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Cloetta Interim Report Q4 2023 Conference Call

2024-01-26 at 10:00 AM CET

Duration: 36 minutes

COMPANY REPRESENTATIVES

Henri de Sauvage-Nolting, Chief Executive Officer
Frans Ryden, Chief Financial Officer

PRESENTATION

Henri de Sauvage-Nolting

Yes, thank you very much and welcome everybody to Q4 and the full year results of Cloetta. It's Henri over here together with Frans and we will take you through a short presentation and then open up for questions.

So if we look at the quarter and the full year, I'm really, really pleased to say that we had a year of strong profitable growth and we reached a milestone in turnover of 8.3 billion SEK. So that is really, really nice to see that we have continued our growth... our organic growth journey and Frans will build that a little bit further.

So the first time in history exceeding the 8 billion and then we nearly touched the 800 million SEK in profitability as well. So also a milestone, we've never been in absolute terms at that level. So really good to see and a strong testament to all the strategic work we've done in the last couple of years in focusing on operations and of course our go-to-market capabilities in marketing and sales.

So our branded growth was again strong, double-digit, 11%, of course, a lot of pricing. More important, I would say, is that our volumes are relatively stable. And I think that is quite important given the economic climate, what we see around us and how other companies are doing. So that is a very positive note, but of course, we also see that we will be affected by consumers changing their behavior, but so far so good.

Also Pick & mix, strong double-digit growth with nearly 14% growth. And that is despite the fact that our #1 customer in the UK, Wilko, is in administration and there are no sales to that channel anymore. So all coming from the other customers and other markets.

Highest ever full year adjusted operating profit despite the compressed margins, because remember, we take fair pricing, we take krona for krona or the raw materials are up with 20 ore, we raise our prices with 20 ore, which means that we lose on the margin which we cover for the profitability. And most of that, of course, is coming from pricing, with also strong cost control, which together are offsetting the higher input cost. Given the fact that we have strong volumes already year-after-year, and capacity is highly utilized, this is also a fantastic moment or opportunity to start taking out parts of the assortment, which are either small and creating complexity, or are maybe not the most profitable parts in the business.

If we take those out and replace the capacity, we then get freed up by products, which are delivering high margins and are already big in volume, hence creating less complexity and we get more output. I'll come back to that in the end.

Then a big decision is after validation is to make the Greenfield facility in The Netherlands carbon emission free. And that is not technically possible. I'll come back in the end of the presentation on that decision. And I would say also very positive is that the net debt over EBIDTA is now at 1.7, also a historic low in this case, which I think should also give confidence that this is a nice cash generating business and that we look with full confidence to go into the Greenfield project in the future given our position over there. And based on all of that, the board also proposed a dividend of 1 SEK which of course will have to be approved by the AGM.

So with having that said, let's get into a bit more details. Frans, can you take over from me over here? You always know best.

Frans Ryden

Yes. Thank you, Henri. So as we close the year and it is worth repeating,, yes we're really happy to report our first year with net sales exceeding 8 billion. And that follows another strong quarter of growth. So in Q4, we grew 14.5% based on 11.7% organic growth. And that's terrific because it's on top of really strong growth also that we had in Q4 last year. That means net sales are 2.2 billion in the quarter. That's also the highest we've ever had. And that beats the last quarter, which was Q3 with 2.1 billion, which at that time was the highest that we've had.

Now, these sales are aided by the translation of foreign sales to what is still a fairly weak Swedish krona. But also, if I strip out the effect of translation, the Q4 sales would still be north of 2 billion and the full year would also be about 8 billion in sales.

Now, I want to repeat here something that I said in the previous quarter that while the stronger euro helps when we're translating our foreign-made sales and foreign-earned profits to the resulting Swedish krona, it also means that input cost goes up relative to the Swedish krona and the Norwegian krona we earn when we produce products and sell them on those markets. So there is a transaction impact which we also have to offset, and we are taking fair pricing for that.

So moving on then to sales by segment, the branded package sales, they account for about 3 quarter of total sales, they grew organically 11.1%, making this a 12th quarter of consecutive growth.

This growth is primarily driven by pricing now and this is also the highest sales we've had for branded package products, since we started with segment reporting.

So at the same time, the Pick & mix segment grew organically and even stronger at 13.6, which is on the lower half of the slide. That's also driven by pricing and premiumization through the CandyKing concept. And this is, as Henri mentioned, despite the loss of the Wilko customer in the UK as they headed into administration.

Now, volume was not a key driver of this growth. That's almost stable versus last year. And I'd like to break that down a little bit for you. So, firstly, as you probably know, FMCG and also many of the retailers have experienced a lot of pressure on volumes with consumers holding back on purchases. At the same time, we've been really, really fortunate to be able to keep most of our volumes. And being able to buck this trend in the market it's something I'd like to attribute to us only taking fair pricing for our cost increases while at the same time, continuing to invest in our brands.

Now, in Quarter 4, if I exclude the impact of the loss of Wilko volumes, we did continue to do well versus that market. Our volumes are still somewhat down, though, about 1% to 2%. Now, within that, Pick & mix is doing better than Branded gaining, and that excludes UK Pick & mix again, whereas Branded package are down about 2%.

So, regardless of the market, we do have some negative volume development in Branded package, and this type of volatility and challenges will remain going forward, based on how the market looks. But regardless of that, we are immensely proud that our volumes show that consumers continue to enjoy our products almost to the same extent as before, despite the higher prices. But to keep this up, it will be even more important for us to remain visible and relevant to the consumers. And I'll come back to that point.

Looking then at operating profit adjusted. So, while the profit is down as a percent of sales, including given, as you know, we're taking pricing for absolute increases of input cost, and that does compress the margin. While that percent is down, we are pleased to report our highest full-year profit ever at 799 million, so it's just shy of 800, which would be the next milestone to hit. Again, that profit do benefit from the FOREX translation, but on the other hand, we've had to manage also the negative transaction on the imported product, and even if I strip out the favorable currency effect versus last year, the operating profit adjusted would still be the highest that we've had.

Now, if you take a step back and ask what's driving this profit, then the short answer would be that we're just a bigger business now, so we make more money. But when you go one more layer down, then the answer is a bit more complex that there's a combination of the growth, our focus on premiumization, both through innovation, portfolio rationalization, what we're doing on the CandyKing side, also our fair pricing, very strong focus on costs throughout the organization, and of course, also last year, we were lagging a bit, so we have been catching up.

Now, you can also see the volume mix, and it's negative, and the full-year impact is mostly coming from this quarter, and this is pretty directly related to what I shared on volumes, being relatively stable but nonetheless down. There's also negative mix effects in here with Pick & mix growing faster than the more profitable Branded package segment.

Now, with respect to the compression of the margin, yes, eventually, when cost starts to come down, we should see an equal and opposite positive effect on our margins. But so far, sugar and cocoa remains very high, and we are not yet at a point where we believe the pricing should be lowered.

Now, if we look at these segments separately. I think it is heartening to see that on a full-year basis that the Branded package margins, despite the compression, just about held versus last year. But also that Pick & mix, despite the loss of Wilko in Q3, and the sales being out in Q4, just by a whisper, stayed on black numbers, making that 11th quarter of growth without a reported loss.

That said, we will continue to drive all the leavers at our disposal to improve margins, including fair pricing, push for volumes, margin accretive innovation, and here an extra focus on pastilles and gum, which have lagged still a bit from really strong growth that we have on the molded candy. And then, obviously, continuous portfolio optimization and overall strong cost control.

Then moving on to sales, general and admin cost, excluding currency, it is higher on account of salary inflation relating to our own workforce, partially offset by cost savings, and likewise, knock-on effects from inflation at suppliers, including where contracts often are indexed. Again, however, we've been able to offset these costs together with all the other input costs, under the cost of goods sold line and get to an operating profit that is improving. And of course, with a much higher sales, spend at the percent is dropping. So, 160 basis points, better in the quarter, and even more on the full year.

Now, coming back to the investments in our brand. As I mentioned that would... when we had the Q3 earnings call, we made a big step up in Q4 versus the first 3 quarters run rate and we even surpassed some of the spend that we did in Q4 last year. Now, we strongly believe that love brands are the key consumers' willingness to consume our product and customers willingness to buy them at the fair price and even more so more when volumes are starting to be affecting and while we are calibrating this term right now, I do expect us to increase our advertising spend in this first quarter of 2024 by around 10 million to 20 million versus what we spend in Q1 2023.

Then let's look at cash. So there is seasonality to our cash flow. I also shared in prior quarters that our cash flow would improve in the second half of the year. It did improve in Q3 and it certainly improved now in Q4. So the free cash flow delivery for Q4 is 394 million bringing the full year free cash flow to 496 million Swedish krona. So as mentioned, the seasonality is part of that, but so is the increased focus that we have on cash throughout the organization but also because the ramped-up inflation has slowed down a bit. So we are not in a deflationary environment and our working capital did increase during 2023 that's nowhere near what we sold in 2022. So together with the increased focus on cash, we are delivering about 60% more cash than what we did in Q4 2022, so an addition of 153 million, and that's despite the higher external CAPEX that we had in this quarter than Quarter 4 last year.

So for my final slide, I am really pleased to bring here another first for the year so beyond the sales exceeding 8 billion and are strong operating profit adjusted. Now, 2023 is also the first year when we close the year with a leverage as low as 1.7 times EBITDA. That's actually slightly below 1.7 if you do the math yourself.

So our financial position remained strong, despite the effect of input cost inflation and offset in pricing and the effect that that has on working capital with strong growth, improved operating profit, improved free cash flow, low leverage and we have access to additional credit facilities and commercial papers plus cash on hand for a total of 4 billion Swedish krona. So consequently, the board has proposed a dividend of 1 krona per share, which is in line with earlier expressed ambition. This is at upper end or just above the initially referred to 40% to 60% of profit after tax, but it is within the range when excluding one-time cost toward the Greenfield.

And with that back to you Henri.

Henri de Sauvage-Nolting

Thank you, Frans. Really good, and I think also very clear. A few strategic updates and of course, the first one is the decision to go carbon emission free for the Greenfield in the Netherlands, which makes it also the first large emission free candy factory in Europe.

The technical ability has been confirmed that was some work together with partners, we worked few days and we are now fully confident that we can do this. The change does not impact the timeline in that sense, it is very possible to do this. Of course, it does contribute to our science-based targets is really important. A big step actually and also it creates an opportunity to shorten the queue for the electricity connection each new side in the Netherlands needs to ask for because if you go fully emission free, it is possible to get a higher place on that waiting list.

Furthermore, the regulatory decision from the city council is expected in the first half of 2024. We are though progressing and we found a way to close the other factory in Roosendaal the Borchwerf factory earlier than the whole project. So we will close that mid-2024 and the volumes produced over there are either being insourced in other Cloetta factories, outsourced to third party or we decided to discontinue because we didn't see the long term EBIT contribution of that smaller part of the portfolio. That it will also mean that some of these savings will start to come in already this year.

Having all those changes, the good thing is that the net investments remains within the 1.9 billion budget even with the higher capitalized interest cost. So I think that is very good news. We are very confident we can build this plant within this 1.9 billion SEK net investment. And as things progress and we are looking at further savings streamlining even further, we can also confirm that the EBIT contribution of this project is going higher up in the range we have communicated so far between the 220 and 260. So we are getting to the higher level in that range, and where we know more about the last 2 points, of course, we will communicate that. So positive and we are ready to start building when we get the decision, but that's a political process and we need to respect that of course.

We're not sitting idle with the rest of our factories. It's a bit of a complicated chart, but operations is complicated, as many of you know. But there are maybe a few things, which are really important towards the right, of course, we work with safety and quality. Those are the most important things, but we are able to create more efficiency, and with the efficiency, we're able to create capacity by multiple things we're doing in our perfect factory program, but also due to the de-complexification we do in the portfolio. So, our line efficiencies on the most important lines, they improve 2.4%.

I've been running factories that actually quite a lot in 1 year to improve with 2.4%, and that gives us quite some extra capacity, which we can then use to produce more products.

And the last one is then the product scrap. So, this is the waste we create, so the inefficiency in the material we are using in the plant, that is 9.5% down. And of course, that is also saving and helping us on our EBIT journey, and is also good for the science-based target to bring that further down. So, this is all work in progress year-after-year in the lean methodology we have in our perfect factory program.

What else is happening on the sustainability a lot? I decided to bring 2 things out here. One is that we have completely trained and also endorsed becoming directive on sustainable marketing, so that we are not putting out claims there, which are not completely substantiated. We want to be open and transparent when we communicate to the consumer, what are the environmental benefits of the choices they can make? So, the directive is not there yet, but we have implemented this across Cloetta. And I think that is important with all the stuff we do in the sustainability agenda. I think it's better when other people are talking about Cloetta and the great things we are doing, that we proactively start to push that into a marketing agenda. So, we will only do that when we are really sure it helps consumers to make the right choice.

The other one is the sustainable sourcing. You know on the science-based target, there's Scope 1, 2, and 3. The sustainable sourcing is about all the suppliers, who are delivering materials to us from sugar to packaging, and how can they help us to reach our science-based target. So, we've gone back into the supply chain and discussed with the top suppliers what their plans and commitments are for science-based targets, so that we can also see what is the CO2 reduction, we are going to get up to 2030 from our suppliers. It's very good to see that we're finding more and more suppliers who are able to help us in that journey and that we are then able to count in those savings into our supply chain, into our reaching of the science-based targets. And also on that area, when we have figures for you, we will come back to that. But it looks really, really positive, I would say.

Then, we talked last time, a few times as well, about how important it is to get our refreshment category to grow again and refreshment, I'd rather say gum and pastilles. Very important product categories for Cloetta, who took a hit during the Corona times when that habit was less obvious for consumers, they deliver good profitability to our business. So, we're constantly working on activations, launches, and marketing support to bring those categories back into growth, and we get success, so that is positive.

I brought 2 examples over here. One is on pastilles, which is Sisu, it was a pastilles brand. I mean, it's starting to become a lifestyle brand in Finland. And of course, branding is about being liked by people. And now you can actually see that people are really liking it because if you start to put a tattoo of Sisu on your arm, and not that many finsthey are there, then, of course, it really means you love the brand and that we are creating a love brand in Finland. You can see some other products being out there. We took Sisu into Candy. And that for me, you know, these are the assets of this company brands, which people like to buy, and have a connection with, so really important.

And the other one is then Sportlife a Chewing gum brand in the Netherlands, very famous, strong brand. We are strong investors less strong in the kind of tops, you can see over here. We're making very good progress to make inroads into that segment. This is then much more fresh and fruity rather than mint and strong, in particular to attract young people into the brand. And as we communicated before, it's also good for your gum health to use chewing gum, and this is all life in the market. So, very good examples.

Then France already alluded on profitable growth for a Pick & mix, there's many things happening over there, of course, both in efficiency and getting more volumes with the same fixed cost, looking at our cost base, but of course, also pricing is really important, and we call it a premiumization where we add more value to the assortment, we add more value into the Pick & mix shelves, we work with TV screens, we work with activation, retailers are starting to see that, we're getting more and more retailers reaching out to us and say, well, hey, you guys are actually the only ones understanding Pick & mix, can you help us to develop this concept for my store or for my formats. And that, I think is really important in the Pick & mix journey.

And today, I brought you one example because now in Arlanda, which is the main airport in Stockholm, we have opened in collaboration with a local partner over there in the tax-free zone, a Pick & mix store with 13 meters, 1 3... 13 meters of candy and nuts. And I would say, when Pick & mix CandyKing can be sold in the tax-free zone where the rent per square meter is really high, I mean, that also shows that we are premiumizing this concept and that consumers are willing to pay for good quality, in particular in this area. And this is like 9 million people who travel through that airport who will, not all, but it's very visible will see this. And this will contribute again to the brand CandyKing and what people are thinking and perceiving about that brand. So really, really important, so that's very, very nice. And that was the last one. I love to talk more about the business, but that was the last slide for today. So then we open up for questions either directly through the operator or you can do it on the web tool, and then we will see it over here.

QUESTION & ANSWER

Henri de Sauvage-Nolting

And I think we have the first question from Stefan. Our further price increase is needed, if input costs stay at the current level?

And Frans already mentioned that sugar and cocoa are not going down, they even creeped up in the end of 2023. And we also of course are taking in currency as an important one. So yes, we have taken extra pricing already in Q1 in most countries as per the 01^{st} of February and all these deals are done. So that like we did in 2022 and 2023, we get the absolute coverage for any adverse effects in raw materials or currency.

Easter... yes Easter is a week earlier this year, I think we always calculate, I look at Frans that a week is about 2 million euro in turnover-ish.

Frans Ryden

Yes, roughly.

Henri de Sauvage-Nolting

Roughly maybe a bit more.

Frans Ryden

But in terms of timing of earnings, basically I think it's rather the fact that with the market seeing this volume pressure, we will invest. So rather than to think that we would have some sales early and we would see more profit, I would probably go the other way around that we're going to have to invest in Q1 to make sure we had strong no only Q1, but also good Q2, when consumers are actually in the stores and are picking up the product.

Henri de Sauvage-Nolting

Yes, good. And then the market thing spend, I mean Frans already alluded to it, that I really believe that the work we've done in the last couple of years to strengthen our brands through innovation, better understanding consumer trends, but also the investments we've made in marketing that these are helping us to keep our volumes relatively stable.

And that, of course, is really important and, also when we are seeing this high inflation environment and people starting to make yes choices because they get worried about their own economics, it is important to keep the support for our brands at the high level. So what we can say is that our plan for 2024 is to spend more than in 2023. And that's I think where I would rest that question.

And then CAPEX guidance, I'll leave that to Frans. but the only thing I'm saying is I'm really happy to see the full control we have over the CAPEX agenda, not only of course the new factory, because that is very clear, but also that we are seeing the effects of the 3 old factories, which are going to be closed down that we are indeed spending much less over there compared to the past, so that we again confidently can say the new Asia factory is going to have a net impact of 1.9 billion or lower.

Frans Ryden

Yes, I would guess for 2024, so in Q4 now it was a little bit higher than what we're normally landing at and that's... that was a good thing, because we progressed a little bit faster with new folding books packing installations that we have in one of our plants that will really support what we can do on Pastilles and also other products. I would say that is... let's say a little bit depending on the situation, but between 50 million to 60 million per quarter Swedish krona next year and probably then to closer towards the 50 and partially because that we spent a little bit more now in Q4. This is then, a little bit less than what we have been doing historically part of it of course projects that are already in the pipeline that needs to be completed. But, then as Henri said, given the upcoming Greenfield, there are you know, other investments that we're not doing in the plants that would be closed.

Henri de Sauvage-Nolting

Good. So, that was from Stefan. Anybody else, Operator?

Operator

We have a question from Mr. Nicklas Skogman, Handelsbanken. Please go ahead Sir.

Nicklas Skogman

Hello, good morning everyone.

Henri de Sauvage-Nolting

Good morning.

Nicklas Skogman

You continue to deliver high organic growth mostly price driven as you say. When we are looking into this year, how should we think about the timing of your annualizing of price hikes that you did in 2022 and last year i.e. when were the big sort of hikes?

Frans Ryden

How we should think about it? I mean obviously there are some pricing that happened during the year, so there is a carryover effect, financially speaking. Of course, for the consumers, it doesn't look like it changed, because that price is already in the store and it's... and also for the customer it's already a part of it, but then given where, you know, the kind of materials that we put in our products have been heading and also because of the points that Henri mentioned, there is more pricing coming, you know, during the beginning of this year and then it also depend a little bit on when did we take pricing the last time with that customers. It's not the same pricing for each customer, but I expect to continue to see pricing driven growth in 2024.

Nicklas Skogman

Okay. Interesting, and then you had some lags between your input cost coming up and getting prices up in 2022. It looks like you know, during last year was... you were definitely on track. Do you feel the same way now going into '24 that you're tracking well with raising prices in the same quarter that you have your higher cost coming up?

Frans Ryden

I think, yes there will be a little bit of a delay at the very beginning of the year here now. So, maybe a little bit in Q1 where we still need to catch up and then we should be on track in Q2.

Nicklas Skogman

Okay, very good. And then finally I just thought I would ask Henri if you would like to comment on your decision at all to leaving the company in September?

Henri de Sauvage-Nolting

Yes, I think it's... it was a difficult decision, but I also believe that we have achieved here in the last couple of years is really good. I mean, I can truly say that we built a real professional top-notch FMCG company with Cloetta, and I can also see that so many things are happening without me even having to ask for it and that is very positive.

A very strong management team in all the different areas and functions, and if I then look a little bit back, you know, we got Corona, we got the supply chain issues where we were not able to get the raw materials we needed due to the war in Ukraine and then we got this enormous inflation which I have never seen before.

And then we now went in 2024 in a more stable situation, but if I look forward of course we are going to build our new factory and that will start somewhere next year. So, it is very good to make the change right now when we have all the markets delivering the organic growth quarter after quarter after quarter. I mean well, it is now 12 quarters of organic growth. Before that, we had 3 quarters due to the pandemic and then 9 quarters before that with organic growth.

Yes, I am fully committed. I am not going somewhere else to another job. So, I am fully committed to help the board finding a good successor either internally or externally and then make a smooth transition up till September. And that will mean that the new CEO would also then have time to step into the role and get an understanding of the total business and all the projects we are doing and the strategic agenda, make the changes if they want to before we start building the new plants because, of course, now we are all focused on getting the permits and start building. But of course during the building there will be things coming up which needs to be managed and then the CEO at least has 1 year of experience running the business before that happens.

So, for me the issue was, you know, either you make the change now or you stay another 3 years and build the plant and get it up and running and start to produce for a full year and then I came to the conclusion that I would like to spend a bit more time with my wife traveling, with my son who is now... who was 16 and in gymnasium school another 2.5 years and spend more time with my friends. But we will stay in Sweden, don't worry. I will keep on being a Handelsbanken client and then we will see what happens in 3 years' time.

Nicklas Skogman
Alright. Excellent guys. Thank you very much.

Henri de Sauvage-Nolting
Good.

Operator
As a reminder, if you wish to register for questions, please press * and 1 on your telephone.

Henri de Sauvage-Nolting

No, I think.

Operator

No questions from the phone at this time.

Henri de Sauvage-Nolting

Yes, and no questions on the screen either. So, thank you very much. Concluding, very proud, we hit 3 milestones, more than 8 billion in sales, 800 million in profit, and also a net debt over EBITDA at 1.7 record. So, really, really nice. That was it. Thank you very much.

Frans Ryden

Bye-bye.

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