**Transcription**

# Cloetta Interim report Q1 2022

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# PRESENTATION

## Nathalie Redmo

Good morning and thank you for joining us on the Q1 conference call for Cloetta. We are now live, we hope. We had some technical issues here, but hopefully everything should be in order now. My name is Nathalie Redmo and I'm Head of Investor Relations at Cloetta. I'm here today together with Henri de Sauvage Nolting, CEO, as well as Frans Rydén, CFO. Henri and Frans will now take you through our first quarter results and we will then move on to a Q&A session. I now hand over to you, Henri.

## Henri de Sauvage Nolting

Thank you, Nathalie. Of course, we start with the tragedy in the Ukraine, which is, of course, a tremendous suffering with a lot of people affected. There are a few messages I would like to convey on this. Of course, we immediately stopped with our shipments to both Russia and Belarus. Not a huge business for us, so no real material impact for Cloetta. We also worked both with direct contribution to people arriving in our countries and we also did an employee scheme where people could contribute money to the UNHCR, and Cloetta doubled that amount. Then of course, there is an indirect impact from raw material and energy prices going up, and we'll come back to that later in the presentation.

So, we go to the next one. What are the key messages from the quarter? Really good to see that we had great growth and through that growth, more volume and through that volume, more profit. Another quarter of strong growth in the Branded business – well ahead of 2019 as well. So really good to see that. But also, the continued profitability in Pick & mix with all the initiatives we've been talking about in the last two years, that's really showing even now with the Covid impact. And we're coming out of that. So, good, improved margins.

Then we took a lot of pricing in Q1 to cover for the cost of raw materials and energy from 2021. And we covered those costs in absolute terms in the quarter. So, as such, stronger profitability driven by higher volumes, but we also managed to invest in the brands on the continued step up, you could say. And that of course drives these volumes to a certain extent as well.

We had quite some supply chain challenges of raw materials or packaging materials or illnesses in our own plants. But we managed that, and we kept the impacts limited. I would say. Of course, there is still uncertainty in the global supply chain, but we're not the only ones, of course, who have to manage that.

And then we see that raw material and energy, of course, keep on going up in 2022, and that means that we are having pricing plans or pricing actions on the way during 2022, both in this quarter but also in the coming quarters. And then there is, of course, a preparation to see, okay, what happens now in our markets with economies maybe going down or inflation going even further up. But I think it's really good to see also, if we look back historically, that our kind of products and we as a company have been quite insensitive to economic fluctuations in the past. So, that's really positive.

So, 2.5% growth on the Branded business, 24% growth on the Pick & mix business – I would say really nice growth figures.

If we go through the next, what do we see on consumer trends, which is also important to say so. We see a lot of channels coming really back, so we can see out of home – so, everything, which is not supermarkets – coming back, also travel retail really coming back, but not yet at 2019 levels.

We also see the Pastilles category recovering and that's both shopper mobility into these channels, but also the cold care now that people get the flu again. We are growing, but we're not gaining share yet. So that's a challenge we have and we're not at 2019 levels, neither with pastilles nor with gum. Also on gum, we can see that we have growth in the Netherlands, but not yet share growth in Finland. And then candy bag as a category in the Nordics is down. Of course, that is coming from Pick & mix growing, but we are growing. So that’s a category trend. But we, despite the big growth we have in Pick & mix, managed to grow our candy bags as well.

So, a few actions for us. Of course, we need to build more penetration in the out-of-home channel. That's important, particularly for pastilles and gum. We work with the pastilles taskforce to get more younger people who have maybe lapsed out of the category back into the category. We have penetration plan for gum in Finland, which is an important brand for us, and that's further optimisation of the pure media spent on advertising. So, a lot of work to be to be done, but in general very positive.

And then we go to Frans to give us a bit more insights into the financials. Frans, here you.

## Frans Rydén

Thank you, Henri. So, as usual, I will also start with the net sale. And of course, we're really happy to report a strong organic growth of 7.1%. And that adds just about to SEK 100 million to our top line on an organic basis, and including the forex translation, we are reporting a double-digit growth for the quarter and these sales are, again, driven by both the Branded packaged products and by Pick & mix. And as you see here, the Branded grew 2.5% in the quarter as sales were supported by the strong marketing and innovation that Henri also alluded to.

Now, this solid Branded growth was achieved in parallel with Pick & mix growing 23.8%, which is really phenomenal to see. But actually, it will get even better as we look at the recovery of profitability, which I will come back to. Henri already talked about Russia's invasion of the Ukraine, and I can here say that our operation for Russia and Belarus was very limited. On a full-year basis, the loss to our top line is about 0.5% of our sales, and it's limited to that.

But that said, let's look at the segments over time. So, starting with the Branded packaged accounting for the majority of our sales. So, this is the fifth quarter of growth and the sales in this quarter is not only matching but actually exceeding the pre-pandemic sales by 2.6%.

And as some of you may recall, we had eight quarters of consecutive growth prior to the pandemic. So, in a way, we're just now over the halfway point. So, five out of three and counting.

And then moving on to the lower half of the slide and the Pick & mix business. So at almost 24% growth, that of course, is great. And it gets us to an index on a constant currency basis of 87 to the pre-pandemic sales of 2019. So that's another step up from Q4 last year and it's about ten percentage points higher than the average we had in 2021. Now, this growth is also despite that Easter is coming a bit later this year than it did in 2021, and that has an impact, especially in the Swedish market. We're also very pleased with this growth.

Then, moving on to the operating profit. For the quarter, operating profit adjusted is up significantly versus last year from SEK 107 million to SEK 158 million, so almost by 50%. And likewise, the operating profit margin is up from 7.7% of net sales to 10.3. So, let me explain this really strong result and help put that into perspective of both what we've said before and what we're seeing in the market.

Firstly, we had previously shared that as input costs were steadily climbing last year, be it raw materials, packaging, energy or transportation, we were partially protected at that time to inventories and forward-buying contracts, but that we would start to see the costs coming through properly in Q1 2022. And I also shared that we were both committed and confident in our ability to offset the full absolute impact in 2022 of those costs. And that is also what you see reflected in these results. We worked with our customers last year to ensure a fair pricing commensurate with these cost increases, and that new pricing became effective in Q1, with very few exceptions, offsetting the cost increases.

Now, what is not in these results, neither as an input cost nor additional pricing, is the full effect of the acceleration of cost increases that have happened following Russia's invasion of the Ukraine. So, we are now seeing drastic further increases to input costs, be it energy or the glucose we use that come from wheat and where Ukraine is a major global producer. Now, our commitment to ensure fair pricing for our products also with respect to these new costs remain unchanged; however, there is a timing difference between when the costs go up and when commensurate new pricing comes into effect, and the cost inflation in the second quarter will only be partially offset.

Now, on the full year basis, where commodities will end up, I think is anyone's guess. We, however, remain committed to addressing this, and based on what we know today, we're still confident that we will be able to manage the costs through pricing and other actions within the year.

So, the first point here is that pricing is offsetting the input costs in the quarter. That means that the key driver to the strong margin and profit improvement is our sales. We have again in this quarter invested heavily behind our brands, giving our sales team's efforts an extra boost, and that has driven not only strong volume growth and better fixed-cost absorption. And we have continued other margin-enhancing initiatives, especially on Pick & mix. And I'm going to share a bit more about the marketing investments and indirect costs shortly. But in combination, this allows us to match the gross margin we had in Q4 2021 at 36.4%, which is actually really great. Normally in Q1, margins tend to be lower than the preceding Q4 given our seasonality of the portfolio. Now this gross margin is of course, very significantly up versus 2021, but that is also, let's say, an easier comparator given the circumstances at the time.

Then moving on to the profit by segment and starting with the Branded package business on the top row. So, the operating profit adjusted, and the margin is up versus last year, adding 90 bps to get to 12.8%. And that's despite the step-up in marketing spend. Now, the unfavourable mix due to lower refreshment sales is still suppressing the operating profit below the 14% we normally quoted for Branded portfolio pre-pandemic, but that is also an important opportunity for us as we start to regain that. It's also important to note that in the step-up in profit versus last year, the real step up is a bit hidden by the fact that we spent a lot more on marketing in this quarter. So, the quality of this result again is very high given that we are not starving our brands, but on the contrary, we are fuelling them not only for the quarter but also for the quarters to follow.

Then, with respect to Pick & mix, this is now the fourth quarter back at profit, which I believe shows that the recovery has been sustainable, and versus last year, it's actually a fairly staggering double-digit margin improvement from minus eight to plus two. As I mentioned before, though, and I want to repeat that again, that this result does include Pick & mix also having absorbed its fair share of common costs in head office, IT, supply chain, etc. So, the segment does provide a favourable contribution beyond the reported profit. We've also said, however, this is not where we're going to stop and input costs aside for a moment, as volumes continue to recover so will profitability improve and we will continue with other margin-enhancing initiatives, better pricing, reducing costs in distribution, warehousing, merchandising and support functions

Moving then to sales, general, and admin costs, including the marketing spend. The increase here is driven by the higher marketing spend as well as higher selling expenses to drive the growth that we are talking about. The comparator from last year also benefited from certain one-time cost avoidances, that includes earlier provisions for long-term incentives, which unfortunately the pandemic rendered unachievable that we could release at that time. And part of these increases are offset by further savings coming from our VIP+ cost programme. And in the quarter, the Swedish business went live with their new joint sales force between Branded and Pick & mix, which is serving us well.

Moving then to the cash flow. Now, when you look at cash, you have to recall that our business tends to generate cash in the second half of the year, whereas in the first half we build up inventories, etc. Now in Q1, the cash flow we see is affected by exactly the same thing. Inventories and associated payables are going up a bit more than normal, of course, because of the cost for those inventories. And we're also securing customer service levels given the uncertainty in supply chain currently ongoing.

In addition to that, our receivables are up despite the later Easter, but that's on account of the strong growth. So consequently, our discretionary cash flow for the quarter is negative, including after about 50 million in CapEx investments, which is roughly what we tend to spend. But it's difficult to draw too much conclusion, but looking at the cash conversion cycle, however, we are down nine days versus last year and that does make a lot of sense directionally given the increased focus on cash we have introduced in the last few years.

Which brings me to my last slide and on our financial position. Looking at leverage and net debt, and that's on par with or even improved versus Q4 last year. And you may recall that I shared at the time that was an all-time best since the Cloetta and LEAF merger in 2012. So, as we close Q1 now, our net debt remains at SEK 1.7 billion and we have additional unutilised credit facilities and commercial papers and cash on hand for an additional 2.2 billion. Now, in addition, we close the quarter with a net debt over EBITDA even below Q4's 2.0 and leverage is now at 1.9, well below our internal target of 2.5 and the lowest for as many years as, frankly, anyone in the company could remember.

And on that positive note, back to you, Henri.

## Henri de Sauvage Nolting

Yes, good. Thank you, Frans. A few examples on our strategic execution. We talked a lot about consumer trends and how we want to capture the amongst all those natural trends. So, it's nice to see that now also our real fruit launch, which is something really difficult to achieve. I think we're the only ones at the moment who are using more than 50% fruit in candy. How that launch has now also hit the Dutch market, meaning that this launch is now live in five countries. So also, a nice testimony to our innovation 2.0 journey where we are making launches being launched in more than one country. So really good to see.

And we go to the next one, which is premiumization, where we say we really want to also get price growth through premiumization. This is a product we launched under the Liquorice brand in the Netherlands. It's a core of liquorice and then chocolate around it. And it's a big success, not only because the consumers are voting this together with retailers as the best product introduction of the year in the chocolate and candy category. So, real testimony that this is something which is really increasing the category value and really liked by consumers, but it's again really helping to premiumise. And if you look at the price per kilo, it's 100% higher than the regular range of Venco. So also, really executing the strategy we have been talking about.

And then last but not least, how to step up – we go to the next one – how to step up our capabilities in customer development. It's a journey we started in the Netherlands a number of years ago, really investing in top-notch capabilities and category management, in trade marketing. Also, our e-commerce capabilities, really important given the fact that most of the retailers in the Netherlands are a few years ahead here from a Nordic perspective in e-commerce, and again, a big piece of research by university, together with an association of retailers, voted Cloetta as the best supplier within the confectionery and snacks categories, leaving the Pepsis, and the nonetheless, the Mars, etc. behind us in capabilities working towards the trade. So that's really good.

It's also something we are copying in the other countries now that we are one Cloetta and working on things like net revenue management, promotion, evaluation tools, category management approach. We are spreading that same skill set across the countries because this is really an important asset to have in order to execute and commercialise our brands in the best possible set with our customers.

Then concluding, the premium mix in Finland; we talked about that before, and here on the right, you can really see there's a lot of demand, more than we can actually manage.

A lot of the store owners are asking for this premium mix. It's €1 per kilo more expensive than the regular Candy King, but a lot of positive consumer reaction. Even more volume we sell on a like-for-like basis through this programme. So again, very nice piece of evidence that the premiumization within Pick & mix can be done since it delivers not only very happy consumers, but also happy customers who see this as a really differentiating factor for them.

And then we go to the last part, which is then the strategic priorities. They stay the same. Of course, we're working on slightly different things. So Branded package, and we keep on working on strengthening the top 25, the recovery of pastilles and gum. More fruit tech innovations like we talked about, the real fruit, or the Venco Choco D'rop we just talked about, and of course, a lot of price increases being implemented, having been implemented, and going forward, to be implemented, where we just keep on our strategy to cover for the cost increases of the input cost.

Number two, we keep on working on the sustainable value creation for Pick & mix. We're relaunching Parrots, which is really good as well because it has a nice margin, new visual expression. The premium mix I talked about has a really good e-commerce pilot we are doing in Denmark, which is showing very good results. Again, we're the first ones over there with an application, which is really something which hits the consumer interest. And here, of course as well, price increases to cover for the higher cost inflation.

And then three, cost and efficiency, Frans already mentioned an integrated sales organisation has other advantages as well. Maintenance systems in the second factory life and then the NRM, net revenue management, launched in our five markets. So, really important that we get bang for our buck, so the money we spend on promotions or trade terms that we get what we also benefit from. And then a promo evaluation tool, that's the latest technology, I would say, available in Europe, to better evaluate the strategy and the effect of promotions across our core markets, again, to get more bang for our bucks.

Having said that, we are at the end, and we want to open for questions.

# Q&A

## Operator

Thank you. Ladies and gentlemen, if you wish to ask a question, please press 01 on your telephone keypad, and if you wish to withdraw your question, you may do so by pressing 02 to cancel. We already have one question coming from Nicklas Skogman from Handelsbanken. Please go ahead.

## Nicklas Skogman

Thank you very much. Good morning, everyone. Can you say anything more on just how big this mismatch between price hikes and cost inflation will be in Q2 and perhaps also what you see in the quarters beyond?

## Frans Rydén

Well, I think, starting maybe with where I left off that, let's say, our track record was that we said we were going to offset the costs that had increased last year, and we've done that in Q1. And now we're saying that we're still committed to doing that on a full year basis. And based on what we can see today, we're confident that we will be able to do this through pricing or other things. Now, of course, exactly where commodities will land in Q3 and Q4, that's of course, not a certainty. And anyone who claims to know that is probably exaggerating their capabilities slightly.

But based on what we know today, we're both committed and confident in our ability to manage these costs. In the quarter, there will be a phasing difference. But, let's say, it's a limited impact on the quarter. It's not like as if these new costs just hit us from day one in Q2. Of course, they've been gradually going up and we have, of course, continued to work on pricing. So, there is a part of it that will not be offset. We're not saying that the full cost increase during this year won't be offset at all.

## Henri de Sauvage Nolting

And of course, all our cost elements we can work on to mitigate part of that gap which we might get in the quarter. But of course, it's so volatile that we have to manage that on nearly a month-by-month basis.

## Nicklas Skogman

Okay, great. So, you're sticking to the comments you said before about on a full-year basis, offsetting the absolute cost increase?

## Henri de Sauvage Nolting

Yeah.

## Nicklas Skogman

Okay, very good. And those other cost elements you said you'd be able to work on, that includes some SG&A costs like marketing and so on.

## Henri de Sauvage Nolting

Yeah. Now you're in the factories' production, production costs, marketing investment to face that in a proper way. So, the more levers, of course, to work with to get a balanced delivery.

## Nicklas Skogman

Okay, good. I was just a bit surprised that you see COGS impacts from the Ukraine war already in Q2, given the normal time lag between your sourcing and also producing. I mean, you produce what you sell in Q2, you've mostly produced in Q1 already, right?

## Henri de Sauvage Nolting

Well, that depends. I mean, on some products, yes, on other products not, because, of course, we see a lot of volume growth. We've also seen stock levels in retail on certain items being low and we're just able to deliver what is being sold. And then when we talk about the supply chain disruptions, we have seen, of course, both suppliers to us not being able to deliver on time. And also, in Q1, we still had an effect from absence levels in our own factories due to COVID, which meant that we've not been running at 100% capacity in all these three months. Some of the products we are selling in Q2 are being produced as well in Q2. So, that's not completely true what you were saying.

## Nicklas Skogman

Okay, perfect. Last question is on this refreshment category. As the market, at least for Pastilles, are up year on year, gum seems to be flat. But as the quarter has progressed, Sweden I think opened up early Feb. Have you seen those trends moving in tandem, refreshments picking up as societies have re-opened?

## Henri de Sauvage Nolting

Yeah, as I said, we see on refreshment, we see two effects on Pastilles in particular, it is the mobility coming back, people going out again, people going into town, people going back to work, to school, etc. And that mobility drives as well mobility within the out-of-home channels, where a lot of these sales on impulse are taking place. And the second big effect is that in the last two years, because of all the corona restrictions, the regular flu season wasn't really there. But now people are getting flu again and getting sore throats, etc. We can see the medical or the semi medical pastille coming back. Not to a level which is more than before, but that is also adding to the growth on the pastille's sales channel.

We see those two things happening now. Of course, we are not so big, or in Finland where we have the semi medical pastilles as well, but we see traffic coming back in these out-of-home channels. So that is positive, but we're not where we want to be. Then, the refreshments, it's the same traffic we talked about. Of course, there's no cold care there. We see, basically, in two markets. We see in the Netherlands that we were, and we are, quite strong in the out-of-home channel. Our product packs are slightly more suited for the out-of-home consumption. People going to school or work or out for a night, there we see a really strong recovery versus the retail channel where our competitor is relatively stronger with bigger packs and jars, etc. We benefit from that with really nice growth and also really nice market share growth.

And in Finland, we can see that we are by far the biggest. We are more than 80% market share within gum. So, there we are not back yet. The category is still down. Also, the Finish restrictions took a bit longer than in the Netherlands. There's a lot more work to do to bring that profitable business back to where it was in 2019.

## Nicklas Skogman

All right. Thank you very much.

## Operator

Ladies and gentlemen, as a reminder, if you wish to ask a question by phone, please press 01 on your telephone keypad to enter the queue for the question-and-answer session.

## Henri de Sauvage Nolting

Maybe we can, while we're waiting to answer the questions which are coming through online. Let's start with the first question. What are we planning to do with the accumulating extra cash and what will be the level of internal marketing efficiency of the growth investment? And it talks on initiating share buybacks to return extra cash.

We stick with the financial framework we have, which is about a dividend between 40% and 60% of our profit. And that's no change to that for the time being, and no talks about share buybacks or things like that. But of course, if we're going forward, there might be other opportunities to use that extra cash in order to support us on the journey towards the four financial goals we have.

Then a question from Andreas from SEB. Given that we've already implemented efficiencies in various programmes, what are required from here to get to your targeted operating margin? And of course, that is back to the journey we stipulated, I think, was it last time or the time before? There are a number of buckets where we said, okay, we need to get the Branded business to grow because it helps us. And Frans already alluded to the recovery we need to make sure happens within the refreshment because that is helping the mix within the Branded business. So, that is one. The second one is then the Pick & mix. We had this gap in profit on Sweden. Well, we've covered that, so that's very positive. But in the meantime, of course, due to COVID, we lost quite some volume in all the markets. And being this, the Pick & mix business with the merchandising, volume is quite important.

So, now we see the volumes are coming back. We are not, of course, if we grow with 25%, we do not see the cost going up by 25%, it’s really limited. There's a big scale advantage in that business. So, we need to get that volume back and there we need to continue with the premiumization because growth is not the number one priority. The priority is to get to a good single-digit EBIT on the Pick & mix business.

Number three is the perfect factory programme we talked about and how we optimise our supply chain footprint to invest in the technologies which are really strategic to us. And we can see that we've done a lot of good progress, I would say, but by far we're not at the end of that journey. And then probably what you're alluding to is the VIP, which was very much the indirect component. And yes, we've done a lot over there. We still think we can do further steps. But of course, low hanging fruit, we've taken out. Hence, the thing we launched last quarter, the net revenue management, because that's a lot of money as well over there, which we spent on promotions, on trade terms, on pricing. And to make that money work better for us, it's either going to give us more top line or it is going to give us more gross margin.

So, I would say those are the levers which are still in place in order to get us to the 14%. Maybe Frans, you take the last one. What to make of your stronger-than-targeted financial position, which is maybe a bit the same as the first question.

## Frans Rydén

Yes, Andreas, it's a fairly open question, I guess, what to make out of it. Of course, I'd like us to make out of it that we're delivering on our commitment and we're doing what we said we're going to do. But of course, it is good to see that we're coming out of the pandemic at this end of the spectrum and not on the opposite side. And then in terms of using cash, etc., it's as Henri said, we've laid that out previously as well in terms of, number one, invest behind the business and dividend and acquisitions is only if it's the appropriate targets that are accretive, etc. to us.

## Henri de Sauvage Nolting

Good. Any more questions online or coming through? No? Good. Well, then we conclude. For me, the conclusion is we had a really good volume growth in the quarter, giving us a lot of extra profitability whilst we have been able to price for the absolute amount of input cost increases known, let's say, in Q4 2021. Unfortunately, that's not the end of the journey. We are, and we have to do more in order to compensate for further cost increases during the year. So, thank you very much and talk to you next quarter.

## Operator

Ladies and gentlemen, this concludes today’s conference. Thank you all for participating. You many now disconnect.