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Orkla ASA (ORK.NO)

Q2 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 Second Quarter Results. My name is Kari Lindtvedt. I'm Head of Investor Relations. Our speakers today will be President and CEO, Nils Selte; and our newly appointed CFO, Arve Regland.

Nils will start by summarizing Q2 and also share some highlights from first half of 2024. And then Arve will summarize and give you more details on the quarter we are reporting. Before Q&A, Nils will summarize our main messages from today. Throughout the presentations today, you're welcome to post questions in the live chat, and we will address all your questions at the end of the presentations.

But now let's begin. I'll leave the floor to you, Nils.

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

Thank you, Kari, and good morning to everyone. I'm happy to see that the financial results for Q2 continue to show progress on several key drivers, in line with our communication in Q1 this year. Adjusted earnings per share in Q2 were NOK 1.66, up 7% from the same quarter last year. We report EBIT adjusted growth of 13% for the group, driven by underlying EBIT adjusted improvements of 22% in the consolidated portfolio companies.

I'm also happy to see volumes remaining in positive territory and overall market share development showing signs on the positive side. In addition, the EBIT-adjusted margins showed good progress in the quarter. The development in raw materials' prices is best described as polarized, but we are starting to see slight positive effects in our Q2 figures.

This slide provides more details on the financial performance of our portfolio companies in the quarter. As you can see from the boxes at the top, growth in Q2 continued to be broad-based on both EBIT-adjust and margin development.

Underlying EBIT-adjust for most of the consolidated portfolio companies saw growth. As the largest portfolio company, I would like to highlight Orkla Foods Europe. The restructuring programs and effective category management secured 19% underlying EBIT-adjusted growth in the quarter despite volumes on the soft side.

For Orkla Confectionery & Snacks, I'm also happy to see that the situation in the biscuit factory continues to improve. Service levels are good and market shares are returning in their category. Orkla Food Ingredients reported strong development in both the Bakery and Plant Based clusters. The development in Sweet ingredients was more challenging this quarter and the Orkla Food Ingredients management has already identified several initiatives.

Jotun also reported broad-based sales growth in Q2. However, negative currency translation effects led to a slight negative EBITA development in the quarter. For the rest of the year, Jotun expects sales growth, but at a lower rate than in the past years due to strong comparables.

Before I hand over to Arve, I would like to share some highlights from the first half of 2024. We have been very clear that our number one priority is to drive organic value in the existing portfolio. As you will see on the next slide, we are progressing well towards the financial targets that were announced in November last year. We are also committed to reduce complexity in the portfolio. This will take time and we will not let ourselves be rushed into any decisions. Long-term value creation stays firm in our decision-making. That said, we have already taken some important first steps during 2024.

The Orkla Food Ingredients partnership was closed in April. And in June, we announced the sales of Lilleborg to Solenis. At our Capital Markets Day in November, I mentioned that we would explore options for how to best create value from our Hydro Power assets. The evaluation is still ongoing and we will give you more information on the outcome over our assessment once we have concluded.

Also, at the Capital Markets Day, I said that we were going to initiate a process to consider structural opportunities for Orkla India, including conducting an IPO readiness study. The result of the study are encouraging and we will now proceed with an evaluation of accessing the capital markets in India. Any conclusion should not be expected until sometimes 2025.

As mentioned, we are progressing well towards delivering on our financial ambitions per Q2 2024. This slide show the targets set by the consolidated portfolio companies for the period ending 2026 and the status on progress as per first half 2024. It is still early days and we expect to see fluctuations going forward. But still, I must add that I'm quite impressed by all the hard work being carried out in the portfolio companies, and I'm very glad to see that the initiatives set out in the full potential plans are starting to deliver positive effects.

With that, I will leave the floor to Arve for more details on the financials.

Arve Regland

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

Thank you, Nils, and good morning, everyone. I will take you through the financial performance of the group and the portfolio companies for the second quarter. Group operating revenues grew by 1% in the second quarter with organic sales growth for the consolidated portfolio companies of 3.3%. EBIT adjust for the consolidated portfolio companies was up 17%, driven by strong underlying growth and improved margins for most of our portfolio companies. Lower EBIT adjust for financial investments was mainly driven by lower power prices for Hydro Power, as well as fewer handover of apartments in Orkla Real Estate.

Other income and expenses was mainly impacted by profit from the sale of Lilleborg and costs related to the sale of 40% of Orkla Food Ingredients. Profit from Jotun and other associates was NOK 529 million in the quarter, with Jotun continuing to deliver strong results. Net interest and other financial items amounted to NOK 275 million. The average interest rate was 5.7% compared to 4.9% in the same quarter last year, driven by higher interest rate levels and the inclusion of external debt in Orkla Food Ingredients. Tax costs totaled NOK 492 million, equivalent to a tax rate of 23.3%. Reduction in tax rate compared to last year is mainly due to the lower resource rent tax for Hydro Power and repeal of the windfall tax.

Profit to non-controlling interest was NOK 106 million in the quarter, the increase being due to Orkla Food Ingredients transaction, and more details of the financial impact of this transaction can be found in the Appendix. Overall, profit after tax to Orkla shareholders ended at NOK 2 billion, corresponding to an adjusted earnings per share of NOK 1.66, an increase of 7% compared to the same quarter last year.

Rolling 12-month EBIT adjust margin for the consolidated portfolio companies was 9.7% in the quarter, up from 9.3% in Q1. As Nils mentioned, margins have been positively affected by easing pressure on raw materials and, in Q2, we saw a reduction compared to last year. The right-hand table illustrates broad-based improvement, with both Orkla Foods Europe and Orkla Confectionery & Snacks delivering solid margin increases.

Organic growth in the quarter was 3.3%, split into 2.3% volume mix and 1% price. We see price growth coming down in line with lower inflation and reduction in raw material costs. Volume/mix in Q2 was positively affected by the timing of Easter. Year to date, volume/mix growth was 1.7%. It's good to see two consecutive quarters of positive volume/mix performance and as shown in the table to the right, the positive volume/mix growth was broad-based.

Total cash flow from operations year-to-date amounted to NOK 3.2 billion compared to NOK 2.1 billion in the same quarter last year. The increase was driven by EBIT growth in the consolidated portfolio companies, lower net replacement investments and reduced inventory levels. Several portfolio companies have a reduction in net replacement investments. A large part of the reduction was linked to Orkla Confectionery & Snacks investment in a new biscuit factory last year. Reduction in operating cash flow from financial investments was related to the decline in profits from Hydro Power and Real Estate, as previously mentioned.

A breakdown of cash conversion per consolidated portfolio company can be seen in the table to the right. Net interest-bearing debt, including leases, amounted to NOK 20 billion at the end of June, up from NOK 18.8 billion at the end of last year. The increase is mainly related to a dividend of NOK 6 billion paid to shareholders in May, offset by cash flow from operations and net proceeds from the sale of 40% of Orkla Food Ingredients and the sale of Lilleborg.

Further, Orkla has received NOK 474 million in dividends from Jotun, corresponding to 50% of the total dividend from Jotun for the financial year 2023. The remaining amount will be received in the second half of 2024.

At the end of the quarter, net interest-bearing debt amounted to 2 times EBITDA last 12 months. If excluding net interest-bearing debt and EBITDA of Orkla Food Ingredients, which now have a standalone financing with no recourse to Orkla, net interest-bearing debt to EBITDA would be 1.6 times.

Now, let's take a closer look at the performance of the portfolio companies, starting with Jotun. Yet again, Jotun delivered a solid quarter with reported sales growth of 4%. Adjusted for negative currency translation effects, sales growth was 7%. Year-to-date, sales growth has been particularly strong in Marine, Protective and Powder, which all have delivered underlying double-digit sales growth.

Sales grew in all regions, with the exception of Southeast Asia and Pacific, where sales remained flat. Jotun's EBITA margin remained strong in the second quarter. The company achieved the margin of 22% year-to-date despite the significant negative impact from devaluation of the Egyptian pound in the first quarter. Reported

EBITA growth came in at minus 2% in Q2. However, excluding currency translation effects, underlying earnings are up 2% in the quarter and 9% year-to-date.

Moving on to Orkla Foods Europe. Underlying EBIT adjust growth was 19% in the quarter, positively impacted by savings from cost initiatives in Norway, Sweden and the Czech Republic. Orkla Foods Europe experienced improved contribution ratio from stronger focus on category and product profitability. The organic sales growth was 0.7% in the quarter, driven by price growth. Timing of Easter had a positive effect on the figures.

Negative volume/mix development was driven by reduced purchasing power, selected customer actions as well as complexity reductions in line with what was communicated at the Capital Markets Day. In terms of market shares, the trend was positive in Denmark on the back of strong campaigns. In Norway, development was fairly stable and, on an overall level, slightly negative in our other markets. Despite higher A&P investment, the EBIT adjust margin ended at 12.3%, up from 10.5% last year.

Next portfolio company is Orkla Confectionery & Snacks. Organic sales growth was 11% in the quarter, split into 4.3% price and 6.7% volume/mix. We saw a positive shift in market share for all main categories in the quarter in an overall growing market. EBIT adjust in the quarter ended at NOK 255 million, with an underlying EBIT adjust growth of 29%. EBIT adjust margins grew to 11.1% compared to 9.5% last year, supported by a 1.2-percentage-point increase in contribution margin, improvements in a new biscuit factory and operational leverage from volume increase.

Service level and productivity from the new biscuit factory continued to improve during the quarter. Approximately half of the underlying EBIT adjust growth in the quarter was driven by improvement in the biscuit factory. A&P investment increased in the quarter, while raw material cost, with the exception of cocoa, began to stabilize in most categories. Regarding cocoa, higher prices create uncertainty about volumes going forward.

Let's proceed to Orkla Food Ingredients. Underlying EBIT adjust growth was 3.4% in the quarter. Price growth was minus 2.3%, and must be seen in relation to lower raw material cost in several key categories. Contribution ratio increased from 28.2% to 30% due to price management. The three different clusters delivered a mixed picture with both Bakery and Plant Based delivering solid volume/mix and profitability improvement, while performance in Sweet was weak. Due to the low results in the first half year, a program on mitigating actions has recently been launched in the Sweet cluster.

Next in line is Orkla Health. Organic revenue growth was 7.3% in the quarter, split by 2.9% price and 4.4% volume/mix. Volume/mix growth was driven by the direct-to-consumer businesses and the global brands, Möller's and Jordan. Underlying EBIT adjust growth was 12.4% with a corresponding EBIT adjust margin of 14.7%. Margins were somewhat muted due to the broad-based cost inflation, increased A&P investments, and higher maintenance cost from increased production volumes, as well as continued margin pressure in the food supplements category in the Nordics. In line with the strategy of accelerating international expansion for global brands and new market entries for NutraQ, investments in advertising and SG&A continued to increase to support future growth.

The next portfolio company is Orkla India. Organic growth was 9.4% in the quarter, positively affected by financial incentives provided by the Government of India of NOK 20 million. Last year, these incentives were mainly received in the fourth quarter. Adjusting for this, volume/mix growth in the quarter was 6.7%, driven by the International business unit. Sales in the Domestic business units were soft due to muted private consumption growth. Adjusted for government grants, underlying EBIT adjust growth was 21.9% in the quarter with a corresponding margin of 14.9%. The growth was driven by higher contribution margin, mainly due to declining cost of key raw materials.

Moving on to The European Pizza Company. Consumer sales for New York Pizza recovered in the Netherlands after a soft start of the year in key markets. Da Grasso in Poland also continued its good momentum, while Kotipizza was negatively affected by a weaker consumer sentiment in Finland. Organic growth and underlying EBIT adjust were notably affected by the ongoing restructuring in Germany, which is now operating at a smaller but more profitable base. EBIT adjust margins were 11.7% in the quarter, up from 7.2% in the same period last year.

Let's proceed to Orkla Home & Personal Care. Organic growth was 10.9% in the quarter, supported by a robust volume/mix performance in the Norwegian market and in contract manufacturing, positively impacted by new innovations. Market share development was strong in the Norwegian and Swedish grocery sector, both in personal care and home care.

Underlying EBIT adjust grew by 22% on back of somewhat muted comparables last year. EBIT adjust margins increased to 12.1% versus 10.7% in the same quarter last year. The improvement is linked to lower SG&A cost, but countered by A&P investments to support new product launches and hero brands.

As regards to remaining portfolio companies, more details can be found in the quarterly report. Still, I would like to highlight the positive development in Orkla House Care. In addition, I would like to mention that the financial results for Lilleborg only include the first two months in this quarter, in connection with the sale effective from the 1st of June. From next quarter, Lilleborg will no longer be included in the financial reporting.

Then, I would like to hand the floor back to Nils.

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

Thank you, Arve. Our portfolio companies had delivered a good first half 2024, in line with our ambition to drive organic value. The portfolio companies achieved high EBIT-adjusted growth, margin expansion and increased return on capital employed. We continue to increase our investments in advertising and promotion and are improving operating margin at the same time. In most of our portfolio company, we are also continuing the positive trend of improving cash conversion.

Wrapping up, I'm glad to see that we are on our way to delivering on the strategic ambitions communicated at our Capital Markets Day and I believe that the potential of our new operating model is becoming more visible.

Then, as a final comment, I want to say a big thank to you, Kari, for your valuable contribution to Orkla since you started more than 17 years ago and specially as our SVP, Investor Relation, last four years. I admire your skills and expertise and I wish you all the best in your new job.

With that, I leave the floor to the Q&A.

Kari Lindtvedt

Senior Vice President-Investor Relations, Orkla ASA

Thank you for those kind words, Nils. The pleasure has been the same.

QUESTION AND ANSWER SECTION

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Let's now take some questions. We have a couple from the Web, but let me start by asking if there are any questions from the audience. Please state your name and company.

Let's move to some questions from the Web then. Starting with two questions from Petter Nystrom, ABG. First question, you mentioned slightly positive effect from raw material cost in Q2. If we assume raw material cost and FX to stay at current levels, do you expect this effect to be larger in the second half of the year?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

We have said to the market in the last quarters that we expect low mid-single-digit improvements in the input cost this year and, I think, that goes for the whole year 2024. And we just want to repeat that message to the market.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. And the second question from Petter. Solid overall volume development in Q2. But for food, foods are struggling with a 1.6% decline. You mentioned select customer actions and complexity reduction. Can you share some more insight on this?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

We see – Orkla Foods Europe, we see some trading-down effects in some of the markets, especially Sweden, Finland, and the Czech. We also see some, we said, customer action and that is kind of due to negotiations with the customers. So, that has also been the case. But we see also in the same period good effects or better development in the Norwegian and the Danish market.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. Then we have three questions from Ole Martin Westgaard. I'll take them one at a time. Question one, how was your market share development in Q2? And how do you see the competition from private label?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

Let's start with the last one. I think we see [ph] the emerging (00:25:00) private label effects through this year. So, that's on the positive side. We have said also that we see positive market development in some [ph] of our (00:25:13) portfolio companies and we see flat on some of the others and slightly negative in a few of them. I think Arve commented up on it in his presentation and we also described this quite details in the report that we have issued. So, I think that cover that question.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. And then the second question from Ole Martin. What have you learned from the IPO readiness study in India?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

As I said, we've got positive feedback from that study. And as I also said that we will now assess if we are going further to access the capital markets in India. And as I also said, we will deliver to the market in 2025 with more information when we have kind of gone down the road with that work. There's a lot of things to do before we're ready to go.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Absolutely. And then the third and final question from Ole Martin. Can you update us on the biscuit factory? What do you expect in the coming quarter? Are problems solved?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

We can repeat what we said at the Capital Markets Day that a significant part of the loss from 2023 will be regained during this year, and I think the message is still the same. So, we are on track on what we said.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. Then Eirik Rafdal. Two questions. First one, cocoa prices. Based on your hedging profile and the prices you are hedging at today, all else equal, how much will cost come up in Confectionery & Snacks and on group level? And when should we start to see effects in the P&L?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

We have said that we are pretty much covered for this year. We haven't said at which price level we have covered volume and price for this year. So, we also said that if the market stays at this level, we will start to see effects into the 2025 figures. But we will also have some slight effect also in the end of this year. But they haven't been precise and we will not be precise on guiding on that.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. And second question from Eirik. You note market share gains across multiple portfolio companies and multiple geographies. Do you have an idea of who is losing shares? Is it private label or competing branded goods?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

We have said that mostly private label has taken market share from us over the last few years, and we still see the same pattern. We see some – still some trading down effects in some selected market. We see that in Foods Europe in Sweden, we see it in Finland, and we also see it in the Czech.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. Then, a question from [indiscernible] (00:28:06), what are you going to do with the money made from selling Lilleborg?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

That's up to the board to decide. But, I think, it's not a big amount compared to the whole system of Orkla. So, I think that will be something that the board will consider when we file for the 2024 Annual Report.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

Thank you. And then, Håkon Fuglu, SE Banken, adjusted for Easter effects, what would volume growth have been for Orkla Foods Europe in the quarter?

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

Arve?

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

A

I think, if you look at – it's actually better now to look at year-to-date numbers because that's more precise on the – than diminishing the Easter effects. So, if you look at the year-to-date numbers, so I think you got the answer.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

A

And those are minus 1.9% year-to-date.

Nils Kloumann Selte
President & Chief Executive Officer, Orkla ASA

A

Yeah.

Kari Lindtvedt
Senior Vice President-Investor Relations, Orkla ASA

Thank you. That covers all the questions from the Web. Are there any questions in the audience? None? Okay. Before rounding off, I'd like to remind you that we report our third quarter results on the 29th of October. Thank you for joining and have a nice rest of the day.