this year is a reflection of fair pricing next to the other efforts on our side.

Now, as we progress into the second half of 2023, I think it's also important to recall that we will meet then a stiffer and stiffer comparable as we ramped up and started to catch up on pricing last year. And also all these other offsetting actions were starting to take hold.

You can also see here an un-favorability for volume and mix. That is correct, but the underlying volumes are pretty much holding, but with a decline, due to our principled approach to fair pricing, and then you also have an unfavorable mix because the Pick & mix segment is doing from a volume point of view better than the branded side.

Now, while profit in Swedish Kroners is improved compared to last year, we continue to see the effect of the compression from pricing with respect to the profit margin. So, adjusted it's just shy of double-digit at 9.6%.

However, as cost eventually start to come down, we will see in equal and opposite positive effect on our margins. And yes, energy cost have come down, but sugar costs are very high, and we also have a very negative currency effect in Sweden and Norway. So, we are not yet at a point where pricing should be lowered. Nonetheless, let's look at the 2 segments separately.

So, the overall drivers are those that I mentioned, but it's clear here that the pricing is offsetting cost and there's a strong improvement versus last year, given the lag in pricing during 2022. Also similar to last quarter, the branded has a favorable mix and Pick & mix is growing in volume, although both are less accentuated now than in Q1, given the tougher comparator.

Now, despite the growth in profit, the compression is very clear here and it's holding branded package margins stable to last year. For Pick & mix, it's actually slightly down. But then we have to also remember that this result is despite the increase in cost. And that's sort of the result of all of our efforts of building profitability in Pick & mix. So, I don't want to see this as a stagnation, but rather as holding to what we've said.

Then moving on to sales, general and admin. So, with the rising top line, there is a significant drop in spend as percent of sales from almost 26% to just below 23%, so that's the same compression effect that we see on the profit margin. Now, SG&A, excluding some minor items, effecting comparability is up and half of that increase relates to this translation of cost incurred in Euro to the Swedish result. And the other half relate to salary inflation relating to our own workforce, but also those of suppliers of various sales services where contracts are often indexed.

As we saw in the earlier bridge, we have been able to offset these costs and we will continue to work very hard on doing so.

Looking then at cash. 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. And our Q2 free cash flow aligns to that at only 2 million Swedish Kroners for the quarter and slightly negative year-to-date. However, I'm pleased to report that that is nonetheless 138 million better than in Quarter 2 2022, despite the continued inflation of our input costs and our commensurate pricing.

As you know, higher input costs per kilo does mean higher payable, but that favorable impact on working capital is more than negated by the effect on inventory values and the higher receivables on account of the necessary higher price we have to charge. So an improvement of the free cash flow versus last year, despite that effect, is quite good.

Now, the driver of the stronger working capital in the quarter is the improved focus on receivables as we have increased the full organization's effort in this area, but we're also helped by the timing of Easter.

The improved free cash flow is also despite somewhat higher investment in property, plant, and equipment this quarter, where the increase relates to investment in folding boxes as used, for example, in Läkerol, which will allow us to harmonize packaging size and also reduce costs, as well as investment in new bag packaging to more fully utilize production capacity. There's also a couple of million Swedish Kroners here related to capitalized engineering support for the technical design of the Greenfield, but as previously shared, CAPEX for the Greenfield will not materially impact this year, but rather be initiated in 2024.

On the matter of the Greenfield, we have again provided the details on items affecting comparability in the report and also in a... what I hope is a helpful bridge, at the end of this presentation. And each quarter we review the accounting for the Greenfield for any necessary updates, including on timing or the outcome as is now on the finalized negotiations. And overall we remain within the range of numbers previously communicated.

Not reflected in the cash flow are the high net financial items in the quarter, given that similarly to Quarter 1, those are mostly unrealized exchange differences, which are not part of the operating cash flow, but they do form part of the exchange differences.

Now, interestingly had we closed the quarter yesterday with the current FOREX rate, we would have had a gain on net financial items. So 80 million Kroner is better than we have now correctly reported. Nonetheless, we didn't close yesterday. So they do have an effect and that is also on the net financial position.

So that takes me to my last slide. I would argue that our financial position remains strong. We have strong growth. We have improved operating profits. We have better free cash flow, and we have access to additional credit facilities and commercial papers plus cash on hand for 3.6 billion Swedish Kroners.

Our leverage is 2.3, which is below our long-term target of 2.5. And it is lower than our leverage in Q2 last year. It is higher than Q1 this year, including due to the effect of these unrealized exchange differences. But I would also say it is primarily higher than Q1 on account of payment of 1 Kroner per share dividend done during this quarter. And on the positive note of paying dividend, over to you, Henri.

Henri de Sauvage-Nolting
Thank you, Frans. So a few strategic updates on the areas where we're working. You know, the 4 areas we focus on. So if we start with the first one, have we already talked about the portfolio harmonization. So to get more out of our installed capacity and also focus on cost decreases and increased gross margins, you can see here, for example, in our branded business, 75% of Cloetta, that we're taking the number of consumer units. So that is SKU, stock keeping units. And this place we're taking that down. You can see that that journey already started in '21.

Low-hanging fruits first, but we keep on pushing that agenda. So a number of items down of 17.5%, another 7.5% down. And then also when we have the new Greenfield, there's even further possibilities when we bring everything together of the plants into one unit. How do we do that? Well, we're classifying our SKUs in A, B, C, D. A are the really big ones doing most of the turnover, and D, are the small ones where we then say goodbye. And it's not only the SKUs, we're also working more integrated backwards. So we look at recipes and raw materials. I think we shared that like last year, the number of strawberry flavors we have, and also semi-finished. These are like the individual products going into our mix bag. So, lot of progress over the year really contributing to cost reductions.

And then if we look at Pick & mix, same kind of journey. You see 2019 that was just after the CandyKing acquisition. So, we have more than a 1’000 active items you can see that we aim to be somewhere north of 600, so that also were lot of cost and stock coming out of the system.

Yes, we are taking decisions on the assortment for all the Pick & mix countries more and more centralized. Of course, with input from the countries where we tried and also to have items to be sold in multiple countries, we're also centralizing the buying, sitting then together with the assortment team to take better buying decision. So, we are doing a lot over here as well in order to bring cost down to contribute to the EBIT margin of Pick & mix.

Then you can see again that we are really stepping up, not only in e-commerce but also in quick commerce. That is quite logic, because when you look at quick commerce where people expect to get a product between 20 to 30 minutes, it is in particular the impulse products which are very attractive in that channels from drinks to ice cream to chips, but also Candy is a really big category with a much higher share in the channel than in e-commerce. So apart from our regular products we are also now launching next to, for example, Tupla. We are launching CandyKing in Foodora, CandyKing pre-packed Pick & mix. You can see that on the picture and off to a stellar start. So, also very interesting channel for us to explore and also learn more about consumers shopping in these kind of Q-commerce channels.

Then we are stepping up our efforts in a bit of a guerilla marketing way to bring the CandyKing brand more and more alive in all the markets where we are working. This is what you could say is the advertising for CandyKing. We do that without too much investments because we know that we don't have the enormous amounts of money to support the brand, but still we are working on that to get a lot of free media in social. Here we have a few examples of L, for example, talking about the kind of products we are bringing to the market and we get a lot of consumer reactions and tractions from that.

So in a relatively cost-effective way, we are able to start really building the CandyKing brand and then you can also see that with the approach we have taken that these kind of Buy and Win themes you can see here, one picture, we are implementing something across all the markets where we are active.

So, again using our scale and bringing something of activation towards the customers and their shoppers and that also is reflecting that more and more customers are coming towards us saying, Hey, we really see that you are the only one really doing something professional within Pick & mix.

We would like to switch to your CandyKing concept. And that of course is a great tribute to all the work we are doing.

Then on the Greenfield, I think we've mentioned a few things. The last union negotiations in Belgium are finalized and signed so that is also good for the people over there that they now know how this is going to work out in the coming years. The City Council of Roosendaal, they have now published the intent to sell the piece of land which you see here within the red stripes we were going to build the new plant. So that is ongoing. We had another open day with all the people from the neighborhood in current plan and future plant to explain even more, you know, what is it to produce candy. How do we do that? What kind of things are you expecting when you live not in the neighborhood but when you live somewhere further out of these industrial estates are quite important.

Electricity supply has been ordered. You need to do that well in advance in the Netherlands and then after the summer, we will start with the next phase in the tendering process for the building. There is quite some interest of companies putting forward their intent to put in a quote and there is a quite strict process we will be following to look at that whole tendering to see we get the best quality for the best price.

And then the last phases are happening in the engineering design so that is all the equipment which will go inside of the factory to get the last specifications ready based on the product portfolio and then also the tendering process can start.

And that was the last slide on the strategic update. So, that means we will now be opening for questions.

QUESTION & ANSWER

Operator

We 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 question queue, you may press * and 2. Participants are requested to use only headsets while asking the question. Anyone who has a question may press * and 1 at this time.

The first question comes from the line of Nicklas Skogman with Handelsbanken. Please go ahead.

Nicklas Skogman

Yes, hello, good morning, everyone.

Henri de Sauvage-Nolting

Good morning.

Nicklas Skogman

A couple of questions from my side. So, it sounds like the... I mean input prices have stabilized, but the overall picture is more like it remains flat rather than coming down meaning that, I guess, we shouldn't expect the gross margin to recover perhaps at least for the next quarter. I mean to reach flat it will remain.

Henri de Sauvage Nolting

Yes. I think you are, right. We do see, of course, energy prices coming down, but there is also an important thing over there. I mean, when the newspapers are commenting about energy prices, of course it's spot prices. That doesn't mean that when you have longer-term energy supply that you get these kind of prices, because we also need to be sure that in December or in January we are able to produce.

But of course we see some positive effects from that and that's, of course, also negative effects which is particularly the sugar price, which is historically now at a very high level. And then there is the currency which we also see as a certain commodity, because we buy a lot of... yes we buy a lot of raw materials in Euros or U.S. Dollars. And we also produce in Euros. So, when we look at the second knock with also the British pound here, we see negative effects of that. So, I think your assumption is quite right.

Nicklas Skogman

Alright. But then... if we then I think... I mean, I think the input costs started stabilizing in Q4 in November. So, maybe then early next year, the gross margin impact will be unchanged?

Henri de Sauvage-Nolting

Well, it's not completely... the sugar prices actually have been going up, up till I would say May or so of this year. And there are a few other ingredients, which also have been going up. And what is then going to happen next year... yes, that remains to be seen, right? I mean, that... I don't know at least.

Nicklas Skogman

Yes. Will... have you then continued to hike prices... your prices because of the higher sugar price?

Henri de Sauvage Nolting

Yes, if there is an... in the combination of energy, you mentioned sugar prices and FOREX, you know, we do these quarterly calculations towards our customers in our fair pricing model. And if there is a reason to raise, we raise.

Nicklas Skogman

Yes. Very good. I mean, it seems to be working for now very well. I think Q2 must have been record EBIT in absolute numbers. If... the second question is on the... there's a lot going on in the net financial items section of the income statement, both now in Q1 and Q2, and you mentioned there would have been a massively different impact if you had closed the quarter today. So, what is actually the... what is the actual underlying interest costs or net effect of loans, if you will that you have and that you expect to have quarterly ahead?

Frans Rydén

Yes, I have to give you a gold star here, Nicklas because we saw that you figured out that it was negative 12. And that's sort of how we looked at it as well if we include you know, whatever realized interest and cash pool income, expenses. I mean, the net of the whole thing. Yes, I would say 12.

Nicklas Skogman

Okay. Great. Good stuff. Yes, that was all from me. Thank you.

Henri de Sauvage Nolting

Thank you.

Operator

As a reminder, if you wish to register for a question, please press * and 1 on your telephone, * followed by 1. We have... sorry, we have a question from Michel Keusch from Bellevue. Please go ahead, Sir.

Michel Keusch

Yes. Hello. Just a quick question actually on the extension of the maturities. Maybe if you could just give a bit of background on you know, maybe the reasons for this and also if there are any cost implications of this extension of the maturities?

Frans Rydén

Yes, well... so, we do that on a regular basis. We don't have a setup where you know, all our facility would expire at the same time. So it's par for the course and we've done that at the same terms as we had previously. So, it's... I think it's more of a point of saying that the banks obviously still have a lot of confidence in us and they don't have a problem with extending our facilities.

Michel Keusch

Okay. So, that's just a normal... basically pushing forward of the... of your portfolio's maturities. It's nothing related to the project itself, which is delays or things like that and you want to match?

Frans Rydén

No, that's it... thanks for asking that. No it's a bit of a correction that that's... those are not the facilities that we've entered into for the Greenfield.

Michel Keusch

Yes, okay. I understand. Okay, very clear. Thank you.

Henri de Sauvage Nolting

Good. Then we have an question from Stefan from Nordea ||have the price increases with your customers become tougher?

I would say yes, in general. Of course in this high inflation environment, everybody is being pushed from either raw material side or of course from the general opinion and the public, but we do believe in our fair pricing model where we say we raised a Kroner for a Kroner.

So, if our input cost of raw materials are going up with 1 Kroner, we also price up to our customers with 1 Kroner and that we have been doing and that we keep on doing. And that means that sometimes customers do not agree to that, and then we step away from that business or we reduce that business. And I think we have communicated that also before that we have been doing that in certain markets and we can do that because, you know... as you know, we are quite well filled capacity wise in our factory networks. So, we can fairly easily... I would say we can substitute these volumes with other volumes. Do we...

Frans Rydén
Can I add to that as well, because it's also... because I mean the cost increases has been so severe over this period of time that we really don't have a choice than to push our pricing as well, because otherwise I mean we would make a huge loss on these products. So, it's not... we are not talking about small margins here.

Henri de Sauvage Nolting
Do we expect to be able to continue to offset price increases?

I would say, yes. We will just continue with our fair pricing model in the way we have been working with that. So, I don't see a reason why we should change that or whether we should not be successful with that.

And then there is a question about one-offs related to the new factory fronts?

Frans Rydén
I mean basically we do have, you know, items affecting comparability relating to the new factory as moving on, because there is... you know there is a project team working on it which and those costs, we want to keep separate with full transparency. And what we will continue to do is not only report all the details in the actual report, but also in the presentation we are uploading. We are providing a very clear, easy-to-understand overview of this to see what it is.

Now, the spend that we have is within the numbers that we communicated originally where we say that we have certain one-off costs initially and then we have certain one-off gains at the end of this when we also dispose of our existing property and land. So, we are within the budget that we've communicated. So, it's not an increase per se.

Henri de Sauvage Nolting

Yes, good. Let's check if there are more questions.

Operator

Once again to ask a question from the telephone, please press * and 1. We have no further questions from the telephone, Sir.

Henri de Sauvage Nolting

No, good. Then we will close with a few remarks. I mean a good quarter, a lot of growth of course primarily driven by pricing, but they can mix with volume and if we take some of the... loss customer volumes out, even the branded part is very close to being stable which is a big tribute, I would say, to all the stuff we have been doing in the last couple of years to strengthen our brands and to get consumers to like our products. So, we will continue on that way. Of course, the step-up this quarter in profit is also largely toward... had to the comparator of last year where we were lagging. So, that we also need to be a bit more modest when we think going forwards about the kind of step-ups. But we are pleased with this quarter and we will continue executing the strategy we are executing for the last couple of years. So, thank you very much.

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.

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