Greencore Group Plc - Q1 Trading Update

Tuesday, 29th January 2019

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Welcome

Jack Gorman

Head of Investor Relations

Okay, thank you. Good morning everybody. My name is Jack Gorman and I'm Head of Investor Relations at Greencore. I'd like to thank you all for taking the time to join us for our Q1 trading update conference call which covers the period to 28th December 2018.

I'm joined on the call today by our CEO, Patrick Coveney, and our CFO, Eoin Tonge. In a moment I'll hand you over to Patrick to give an overview of trading in the period, and after that, we will open the call to Q&A. At the point of Q&A, please press star one to ask a question.

Finally, I would draw your attention to the forward-looking statements at the end of today's release.

And with that, I'll pass it over to Patrick.

Trading Overview

Patrick Coveney

Chief Executive Officer

Thanks Jack. Good morning everybody; it's Patrick Coveney here speaking. For those of you who don't know me, I'm the CEO of Greencore, and I'm joined for the Q&A element of this call by our Group CFO Eoin Tonge.

The purpose of this call is over the next ten minutes or so to provide more colour on today's trading statement, and then for Eoin and I to field any questions that you have. We believe that it's a relatively straightforward statement, and as such I anticipate both the introductory comment and the Q&A finishing by about 09.00 this morning.

In summary, we've made an encouraging start to the year and specifically we are executing well against all of the business and organisational objectives that we've had for the year so far. In particular this morning I would like to draw out five key themes. Firstly, our good revenue performance during the quarter, despite a more muted period for the overall UK market particularly in November.

Secondly, how we are progressing against our organisational, commercial and operational objectives.

Thirdly, to provide an update on the various capital management initiatives that we have undertaken post the disposal of our US business, a disposal which completed during Q1 at the end November.

Fourthly, our continued preparations for Brexit, and finally, reaffirming our outlook for the financial year 2019.

Let me now draw out each of these a little more. Our strong relative growth was delivered in the context of a UK grocery market that had another challenging quarter, characterised by a very competitive market conditions, seen at customer level; a high street consumer that remained cautious, most particularly in November; and ongoing inflationary pressures. Within this context, we delivered good pro forma revenue growth in continuing operations up 5.8% in Q1, an encouraging start to the year. Specifically, we achieved pro forma growth in the food to go categories in which we trade, up 6.4%, and we achieved pro forma growth in the rest of our continuing operations, at a level of 4.7%. we were happy with our performance in the food to go categories in a period that is not as seasonally significant as in other quarters. The components of pro forma revenue growth were broadly similar to those experienced in FY18 and we continued to outperform the broader category.

We made excellent progress with each of our customers in these categories. Food to go propositions continue to be a focus for all of our customers, and we are confident in the long-term growth dynamics of these marketplaces, as we've guided and spoken about in the past.

Elsewhere, the 4.7% pro forma revenue growth in the rest of our portfolio was a positive performance against what was a tough comparative period. We had decent growth across most categories but specifically we saw strong volume growth in our cooking sauce business, as own label propositions continue to increase their penetration in the category.

More broadly, we were delighted with the progress that we’re making against our organisational, commercial, operational and wider financial objectives. At an organisational level the UK’s senior leadership team is bedding down well and now leveraging the combined scale of the new structure as they engage with customers.

We executed well in Q1 on our plan to review and reduce central costs post the disposals of our US business. Commercially, and as we noted earlier, we have many initiatives in train with customers focusing on growth. In addition, we are progressing to plan, with the exit of our longer-life ready meals facility in Kiveton and improving overall ready meal performance.

Operationally, the efficiency programmes remain on track and are delivering against internal expectations. As we said at year end, the management focus now is on extending these programmes across broader sets of our supply chain. Where this continues to be an important lever to mitigate against raw material and labour inflation which in aggregate were in line with our expectations for the quarter. Each of these initiatives underpin our financial performance and business objectives for the full year.

I want to now provide an update on capital management. Firstly, we completed the US disposal on 25th November and as such there have been two months of performance presented at discontinued operations in our FY19 results. The financial impact of the net proceeds, capital return and leveraged reduction will all be incorporated into the performance of continuing operations. As most listeners on this call will be aware, our tender offer programme to return up to £509 million of capital to shareholders is subject to shareholder approval at our AGM today.

With the tender offer scheduled to complete at 13.00 today. We expect to update the market on the details of this tender offer on Thursday. During January, we also completed the refinancing of our primary debt agreements with our lending group. We are happy with the structure and terms of our new agreements and as of today we have £462 million sterling of committed facilities, with a weighted average maturity of 4.7 years.

Taken in aggregate, these debt facilities position us well to deploy our dynamic capital management approach. Given the balance sheet and underlying cash generation that we have, we believe that we have appropriate resources to deploy over the medium term for organic and inorganic opportunities as they arise and execute against the dynamic capital management programme that I referred to earlier.

Moving now to Brexit, our preparations for Brexit continue in earnest. Standing back and just giving you our overall point of view, as I have said and we have said many times, we as a company are relatively agnostic to the final Brexit solution, assuming a smooth transition. Clearly, we would be concerned about a transition that is not smooth. Over the last few months we've been working on multiple fronts to assess and mitigate against the impact of various scenarios that may occur. In almost every instance, we are working hand in glove with our customers to make sure that our solutions match against their solutions and that we have the best possible chance to have high quality products available for consumers on the shelves regardless of the exit scenarios.

We have continued to work closely with our customers and with our suppliers to prepare contingency plans in this regard, and clearly that's a heightened area of focus for us over the next couple of months.

We conclude then with a brief commentary on outlook for the rest of the fiscal year that we have reaffirmed this morning. As noted earlier, we have made an encouraging start to the year. We expect our revenue outturn for FY19 to be driven by continued underlying growth in our key convenience food categories. We anticipate that operational leverage will be driven by this revenue growth and that we will have improved operational performance across the business, and that the review of overheads following the disposal will generate positive returns.

The strengthened balance sheet and continued strong cash generation of our Group leave us well positioned to allocate our capital sensibly across organic and inorganic opportunities as they arise.

And we also reiterate the healthy outlook for underlying cash generation and returns across our Group. Let me conclude by saying that our next result update will be our interim 2019 results which are due out on 21st May.

So hopefully that update helps, and with that, Eoin and I are happy to take questions from the participants on the call.

Q&A

Operator: Okay, and just a reminder, everyone. If you wish to ask a question, you can ask star one on your telephone keypad and wait for your name to be announced. If you wish to cancel your request, you can press the hash key. Please stand by while we compile the Q&A queue. This will only take a few moments.

We have some questions. The operator is just taking their names. And again, just a reminder, if you wish to ask a question, you can press star one on your telephone keypad and wait for your name to be announced.

Alright, we have your first question. It's coming from the line of Karel Zoete. You can go ahead; your line is now open.

Karel Zoete (Kepler Cheuvreux): All right. Thank you. Good morning for taking the question – thanks for taking the question. I have two questions. The first one is on the terms of the refunds – can you update us on interest rates and you're now paying with stronger balance sheet?

The second question is on the non-food to go part. There is an uplift in the – in the growth rate. Yeah, could you provide some more insights why – why growth was better in the first quarter? Thank you.

Eoin Tonge: Sure. Karel, it's Eoin here. Why don't I take both questions? So firstly, on the refinancing – so I mean – as you can imagine, quite a lot of activity from the treasury perspective post the disposal of the US operations. Because effectively we've – we've signed a whole new capital structure, in essence. The refinancing of our primary debt facilities which we completed just literally yesterday were largely in line with our previous terms. I think it's fair to say the – you are right in saying, you do get a benefit in terms of spread versus when you operate a lower leverage, and we will get that benefit. But it's in line with the previous credit profile and credit conditions if you will. So our average spread I think at the back end of last year was 2.3%, so it'll be a little bit lower than that. Which is good.

And in terms of growth in non-food to go – I mean, it was a good performance across the board. We had good – very good performance in our cooking sauce business which benefited from business wins, but just general overall performance, we had a small win in our Soups business as well. But if we look across all of the categories, actually they – they performed relatively well and kind of in line with category growth rates there.

Karel Zoete: Okay. Thank you.

Operator: We have your next question. It's coming from the line of Jason. You can go ahead; your line is now open.

Jason Molins (Goodbody): Good morning. Jason Molins here from Goodbody. I guess just starting off on the food to go and the growth that you had there – maybe if you could just talk about the trajectory of third-party distribution revenues? What contributing factor they had in that period – in this period, rather, but also what we should expect as the year progresses, given the trajectory that we saw last year. And then just quick on the non-food to go, can you maybe spell out the 4.7% between volume and pricing? Obviously pricing was quite strong last year versus maybe a more muted volume performance, but has that reversed somewhat this year? Thanks.

Patrick Coveney: Hey Jason, it's Patrick. Yeah, I mean, so just to recap, of that 6.4% pro forma growth in food to go, about 2.5% was manufactured goods and about 4% was the distributed items that go alongside the manufactured goods to our customers.

I think the – you know, that will move around a little through the year because we will see the growth in fast food[?] moderate somewhat as we lap against some of the new business that we signed up last year as we go through the rest of the year. We're hopeful that we'll see manufacturer growth tick up as we go through the year for a whole variety of reasons as we're given the initiatives that we're working through with customers. So overall, I'd anticipate that that growth level of, you know, north of 5% that we've been signalling for a while in food to go for the rest of the year is where we'll come out with, as we transition through the year, the relative contribution of manufactured probably being a little stronger and fast food moderated somewhat as we go through the year.

On non-food to go, the – I mean it's mainly volume and it's mainly cooking sauces, is probably the best way of putting it. And there is some price recovery, but you know, the truth is, in the context of where the market is, that kind of near 5% growth in that part of our business is pretty good. And you know, the real stellar performer in terms of growth there is our ambient cooking sauce business in Selby, where we've just had very strong volume growth.

Jason Molins: Okay. Thanks. If you don't mind, can I just ask a sort of follow-up question around Brexit and the contingency plans that you're working through? I guess obviously a lot of uncertainty, and you mentioned that in the statement. Where do you think just generally you sit in the category, particularly around sandwiches, versus say, other food to go items, salads, et cetera, that, you know, leaves you better or worse protected from, you know, the no-deal scenario with regard to sourcing products and materials.

Patrick Coveney: Yeah, I mean I think the, as I said in the introductory remarks, you know, we think the business is pretty well set-up assuming there's a managed transition to some Brexit solution, right, so by that I mean in terms of, you know, the 70 to 80% of our raw material and packing coming from within the UK, a labour force that's not particularly seasonal, so the – and a good match of sterling exposure on both revenue and cost side.

So, you know, we think we're, and, you know, the direction of travel towards local sourcing, which we think will follow as well. So all of that I think sets us up nicely to, you know, to continue to progress with our agenda assuming there is a managed transition to something by way of Brexit solution.

If there isn't a managed transition to something, if there's a no deal or, you know, hard, you know, crash out at the end of March, then you know, I think the whole UK food industry and large chunks of the UK economy are going to find things quite difficult, and, you know, I would reference the letter from the BRC to Parliament yesterday as kind of setting out broadly what some of the, you know, key features are in terms of the pressure around fresh ingredients. And in particular the seasonal pressure around fresh ingredients at the end of March, given the growing patterns in the UK for produce and fruit and vegetables, but most particularly produce.

Now, if I come narrowly to us, the principal sourcing challenge for Greencore in a hard Brexit scenario will be around fresh produce and in particular around various forms of lettuce or leaf of varied kinds. Broadly, we think we have already got in place good continued solutions for pretty much everything else. And so the choices that we will have, and the contingency solutions that we're progressing on a daily basis now really goes to whether we would take on board two different things. One, a conscious decision to pivot aspects of our sandwich range away from components that require, in particular specialist leaf solutions like rocket or fresh spinach. Or two, and a little bit more radically, whether we commit now to actually air-freight in portions of our fresh spinach and rocket requirement.

Clearly in order to do that we will need customers to sign off on the cost implications of those solutions, but they are actually available. And so that's the space in which we're in, and our sole focus will be having available product on-shelf. I could take you and everyone else on this call through a whole raft of details on this, but, you know, there are just so many unknowns here, about both around what the, whether there is or isn't a no-deal Brexit, but frankly the other piece of this that I think, you know, will be a challenge for all of us is what happens to shopper behaviour in the lead-in to the end of March and immediately thereafter.

In other words the kind of presumption that kind of many people appear to have here is that the task is how do you maintain supply assuming a maintenance of current demand patterns. And I think it's unlikely that demand patterns would be unchanged in the event of a hard or no-deal Brexit. And so again we've got to try to do some work around what skews and ranges to prioritise in the event of all of that.

So lots of different things going on, I think insofar as we can be, we're doing everything we can, and, you know, the nature of a business like ours is that, you know, what we do we have to do absolutely hand-in-glove with our customers, and that's how we're working it.

Jason Molins: Okay, great, thanks for that.

Operator: We now have your next question; it's coming from the line of Nicola Mallard. You can go ahead; your line is now open.

Nicola Mallard (Investec): Thank you. Hi, just a quick question on the Kiveton exit; you mentioned obviously you're still working towards doing that, was any of that in the first quarter or is that still something that we'll see wash through the more reported numbers, I'm guessing, through the rest of the year? And secondly, I know you said you'd update the market on the capital reorganisation, but should we be prepared for any special dividends at all from what you can see so far? Thank you.

Eoin Tonge: Hey Nicola, it's Eoin here, I'll take both of those questions.

Nicola Mallard: Hi.

Eoin Tonge: So I mean the impact of the Kiveton closure, we've said previously the impact on the year, it will be about £20 million of revenue. And in the quarter it wasn't that significant, it was sort of, kind of, low single digit millions in the quarter. And we have as you have seen stripped that out of our pro forma, so we've adjusted the pro forma to reflect that, so just to get a better underlying like-for-like.

And just by way of note, as Patrick mentioned, the process in terms of that project is progressing in line with plan and well, so we're happy with that. In relation to the tender, I mean, to be honest with you Nicola, we're not going to be able to – it's a little bit like the Brexit conversation, we're not going to be able to speculate at the moment in relation to what the result is going to be, I think we're just going to have to go through, first of all what the actual result will be, which we will know obviously over the next 48 hours or so and communicate to the marketplace on Thursday morning, and at that point in time we will communicate exactly what the plans are for any sort of remaining events capital to repay if any.

Nicola Mallard: Okay. Thank you.

Operator: We now have your next question; it's coming from the line of Clive. You can go ahead; your line is now open.

Darren Shirley (Shore Capital): Yeah, morning gents, it's Darren actually. Just going back to your comments around demand patterns, Patrick, I wonder if you could characterise where we are now? We obviously had October and November were particularly tough going into Christmas. I mean after the Christmas spend, have we returned to those sort of very demanding trading conditions? Or are we more normalised, would you suggest?

Patrick Coveney: Yeah, Darren, I mean I want to be careful about, you know, attributing cause and effects to different things, but I mean the facts as we've seen them over the first four months of the year are that the market was soft enough in October and November but was more buoyant in December. January has actually been a decent month for us, but I am also conscious that on a relative basis, we had the beginnings of some of the kind of real cold snap in January of last year, which have not had in January this year.

So you know, we've been encouraged with the trading trajectory both in December and since, but you know, having done this for eleven years or so now, I tend to be very careful about drawing any real conclusions for the rest of the year from what happens in January, because it can bounce around a lot for a whole variety of different reasons, and it's really once you come into February or March that you get a better sense for how the spring and rest of summer is set up.

But undoubtedly as we referenced on the call, we were pleased to see an improvement in December versus the end October and November trading patterns.

Darren Shirley: Okay, that's helpful, cheers gents.

Operator: Okay, now we move onto your next question, it's coming from the line of Doriana Russo, you can go ahead, your line is now open.

Doriana Russo (HSBC): Yes, good morning everybody, Doriana Russo from HSBC. Just wanted to come back to the trading patterns that you've just commented, have you seen any major difference in terms of performances across ranges, low end of the market versus high end of the market, and can you give us some colour in terms of what you think might be working better than others. And also in terms of what you have seen in ready meals, you said most of the 4.7% performance in the non-food to go was coming from cooking sources, can you give us some sort of comment on how your ready meal is performing at the moment after your exit from long shelf-life products please?

Patrick Coveney: Yeah, Doriana, again I hesitate to point out any schemes beyond the obvious that you'll be seeing elsewhere. So I mean we, you know, in general, you know, as we've seen for many years, we're encouraged to see that our food To go business is trading well, and that that performance is running across most customers. There are always puts and takes as ranges change or, you know, different ordering systems coming in and out with different customers. But overall, I think it's a pretty broad-based level of growth consistent with the consumer trends, the consumer preferences that underpin food to go demand.

Specifically, on ready meals, we – our ready meal business has been relatively flat in the period. As I said earlier that the really strong growth driver in the non-food to go parts of our business has been our cooking sauce business. There are some mixed implications in ready meals. And I think the encouraging component of that is that the somewhat more premium, fresher, higher-quality propositions that we're driving are doing relatively better within ready meals. And so one of the kind of the factors underpinning the reset that we're putting through our ready meals business that we described for the first time back last July-August was this conviction that we have this, the fresher, more premium, higher-quality, better tasting, better merchandised ready meal range is where we ought to be and that's why we've scaled back somewhat on the kind of longer life retorted items.

So they are the main things that I would say and we're – we are truly a multi-customer business across the key categories in which we play and it is our job to make all of them successful and that's what we're trying to do.

Doriana Russo: Okay, thank you.

Eoin Tonge: And Doriana, it's Eoin here. Just to add to that, the mix effect that we saw in our ready meal business in the first quarter were carried over from the backend of last year but there's been no material shifts in mix in the quarter at themselves.

Doriana Russo: Okay. So shall I take that, that you haven't really seen a major divergence of customer demand across different levels of products, because that was – okay, thanks.

Eoin Tonge: Yeah.

Operator: Thank you very much. We now have the line of Cathal Kenny. You can go ahead. Your line is now open.

Cathal Kenny (Davy Stockbrokers): Good morning, gents. Cathal Kenny here from Davy. Three quick questions from my side. One, just interested in the outlook for the sushi business. Cognisant if there is a quite a bit of capital come into that over that last two years. Secondly, just a follow-up on ready meals. How should we think about the rebuild of profitability within that segment this year? And finally, again related question on the – just the phasing of operating profits this year? Is there anything on you were call out kind of relative to history in terms of the seasonality of profit delivery? Thank you.

Eoin Tonge: Yeah, Cathal, why don't I just take the phasing quickly because I think it's fairly straight forward answer. It's a similar – I mean, we're – obviously with the disposal of the US business, we sort of go back to what the historical phasing of our UK business is. So it is the second half weighted business, particularly in food to go. So we're not really – we're not anticipating any material shifts for that. And Maybe Patrick, do you want to take the first one?

Patrick Coveney: Yeah, Cathal by the way I'm glad you clarified who you were there because it was confusing to us all. I mean, we're pretty positive on the outlook for sushi, in particular the work that we're doing to get value from the investments that we've made into Northampton in sushi. So, it remains a relatively modest part of our – in total volume terms, of our food to go business, but important in a variety of different ways.

I think we've got a nice plan to continue to get value from the investments we've made, particularly the investments in Northampton. And certainly, if you are in store with our sushi customers, and in particular the principal sushi customer from which we source product in Northampton, I think you'll see some pretty cool stuff over the course of the rest of this year.

On ready meals, I mean, I think the view that we have here is that we're executing this reset through this year with the phased exit from Kiveton and the various different moving parts. I think the most prudent planning assumption is that ready meals will, in terms of its profit contribution, will probably remain flat year-on-year as we deliver through those changes with this step-up in performance in ready meals anticipated for FY20 rather than FY19.

And overall, I think that some of those kind of reset plans can be complex to deliver and I think you'd have heard us be pretty bullish on how we're getting on operationally you get delivery of that plan, but we're certainly cautious enough for about the phasing of the kind of rebuild in ready meal profitability and I think it'll be more of an FY20 than FY19 opportunity for us.

Cathal Kenny: Thank you. That's very clear.

Operator: Thank you. We now have your last question. It's coming from the line of Damian McNeela. You can go ahead. Your line is now open.

Damian McNeela (Numis Securities): Okay, thank you. Morning, gents. Just a couple of quick ones from me, please. Firstly, can you just remind us of the level of labour inflation that you're expecting to see this year and what, given current FX rates, you expect for material inflation to be, please? And then finally, I think, Patrick, you mentioned that you're pretty encouraged about returning to that sort of call 5% growth in food to go due to some initiatives that you've got going. Can you give us a bit more colour on that, whether that's – in terms of the timing, is that sort of H2-weighted and whether that's with sort of new customers or with the existing customer base, please?

Patrick Coveney: Yeah, thanks, Damian. Just to – so I mean, I think we expect our direct labour inflation to approach 5% and our raw material and packaging inflation assuming a continuation of broadly similar exchange rates to where we are at the moment to be of the order to 2% to 3%. And importantly, all of our guidance and all of our initiatives are designed to enable us to hit the financial metrics that we've been speaking about while handling inflation at that level in those two parts of our cost base.

On the growth in manufactured sandwich units and the kind of 5% or so, I think that inevitably balances around a little bit month-on-month and quarter-on-quarter. But I think as per my comments earlier and when Jason asked me about that, I think, you will see the relative contribution of manufactured volumes within the overall growth components of food to go strengthen as we go through this year and our grounds were believing that a combination of new commercial activity and particular programmes across sandwiches, sushi and salads that we've got locked in for the rest of this year. So that's probably all I can say on it.

Damian McNeela: So is the new commercial activity with existing customers though or is it with new customers as well?

Patrick Coveney: It's a combination of both and it's – some of that is the annualisation of things that we landed in at various points last year too. So again, I want to be a little bit careful here. I mean, we obviously have a very significant overall level of market share, as I think everyone on this call would know. So the scope for adding material new customers into our business is limited. So the really big driver here is achieving strong like-for-like or samestore growth in sandwiches, salad and sushi with our existing customers and we think there's a ton of scope to do that through availability programmes, promotional programmes, new range launches and it's really tightening up ordering and supply chain issues. And we just got a lot of that work going on with each of our customers and I think we're pretty encouraged by what we're seeing and what we're planning for the rest of the year.

Damian McNeela: Okay. That's great. Thanks so much, Patrick.

Operator: We have one last question. It's coming from the line of Martin. You can go ahead. Your line is now open. Martin, your line is now open. You can go ahead.

Martin Deboo (Jefferies International): Hello, can everybody hear me?

Patrick Coveney: Yeah. Hi Martin.

Martin Deboo: Hi guys. It's Martin Deboo at Jefferies. Sorry, there seems to be a few problems on the line. My apologies. Maybe just quick follow-up to Damian's question. You mentioned 5% wage inflation. Can you just give an indication, how much of that is feed-through of national living wage and how much is sort of underlying wage inflation? It's probably difficult to be scientific. But any indication you can give would be helpful.

Patrick Coveney: It is difficult to be fully scientific but the vast majority of it has to do with the flow through of the natural living wages. As we said many times before, it's not the actual national living wage itself. It's the fact that a lot of our salaries are set by reference to the national living wage. So as the national living wage increases, you get the flow-through effect into their wage structure. It is a fairly big adjustment scheduled for April on the programme. It goes to 8/20 and that, we budgeted for that and that's what reflects into that number. So there's no real new news actually on labour inflation market. That's the big movement, really. We're not really seeing anything that's different other than that one.

Martin Deboo: Okay, it's very clear. Thank you.

Patrick Coveney: Thanks to everyone for joining. And apologies if it's been just administered a little bit difficult for people to ask questions. We'll make sure to sort that for next time out. But listen, as we said on the call, we'll be updating the market on Thursday in relation to the outcome of the tender offer and our anticipated next trading update is at the end of May when we'll have our interim results. But thanks to so many people for joining us and we look forward to speaking to everyone soon. Bye-bye.

Operator: Ladies and gentlemen, that does conclude our conference call for today. Thank you all for participating. You may now disconnect.

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