

29-Oct-2024

Orkla ASA (ORK.NO)

Q3 2024 Earnings Call

CORPORATE PARTICIPANTS

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

Arve Regland

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

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

MANAGEMENT DISCUSSION SECTION

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

Good morning and welcome to Orkla's Presentation of Third Quarter Results. My name is Annie Bersagel, and I'm the new Head of Investor Relations. To begin, our President and CEO, Nils Selte, will begin with a summary of the quarter. After that, our CFO, Arve Regland, will go into a deeper dive of the financials. Before we move on to Q&A, Nils will summarize some of the main messages from the quarter. Just a bit of housekeeping. So, during the presentation, you're welcome to submit questions in the webcast and we will address all your questions in the Q&A session at the end of the presentation.

So, I'll now leave the floor to you, Nils.

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

Thank you, Annie, and good morning, everyone. Overall, in Q3, we continued to improve profitability and cash flow. Adjusted earnings per share were up 10% with underlying EBIT adjust growth of 17% for the consolidated portfolio companies, including headquarter. This comes despite significantly increased advertising and promotional spending during the quarter. Organic growth was 3.9% in the quarter, with positive contribution from 8 of 10 consolidated portfolio companies.

On a macro level, inflation rates continued to normalize in many of our markets. Competition from private label remains high, and some markets were negatively impacted by weak consumer sentiment. We nevertheless see that the challenges associated with weak consumer purchasing power have eased somewhat compared to the same quarter last year.

As we said in Q2, the development in raw material prices remains polarized, but we see slight positive FX in our Q3 figures. Based on what we see today, going into 2025, we expect raw material prices, in sum, to stabilize excluding cocoa. Lastly, turning to cash flow. Under the new operating model, we lifted cash conversion as a key metric for the companies, and we are seeing positive effects. Arve will revert to this later in the presentation.

As I said, underlying EBIT adjust was up 17% for the company as a whole. Let me give you a few comments on the largest portfolio companies. Jotun continued to perform well ahead of the company's communicated financial targets. Sales growth was 8% year-to-date for August, despite strong comparables. Jotun's return on capital employed was 34% on a rolling 12-month basis.

For Orkla Foods Europe, volume growth was slightly positive for the quarter, with variation across the markets. Operating margins in Foods Europe continued to improve, supported by ongoing cost reduction. And in September, Aku Vikström joined as the new CEO for the company. I'm very happy to have Aku on board.

For Orkla Confectionery & Snacks, operational challenges at the biscuit factory are now largely resolved. We see a positive market share development overall. And in terms of volume, we see pressure on the chocolate category, following an extraordinary increase in market prices for cocoa.

For Orkla Food Ingredients, operating margin growth and volume/mix growth were positive for both the Bakery and Sweet segments. The company's performance was especially strong in the Bakery segment, both in terms of volume and margin development.

Returning to our targets from the Capital Markets Day. The three targets on this slide represent the aggregate effects of the portfolio companies reaching their targets over the strategy period. Although it's still early days, we are on track on each of these metrics.

I will now hand over 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. So, the third quarter was a strong quarter for Orkla, with a 4.3% operating growth increase to NOK 17.5 billion and an EBIT adjust growth of 13%. EBIT for the consolidated portfolio companies, including HQ, increased by 17%, driven by strong underlying growth and improved margins for most of our portfolio companies. The decline in EBIT adjust for financial investments was mainly related to the handover of apartments in Orkla Real Estate last year.

Then on the other income and expenses, we have a negative number of NOK 741 million this quarter. NOK 650 million of this is related to three specific write-downs. Firstly, we have done a NOK 300 million impairment of Orkla Confectionery & Snacks Latvia. So, this is not the biscuit factory but the business unit acquired back in 2015, which has not shown the necessary profitability to defend the book value of intangibles in the balance sheet.

The same reasoning is behind a NOK 50 million write-down of NIC Germany, a part of the Sweet segment in Orkla Food Ingredients. And lastly, we had done a NOK 300 million write-down of a common ERP template, which was developed under the former strategy of Orkla, developing a common ERP system for all group companies which has not the same relevance now with more independent portfolio companies. On that basis, the system is taken down from NOK 360 million to NOK 60 million on the balance sheet. And please note that these write-downs have no cash effect.

Profit from Jotun amounted to NOK 548 million in the quarter and increased by 8% compared to last year. And the increase in profit, the non-controlling interest, is linked to Rhône's ownership in Orkla Food Ingredients. Reported earnings per share were NOK 1.18, while adjusted for other income and expenses, it's NOK 1.77 per share, an increase of 10% compared to last year.

Overall, we continued to see EBIT margins to tick upwards, reaching 10% on a rolling 12-month basis at the end of third quarter and an increase of 30 basis points compared to last quarter. All of the largest portfolio companies experienced positive EBIT adjust margin growth supported by positive volume/mix development, despite of the higher advertising spend across the portfolio companies in line with strategy, as also Nils mentioned.

Organic growth was 3.9% in the quarter, of which 2.6% volume/mix, positively affected by one additional sales day compared to last year. And as shown in the table to the right, the positive volume/mix growth was broad based across the portfolio companies. At an aggregated level, we continued to see stabilizing market conditions following a period of high inflation pressure.

Total cash flow before capital allocation year-to-date amounted to NOK 4.9 billion, up NOK 2.1 billion compared to last year. You'll notice a slightly different format to this cash flow than in previous quarter focusing on the cash flow before capital allocation to M&A, CapEx, or distribution to owners.

The increase in cash flow is mainly driven by EBIT growth in the consolidated portfolio companies, lower net replacement investments, higher dividend received from Jotun, lower taxes linked to profit in Hydro Power, but partly offset by reduced profits from financial investments.

Cash flow from financial investments declined to approximately NOK 500 million due to working capital buildup in Orkla Real Estate, hand over our apartments in Orkla Real Estate last year, and reduced profits in Hydro Power. Cash conversion in the portfolio companies remained strong on an aggregate 112% on a rolling 12-month basis.

And we maintained a strong balance sheet supported by the increased cash flow as discussed from the previous slide. Net cash flow from M&A, but also taken into account the increased dividend paid to shareholders in the second quarter. Net interest-bearing debt was NOK 18.3 billion at the end of the quarter, corresponding to a net interest-bearing debt to EBITDA of 1.8 times. And excluding external debt and EBITDA in Orkla Food Ingredients, the ratio was 1.4 times.

Now, let me walk you through the financial performance in the portfolio companies. Starting off with Jotun, the company continues to deliver strong results, with revenue growing 8% on a year-to-date basis with growth across all segments and regions. Growth was particularly strong in the Protective Coatings with double-digit sales growth. The Marine business also had good growth, while decorative paints and powder had a more modest development.

EBITA grew by 2.3% year-to-date, driven by positive volume growth on back of high demand in most geographical areas. Raw material prices have remained fairly stable, but the company is facing some inflationary pressure on operating costs going forward. However, the outlook for the remaining rest of the year is still positive.

Orkla Foods Europe had an organic growth of 2.7% in the quarter, evenly split between price and volume/mix. The volume/mix growth is mainly driven by Norway, partly due to a weak July last year, but also positive out-of-home development this year. We have a continued market share growth in Denmark, and we had a comeback in retail in the Czech Republic following price reductions. We continue to experience demanding markets in Sweden and Finland, where the consumer sentiment remains muted.

Despite the substantial increase in A&P spend compared to last year, underlying EBIT adjust grew by 17%, and EBIT margin was up 1.6 percentage points. The increase is positively impacted by stronger focus on category and product profitability, supported by cost savings from reorganization projects in Norway, Sweden, and the Czech Republic. Note that the third quarter EBIT last year was negatively impacted by one-off costs of approximately NOK 25 million from recall of ketchup across several markets.

Orkla Confectionery & Snacks reported organic growth of 4.4% in the quarter, driven by price, as volumes were hampered by softening demand in the confectionery segments related to increased chocolate prices as well as production issues at the BUBS factory. These production issues are now resolved.

In Q3, improvements at the biscuit factory contributed approximately NOK 45 million to the EBIT growth. Even though the biscuit factory improvement was the key driver behind the NOK 53 million underlying EBIT growth in the quarter, growth was still solid given the substantial increase in A&P spend compared to last year.

And when it comes to cocoa, we want to reiterate that volumes for 2024 are secured. We have also started to secure volumes into Q1 next year. And while cocoa prices have declined since the spring, they remain extraordinarily high compared to historical levels. We continue to take mitigating actions to dampen the effect.

Lastly, at Orkla Capital Markets Day last year, a redesigned operating model was presented. The transition to this new model is progressing well and is expected to be fully implemented by early next year. Orkla Food Ingredients delivered organic growth of 3.1%. Volume/mix was positive at 4.1%, while prices declined slightly on the back of input price reductions.

The Bakery segment continued its solid performance driven by volume/mix growth and price management. Volume in the Sweet segment grew during the quarter, partly explained by weak comparables in Q3 last year for ice cream ingredients. We also see that the program of mitigating actions mentioned last quarter is progressing according to plan.

We have a slight decline year-over-year for Plant Based, but that's fully related to the margarine segment where results were temporarily very strong in the second half of 2023 and, in particular, in the fourth quarter. The strong underlying EBIT adjust growth of 18% in the quarter can be explained by the organic growth in Bakery and Sweet.

Moving on to Orkla Health. Orkla Health had an organic growth of 10% in the quarter due to broad-based price increases combined with continued good momentum for Möller's and Jordan. We had the Maxim relaunch in Norway, and as well as positive development for [indiscernible] (00:15:36) and our D2C business.

Underlying EBIT adjust growth of 13% was driven by top line growth and favorable mix, but partly offset by increased investments in the A&P and commercial resources. This is in line with the growth strategy to accelerate international expansion for global brands and new market entries for NutraQ, as well as supporting our brands in our Nordic home markets.

Organic growth in Orkla India was driven by positive volume/mix development of 3.3% and negative price effects on back of input price reductions. The strong growth in the international business continues, while consumer sentiment in the domestic market was weak, combined with modest festive sales and distributor inventory reductions. Underlying EBIT adjust growth was 8.4% in the quarter, driven by contribution margin improvement and reduction in fixed cost, but partially offset by higher advertising cost.

European Pizza Company reported an organic growth of 2.3% in the quarter. Da Grasso in Poland continues to show positive momentum, while consumer sales in Finland and the Netherlands remained soft. The strong focus on pricing and cost control contributed to underlying EBIT adjust growth of 23%, but growth was also positively affected by the turnaround in New York Pizza Germany, which is now operating at a smaller but more healthy base.

Orkla Home & Personal Care achieved an organic growth of 4% in the quarter, driven by increased volumes in contract manufacturing, meaning manufacturing projects on behalf of external customers. And then underlying EBIT adjust increased by 25%, driven by revenue management and lower input prices, but partly offset by higher advertising spend.

Turning to the remaining portfolio companies in the transform or exit category. All three of them experienced challenging market conditions during the quarter. I'm impressed that Orkla House Care, nevertheless, continued to perform in line with the company's financial targets, delivering 17% EBIT growth in the quarter, driven by improved cost efficiency as well as onboarding of new customer and successful campaigns.

Then, I would like to give the floor back to you, Nils.

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

Thank you, Arve. In my view, the Orkla organization has delivered solid results year-to-date. We see positive development in value creation and growing entrepreneurial spirit within our portfolio companies. It is crucial that we continue to adapt and evolve to stay competitive on all levels. I'm, therefore, reducing and simplifying my management team. Both Atle Vidar Nagel Johansen and Christer Grönberg have decided to retire early in 2025.

I want to thank Atle and Christer for their dedicated leadership and service over the past 25 years. Having said that, Atle Vidar will continue as Chair of Orkla India for a period to come. The new Orkla ASA organization will be operational from November 1. In addition to the organizational changes, we are also reviewing costs within Orkla ASA with the aim of achieving a leaner and more cost-efficient operation.

My number one priority is to drive organic value in our existing portfolio. This is only the third quarter of our 12-quarter strategy period. We are performing in line with targets. We see high EBIT adjusted growth, margin expansion, and increased return on capital employed. While this reflects normalization to a certain degree, these are encouraging early signs.

We have started to reduce complexity in our existing portfolio with the sale of Lilleborg in June this year. As previously communicated, we are also considering different structural opportunities involving Orkla's Hydro Power business. We have initiated a sales process involving the whole or part of our Hydro Power assets. We will provide an update when and if an agreement is reached.

I experienced that there might be some misunderstanding in the market at both the Orkla Food Ingredients transaction with Rhône and the assessment of the Capital Markets Day for Orkla India are only about crystallizing value. Let me clarify. Both are examples of how we are working to find the right platform for further growth and value creation. Lastly, we will still pursue structural opportunities when the timing is right.

With that, we will move on to the Q&A.

QUESTION AND ANSWER SECTION

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

A

Let me begin by asking whether there are any questions from the audience? We have a microphone around here, so please just state your name and company. Don't be shy. Okay. Well, we have a few questions on the Web, so we'll start with that.

First is from Eirik Rafdal from Carnegie. He asked, on the Hydro Power sales process, first, could you give any indication of a timeline? Second, how does Saudefaldene impact this? And excluding Saudefaldene, are you free to pursue any potential buyer for the remaining assets, or are there any limitations from a regulatory perspective?

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

A

First of all, timeline-wise, I don't want to guide on that. I think we will do a thorough process and make sure that we get the right price if we achieve the final sale of the assets. This process also includes all assets, as I said, for all our Hydro Power assets. And we don't want to guide any more than that on this issue. Of course, we have checked the regulatory issues before we initiated such a process.

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

A

Second question is from Håkon Fuglu from SEB. First question is, how confident are you on maintaining price increases in 2025? And the second question is related to BUBS in particular. What is the last 12-month sales from BUBS and what is the potential of expanding the brand abroad? So, we can start with the first question, how confident are you on maintaining price increases in 2025?

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

A

As we are always saying we don't guide going forward. So, I will – but we have seen, so far this year, the price increases are – or lower this year than the last previous years. Otherwise, we don't want to guide going forward.

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

A

And on BUBS, last 12-month sales and what is the potential of expanding the brand abroad?

Arve Regland

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

A

Well, we don't give details on each of the different categories. What we can say about BUBS is that the demand is increasing and it's the brand is also now globally. So, what we're working on is BUBS is to actually to increase production volumes to meet that demand. So, still find a huge potential for that brand globally.

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

A

The next question is from Ole Martin Westgaard from DNB Markets. He asked, on the biscuit factory, we understand that the operational challenges have now been resolved. Was this fully reflected in Q3 or should we expect a further improvement in Q4?

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

A

We said, at the Capital Markets Day last year, that we will – a significant part of the cost of NOK 150 million last year will be [ph] the gain (00:24:32) this year. That is still the case, and we continue to guide that. So, we will see a slight effect also in the Q4 numbers.

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

A

The second question from Ole Martin is how should we think about the impact on cocoa prices for next year for Orkla Confectionery & Snacks? Will you be able to offset this with price increases?

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

A

As I said, we don't guide specifically to the market on that. We have covered volumes for this year and also partly into the first quarter next year, and that's everything that we want to say on the cocoa prices effects this year. If the cocoa prices remains at this level, we will continue increasing prices if necessary.

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

A

Next question. Two questions from Petter Nystrøm at ABG. First, you talked about reviewing cost at Orkla ASA. Is it possible to share some more details on this?

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

A

We will revert to that later. We are exploring going through all the costs in Orkla ASA and we will revert to the market maybe fourth quarter this year.

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

A

And we also have a question from Petter on India. His question is India delivered relatively soft sales growth in Q3, can you give some more details on the development in India?

Nils Kloumann Selte

President & Chief Executive Officer, Orkla ASA

A

I think what we see in India, if we look at peers, they also have a soft development in the third quarter. So, this is a market due to the market situation in India and consumer spending or consumer confidence. It's also about inflation is quite high on some food prices to say, so that affects also our value chain. So, I think we are performing in line with our peers in India third quarter. This is, in our belief, a temporarily drop in the market.

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

A

That was the final question on the Web. Are there any more questions from the audience? No?

Annie Bersagel

Senior Vice President-Investor Relations, Orkla ASA

Before we round off, let me remind you that we report our fourth quarter results on February 13. Thanks again for joining and enjoy the rest of your day.

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2024 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.