Transcript

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2022 Half Year Results

Questions and answers conference call and live webcast

Company representatives
Gilles Andrier, Chief Executive Officer
Tom Hallam, Chief Financial Officer

Operator
We will now begin the Question and Answer Session. Anyone who wishes to ask a question or make a comment may press * and 1 on their touchtone telephone. You will hear a tone to confirm that you have entered the queue. If you wish to remove yourself from the question queue, you may press * and 2. Participants are requested to use only handsets while asking the question. Anyone who has a question or comments may press * and 1 at this time.

Our first question comes from the line of Heidi Vesterinen with BNP Paribas. Please go ahead.

Heidi Vesterinen
Good afternoon, everyone. I have 3 questions. First, you talked about tight cost control in your speech. Should we expect items such as R&D and sales and marketing to be lower as a percentage of sales going forward or was there some phasing in the H1 results. If that is what had helped your EBITDA margin?

Second question, could you talk about your expectation in terms of free cash flow and your leverage on a full year basis, please, as 3.5 times is on the high side for your company. And then a third related question, I wondered to what extent your leverage impacts your thinking on further M&A. Can you remind us on what you are thinking, what kind of size you would be looking at? There has been deals in the sector recently. Does that change your thinking at all? Thanks a lot.

Gilles Andrier

Thank you and good afternoon, Heidi. So, yeah, the question on, are we cutting on R&D expenses? Absolutely not. This is the engine of Givaudan. In the first stage, I can confirm that the actual bridge pipeline that you know that we are measuring on a monthly basis across the whole Group is in very good shape, also the amounts of new wins and that we see going forward. So the fact that the ratio of operating expenses has been going down over the sales has a lot to do that.

Yes, we are tightening expenses, but for the discretionary expenses, we are maintaining obviously the… a bit of a headcount neutral but in no way are we cutting jobs in any way or slowing down the investment especially related to working on (brief) with our clients and so forth. And so the fact that the ratio is going down has a lot to do obviously with the fact that the sales growth is high and therefore, perhaps on the ratio and the fact that we are also frugal on some… many items, which are not critical to servicing our clients.

Then I get… I hand over the question on free cash flow to Tom.

Tom Hallam

Yeah, thanks, Heidi for the question. And just to couple of additional comments on… particularly on the OPEX, of course, you will have seen in the half year report in the back up, we have a table which shows the amortisation of intangibles, which is split between the various elements.

We actually have about 12 million of reduction in amortisation of intangible expense year-on-year. So that's also driving the reduction in absolute R&D expense and selling and marketing. And then of course, as I mentioned, there is a lot of volatility in currencies. We are naturally hedged on the EBITDA margin, but of course, we have currency swings throughout the P&L.

On the free cash flow and on the leverage, in any year, it's really finding the right balance between supporting our customers on growth, investing in the future and you made the comment on R&D, but if you look at our CAPEX, we have a significant increase in CAPEX this year, which is a clear demonstration of our long-term commitment to invest.

And finally delivering on our long-term financial targets. The reason that we set 5-year financial targets is to take into account the volatility that occurs in at least once every 5 years as we have experienced and that's certainly what we see this year. If you make the calculation between now and the end of the year and so, okay, what would be needed to be done to achieve a single year target, clearly, that would be reckless in terms of business support. That being said, we have a strong practice of paying the dividend to our shareholders and we are very clear that that requires a certain amount of free cash flow, which needs to be generated during 2022.

On leverage, and then I'll hand back to Gilles really to talk about where we consider bolt-on acquisitions. But if you look historically, we've been up to 4, 4.5 times net debt to EBITDA. Clearly, if I look at the pipeline today from an acquisition perspective, there is really nothing that drives up the net debt to EBITDA and anything that we would do would be bolt-on acquisitions and very similar size to what we've done in the past.

But maybe I just hand back to Gilles to comment on the areas of interest for us.

Gilles Andrier
Yeah, Heidi, as we have already stated, the… we… as well, we look for I would say, companies to acquire and I would say to join the Givaudan family. It's across multiple dimensions.

It's still above the core F&S, you still have some small and mid-size players out there. The second dimension has a lot to do with our 2025 strategy, which is very much around those adjacent spaces.

You know that if I just remind the fact that on the… basically the Food & Beverage related ingredient space, we operate in a market size, let's say 15 billion of flavours. But we are also… .we also want to play in the adjacent spaces of Health, Nutrition and anything that contributes in a positive way to a formulation in food & beverage and that amount to, as we… as a reminder to another 14 billion, 15 billion of market size.

So, you've seen the acquisition of DDW at the end of the last year. You've seen some of the things we did with Ungerer. That comes obviously after Naturex and they are clearly and today we have only a 5% in this 15 billion. So clearly, there are assets out there, which are interesting. The question that you are asking is really about also availability, because we will remain opportunistic.

We have done 20 acquisitions in the last 4 years. We have a great, I think, name and reputation in the way we… in the way not only we make friends out of an acquisition but also the way we integrate companies and that has been very successful so far. So, the question is availability. Valuations of companies have gone down.

So, the question for the owners is, is that the right time I should sell my company, but yet we still remain very active and looking at that from a short term and also mid-term perspective building relationships and so forth. So now the next question maybe?

Operator
The next question comes from the line of Charles Eden with UBS. Please go ahead.

Charles Eden
Hi. Good afternoon. Thanks for taking my question. Just want a comment for me. Obviously, we've seen pricing step up in Q2 and volumes also remain as you accelerate. Can I just ask how you are thinking about the resilience of these volumes in the second half of the year? I guess, we've already seen some US food companies support negative volumes of their quarter to the end of May in recent weeks and I appreciate the CPDs are only about half of your sales and the category over that for some of these customers were somewhat limited. Just appreciate your thoughts on the volume trajectory from here given they've remained very resilient in a continued price rise environment. Thank you.

Gilles Andrier
Yeah, that's certainly... obviously, we increase prices, our clients increase prices because many of the categories that they actually acquired not just buy, not on these fragrance flavours and other ingredients increase. But yet, we have not seen on our side a slowdown in volumes. Obviously, and you said it's a bit in your question you are only tracking, let's say now 44% of our sales indirectly by tracking the big clients, our big clients which report that figures.

But you don't see the other 56% of... and how they are doing. So that maybe also explains that at least the 56% grow... are growing to 3 times the rate of the large ones. So that's also the natural hedge that we have there. So let's see what's the coming months are going to see in terms of volumes development. But today... and in any year actually it's very... it's always very, very difficult to have a precise number on where the volumes are going to go on the existing business.

The only thing that we control in our business is basically what we call the new wins and the new businesses that we win, which actually is the only way to gain market share by the way. And on that side, I can only concern that is very positive in both divisions continues to be positive and also explains why in many parts of the business we are clearly growing very fast.

So, that's what we can say about how volumes can develop. What's interesting is that volumes have actually accelerated from Q1 to Q2. So, not being impacted by any pricing on the client side. And obviously also something to specify in a way that when we increase prices that has actually no effect on the volume that we sell to our clients. There are no consequences of having increased prices to the volume that we sell to our clients.

Operator
The next question comes from the line of Lisa De Neve with Morgan Stanley. Please go ahead.

Lisa De Neve
Good afternoon, Gilles, and Tom. Thank you for taking my 3 questions. First, can I follow-up on the M&A question? So you talked about your perspective towards the markets. Can you also share some details on how active the M&A market is at the moment? And so, in terms of the willingness for companies to potentially divest and what the multiple is in the sort of private space looks like today given the sort of reduction we've seen, decline we see in the public markets?

And secondly, can you provide some detail on how your price conversations with your customers have and evolving through the first half?

Some of your peers, as well as some news what we've seen are noting for a step up into the resistance to higher prices on the retail and or the customer... end customer, consumer end.

So hence my question, what are you seeing on the customer front in terms of pricing and resistance? Thank you.

Gilles Andrier
Well, on the second question, and on price, obviously, I can't disclose our pricing conversations with all our clients, because certainly they are very numerous. And 2, I would say that the fact, the answer is basically in my statement, I can only confirm that essentially we are fully covered in terms of all the pricing negotiations we have completed with all our clients to recover all the 9% of raw materials cost that we mentioned earlier.

So, that has been done with more or less difficulties and resistance that basically that I can confirm this is in the system going forward. So that means it's concluded in a positive way. Pricing conversations are never easy. So... and the second thing, as it relates to the pricing up again of our clients to the retail side and so forth, yet we have not seen any slowdown in volumes to them, but which doesn't mean that some of them have... are seeing that on an individual basis. So that's really what we see today.

On the M&A side, obviously, I would say, as I mentioned, it's true that there is a bit of a correlation between the number of... if you look at history, the number of transactions and M&A deals are usually a function of high valuations and the result is also true that when valuations slowdown, you have also slowing down in transactions. It doesn't mean that there won't be any M&A opportunities going forward.

What's important in terms of valuation is really... we have a very... almost strict view on whether to make an acquisition or not, which is very much about 2 principles, one is to make sure that the multiple of buying something is lower than our own multiple and it's a higher multiple. There must be very good reasons to do that of very big synergies and we have never been in this situation, because Givaudan has a very high multiple.

And the second principle is really to make sure that it's not about earnings per share appreciation, it's not about any of that. We look at value creation through synergies and especially, well, in the first place, cost synergies that's given, but also sales synergies.

In every of the 20 acquisitions we've made, clearly, we have looked at both sides and I can only confirm that we have created a lot of value with many of them simply by not only delivering on the cost synergies, but accelerating the growth rates of every one of those companies and thinking there of... and follow them essentially.

And basically going forward, this discipline we will continue to have and this is very much driven by, I would say, very thorough disciplined thinking process to say that this really fits Givaudan not for more dimensions. The portfolio that it makes sense for what we do. Do we really see the sales synergies as opposed to dreaming about cross-selling, for example? And so, this I think has been valuable for us to keep on being disciplined when making an acquisition. So we will be remaining active, but again it takes 2 to dance.

Lisa De Neve
It's very helpful. Thank you.

Operator
The next question comes from the line of James Targett with Berenberg. Please go ahead.

James Targett
Hi, good afternoon, everyone. Yeah, a couple of questions. Firstly, if I could turn to North America, I appreciate the comment you made on comps. But maybe if you could clarify firstly if the supply chain issues are still lingering into Q3, specific ones for North America and also whether or not you have seen any… what your shares are like in North America? Are you seeing any change in the competitive environments, I was specifically thinking about the IFS and would you hope for North America to be back in positive territory for the second half of the year (clearily) the comps still relatively demanding in H2 as well? That's my first question on North America.

And then my second one, I guess, is really on the Fine Fragrances outlook. Clearly, you had a very strong couple of quarters. Again, obviously, you mentioned the recovery of travel retail, but just any visibility on the outlook for H2 for that unit? Thank you.

Gilles Andrier
So, for North America, yes, you mentioned comparables. I would say, when we mentioned…

well, the supply… 2 sides to the story. The supply chain challenges are being… having ingredients and raw materials on time, so that you can actually make a fragrance or a flavour and deliver it on time to your clients.

Obviously, we've encountered a lot of challenges in terms of lead times in these supply chain delays. It's actually slightly improving and we have seen some slight improvements over the last recent weeks.

The other culprit was the labour market. The labour market in North America is very, very tensed and that didn't start 1st of January of this year, it's already in the fourth quarter. So they are actually about… and it's true for our industry, it's true for many industries I believe.

And there it's also why last year we had to use a lot of temps and had to incur additional production cuts in North America. But things are improving rapidly in our operations footprint. I don't believe that it's a question of losing market share to anybody, because I hear that the issues are a bit the same for everyone, because they are a bit external labour and supply chains. So, that's a bit where we are today.

So, hopefully, we'll get to better grounds in the coming months in North America, especially on the Fragrance, Consumer Products side, because Fine Fragrance is doing very well and some other parts of the Taste and Wellbeing is also doing very well.

Fine Fragrance, well, it's a bit… I would say, it's a bit magic of Fine Fragrances. To give you an outlook for the second half, I think that we have just to remind when we were right in the midst of COVID in 2020, all our clients were saying we are going to be back to the 2019 level in 2024, 2025, maybe and to everyone's surprise, many Fine Fragrance clients now are including ourselves supplying them were already back to the 2019 level in August of 2021 given the formidable rebound that we have seen across the business. And then, everybody thought, maybe that's going to slowdown in 2022 and as you can see from the figures, it absolutely not slowed down at least for us. I don't know about our competitors. It obviously echoes a lot of our Fine Fragrance clients which are growing very strongly.

So, will continue it going forward? I don't know. The only thing I can say is that, again back to the thing that we control, the amounts of new wins, new businesses is very strong in Fine Fragrances. We have a formidable momentum which explains last just it gives us also this year's figures.

So that's basically what we can say about Fine Fragrances. We have also a very well hedged portfolio. We are on both Prestige Fine Fragrances, as well as more what we call the mass market specialty retail fragrances, which is very strong in the US, as well as the SAMEA, Latin America. So there is a huge diversity of Fine Fragrances, which also helps us navigating those times and really capturing all growth opportunities.

James Targett
Thank you.

Operator
The next question comes from the line of Matthew Yates with Bank of America. Please go ahead.

Matthew Yates
Hey. The first question was around the continuity planning you alluded to early into the presentation. I am not sure, so if I mean, you are going to talk more about the event at the end of August. But just curious if you had any early thoughts there on where you see the risks or the bottlenecks around the gas crisis. Is that with your own production sites or rather your suppliers, particularly in synthetics in Germany?

I know that's somewhat related another question is about M&A. BFS today put some assets out for sale around Food and Health performance ingredients. I think these are things occur emulsifiers and fat powders. Would that conceptually fit with your strategy of going into adjacent markets or these technologies that are perhaps more commoditised than the area Givaudan typically wants to play at?

Gilles Andrier
Okay. So, maybe I'd start by your last question. Essentially, we don't have so much appetite if I may say so for commodities. This is not our business model. As you know, we are... there are 2 or 3, let's say, almost criteria or attributes to our business model or the company we want to be which is any ingredients, any contribution to a formula which delivers a very clear benefit to the consumer that customers can actually build upon to build clients, to advertise and to be proud about.

And that's obviously... it starts with fragrance flavours, but then you go Active Beauty and so the many things that we have added in our portfolio follows this first rule. The second rule is that, those ingredients need to be not only contributing to something very positive that clients and brands can claim, but also, backed by innovation, highly specialised, requiring expertise.

And then, obviously, things which can help clients to differentiate and make their brands or their products bespoke obviously, yes, that's part of Fragrance and Flavors but it's the same with many... the more you are innovative with ingredients, the more clients and brands can actually have them develop specifically for them and then that's when we start to talk about solutions and things which are bespoke which is basically the essence of what we do.

And so, that's why that... at the end of the day, that translates into high levels of pricing, profitability and so far that... it's a consequence. And so that's why commodities by definition don't fall in many of those attributes I just mentioned. This is why we've been quite discriminating in terms of the acquisitions we could have made over the recent past if you look at the landscape which has changed around that. So, that's basically one.

The second one, the second question you are asking, may be Tom answer this.

Tom Hallam
Yeah, Matthew. So on the BCP and, maybe you... of course you picked on a couple of items, you mentioned the gas in Europe and we are looking at a number of things that we can do, but clearly we are a very small portion of the supply chain and as always, we

are highly reliant on our suppliers. What we also… what you also need to really remember and if you look even at the lockdowns in China in the first 6 months of this year, we have a geographical spread of our footprint. That has protected us. That clearly was a significant advantage during COVID and when we talk about BCP, it's also the ability to produce different ingredients in different facilities and this is really part of the BCP, the BCP that we talk about. So, we are taking measures, but clearly, we are a very small cog in a very, very long chain. But we have many, many facilities and we think about how we can balance and supply from each of them.

Matthew Yates
I guess, Tom, we all remember the citron crisis a couple of years ago, but are there particular material products that you are somewhat dependent on Germany to provide to you, any context as across your 10,000 raw material imports, you are dependent on synthetics in Germany?

Gilles Andrier
Well, you named it. Well, we are highly dependent on Germany, you named it already. So the citron, the reality is absolutely, but in Germany they are no others that I know. So the dependency, the 14,000 already spread across many, many different countries.

Matthew Yates
Alright. Thanks guys.

Operator
The next question comes from the line of Isha Sharma with Stifel Europe. Please go ahead.

Isha Sharma
Good afternoon. I have one next, please. I appreciate your comments on the net working capital shrink to secure supply chain. Based on that, are you still confident of delivering at least 12% of sales after the minus 4% in the first half?

Gilles Andrier
So, Isha, as I said, I mean, to achieve 12% this year would… if you look at the numbers, it's unachievable. I mean, that's why we said 5-year targets and that's why we have this 12% over 5 years. And again, all I can say is, it's really balancing between delivering to our customers, investing. We have a catch up in CAPEX after really 2 years of not making significant investments because of the COVID pandemic and delivering on our long-term financial targets. Again, I can only repeat, we have a strong practice of paying the

dividends to our shareholders and this requires a certain amount of free cash flow in any particular year.

Isha Sharma
Understood. Thanks a lot. Maybe just one follow-up on the margin. Typically, seasonally, you have 100 bps lower margin in the second half. Would that still hold true for this year which would actually mean a step-up year-over-year from the second half of 2021?

Gilles Andrier
Well, Isha, I think we have told you where we are in terms of raw materials inflation. You know what we need to do in terms of price increase. We've said we will fully compensate. Clearly, you'll see the acceleration in price even from Q1 to Q2 and that will also be in Q3 and Q4. So, I think, we've given you all of the elements that allow you to make your projections.

Isha Sharma
Thank you very much.

Gilles Andrier
Okay. I think we are leaving now to the last question, operator?

Operator
Today's last question comes from the line of Ranulf Orr with Citi. Please go ahead.

Ranulf Orr
Hey, afternoon, everyone. And it's the right term, it's 3 last ones, not just one last one. Firstly, on the cost savings, I am just wondering how much of this is... could be continuing into next year? Should we hit another year of high inflation? And how much of the cost savings would need to come to them before irreparable damage sort of is done to the business?

Secondly, I know we focused on M&A already, but just one more here. I am just curious to understand whether you think the evolving supply chain environment is leading you to think more about a move upstream as well?

And then thirdly, just on the pricing gains that we've seen this year-to-date. Is this all just offsetting raw material inflation or is there any sort of kind of mix or underlying pricing power in the business at the moment? That's all. Thank you.

Gilles Andrier
Can you restate the third question, because I didn't understand it clearly? You said what?

Ranulf Orr
Yeah, I was just curious to understand if there is any underlying pricing power in the business at the moment or whether the pricing increases are just purely, entirely offsetting raw material increases?

Gilles Andrier
Yeah, so, they are there to actually entirely offset the raw material increase and the pricing is obviously a function of actually on both sides. When you look at raw mats, we give an indication but that's based on actually what we actually buy. And therefore the mix of raw mat can influence the actually... and increase and this is also true on the pricing to our clients. It all depends on which types of products and which products are going too picked up and that actually translates into a pricing which can actually have some minor fluctuation. So, it's not an exact science.

As it relates to pricing power, I would not like to... us taking of pricing power, it's true that however you read it, I can only reconfirm we are fully... all our pricing negotiations are fully complete to be able to recover that in a successful way. And then the first question...

Tom Hallam
Maybe I can take it. Just Gilles, thanks. So, on the cost savings, look, I think at the end of last year, we were very clear we said we had 30 million of cost incurred in 2021 related to COVID, which we felt that we would be able to get out during this year and you see and we've demonstrated our ability to get that cost out. Just again to reiterate what Gilles mentioned, we are not cutting muscle, we are cutting bone. We are not cutting on R&D and selling and marketing from a fundamental business perspective.

And then, just on the M&A, on backward integration, again, as Gilles has mentioned, we buy 14'000 raw materials to try and pick the right one to be back with integrated is extremely difficult and to do even a handful is... becomes almost impossible. So, we have our clear areas of focus in terms of M&A, not backward integrating. We like the flexibility and the optionality in terms of having multiple sources of supply and that's very much in line with our M&A strategy.

Ranulf Orr
Great. Thank you.

Gilles Andrier
Well, thank you very much for your questions. This ends now our call. I'd like to remind you that we hold on August 30thour traditional half year conference in Zurich. The theme of this conference will be dedicated to plant-based food and alternative proteins, co-creating safety, healthy and nutritious food experiences for all. I hope, not only you will enjoy what we'll tell you, but also as well, how we'll feed you. Thank you very much. I am looking forward to see you at this event.

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.