Transcription: Q2-report 2014

Title: Cloetta Interim Report Q2 2014
Date: 18.07.2014
Speakers: Jacob Broberg, Bengt Baron & Danko Maras
Conference Ref. No: EV00014517
Duration: 30:16

Presentation

Jacob Broberg
Good morning and welcome to Cloetta Conference Call. My name is Jacob Broberg, Head of Investor Relations, and as always I have Bengt Baron CEO and Danko Maras CFO with me. So I will, as always, hand over to Bengt please.

Bengt Baron
Thank you, Jacob. Good morning everybody. It's a pleasure, this sunny warm Stockholm day to deliver what we feel is a very solid quarter and a solid quarterly report. Going directly into the material looking at the highlights, we'd say that the net sales growing to SEK 1,238 million, which is a 9.5% growth. I'll come back to that in a sec. Underlying EBIT flat, slightly up by SEK 110 million despite having a headwind on the foreign exchange of the Swedish krona and the Norwegian krone, and Danko will talk more about that in a sec.

We're also seeing, which is satisfying, that the items affecting comparability are coming down, and becoming less and important to plan, and that the operating profit increased by 57% to SEK 85 million. Also showing that we are converging the underlying and the reported EBIT, which is also entirely according to plan. Cash flow reversed from a negative to a positive, SEK 44 million, and as previously announced we acquired the Jelly Bean Factory brand and the Aran Candy Company in May, and the net debt EBITDA stays at 4.6 times and Danko will touch up on that as well in a sec.

Going to sales, 9.5% growth in flat-to-negative markets across the board. The only one that has actually had market growth is Sweden, otherwise we are facing a little bit of headwind. Despite that, it's the fourth consecutive quarter with organic growth and in fact 2.2% organic growth, which is the best quarter since the merger of LEAF and Cloetta back in 2012. Also, we are growing in every market except in Italy, and then also we had a decline on contract manufacturing. So all the other markets grew ahead of the 2.2%, which is very positive. The sales decline in Italy, it has been and will continue to be a bumpy road as we've said; we're basically up as often as we're down when we look at the market. This quarter it was a significant headwind in Italy. The good news on that is, of course, that Italy is really big for us in Q4 and because of the seasonal sales of the Sperlari brand, and much less in quarters one, two, and three. And as I mentioned, the market shares grew in most markets as we are growing faster than the market in most places.

With that, I'll handover to Danko and the numbers.

Danko Maras
Thank you very much Bengt, and good morning everyone. I'll start with the top line again. You see the 9.5% growth being itemised. So once again exchange rate we have favourabilities of about 3.7% on the fact that we have exchange rate moving in a strengthening euro. Structural changes being 3.6% and, above all, the organic growth of 2.2%, it's the fourth consecutive quarter with growth. That gives about 9.5% growth in the quarter.

If we then go down and look at the different line items on profitability, on gross margin you've seen that we have 37.8% versus 38.4% last year. That's deterioration of about 60 basis points. That was 200 basis points in the first quarter, so we are lessening the gap there, and yet again we are having the impact of FOREX impacting the gross margin. But also, the technical dilution we were talking about when we have Nutisal included in the gross margin. The benefit we see on top line on revenue on the euro, we see some negatives on the cost side on euros. And for the quarter we are having approximately SEK 10 million of currency impact in the gross margin. And that is what we are doing on the price increases from 1st July, mitigating that through both Norway and Sweden.

If you look at the underlying EBIT, Bengt was saying 110 versus 109, so it's about flat to last year, and of course the FX impact is still there impacting us. But we have less restructuring and the operating profit is improving to SEK 85 million versus SEK 54 million last year, so SEK 31 million or 57%.

Perhaps worthwhile to mention also, if you look at the finance net, you see there is a charge of about SEK 66 million and it's important perhaps to highlight that with the strengthening of euro, and the fact that we are having interest rate swaps in place to hedge out variable interest to fixed for about two and a half to three years, we have to revalue those interest swaps. So its derivatives being revalued immediately, although they actually don't mean any gain or loss from a cash point of view. So in the end, they actually are an effect of accounting that we have to show in our earnings per share. And I'm sure one or two of you know about what we need to do when we mark-to-market those interest swaps.

We also have another accounting entry there that costs us an interest, and that's interest part on the earn-out liability we have on these acquisitions we've done. And because we did that in Q1 and also in Q2, we are now including those. They are together representing approximately SEK 20 million, so that might be worthwhile to remember when you look at the underlying effective interest rate. And then following that, no big items on the profits for the period.

If we turn page and go into the graph, you can still see a good depiction of how we historically have been delivering. The growth year-to-date is 7.7%. The underlying EBIT is flat to last year, a little bit better than last year. Cash flow being both quarter is better than last year, together amounting to SEK 135 million. So if we go to the next page, you can also see the cash flow a little bit more in detail. The good cash flow delivery from the operating activity is SEK 74 million. Slight negative movement, SEK 30 million, on working capital. And here I need the highlight again we are not yet completely out of the manufacturing strategy; so we are ramping down, but there are still effects from the manufacturing strategy having a negative impact on our inventory. So the net impact of the movement in our working capital is about SEK 30 million.

You can see that we are reducing our CAPEX, SEK 44 million versus SEK 54 million, and we are continuing to reduce that as we have said all along to be approximately 3% of our turnover and that is just continuing. The other line item, the other cash flow from investing activities contains two items that are relevant to mention. Perhaps one is the acquisition of Jelly Bean Factory, but also SEK 53 million of proceeds coming in from the fact that we sold the Gävle factory in Q2, helping with the financing of the net impact. Our net debt is about SEK 3.4 billion. Our rolling EBITDA is SEK 760 million; that's significantly higher than last year, therefore, the 4.6 times net debt to EBITDA is equal to last year.

And with that, I'll give the word back to Bengt.

Bengt Baron
As Danko mentioned, we're not entirely through but almost through on the restructuring. And also as he mentioned, the Gävle factory which was closed in December has now been sold. So everything is completed and done in Gävle, and also very gratifying is the ramp-up in production; both Levice and Ljungsbro is proceeding according to plan, and we are actually producing the same volume now as Gävle did before. So we are ramping up and everything is working as well as it should.

What's remaining is the insourcing of the chocolate [inaudible] line Tupla, which is a big product in Finland and also has been launched under the Power Break brand name in Sweden. That has started: in the last two weeks we actually produced finished goods. But of course, it's still small scale and we need to ramp it up, and all of that should be done during Q3 of this year, meaning that we towards the end of the year should be at full run rate of the savings from the restructuring.

Also as announced earlier, we have acquired the The Jelly Bean Factory which is an Irish-based company. Premium product; most of the people who've travelled around the world, and maybe specifically the US, probably know the jelly beans quite well. These are the gourmet jelly beans, meaning that also the core is flavoured. It's not sort of a neutral flavour, but the core and the outer shell both flavoured and leading to a fantastic product. It's a company that has shown nice growth over the past five years primarily in the UK, and some within the US and Canada. It is financially very healthy and has an attractive EBIT margin, so it will support our profitable growth proposition. It fits straight into our sugar confectionery offering, strength of position in the UK, and also has an opportunity to travel into other core markets over time; that will not happen overnight. This is a strong premium position, so we need to expand in a sensible way. And it's all produced in one fit-to-purpose factory just outside of Dublin.

Also about a week ago, two weeks ago, we announced the fact that we will be Coop's supplier of Pick & Mix, both the candy part – confectionery part and also the natural snacking part of it. And we will run the entire concept, which would be very exciting for us. And we are very, very early, so not too many details. We're working together with Coop to really sort of roll out the plan. It will start in 1st January, but we're talking about approximately 600-plus store so it's quite an undertaking.

We will be able to source quite a bit from our own production facilities, but we'll of course complement this assortment with the classics that the consumer is looking for. So we're working through the specific product range at this point in time. And just to remind everybody in Sweden, Pick & Mix is about 30% of the total confectionery market. We do have experience for running Pick & Mix business; we have done so for many years in Finland under the brand name Karkkikatu. So it's not entirely new to us as a company, but it's the first time that we run the complete concept in the Swedish market. So going forward: in focus, it's business as usual. It's about profitable growth. We are stubbornly focused on making sure that we complete the restructuring. Hopefully next time we speak we should be able to say 'done deal', and this box should be gone. And then of course we are working on integrating, accelerating the growth of Nutisal and the Jelly Bean Factory.

We're also active in the marketplace, so as always a couple of highlights on some product launches. There's some seasonals in there; if you look at for instance, Läkerol and the Ahlgrens bilar Glassbilar. We also see that Polly Goes Bananas with Sean Banan. Fantastic success with YouTube if you haven't seen it, go in there and watch the three films. A lot of people like them. We are well over a million, 1.2 million showings, which is fantastic. We also see Goody Good Stuff beginning to roll out, launched in Sweden and in Holland. We see some line access[?] on Gott & blandat TV Mix, two huge brands. Also Jenkki, market-leading gum in Finland. We're also seeing an exciting geographic roll-out of our chocolate products from the Swedish market into the Finnish market, under the umbrella brand Cloetta. So that it is also very early, but exciting to see that we are now starting to move in the direction that we outlined back in 2012.

So with those messages, we feel that we have a solid quarter under our belt. We're staying very active in the marketplace. We're staying consistent in the message: it's about profitable growth from finalising restructuring and integrating the positions. There is headwind from FX. We are addressing that, and we continue. And we all know that the FX has deteriorated further recently. So we're just tracking that with some months' lead time; if necessary, that will be handled again. So overall, we feel good about the quarter. And we'll open up for any questions if you have.

Q&A

Operator
Ladies and gentlemen, if you have a question for the speakers please press 01 on your telephone keypad and you'll enter a queue. After you are announced, please ask your question. That is 01 on your telephone keypad to ask a question, 01.

Our first question comes from Mr Erik Sandstedt from Handelsbanken. Please go ahead, sir.

Erik Sandstedt
Hi there. I'm Erik here with Handelsbanken. And I've got three questions if I may. Firstly, in Q1 you mentioned that earnings were distorted by higher marketing spend and also some lower production volumes. Were there any such material impacts in the second quarter?

Danko Maras
So hi Erik, it's Danko here. So on your first question there, no materially impact. We talked a little bit about absorption, if you remember, in Q1. Now we have some benefits, small benefit, coming through in the second quarter, but no major impact.

Erik Sandstedt
Okay perfect, thanks. Then if we look forward here, I mean with effect from Q3, you will basically start to face more difficult comps on organic growth, as the organic growth really kicked off in Q3 last year. Do you feel comfortable also growing organically on tougher comps?

Bengt Baron
Our ambition is to continue to grow. And as we said, we should grow at least in line with the market. And that's what our focus is and that's what our intention, ambition is.

Erik Sandstedt
But no comments on sort of short term here, looking to Q3 for example?

Bengt Baron
No I – we don't do forward-looking statements. We don't want to do predictions. We feel good about four straight quarters of growth, organic growth, and we're focused on trying to continue to do so according with our targets.

Erik Sandstedt
Perfect. And finally, you might have touched upon this on the presentation here. But on current FX rates, could you see anything about the actual FX impact on earnings in the third quarter?

Danko Maras
Erik, again on forward-looking statements; on backward-looking, I can tell you that we had about SEK 10 million. It was slightly less, but around that level also in Q1. That's the impact, and then of course we are now addressing part of that with the price increases we are doing.

Erik Sandstedt
Do you see price increases mitigating or slowly offsetting FX?

Danko Maras
Well first of all, remember these things take time. It's negotiation. Its customer-by-customer. We have to do it in Norway and Sweden. So on a rolling 12-month basis, our aim is to offset these completely because we see FOREX as a commodity just like any other raw material. And at the end of the day, that should not affect our underlying 14% EBIT margin objective.

Erik Sandstedt
Perfect, thank you very much. That's helpful. Thanks.

Danko Maras
But again, I would like to iterate what Bengt was also saying: the impact of a 50-basis-point decline in the interest rate will – we'll see what happens, and if we have to do more we will have to do more. But the currency currently for SEK and NOK are weak to the euro, and that of course, we have to accommodate and deal with.

Erik Sandstedt
Perfect, thanks.

Operator
The next question comes from Mr Mikael Holm from Danske Bank. Please go ahead sir.

Mikael Holm
First, just a follow-up on the currency. You mentioned SEK 10 million transaction effect on the gross profit: is it fair to assume that some of that was counterbalanced by positive translation effects? Basically translating foreign earnings into Swedish kronor?

Danko Maras
I would say it's safe to assume that Mikael, but it's the residual amount. So I think I will refer to the SEK 10 million as the impact that you should count.

Mikael Holm
Okay, so that's the total FX impact in Q2?

Danko Maras
Yeah.

Mikael Holm
Okay great. And then on the Gävle closure: with this SEK 100 million savings programme with the three factors you mentioned, you said that Gävle was the major part of this. Will we see the full benefit from savings in Q4, and is it valid to assume that it is the largest share of those SEK 100 million savings?

Bengt Baron
One thing Mikael, it's that towards the end of the year we should see the full run rate; whether it's going to be the entire fourth quarter, I cannot predict. It could be a little bit sort of couple of millions here and there as well, but towards the end of the quarter there should be full run rate.

Mikael Holm
Okay. And my last question is about the expansion into Pick & Mix segment: how are you thinking going forward? Do you want to see how best it is progressing before you approach other customers, or – what are your like, three-year[?] views on the Pick & Mix business in Sweden?

Bengt Baron
Our focus right now is to ensure that we service our customer Coop, basically, from 1st January, and that's a huge undertaking. There's a lot of execution that needs to take place, so our focus right now is to make sure that we have a very solid and good launch together with

Coop. We of course believe that we have a very good concept. We have a fantastic product assortment. So if it is successful we would be happy to talk to other customers as well.

Mikael Holm
And what is the main risks in that business?

Bengt Baron
I think – I mean, primarily we have experience from running it in Finland, so we feel quite comfortable in the whole merchandising, the assortment and everything. But of course, it is quite an undertaking to refurbish and build, rebuild, a lot of stores. And then over time – I mean, these are big contracts that are run over a number of years so there is a – it could be a bumpy road; sometimes you win and sometimes you lose.

Mikael Holm
Okay, thank you.

Operator
Our next question comes from Mr Dean Best from just-food.com. Please go ahead, sir.

Dean Best
Good morning. I have a few questions, starting off on the issues in Italy. Bengt, you described the outlook for the market as a bumpy road ahead: why did you call it that?

Bengt Baron
If we looked over the past ten quarters or so, we basically have every other 50% have been up, and 50% have been down. And then sometimes last year we had a string of three quarters in a row where it was positive, and now we have two in a row where it's negative. And we think it is up and down. What we've seen from other companies, in the Italian market it is been a tough market all around during the second quarter. And we think it's going to be bumpy, and confidence comes and goes in the Italian market, which is not entirely surprising given the macros and also the political insecurities there are already in the marketplace. So we're not calling out that it's either going to be very depressing or very optimistic; we believe we should stay cautious. As I mentioned I think, I mean quarters one, two, and three Italy is not huge in our portfolio. But in Q4 it basically doubles in weight. So our focus right now is to make sure that we have solid plans in place for the fourth quarter.

Dean Best
What are the specific issues there? Is it just the fact that this macroeconomic situation is impacting consumption?

Bengt Baron
I think is a combination of consumption, and then as you may recall that there was a new payment law put in place, which is almost two years ago, where it went basically from 120 or so days' payment terms down to 60 days' payment terms. And we were surprised initially that we didn't experience any bankruptcy then, but of course inventory was pulled down and cash shortages, especially in the traditional trade, but also to certain degree in the modern grocery trade. So people are cautious on putting on inventory, and if they do put on the inventory they're not selling through, well then they are hurting the next quarter. And that's

why we think we're seeing bigger swings that you normally see in sort of a more stable marketplace.

Dean Best
Okay. You made a couple of acquisitions in recent months. How happy there are you with your current portfolio? Are there any gaps you wish to rectify?

Bengt Baron
We think there are a lot of Munchy Moments out there that were not satisfying at this point. So we will continue to look for opportunities. It's very difficult to say when and how. We're also not committed to sort of a percentage of NSV or a number of transactions, because we don't want to be slaves to this sort of external commitment. But we're looking for interesting propositions that sort of complement our portfolio; whether it's within existing segments like Goody Good Stuff or Jelly Bean Factory, or whether it's complementary like the Nutisal was. And we will continue to look because we think that we have skills and there is consumer demand with Munchy Moments, and that is our territory.

Dean Best
Can you be more specific on those Munchy Moments that you're not meeting right now?

Bengt Baron
Not really. I think if you think about everything that is in between the three main meals, that are brand-driven and impulse-driven, and that fits our customers' steps and that fits our physical distribution, then I think you are as solidly equipped as we are in sort of thinking what the alternatives are.

Dean Best
Finally, sort of your medium-to-long-term growth trajectory: I'm interested to know if you guys would looking more at emerging markets and expanding your position there, or is your medium-to-long-term growth strategy more about finding pockets of growth in the flat to declining Western European markets that you're mainly in?

Bengt Baron
We would be very excited about finding a good entry way into emerging markets, of course. I mean, it's nice to be sort of more exposed to faster-growing markets than we are right now. However, we are within confectionery. Confectionary is quite a fragmented category and also, as I said, it's impulse-driven through its brands. So you need to have a solid position in order to be in front of the consumer's face, and therefore given the opportunity to be bought by impulse. And to be able to really sort of get the best sort of shelf positioning and in the right slots and promotions, and in the cash registers on the way out, and secondary placements, you need to be a significant player and have a significant portfolio. So therefore, if we were to go into an emerging market, either we have to find an acquisition candidate that has the portfolio whose local impression is culturally similar to us, or we need to find a partner that has a portfolio that is willing to invest and drive our portfolio. That is not that easy. However, I mean we definitely look at those opportunities.

In the meantime, we still think that there are plenty of opportunities to find more synergistic acquisitions and opportunities, as we have over the last year and a half or so. So I think is bold, but it's not as easy getting into the emerging markets. I think a lot of our colleagues in the industry are finding that.

Dean Best
Therefore, would you say that the priority is more for pockets of growth in the more matured markets then?

Bengt Baron
I would say – I mean, the focus is on both, but I would say that the likelihood would be more in existing markets.

Dean Best
Okay, thanks Bengt.

Operator
Our next question comes from Mr Fredrik Villard from Carnegie. Please go ahead sir.

Fredrik Villard
Hi. Good morning. I was wondering, talking a little bit about the gross margin and Nutisal and now the Coop business coming in: would you say – given the type of business that this is slightly different for what you do normally in Sweden, is it a fair comment to say that that has a lower gross margin than you're used to, or do you wish to rectify that statement and say that is perhaps in line with your overall business or even higher?

Bengt Baron
What I can say Fredrik is that is we have – we see no reason to change our ambition level to the 14% EBIT margin, that is what we're focusing at. Then when you do acquisitions – take the Nutisal example: as we mentioned, it will not be EPS accretive until 2015. So maybe it pushes the 14% EBIT into the future, but we're saying: focus on the 14%. It's our mission, and our intent to get there.

Fredrik Villard
Okay, perfect. And just if you could comment on the Coop business; you mentioned refurbishment and then are you going to – how fast will you be able to sort of get merchandise? So will you be able to use your current personnel or staff to sort of spend time in stores? And how are you thinking about sort of – are you taking over the cleaning and the refilling and the – everything in the stores? And how fast will you be able to sort of get that staff in place and get that operation running smoothly?

Bengt Baron
We are – yes. My answer to number one: yes, we will take care of the merchandising and everything that is – and all the practicalities around running the concept. We are looking at the alternatives, on whether to do it in-house or whether to do it third party. So we're working that through. It will be a ramp-up. Our clear intention and desire is to be fully operational, fully rolled out by the very important Easter season 2015. But it will be, as I said, a very hectic period during the first quarter.

Fredrik Villard
All right, perfect, thanks. And just basically, your last comment on your interest rates you paid to your banks on your loans. If we exclude all the hedgings and the interest on the earn-outs etc., what's your interest rate currently?

Danko Maras
So what we have said is – hi, Fredrik. We've said 3.8% is the effective interest rate on the average net debt that we had in 2013. What we're having this year is in that level.

Fredrik Villard
All right, perfect, thanks.

Operator
The next question comes from Mr. Rickard Hellman from Nordea Bank. Please go ahead sir.

Rickard Hellman
Thank you. Just a follow-up question regarding the new Pick & Mix concept. Do you expect a lot of investments in terms of perhaps for racks and things like that, when you enter this market?

Bengt Baron
It will be an investment in racks absolutely, but it will not really rock the boat for us.

Danko Maras
It won't change our CAPEX ambition of 2.5% per year. We will manage that within it.

Rickard Hellman
Okay, thank you.

Operator
I remind you, if you have a question for the speakers you'll have to press 01 on your telephone keypad. That's 01 to ask a question.

Our next question comes from Mikael Holm from Danske Bank. Please go ahead sir.

Mikael Holm
Hi. I just have a question on Nutisal. I think you have mentioned that this business would add around SEK 200 million there, when downsizing the contract manufacturing you have there. But looking at the run rate for the first six months, it looks more like SEK 150 million. Is there something I'm missing there?

Bengt Baron
No, I don't think you're missing anything. And I think what we said the contract manufacturing, the private label business, has not been reduced to a lower level than expected and planned, but probably faster than expected and planned. So it might take us a bit longer to grow the branded sales to compensate that, but we're having some nice growth on the branded sales. And we still feel we're going to get to where we should get to. But we have gotten out of the contract manufacturing faster than we thought.

Mikael Holm
And the branded products; I think you said that that should add around SEK 50 million in growth per year the coming years? Are you trending on those numbers?

Bengt Baron
We're seeing no reason to change that ambition level.

Mikael Holm
Okay. Thanks.

Operator
There are no further questions at this time. Please go ahead speakers.

Jacob Broberg
Okay, thank you very much. I would like to take the opportunity to wish you all a nice summer and holiday in case you have it, and speak to you next time. Thank you and goodbye.