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Orkla ASA (ORK.NO)

Q1 2024 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Kari Lindtvedt

Senior Vice President-Investor Relations, Orkla ASA

Good morning and welcome to the presentation of Orkla's First Quarter Results. My name is Kari Lindtvedt. I'm Head of Investor Relations. The speakers today will be President and CEO, Nils Selte and our CFO, Harald Ullevoldsæter. During the presentation today, you're welcome to post questions in writing in the webcast and we will address your questions in the Q&A session at the end of the presentation.

But without further ado, I will now leave floor to Nils, who will start by summarizing our main messages for the quarter. Please, Nils.

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

Thank you, Kari, and good morning, everyone. Let me start by summarizing the result for Q1. We report a strong first quarter 2024 and the quality of our earning is improving. I'm very pleased with strong operational improvements in most of our portfolio companies. There's a lot of focus on execution of the full potential plans across all the portfolio companies in line with what we communicated at the Capital Markets Day.

This quarter, we see that underlying drivers are showing positive momentum. We continue to see signs of easing volume pressure and report overall positive volume growth of 1% despite negative effect from the timing of Easter compared to last year. As communicated at our Q4 presentation, we continue to see that inflation rates on our input factors are starting to come down, although the picture remains somewhat polarized between various categories.

Adjusted earning per shares improved by 14% to NOK 1.5 per share. This includes a significant currency loss in Jotun. Underlying EBIT adjusted growth for the consolidated portfolio companies including headquarter was 16% this quarter. This performance includes an increase in A&P investment in line with the strategy to invest more behind our core brands and positions. I'm happy to see that the 40% sales of Orkla Food Ingredients was closed in April, and we are now excited to execute on our strategy together with Rhône as a partner.

Let's have a look at the details for the performance across the portfolio companies this quarter. This slide show the EBIT adjusted contribution made by each of the portfolio companies during the quarter. The boxes above the graph show the rolling 12 months EBIT adjust margin and the underlying growth in EBIT adjust for each portfolio company. As you can see, the underlying EBIT adjust improvement remain broad based this quarter.

I would especially like to emphasize the volume development in Foods Europe, which continue to improve and was flat when adjusted for the estimated effect of the timing of Easter. Several of the portfolio companies are seeing easing of inflation pressure on input cost, and they continue to focus on realizing cost efficiencies through cost savings and cost avoidance programs in the portfolio companies.

Before moving to start us on our long-term financial ambition, I would like to highlight that the situation at our new biscuit factory in Latvia is improving. We reaffirm that a significant part of the negative NOK 115 million EBIT impact in 2023 is expected to be [ph] again (00:04:14) through 2024.

At our Capital Markets Day in November last year, we announced new financial targets for each of the consolidated portfolio companies for the strategy period 2024 to 2026. We also consolidated some of the most important financial target for each portfolio company, specifically underlying EBIT adjusted growth, operating margin expansion and the return on capital employed. Delivering on these targets will be key to delivering an annual total shareholder return of 12% to 14%.

As you can see from the graph on this slide, performance in the first quarter of 2024 show good progress towards these KPIs. In my view, they have had a good start to the year, not only in terms of the financial performance, but also related to the ongoing work in the portfolio companies, the investment team and in the boardrooms.

Let me now hand over to Harald for more details on the financials.

Harald Carlos Ullevoldsæter

Chief Financial Officer & Executive Vice President-Finance, Orkla ASA

Thank you, Nils, and good morning, everyone. Let's have a look at the financial performance this quarter. Group operating revenues grew by 6% in quarter one, on the back of organic sales growth among consolidated portfolio companies and positive currency translation effects. Organic growth was linked to both volume growth and price increases in the portfolio companies.

EBIT adjust for the consolidated portfolio companies was up 15% despite negative phasing of FX related to Easter. The increase was due to continued organic revenue growth, as well as improved margins for most of our portfolio companies. I will elaborate more on this in the upcoming slides.

Lower EBIT adjusted for financial investments was mainly driven by lower electricity prices for Hydro Power. Net other income and expenses in quarter one amounted to minus NOK 30 million, of which approximately 50% related to M&A costs in Orkla India and Orkla Food Ingredients, as well as ongoing restructuring projects in Orkla Foods Česko a Slovensko in the Czech Republic.

It's also worth mentioning that in relation with the closing of the sale of 40% of Orkla Food Ingredients, we expect other expenses around NOK 120 million in quarter two. Profit from associated total NOK 415 million, mainly related to Jotun. This figure includes the significant negative impact of a devaluation of the Egyptian pound, and I will come back to Jotun in more detail later in my presentation. Net financial costs amounted to NOK 278 million. The average interest rate was 5.5% compared to 4.4% in quarter one 2023.

Reported tax costs total NOK 356 million. Reduction in tax is mainly due to lower resource rent tax for Hydro Power and removal of the windfall tax. The tax rate, excluding associates, was 24.5%.

In sum, profit after tax and non-controlling interest ended at NOK 1.5 billion, corresponding to an adjusted earnings per share of NOK 1.5, an increase of 14% compared to quarter one 2023. And as Nils said, excluding the currency loss in the Jotun, the growth would have been significantly higher.

Now, let's look at the EBIT margin performance in the quarter. As communicated last quarter, we saw signs that EBIT adjusted margin had [ph] reached through (00:08:48). The rolling 12 months margin for the consolidated portfolio companies, including headquarter in quarter one, was 9.3%, up from 9% in the previous quarter. The year-over-year improvements, quarter one 2024 versus quarter one 2023, was 100 basis points, driven by increased contribution ratio of 140 basis points, but negatively affected by increased investment in A&P.

And the table to the right illustrates broad-based improvement in our consolidated portfolio companies. The strong improvement in Confectionery & Snacks must be seen in relation to the ramp-up problems in our new biscuit factory last year. As expected, the factory's performance has improved.

Let's move on to the breakdown of the organic growth. As I said the last quarter, this is a business line but let me walk you through it. The graph shows the breakdown of organic top line growth, split into volume/mix and price. Annual developments for 2019 to 2023 and quarterly developments from quarter one 2023 to quarter one 2024. Year-over-year, organic growth for the consolidated portfolio companies amounted to 3.6%. As illustrated in the graph, price has been the main driver for growth in recent quarters.

In quarter four, we commented on an early indication of improved volume performance. Now, however, we are reporting positive volume/mix growth of 1% in the quarter, despite negative effects from the timing of Easter. As we can see from the table to the right, this is evident in the volume/mix performance of most of the portfolio companies. Adjusting for the estimated effect of Easter, volume/mix growth will increase from 1% to approximately 2.5%. Further, the volume/mix growth in Orkla Food Europe would have been flattish and Orkla Food Ingredients would have seen a slight increase.

Then have a look at the cash flow. Total cash flow from operation was NOK 1.4 billion in the quarter, compared to NOK 740 million last year. In the same period, adjusted cash flow from operation from the consolidated portfolio companies amounted to NOK 1.3 billion, up from NOK 500 million last year. The increase was driven by strong EBITDA growth, lower net replacement investments and improving working capital performance from reduced inventory levels.

The year-over-year reduction in net replacement investment was mainly due to large investments in Orkla Confectionery & Snacks last year in connection with the new biscuit factory in Latvia. In quarter one 2024, net replacement investment consisted of several replacement projects at various factories as well as ERP projects and new concluded long-term leases.

The reduction in operating cash flow from financial investment is related to a decline in the profits from Hydro Power as previously described. Further, rolling 12-month cash conversion for the consolidated portfolio companies, including headquarter, was 111%. A breakdown of cash conversion per consolidated portfolio company can be seen in the table on the right.

Net interest bearing debt, including leases decreased by NOK 0.4 billion from year-end 2023 to NOK 18.4 billion at the end of quarter one 2024. As previously mentioned, cash flow from operation amounted to NOK 1.4 billion. Taxes paid were lower in quarter one year-over-year, mainly due to reduced profits from Hydro Power. Orkla received NOK 474 million in dividends from Jotun corresponding to 50% of total dividend received from Jotun for the financial year 2023. The remaining 50% will be paid in the second half of 2024.

Forex effects were negatively impacted by depreciation in the Norwegian kroner relative to euro and US dollar. At the end of the quarter, net interest-bearing debt amounted to 1.9 times EBITDA last 12 months. And if we adjust for the Orkla Food Ingredients transaction and the communicated Orkla dividend of NOK 6 per share to be paid today actually, the net interest-bearing debt to EBITDA last 12 month is 2.2 times.

Now, let's have a look at the performance of the different portfolio companies. Starting with Jotun, sales continued to grow in quarter one with reported year-over-year sales growth of 4%. Adjusted for currency translation effects, sales growth was 7%. The positive sales performance was mainly driven by volume growth with sales increasing in all segments and all region other than Southeast Asia and Pacific where sales remained flat.

Operating profit was up 12% year-over-year driven by increased sales and continued improvement in gross margin. Please note that the EBITA was negatively impacted by a currency loss of NOK 252 million linked to the devaluation of the Egyptian pound. Profit before tax was also negatively affected by NOK 189 million on financial items related to US dollar-denominated loans. Jotun expects sales to continue to grow in 2024, but at a lower rate than in the past two years.

Gross margin and profitability are expected to remain at a favorable level in the first half of the year. At the same time, raw material prices are expected to increase slightly in the upcoming quarter. In addition, price competition and bids for new customers, contracts and projects are intensifying. These factors are expected to gradually put pressure on gross margins as the year progresses.

Let's have a look at Orkla Foods Europe. Organic sales in Orkla Foods Europe grew by 3.2% in the first quarter. Growth was broad-based across all channels, driven by price increases. Overall volume development was less negative than in previous quarters and flat when adjusted for the estimated effects of the timing of Easter.

Market share performance in the grocery channel was on par with the previous quarter. Underlying EBIT growth was 12%, positively impacted by organic revenue growth and cost savings from reorganization projects in Norway, Sweden and in the Czech Republic.

Input costs development is improving, but continued weak exchange rates are putting pressure on purchasing costs. The EBIT adjusted margin was 11.1% in the first quarter. The underlying change was positive with 0.9 percentage points. Rolling 12 month cash conversion was 131% and return on capital employed was 12.7%, up from 11.6%, positively impacted by reduced inventory levels and more restrictive capital expenditure.

Moving on to Confectionery & Snacks. Organic sales growth was 10.8% in the quarter split into 7.7% price and 3.1% volume/mix, driven by successful marketing activities. The overall market development was positive, and there was a positive shift in market share performance. Market share increased in the snacks category. Service levels at the new biscuit factory in Latvia normalized during the quarter. Productivity is gradually improving, and the outlook is unchanged. A significant part of the negative impact in 2023 is expected to be regained in 2024.

EBIT in the quarter ended at NOK 255 million with underlying EBIT-adjusted growth of 30%, positively impacted by an improvement in the biscuit factory of approximately NOK 20 million. EBIT-adjusted margin increased to 11.1%, up from 9.4% last year.

In terms of raw material costs, market prices for cocoa increased significantly during the quarter. Our cocoa contracts extend beyond the average three to six months coverage paid in Orkla as a total. Total volumes for

2024 have been contracted, but we will not go into details in price. For other raw material costs, although still higher than in the same quarter last year, prices are gradually leveling off in most purchasing categories.

Moving on to Orkla Food Ingredients. Operating revenues increased by 1.6% in the quarter, while organic growth was minus 2.9%. The organic volume/mix decline was 0.3%, but when adjusted for Easter, the volume/mix growth was slightly positive. Further reduction in customer prices were implemented in response to lower input costs.

Both Bakery and Plant Based had good underlying EBIT adjusted development. The decline in underlying EBIT adjusted was related to the Sweet segment. However, note that quarter one is typically a low season for the Sweet segment.

Orkla Health organic revenue growth was 9.9% in the quarter. Organic volume/mix growth amounted to 6.3%, driven by direct to consumer business and sales of Möller and Jordan in international markets. Broad-based price increases were implemented to mitigate negative effects from higher input costs.

As regards to market developments, private labels continue to take market shares in grocery channels as was especially evident in Norway. Underlying EBIT adjusted growth was 12.2% with a corresponding margin of 15.8%. The reported margin decline of 60 basis points was mainly driven by structural change now including the oral category taken over from Orkla Home & Personal Care, while the underlying margin change was plus 30 basis points in the quarter. However, negatively impacted by increased advertising investments in core brands and international expansion in line with the strategy.

Orkla India achieved organic growth of 11.6% in the quarter, driven by both volume/mix and price. Volume growth was especially strong in the International business unit, supported by the timing of the festive season around Ramadan. Underlying EBIT adjusted growth was 22.5% and was positively impacted by an improved contribution margin, supported by positive carryover price effects from 2023 and declining raw material prices. EBIT adjusted margin improved to 12.1% at 1.1 percentage points compared to the same period in 2023.

The European Pizza Company delivered underlying EBIT growth of 19.5% in the quarter. Growth was driven by the ongoing restructuring in Germany, where 54 locations were closed last year. Consumer sales total €102 million. In markets outside Germany, consumer sales were up 3%. Market conditions in Western Europe were impacted by soft consumer sales on the back of weaker consumer confidence. On the other hand, consumer sales by Da Grasso in Poland continue to show positive momentum.

Orkla Home & Personal Care delivered organic growth of 10.7% in the quarter, supported by robust volume/mix performance in the Norwegian market. Market shares developed positively in the Norwegian grocery sector, especially in the personal care segment. Underlying EBIT adjusted growth of more than 60% year-over-year explained by increased revenue and higher contribution margin. But should be seen in light of a weak, comparable quarter last year.

Further, reorganization of sales and administrative functions in the second half of 2023 resulted in cost reduction this quarter, countered by higher advertising investments to support new product launches and our hero brands.

As regards the remaining portfolio companies, I will not go into detail. But in general, we see good underlying improvements among these companies.

And before I hand back to Nils, I would like to draw your attention to the appendices to this presentation, which include an overview of the current status of the financial targets for all consolidated portfolio companies.

Thank you for listening. And I leave the word back to Nils.

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

Thank you, Harald. You have seen this slide before, and I intend to continue revisiting it to unlock our commitment to deliver on the three priorities communicated at our Capital Markets Day. The figures that we report today are a good start to the year and to drive organic value in our existing portfolio.

As communicated, executing on the strategies in each of the portfolio companies is our number one priority. The work to reduce the complexity in our existing portfolio is ongoing and according to plan. I'm sure you'll understand that I cannot go into detail on this. We will, of course, notify the market when there is information to be shared.

Lastly, we are working on exploring value adding structural transaction, but the timing need to be right. As I have emphasized before, you should not expect any new platform investment before we have delivered on the other priorities and proved that the new operating model is creating value.

Before we move to Q&A, I have one final comment. In February this year, we announced Arve's appointment as new CFO at Orkla. He will take up the position on the 1st of June this year. I would like to give him a warm welcome and say that I'm looking forward to working with him. However, this also means that this is Harald's last quarter as CFO at Orkla. I want to take this opportunity to thank Harald for his great contribution to Orkla over many years. On a more personal note, I would like to say that I have really appreciated working with you, Harald. And I especially appreciate the great support you have been through Orkla's transformation.

On that note, let's open for Q&A.

QUESTION AND ANSWER SECTION

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you both Nils and Harald. Let's start by asking if you have any questions in the audience. Please raise your hand and state your name and company. Okay. We have a couple of questions on the Web as well. Let's start with those. First one from [indiscernible] (00:28:00). He has one question. Will you guys have any more dividends this year?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

I think we have been generous to our shareholders this year. So far this year, we paid out NOK 6 in dividend to the shareholders this morning. But I think that's to be discussed with the board at the right time, and we don't comment up on that at this stage.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. Then we have two questions actually from Herman Dahl, Nordea. I'll take them one at a time. First one, how do you see volume and price development into Q2?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

And again, no, we don't guide the market on this but I think we said that we see easing pressure on volume. We said that in Q4. We restate that we see easing pressure and we also see less aggressive private label behavior in the markets we operate.

And thirdly, I think it's fair to say that, as we have communicated, the Easter effect will hit us positively in Q2.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Sure. And then second question from Herman. Can you say something of the scope of the uptick in cocoa prices that hit Q1 and how it will impact Q2 margins?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

We don't want to go – of course, this is sensitive information, so we don't want to give precise comments on the cocoa prices and how it affects our P&L.

Harald Carlos Ullevoldsæter
Chief Financial Officer & Executive Vice President-Finance, Orkla ASA

A

But we have said that we have been contracted volumes for 2024.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Yes. Okay. We have actually five questions from Ole Martin Westgaard at DNB.

Harald Carlos Ullevoldsæter
Chief Financial Officer & Executive Vice President-Finance, Orkla ASA

A

Only five?

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

I'll take them one by one. How do you see your market share performance in Q1?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

We have communicated that it varies a bit between the different categories and the different portfolio companies. But in general, it's flattish through the quarter.

Harald Carlos Ullevoldsæter
Chief Financial Officer & Executive Vice President-Finance, Orkla ASA

A

But I can mention a couple of positive elements. We have increased market shares in this next category in the Confectionary & Snacks. We also have strong development in Orkla Home & Personal Care and especially in the personal care segments, we have increased market shares. And most of the other categories are more or less flattish.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. Second question, Orkla Foods Europe. What is driving recovery in volumes?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

As we said, less competition in certain categories from private label is, of course, hitting us. But I think it's a good execution throughout the whole organization that is lifting the performance. As we said also that we are increasing A&P spend. I think that's also helped through the quarter.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. Question three, Confectionery & Snacks. Which categories are driving the volume growth?

Harald Carlos Ullevoldsæter
Chief Financial Officer & Executive Vice President-Finance, Orkla ASA

A

I think snacks is very, very good. But we also have good volume growth in the other categories as well. So it's kind of broad based.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Okay. Question four, can you please add some more color on the biscuit factory in Latvia? You stated NOK 20 million recovery this quarter. What should we expect in the coming quarters with regards to the timing of the recovery of the NOK 150 million lost in 2023?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

I think we really don't want to be precise, as we said. And we said – at the Capital Markets Day we said in Q4 2023 and we would say again that we will take back the significant part of the loss in 2023 through the year. We had NOK 20 million impact this first quarter and we will see that gradual increase through the year. I don't want to be more precise than that, I guess.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Good. And then the final question from Ole Martin Westgaard, contribution margin improved in Q1 year-over-year. Should we expect this trend to continue to improve in the coming quarters as raw material cost inflation ease?

Harald Carlos Ullevoldsæter
Chief Financial Officer & Executive Vice President-Finance, Orkla ASA

A

I think it really depends on the development in raw material costs. But [indiscernible] (00:32:16), we don't do any guiding. So we won't comment on our expectation. But we have seen a strong improvement in quarter one of 140 basis points. And it's quite broad based as well.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Good. One question from [ph] Patrick (00:32:32), I don't have a last name here. Will the negative currency effect in Q1 for Jotun be a one-off, or will this continue in the coming quarters as well?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

Good question. I think if you look at the Egyptian pounds towards the NOK and US dollar, it seems to stabilize. So, if that's the case for the rest of the year, I guess it will not hit Jotun any more than we have seen in the first quarter.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Good. Then we have a question from Nicklas Skogman, Handelsbanken. Question on Jotun, based on the results in Q1 and Jotun's outlook of gross margin pressure towards the end of the year, do you expect Jotun profit contribution to Orkla to decline year-over-year in 2024?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

We don't guide on that.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

And then what seems to be the final question on the Web from Eirik Rafdal, Carnegie. At the CMD you said 150 to 200 basis point margin expansion by year-end 2026. But that is somewhat back-end loaded. Do you still stick with this view, 90 basis points up year-over-year in Q1? So what is the run rate for the year? It looks pretty okay.

Harald Carlos Ullevoldsæter

Chief Financial Officer & Executive Vice President-Finance, Orkla ASA

A

Yeah. I think, first of all, this is first quarter of 12 quarters in our strategic periods. So it's early to conclude, but we have a strong start. As I said, we have increased margin by 1 percentage point in the first quarter. And as Nils said, we are in line with our capital markets targets.

Kari Lindtvedt

Senior Vice President-Investor Relations, Orkla ASA

A

Great. Thank you. That was the final question on the Web. Are there any questions from the audience? No, there seems not to be.

Kari Lindtvedt

Senior Vice President-Investor Relations, Orkla ASA

Thank you, Harald and thank you, Nils. Before we round off, I'd like to remind you that we will report our second quarter results on the 15th of July. Thank you all for joining and have a nice rest of the day.