Q3 Trading Update

Tuesday, 30th July 2019

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Jack Gorman: Great, thank you and good morning, everybody. My name is Jack Gorman, I'm Head of Investor Relations at Greencore and I'd like to thank you all for taking the time to join us this morning for our Q3 trading update conference call, which covers the period to the 28th of June 2019.

I'm joined on the call here today by our CEO, Patrick Coveney and our CFO, Eoin Tonge. In a moment, I'll send you over to Patrick to give an overview of trading in the period and, after that, we will open the call up to questions and answers.

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

So, with that, I will pass you over to Patrick Coveney. Thank you.

Patrick Coveney: Thanks, Jack and good morning, everybody. It's Patrick Coveney speaking here. The purpose of this morning is to briefly provide some colour on today's trading statements and then to hear any questions that you have for Eoin or for myself. We will be dealing with broader topics, such as the Group's vision, strategy, growth agenda, business model and capital allocation plan in detail at our Capital Markets Day at the end of September. So in the Q&A today we do intend to focus on the contents of the statement itself. As such, we would anticipate finishing this call at about 9 o'clock.

We've achieved a solid performance in Q3 in what has been a particularly challenging quarter for the UK grocery sector. Now I would like to address three key themes: our revenue progress in a difficult marketplace, the delivery against our organisational, commercial and operational objectives and our outlook for the financial year.

Let me draw out each of these themes a little more. Firstly, our revenue progress in the quarter. We delivered a solid performance in the UK grocery market that had particular challenges in this quarter. The UK high-street consumer has remained cautious with regards to spending throughout the period and this was exacerbated by prolonged, unseasonal weather right up to the end of June.

I've applied two statistics to illustrate the outcome of these conditions. First, overall retail footfall was negatively impacted in the quarter. The BRC, our British retail consortium recently noted a 2.9% reduction in footfall in June, bringing this three-moth average reduction retail footfall to 2.4%. Second, the UK food and drink market as measured by Kantar was flat in the three months to mid-July, with overall grocery market sales down 1.5 to 1%. These two statistics, albeit at a macro retail level, give you a strong sense for the overall consumer environment in which we traded during this quarter. Against this context, we delivered a resilient revenue performance. Pro forma revenue growth was 0.8% in Q3, specifically, pro forma and reported growth in our food to go categories was 0.6% and pro forma growth in our other convenience group categories was 1.4%.

Within the food to go parts of our business, there are several features of the quarter that are worth highlighting. As anticipated, the driver of growth in Q3 was volume growth in manufactured products. Revenue growth was approximately 1% in the quarter, volume-driven and supported by the year on year impact of business wins. The year on year boost in revenue from the distribution of third-party products is now completed, with distribution revenues actually modestly down year on year in this quarter. Our food to go business outperforms the overall market in this period; using the most recent data to hand from IRI, the overall food to go to market actually declined by 2.7% in value terms for the 12 weeks to the middle of June. Unseasonably cold and wet weather contributed to weak market conditions for much of the period, impacting this overall market performance for food to go.

As I mentioned before, we are also observing surprisingly varied customer food to go volume performance in recent periods, and this was very evidenced throughout Q3. Some customers have responded well to the commercial initiatives that we are working on together and we've seen positive volume momentum with these; but with others we have more work to do and this is now progressing. Of course, our relative quarterly performance year on year is also impacted by the tough comparative period. In Q3 of FYA seen, that was a quarter in which our food to go revenues actually grew by 10.5% underpinned by strong increase in revenue from the distribution of third-party products last year.

In summary, then, on food to go. These are somewhat disappointing revenue numbers relative to both our history and our expectations of ourselves, but they're actually pretty solid when compared to the market, individual customer performance in the quarter and a demanding prior year comparative period.

Our other convenience food categories delivered a solid performance, with 1.4% performer revenue growth in this soft retail environment. As always, there are some putts and takes across this part of our business, but we saw a good performance in soups and ingredients, solid performance in ready meals and our cooking salts revenues were back a little compared to the prior year period.

Taking us down back, we are making excellent progress against our strategic, organizational, commercial and operational objectives. We have seen deep – commercially, we have deep, longstanding relationships and multiple specific initiatives with customers focused on reigniting growth for the months and years ahead. As flagged in our H1 results presentation, our plans to launch into food to go solids with several customers were initiated in early July and the early signs up from these initiatives are encouraging. Our capabilities have also expanded in sushi manufacturing. We can now deliver raw sushi with a proposition that works for selected customers in terms of shelf life availability and supply chain. This model can now deliver equivalent quality sushi in retail stores to that previously only available in sushi specialists. And, finally, we've invested in our cho soup capacity and capability, reflecting business wins in that category.

Operationally, we've seen continued strong performance being delivered by our excellence programs across manufacturing, but increasingly also on purchasing, which is helping to underpin financial delivery in a tough marketplace. Each of these factors contributes to our FY '19 outlook that I will describe now.

First off, we are progressing with our overarching strategic and financial objectives. We are excited and confident about the prospects and potential for our business in a market full of change. We are convinced that we can outperform. Q3 was a little softer than we anticipated it would be back in May. Q4 is very important to our full year profit delivery. It is and always has been our biggest quarter. In early July we did see a pickup versus June, but the year on year comparatives are still tough, given an exceptional start to July last year. However, as we've got into the second half of July, we've seen a stronger picture emerging. Informed by all of these factors, we continue to anticipate growth and adjusted operating profit this year driven by underlying revenue growth and strong operational performance across the business.

Beyond the operating profit, we are particularly happy about the progress that we are making on all elements of cash generation, including working capital, capital expenditure, and each of the other cashflow items. This progress sets us up for a really strong second half of the year in terms of cash generation, which we anticipate will leave us at the lower end of the net debt EBITDA leverage range of 1.5 to 2 times.

Finally, I'd like to highlight to all listeners that our next Capital Markets Day is on the 26th of September in London and further details of this event will be provided later in the summer.

And with that, I'll now turn the call over for questions to Eoin and I. Thank you.

Q&A

Jason Molins (Goodbody): Hi. Good morning. A couple of questions from my side. Patrick, I think you mentioned there, in terms of the food to go category performance, it was largely driven by volume. Can you just talk about, on the other side, pricing and in particular the raw material inflation that you're seeing? Just to give us a bit of context around that.

And then just from the array of your outlook statements and the [inaudible] you've given in terms of July in that performance, that's maybe improved as that period has unfolded throughout the month. How important is July in the context of the overall Q4? Thanks.

Patrick Coveney: Thanks, Jason. Yeah, quick answer to both, actually. Very little inflation in aggregate terms in our food to go business, actually in raw material and packaging. I mean, it's not zero, but it's pretty low. So the – you know, we've been able to fully recover that through the combination of mixed pricing initiatives that we have. And as a result all of the growth that we're seeing is in value. And that's what we'll anticipate through the rest of this year, as well.

In relation to – I mean, I want to be careful not being, you know, too definitive from week-on-week performance. You know, the first I say, July is a very important month for us. You know, Q4 is our most important quarter and, typically, you know, we see food to go sales very strong in quarter four, because of, you know, they just correlate well with summer. And that's right the way across, that's salads as well as well as sandwiches. And so, as I touched on in my comments, we've seen improvements in July on June, the early parts of that. We are conscious we are comping against very, very strong growth in the prior period. But as we've begun to comp against the more normalized summer, we are then seeing growth and that's what we hope to see. And we are.

So, you know, we recognize that we've got a bit to do in Q4. But we're on with it and our plans are working in line was what we expected and consistent with this guidance.

Jason Molins: Okay. Thanks very much.

Nicola Mallard (Investec): Hi, good morning. The words that we're missing, I suppose, from the outlook statement was in line with expectations. So I'm reading and, from your comment just now, you think you've got a bit to do in Q4 that right now, as we stand at the end of Q3, you're probably not in line with expectations. Is that a fair assumption?

Patrick Coveney: Well, Nicola, I mean the wording that we've used in the outlook statement around operating profit growth year on year is the same as what we used in our interim results back in May. So if you try to do the, you know, join up all those pieces, what that essentially means is that we were a bit softer on revenue in Q3 than we thought back in May and there'll have been some operating leverage impact on that; but we think we can, you know, deliver in Q4 such that we mitigate that impact and come in broadly in line with the guidance that we gave back in May.

Nicola Mallard: Thank you.

Doriana Russo (HSBC): Good morning. I just wanted to ask if you could give some colour in terms of your performance by category, both in food to go and convenience. You have done some, but in terms of the food to go, can you give us a sense of how much your sandwich business – what did it do relative to the rest, please?

Eoin Tonge: Eoin here. I'll have a go at that. I think, I mean there's a couple of categories – one category in particular, food to go, got impacted harder in the kind of tougher weather, which would mean our wet salad business. Effectively, there weren't those kinds of nice weekends where people would've had barbecues and so forth. So we would have seen a more adverse performance in that part of the business. Our sushi business is performing really strongly. In fact, actually, a lot of the activities that Patrick mentioned, are yielding good returns from a top line perspective. And I think sandwiches, I mean a lot of the – in truth, a lot of the commentary that Patrick's already gone through really relates to sandwiches. You know, sort of what we would've seen in sandwiches is the mixed performance around the customer base and sort of no overall impact on weather would have impacted sandwiches.

And if I switch to the other convenience categories, just give a little bit more colour to what Patrick said. We've had a pretty flat performance from a revenue perspective with ready meals, but I think the bigger story in ready meals is that we're progressing really nicely in that part of our business post to the reset we've done this year, in terms of closing one of our facilities there. So that's progressing very nicely, and we've had some wins in soups, which is helping top liner, our Irish agribusiness straighten well. Our [inaudible] went back a bit, we will put that down to some destocking that we would've seen in the market, post the March Brexit date that was postponed. So that's pretty much the mixes' colour, I think.

Patrick Coveney: If I may just add one thing on the food to go piece, which is different from the reported performance in the last five or six reporting periods, which is that, within food to go, we – and I mentioned this, Doriana, in my comments: we've stopped lapping against the very big changes in our – growth in our distribution of third-party product portion of our business. And so, if anything, actually, the actual growth in manufacturing product is actually stronger than the overall food to go numbers. So, it's about 1% for a manufacturer of products and a very modest flat to modest decline in distribution revenues. But you know, I mean in substance, at least for the moment, we're working hard strategically to evolve this. Our food to go business in substance is all about sandwiches. And so it's, you know, that's where the manufactured volume movements come from.

Doriana Russo: And can I ask you also, because you seem to be quite confident that you will be able to make up some of the ground lost in Q3 in Q4, but obviously part of it must be weather-related. What sort of confidence, you know – how much room do you think you have to be able to meet these expectations?

Patrick Coveney: Well, if we were uncomfortable with our ability to meet expectations, we'd have to say so. So, in that sense we've got a detailed plan that we think are going to deliver the year in line with this outlook. We've got nine weeks to go now. So, you know, four weeks of the thirteen in Q4 are already gone. I mean, specifically on your assumption around whether we're not holding out for some, you know, Saharan type conditions through August and September, we're just assuming normal weather conditions through the last nine weeks of the year. Which is, by the way, pretty much what we had in August and September last year. So the, you know, the really strong, positive series of events, the World Cup, the royal wedding and stuff like that, plus the very, very warm weather in May, June and early July of last year. We've lapped out of that and we're – you know, our plans assume a normal volume environment, if I can describe it in that way.

Doriana Russo: Okay. Thank you.

Damian McNeela (Numis): Hello. Hi. Morning, gentlemen. It was really just a quick one on Brexit and preparations, given the fact that sort of the political environment shifted more towards – or, the likelihood of a No Deal has sort of increased, as reflected by the currency markets. I'm just wondering whether there's been any change in your approach to Brexit, on the 31st of October and given the backdrop?

Patrick Coveney: Yeah, I mean, two things I'd say, Damien. First of all, we were very well geared up in the late winter-early spring for a No Deal Brexit at the end of March. And our supply chain planning and our customer engagements was absolutely aligned with planning for that outcome. And I think if you were to talk to the supply chain and commercial directors of our customers, they'll talk about how proactive we were in working with them to plan for that scenario. As it happens, I think we do have unanimity on this topic in the political system now, which is the British-European governments are all saying we're heading towards a No Deal.

So our planning is going to take that on face value and that's what we're heading towards. And what we are doing is planning our supply chain, planning our range and engaging with our customers on different demand scenarios for that outcome. And, you know, hopefully it won't come to pass, but I think we'd look very silly if we, if we lived on just hope based on the sentiment on public statements of all stakeholders in this process right now.

Damian McNeela: Yeah. Okay. Thanks, Patrick. And just to be clear, I know most of your inputs are short shelf life, so you can't really sort of build stocks of them, but for packaging and stuff, we shouldn't be expecting any sort of big outflow of working capital at the year-end as you sort of get ready for Brexit.

Eoin Tonge: I don't think any material one Damian. I mean, certainly, if I take our planning from March and use that as a proxy, I mean we had a modest amount of working capital outflow for March and I kind of expect something similar again for a year-end. I mean, year-end is one month before the actual dates. So that gives us a little bit help in that regard. But I mean it would be the same themes that we would have looked at in March. It would have been, as you say, ambient product and domain and in packaging.

Patrick Coveney: And the other thing I would just highlight, I don't want to consume the rest of this call and talking about Brexit planning, we'd be well able to, but I don't want to do that. Is this, a lot of the short shelf life ingredients that you reference, which of course is a feature of short shelf life product, are sourced from within the UK. The majority, in fact. So, you know, bread, protein and so forth. So, an aspect of our produce, it's relatively – in the context of our overall raw material and packaging consumption, it's a relatively modest part that comes from outside the UK and a portion of that is fresh. And we are working on mitigants of multiple kinds in terms of sourcing, supply chain and also tweaking of our ingredients and range, to reflect as we were back in the spring. And that's what we'll be doing this time.

Damian McNeela: Okay. Thanks. Very clear guys.

Cathal Kenny (Davy): Morning, gents. Two questions from my side. Firstly, Patrick, your reference, I think it's 'surprisingly varied customer performance within the quarter.' Do you think that's the dynamic that's going to persist for the next couple of quarters?

And my second question just relates to your point on seasonality. I just wonder, would it be possible to get a sense of the percentage distribution of profit that typically lands in Q4? Thank you.

Patrick Coveney: Let me talk to the customer variability point and let Eoin jump in on seasonality. One of the – I would count this, frankly, as a surprise to [inaudible] in food to go. And it's not – it hasn't been unique to this quarter. It's probably, you know, it's unfolded through all of the nine months of this year, which is: bear in mind that in terms of our product supply arrangements and customer terms, we actually have tremendous stability in the food to go part of our business. Right? So, the big customers that we have, we do as a – as you know, Cathal, we do in almost all instances all of their product. So, in that context, it is somewhat surprising to see the level of variability of our performance across that customer set. And by that where, you know, we're talking about, you know, in kind of mainstream groceries, some who are running high single digit or even early double-digit outperformance and some that are high single digit or low double-digit underperformance. So it's quite a wide spectrum of performance across our customer set in their food to go sales, in the context and in the context of there being no change in their supply arrangements. And so that's really what I'm referencing now.

The truth is all of these customers matter a lot to us. We're working hard with all of them. So, it would be completely for me to be drawn on the specifics of which customers sit where on that continuum. But suffice to say that the average, both our average and the market average, is somewhat meaningless to the individual performance of those customers, because they spawn a very wide continuum of performance in volume terms.

Cathal Kenny: Okay. That's clear. Thank you, Patrick.

Eoin Tonge: And then, in terms of seasonality, as we said, the fourth quarter is the most important quarter in terms of profit delivery and it's approximately on a third, if you kind of look at last year as sort of computation. And that's been the case for a long number of years. You know, it's always been a big, big part of our performance.

Cathal Kenny: Thank you, that's very clear.

Patrick Coveney: Great. Well, thank you for hosting us this morning and thanks – I understand we had 35 or so people on the call. So thank you for joining us this morning. Happy to follow up as needs be. And I know Jack would be doing that with some of you in any event. And I do want to just finish by reminding everyone that we are and we're looking forward to the Capital Markets Day. It's scheduled for the 26th of September and hopefully many of you will be able to join us in person for that in London. That's where we will take the opportunity to do more of a stand back on the market on which we are sitting and to set out our vision, strategy, business model, economic model, capital allocation model and also showcase both our food and our wider team who are delivering all of this. We think it's going to be an exciting day and hopefully many of you will be able to join us in person for that.

But thanks for being with us this morning and we look forward to talking to you soon. Bye.

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