

Full Regular Transcription

Creo Media Group AB

Cloetta Interim Report First Quarter 2023 Conference Call

2023-04-26 at 10:00 AM CET

Duration: 35 minutes

COMPANY REPRESENTATIVES

Henri de Sauvage Nolting, Chief Executive Officer

Frans Rydén, Chief Financial Officer

Nathalie Redmo, Investor Relations

PRESENTATION

Operator

Ladies and Gentlemen, welcome to the Cloetta Interim Report Q1 2023 Conference Call. I am Sasha, 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 handover to Nathalie Redmo, Head of Investor Relations. Please go ahead.

Nathalie Redmo

Thank you for joining us on the Q1 Conference call for Cloetta. My name is Nathalie Redmo, and I am Head of Investor Relations. I am here today with Henri de Sauvage, CEO of Cloetta and Frans Rydén, CFO. Henri and Frans will take you through our first quarter results, and we will then move on to a Q&A session.

And I will now handover to Henri.

Henri de Sauvage-Nolting

Yes, thank you Nathalie and welcome everybody. A new year, Quarter 1 and we are off to a very strong start when you look at our growth which is also bringing us volume through Easter, and of course, all the other things we have been putting in place in the last couple of years, so very proud the fact on that we have volume growth as well in the business. So strong growth in branded, driven by pricing and enabled by our strategic marketing investments, we can see that our brands are a lot stronger than they were a few years ago, so that's even at higher prices, people continue to buy our products, so that's really encouraging to see. Also very good to see now the 8th quarter of volume growth in Pick & Mix and as you know, more volume in Pick & Mix is generating merchandizing efficiencies, of course it also helps us in the factories to bring the unit cost down and that helps us to improve our profitability on that segments.

If we look at pricing, because of course there is a lot of pricing, the pricing corresponds to the input cost, so 0.10 Euro up in raw material, energy also means that we raise our prices with 0.10 Euro to our customers. On the other hand, the improved profitability is coming from mix, volumes and also cost efficiencies, so mix within the portfolio and also between the countries is very positive. Volumes are up and again that helps us both in the factories to get better transfer prices, but it also helps us of course in the whole merchandizing fixed cost elements of the business, and then the cost efficiencies are there again as well.

The new green field project is proceeding, the design work has been finalized, and we have brought that into the City Council from both the zoning permit and environmental permit into one process, so that is now starting. But we also think that the regulatory process will take longer than estimated. There are a few things which have been changing in the last couple of months, so we now expect the major investments to happen in '24 and not in '23.

And when I look at the net debt over EBITDA, we're well below the targeted 2.5 factor for that. So, looks off to a good start with of course pricing very important, volume very good to see that we are... that we are positive and attribute to all the works we have been doing to both Pick & Mix and the branded business in the last couple of years that we are able to keep it at that level.

With that, I hand over to Frans to take you through the financials.

Frans Rydén, Chief Financial Officer

Thank you Henri. So our organic net sales growth of 23.5% is the highest we've had in any quarter, that's more than 500 bps higher than the second highest quarter, which was Q2 2021, when we were bouncing back from the first shock of the pandemic. But not only that, at net sales just shy of 2 billion Swedish kroners, it is also the highest sales we've had in any quarter, so it's not just a rebound here now. Now the carry over effect of our pricing taken last year, of course compared to with a not less pricing in Q1 2022, and our new pricing taken in Q1 this year, is of course a major contributor to the growth.

So let me comment first on that, also given the attention that pricing has had in the media. And as Henri mentioned, we have shared also for some time that we are taking pricing to offset our own rising input cost. And you will see later on in this presentation that our growth in profit is not coming from the pricing, but from the effect of our other efforts to strengthen Cloetta.

Second, and unlike let's say electricity or food, where the consumer does not have any real choice to paying the higher prices, if they want to run their homes or feed their families, the consumer is completely free to decide to buy or not to buy our products, and we are incredibly proud that so many have chosen to continue to enjoy our brands in these times. And connected to that neither customers or consumers will accept higher prices by default, but our products have this pricing power is the result of the multi-year effort to strengthen the quality of the products, and the quality of our brands, and of the organization that carries out the work across our functions and markets.

Now, moving then to net sales by segment and starting with the branded packet sales. Accounting for close to 3 quarters of our sales, it's growing by double-digits over 20%. And this is the 9th quarter of growth, which means that we have now beat our pre-pandemic record of 8 consecutive quarters of growth. And this is also the highest sales we've had for branded package products, since we started with segment reporting. And I would argue also before then. Now this growth is driven, as mentioned primarily by the pricing but also by a favorable mix, both geographic and category mix and we've had very strong volume growth in pastilles.

Overall volumes are down somewhat in branded, but I would argue that the underlying volume is holding given that negotiations are ongoing with some customers relating to our fair pricing and that has affected the volumes slightly.

Now, despite this, for total Cloetta volumes are growing versus Quarter 1 last year and that growth is driven primarily by our Pick & Mix segment, which you have on the lower half of the slide and where you see Pick & Mix growing a staggering 32.7%, making this the 8th consecutive quarter of growth with profit in Pick & Mix. Now, same as for branded in this quarter, the Pick & Mix sales are the highest we've had of this segment and this growth is of course also driven by pricing but also by premiumization and as mentioned, by pure volume, and where I should add that Pick & Mix is also the bigger benefactor of the 2 segments of the earlier Easter this year with around 20 million in extra Q1 sales.

So let us look at the profit. On the operating profit, we are pleased to report a very strong quarter where our pricing has offset the higher input cost in line with what our stated ambition is and has been. But then we have been able to improve our profit through the volume growth, the favorable mix as well as continue to pull all other levers to our disposal. Efficiencies in supply chain with a higher volume Easter helping there as well, as well as, build some extra inventories in the quarter on the back of good performance on the production lines.

Volumes again, Easter helping... helped with efficiencies in merchandising, Henri mentioned that, although the overall sales general and admin cost increased with the salary inflation also in our own company, and despite somewhat lower marketing spend in Q1 this year than last year.

Now, we are very pleased to have been able to keep the adjusted margin double-digit for Q1 at 10.1% of the net sales. It is down versus last year, which is an effect of the compression from pricing, which offsets cost, but does not generate profit. It is challenging to offset that effect, but eventually, as I have also mentioned many times in the past, cost will start to come down, and then we will see an equal and opposite positive effect on our margins.

Now, some costs have come down already this quarter, such as energy, but the effects linger, and that will do for some time, for example, through the salary inflation throughout the supply chain, whether in our company or for our suppliers.

Now, not all costs are down. For example, sugar is around and all-time high, and Europe has a sugar deficit. So imports also carry extra cost of customs duties and transportation. And gum-arabic, which we used in pastilles, may be affected by the strife in Sudan. Then, of course, any imports to Sweden and Norway with the currencies weak means extra cost for us. That said, last year, we proved, and I think we did again in Q1 this year, that we will continue to take fair pricing to offset our own input cost, and we are not stepping away from that approach.

So let's look briefly at the 2 segments separately. I'd say briefly, because it's pretty straightforward this quarter. Again, it's a pricing offsetting cost, both categories helped by efficiencies while branded has the favorable mix with the strong pastilles and Pick & Mix has the solid volume growth.

The numbers show the same direction, with profit up in both segments and the compression still holding branded package margins short of last year. But you can see that the improved margin in Pick & Mix is despite the same compression. I've also said this before, but I think that the hard work on building in Pick & Mix is evident from the ability to avoid making a loss in the current environment, rather than seeing as a stagnation on the journey. And that dispositions as well to reach mid-single-digit margins in Pick & Mix, 5% to 7% in the midterm.

Moving on to the sales general and admin. And I think yes, so with the pricing raising the top line, there is a significant drop in spend as percent of sales. So it's a bit the same compression you see here, but helping us. So from over 26% to just over 22% of sales. And that is despite the impact of the FOREX, which adds 16 million to the reported sales general and admin. Excluding the translation effect, we are controlling costs, not only with respect to the marketing spend, which is slightly down this quarter, but also holding back increasing costs such as in merchandising, below the continued growing volumes.

Now, despite this, costs are nonetheless up given the salary increases. Now this impact not only our employee salaries, but also those of suppliers of various services where contracts are often indexed. However, as we saw in the bridge for operating profit, we are able to offset these costs through our own efficiencies, premiumization and that is also what we will continue to do to complement the cost controls.

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 Q1 wasn't different this year and coincidentally generated exactly the same free cash flow as we did in 2022. Now, that is despite the significant effect of the increased input costs and our commensurate pricing and how that affects the working capital, which is already tying up cash in Q1 in line with our normal C-slot pattern of billing inventories. But the effect here is enlarged.

So basically with the higher input costs, that increases our payable, which has a positive effect on the working capital, but that is being more than offset by the resulting higher amount of cash tied up in inventories and the higher amount of cash tied up in customer receivables, even if we would have held volumes and sold the same amount of volumes as we did last year. But then again, also this is something that over time will reverse itself out. And in the meantime, we're putting extra focus on cash management during 2023.

On CAPEX, the spend is a bit lower than our most recent run rate of about 50 million Swedish kroners per quarter. Now, with respect to the Greenfield, last quarter I shared that CAPEX spend for it would not materially affect the first half of the year. And as you heard Andre confirm, we now expect that any material CAPEX spend won't be initiated until 2024, given the timing of regulatory processes.

Now, given that timing, I also want to comment on the items affecting comparability relating to the Greenfield. We have again provided the details in the report and a hopefully helpful bridge at the end of this presentation. Now, each quarter we reviewed the accounting for the Greenfield for any necessary updates. And as you understand with the increased salary inflation, we have made changes versus what was originally assumed for severances. And now with the shifting timing for the Greenfield, that impacts both provisions as well as impairments, although partially offsetting.

Nonetheless, this falls within the range of numbers previously communicated for the Greenfield. Actually, in some ways, of course, a later cash outflow will not hurt at all as the currently high interest rates are expected to start to come down next year.

Going back to the cash flow, something that has not affected the free cash flow, and that are the high net financial items in the quarter. The simple reason for that is that they are mostly unrealized exchange differences, which are not part of the operating cash flow, but form part of the exchange differences. They do not have an effect on the net financial position though. So let's move to that, my last slide.

So our financial position remains strong. Our net debt does not exceed 2 billion. And our leverage is also at 2 times EBITDA, well below our long-term target of 2.5. And this is despite the impact on our net debt on account of the unrealized exchange differences that I mentioned. Our utilized credit facilities and commercial papers and cash on hand were 3.8 billion, including for the agreed financing for the Greenfield. And you have the details shared in the annual report and at the investor event earlier this fall available on our website.

Now, finally, 478 million in cash, the green box at the top of the right-hand side is maybe a bit much, but then it has declined significantly since then with the payment of the 1 kroner dividend per share in dividend in April.

And with that, back to you, Henri.

Henri de Sauvage-Nolting

Thank you, Frans. So a few strategic updates. The Jelly Bean Factory is one of our international brands. And we've just executed a complete review of the brand-positioning making it much sharper and we can see that this is already helping us to get more growth in the core markets and international of the Jelly Bean Factory. So, you can see both the design is sharper. We are having great success on e-commerce with Jelly Bean. It is also a product and a brand which is more in the gifting area. We are now live in Amazon U. S. as well after the successes we have with Amazon in Europe, in Germany and in UK. So, really picking off and also Easter was very good. Then it also is really working well for us in travel retail. So, airports, I myself flew back from Malaga after Easter and then you know, gave me such a great feeling if I see big Jelly Bean exposure in the... how do you call it, duty-free shop over there and people shopping and looking at that. So, that's really building for the future a strong and profitable brand. So, that is one.

Then of course, in our core brands, we know also now within the current environment. It is so important to focus on the core of your brands and not to venture in too many new initiatives. So, just to share you what is happening. You can see Lakerol a mix of 3 of our bestsellers into one box, really targeted at young people. That's where we want them to enter into the brand that you can see the results from Nilsson, the fastest-growing SKU in pastilles are really good. Then Mynton that's a zip mint pastille in Finland just being launched, very good to see that doesn't happen, that often that it is the 1 in Kesko which is one of the 2 big customers in Finland.

Then also, another example, Tupla our count line from Finland, every year we come with addition, a new flavor to entice people within the brands, and bang 10% market share, 1 count line in the market. So, these are just a few examples of what we are doing to grow the business to keep our volumes and as we are directing most of our effort to what is core brand, because that's where the business is and that's where the money is.

Yes, we talk a lot about Candy King. We talk a lot about the cost and the merchandizing efficiency and all the other stuff we have been doing to make the brands profitable and we are showing profitable growth in a very low-cost manner, the team, and that's the beauty with one brand across this market with similar consumer behavior and the team is able to generate more and more, let's say, earned media on platforms like Instagram or TikTok and other traditional newspapers.

And then it's really starting to have a positive effect on the brand. It starts to have a positive effect, of course, on consumer behavior, but we also see which is very good to see, more and more customers who were approaching us who want to move into the Candy King brand and that's happening across markets, where we then get new customers who really like the Candy King brand and the fact that they see this also in media or on social media, so very positive.

And then of course, with the Greenfield, I mean we are spending a lot of money and we realized that we feel it's also important to keep you updated on how this is going to look. So, here you have like a bird's eye view of the industrial area which we are intending to purchase and to buy, so that the greenfield is within the red line. You see this road going across with the red line and then you see the black building which has the Cloetta logo. That's the warehouse and then the actual plant is the big building behind the black building and then on the left, you can see an amenities office, canteen, changing rooms place et cetera. So, a big square box and you see grass towards the right. That is where we can extend in the future and it is well-placed within this industrial area as you can see. So, this is the building design we have forwarded to the community also approved by their aesthetics committee and this now goes into the permitting process of the commune.

And with that said, we are ready for questions. We realize you have a lot of other calls this morning, so that's why we tried to keep it as quick as possible. So, we'll start with the questions in the live audience and then we'll go to the internet questions.

Q&A

Operator

We'll now begin the question and answer session. Anyone who has a question may press * and 1 at this time. The first question is from Nicklas Skogman from Handelsbanken. Please go ahead.

Nicklas Skogman

Hey, good morning everyone. I apologize, because I just joined the call since I was on another one before, but would you be able to give an update on what you're seeing in terms of input costs? I just heard from a food retail here, it appears that they are stabilizing at least the raw material side. Could you please run through sort of your key raw materials and say what you are seeing there, and sort of how you see that filtering through to your cogs for the remainder of this year, please?

Henri de Sauvage-Nolting

I can give you a feeling for the raw material, so we also see... only in the last 3 weeks that it is stabilizing although we will be stabilizing on the high level. 2 exceptions, one is the sugar price as Frans already alluded to. Sugar price is at an all-time high and there is an underproduction in Europe. So that is a negative in that sense and on the other hand of course, we all see the energy prices coming down. Of course, these are stock market prices. That doesn't mean that it will be like that in the coming months. But that of course, then has to work through in the raw material prices of our suppliers as well, because as we explained in Q4, we saw a lot of raw material price increases on the basis also of the high energy cost. And then this has to stabilize, and then also come down as we... I think all expect and then if it comes down, it will have to come through hard negotiations, of course, with our suppliers to start bringing down prices before we can enjoy the benefits of that.

Nicklas Skogman

Okay. So my thinking is that for you to, sort of, start repairing your margin, I mean, admittedly the absolute EBIT is, I think, as far as, I can see, the highest Q1 in the history of the company but anyway, if we focus on the margin. Am I right in thinking that you would basically need to see input prices not only stabilizing but... at these levels but also start coming down for the margins to start picking up?

Henri de Sauvage-Nolting

Yes, that is also what Frans explained. Then you get the reverse of the compression effect and then the margins will be positively... that's a big one, but as we also explained there is other things we are doing of course in the mix of the products are more gum and pastilles. The country mix is also helping us. Then of course, the cost side is important so about the... the on cost but also merchandize... there is also our on-cost and merchandizing cost and then of course, the fact that we have volume growth. I think that is we cannot underline that too little. The fact that we have volume growth in total Cloetta also means that our factories are benefitting from that sort of the unit production cost are also positively impacted with that. And this of course, these factors also contribute to margin.

Nicklas Skogman

Yes, and on the pastille order refreshments category, is it sort of a normalizing consumer behavior or is it a lot of your pushing these categories or reworking packaging or what's driving the recovery in this?

Henri de Sauvage-Nolting

Yes, it is bit of both, I mean, normalizing, that's always difficult and I rather look forward than backwards. I mean we just need to grow this business. We need to execute our strategic plan, which is very much about bringing people into the brand, into the categories and we do that for example with what I showed you with the Lakerol mix because that is more fruity, which is very much against youngsters and then limited editions and then of course, it is a mix of what we call our 6B mobile. So it is about promotion. It is about advertising. It is about visibility place in store et cetera. And that is going in the right direction. So that will keep on contributing positively to the mix.

Nicklas Skogman

Okay, very good. And based on, sort of, my back of the envelop calculations, it looks like maybe volume in package is flattish and then Pick & Mix is growing decently. It seems like you are very much insulated from any private label encroachment that we are seeing in other categories. Would you agree with that?

Henri de Sauvage-Nolting

Yes and no. Of course, we were in different markets and in some markets, we do see private label coming up. But as we started, it's a tribute to the investments we made our brands because it's perfectly fine if private label becomes more active, as long as, you have the strong brand. As if you have strong brands with good consumer propositions and good products and you would have supported our brands, you are perfectly fine as a brand. Then of course, the... where the private label is growing in certain markets across Europe and we also have markets where there is more private label activity than in others but it's all about your brands. Strong brands are not being affected by private label.

Nicklas Skogman

Okay. Good. And then what can you say in terms of Q2. Is there more price increases coming or I mean, I am sure you do sort of minor price increases all the time but the big sort of hikes that you have needed to do the past given that commodity...

Henri de Sauvage-Nolting

Yes, you gave the answer yourself, right. You also said that you see raw materials stabilizing and I would see that as well, so there is always going to be minor price increases here and there, there is a few things we like Frans alluded to whether the few customers in some markets where we are still in discussion about the second part of the price increase et cetera, but I mean the big block of course has been done.

Nicklas Skogman

Okay, good. And I ask because sometimes the FMCG industry turns to lag the hikes they need to do in order to sort of catch up, but okay, I hear you. Good, okay, I think that's it from me actually? Thank you very much.

Henri de Sauvage-Nolting

Good, than I think we take Frans you want to take this?

Frans Rydén

Yes, a couple of questions from (unintelligible). First, just to understand the positive impact of the early Easter this year. And the question is, would by the 10 million upside on the Q1, is it be a fair assumption?

Yes, as I mentioned it's about 20 million extra sales, now there, of course, when Pick & Mix does really well towards the Easter maybe little bit less on the branded side. Now, we don't have a 50% gross margin on Pick & Mix for sure, but then you also have efficiencies as a result of the volumes both on merchandizing and in supply chain. So, I think, you know, you are not... I think it's a ballpark it's probably a fair assumption.

Then, there is a question here, if we expect one-off costs in the coming quarters?

And I assume that Stefan you are thinking about items affecting comparability, so the board would be there, I mean, we always had a little bit here and there and now in Q1, it's a big figure, and as I mentioned its partly related to the timing of the greenfield, so a later go-live effects all provisions and impairments. But, of course, since we started with... let's say the first provisions in Q2 last year, the big driver here has been the salary inflation which is also captured, you know, fully in our items affecting comparability. So, there won't be a little bit here and there, but this doesn't deviate from the range of... sort of net range of one time as expected for the greenfield that we have communicated previously?

Henri de Sauvage-Nolting

And if you look at the Pick & Mix contracts, I mean these are mainly stores from chains which are coming towards us, so this is not like one big central agreements with 500 stores shopping and one go to us, this is about retailers in certain countries coming towards Cloetta saying hey we would like to swap the current Pick & Mix concept we have for your concept, because we can see you have a lot of traction in the market.

So, it's not going to have a huge effect on the sales of course, it helps with a more tribute to the fact that we are making progress in really building the Candy King brand as a very attractive retail concept as well.

Okay. I think we don't have any more questions on line and more on the internet either, so concluding very strong growth, of course a lot of pricing but also a tribute that we are able to get that pricing through and that consumers keep on buying our products to all the strategic marketing and sales stuff we have been doing in the last couple of years. And as we already alluded to, we think that the raw material costs are now stabilizing and then we will see how this develops in the coming quarters that we will not change our strategy and the way we work through with pricing with our customers. So, thank you very much and that was it for today.

Operator

Ladies and Gentlemen, the Conference is now over. Thank you for choosing Chorus Call and thank you for participating in the Conference. You may now disconnect your lines. Goodbye.

- END -