Greencore Q3 2022 Results

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Operator: Hello, and welcome to the Greencore Group plc Q3 2022 Trading Update Conference Call. My name is Ben, and I will be your coordinator for today's event. Please note this call is being recorded. And for the duration of the call, your lines will be on listen-only. However, you will have the opportunity to ask question at the end of the call. This can be done by pressing star one on your telephone keypad. If you require assistance at any point, please press star zero and you will be connected to an operator.

I will not hand you over to your host, Mr Jack Gorman, to begin today's conference. Thank you.

Jack Gorman: Thank you, Ben. And good morning to everyone on the call. 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 conference call, which relates to our Q3 trading update released this morning, covering 14 weeks to 1st July 2022. I'm joined on the call today by our Executive Chair, Gary Kennedy; our Deputy CEO, Kevin Moore; and our CFO, Emma Hynes.

In a moment, I'll hand you over to Gary for opening remarks. And Emma and Kevin will then give an overview of trading in the period. Following that, we will open up the call to Q&A. I would also like to draw your attention to the forward-looking statements included at the end of today's release. Thank you.

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

Gary Kennedy: Thank you, Jack, and good morning to everybody on the call. You're very, very welcome. As Jack noted this morning, we released our Q3 trading update for the 14 weeks to 1st July 2002.

Our year-on-year financial momentum has continued to improve in the third quarter, supported by strong underlying volume growth and good operational performance, notwithstanding the demand volatility and supply chain challenges that persist across the industry. We have recovered well against an inflationary challenge that has increased further since May and we have worked very, very closely and very effectively with our customers to manage this challenge.

As I noted at our half one results in May, profit conversion is our absolute focus for second half, and we are pleased with our progress in the third quarter. This leaves us comfortable that we can deliver to the adjusted operating profit, adjusted EPS, and net debt metrics that we outlined in our financial year '22 guidance today.

Today, we've also issued a separate release to launch the initial tranche of our share buyback programme. This is part of our commitment to return approximately £50 million in value to shareholders over the next two years.

And I'm conscious that this is our last communication before our year-end results. The performance summary I have just given you does not capture remotely the challenges and wins that the company and my colleagues have had to wrestle with, but also enjoyed. Dealing with COVID as a business was huge for us and it will always remain in our minds because of the irrecoverable impact on some of our people.

But against that yardstick, financial year '22 will be remembered as the most business challenging year on our history, given the host of external disruptions and volatility that we have faced, but also the leadership changes and internal transformation that is going on in our company. And yet our economic model is rebuilding across our KPIs, adjusted operating profits, earnings per share, balance sheet leverage and return on invested capital.

We are on track to deliver close to our best-ever second half of absolute profit performance in our history, and we had a record week of food to go volumes in the middle of July with over 14 million units produced. And we continue to face into continuing challenges and further transformation in our business, but we are way better equipped to deal with this.

Finally, and particularly with this context, I want to really acknowledge and thank our teams and colleagues who have done and continue to do a fantastic job every day in driving the business forward.

And at this stage, I will hand over to Emma.

Emma Hynes: Thanks, Gary, and good morning from me. I would like to provide more colour on our trading performance and an update on our operating and strategic developments during Q3.

So specifically on Q3 trading, we continued to see good revenue momentum across our business during the quarter. Revenues were up significantly year-on-year and also comfortably above pre-COVID levels, driven by a combination of good volume growth and the impact of pricing secured during the period.

The total reported revenue in Q3 was £486.2 million, which was an increase of 35%. On a pro forma basis, the year-on-year increase was 25.8%, adjusting for currency and the impact of an additional trading week in this year's accounting period. And to break down Q3 revenue a little further, revenue in food to go categories totalled £333.4 million in Q3, growing by 41% on a reported and by 31.2% on a pro forma basis versus Q3 '21. While revenue in other convenience categories totalled £152.9 million, with a pro forma increase of 15.5% year-on-year.

And looking at Group revenue in price volume terms, pro forma revenue growth was driven by a combination of increased volumes, a low teen percentage increase in underlying pricing and increased revenue in our Irish ingredients trading business. And then, if I compare the Group's revenue performance versus the equivalent period in Q3 '19, pro forma revenue was 22.3% above these pre-COVID levels, though I would note this comparison is really becoming less relevant, given the level of inflation pass-through that is in this year's revenue base.

And as Gary noted on inflation recovery, our market strength and our customer partnership model have continued to serve us very well in Q3 as we managed through this challenge.

Now in May, we described three so-called waves of inflation. However, the rates of underlying input cost and other inflation continued to increase, and as such, we're working through what's a fourth wave at present. In aggregate, this is equivalent to a low teens rate of inflation on the overall cost base. And to-date, we've recovered over 90% of this aggregate inflation, so that is of the four waves in total, through our various internal and external levers with more recovery to come.

And as we look at it today and while it's too early to be precise as yet, we're planning for another year of significant inflation in FY'23.

And inflation has also increasingly been reflected at consumer level now across all of our product categories. We did see some limited impact on demand in some areas such as solids, and obviously this is a factor that we will continue to closely monitor through the coming quarters.

On operationally, I'd add that we're actively and very effectively monitoring service and labour availability to reflect demand patterns through what has been a very busy summer trading period. Kevin will speak to both inflation and consumer collaboration in more detail later on the call.

Now moving to strategic developments, we also progressed in a number of important respects during Q3. So firstly, we continued to onboard new business wins during the quarter, in particular in our other convenience categories, where we launched the initial products from the expanded ready meals products at Wisbech. This was followed by the first new launches from the expanded Kiveton site in July.

And secondly, our strategic CapEx programme that supports these new wins has proceeded very well and is on track to be completed by the end of the year. Thirdly, Phase one of our Better Greencore programme is now well underway. And as a reminder, this phase targets an annual recurring benefit of £30 million in FY'24.

The internal operational and organisation model is changing fundamentally in this first phase, so realigning our teams from a business unit structure to a functional model. And while this is a complex task, it will deliver a more customer-centric approach across our business. And this is being supported by the full deployment of an integrated business management model that will make our specialist teams more effective across product development operations and overall cost management.

As we noted at our half one results in May, we will invest a total of £24 million during '22 and '23 to unlock these improvements, including CapEx of approximately £8 million that will be spent during this year and next. We've also initiated planning of the second phase of the Better Greencore programme that focuses on output optimisation, and this will deliver additional benefits for the business. We will update the market with further detail at the appropriate time.

And then finally, on our sustainability agenda, we continue to make progress in Q3, building the relevant data and systems so that we can measure and assess our own performance against our short and long-term commitment.

Now, with that, I'd like to hand over Kevin for the Q3 commercial update.

Kevin Moore: Thanks, Emma, and good morning, everyone. It's a pleasure to be with you all on the call this morning.

I'd start by saying that we've continued to work closely and diligently, both internally and with our customers in what has remained a challenging but very productive and progressive quarter. Overall demand in our categories has been very resilient, given the trading environment in which we are operating. It is also continued to be volatile as we face challenges. For example, the national rail strikes, both volatility whilst extreme temperatures that we've seen in recent weeks across the UK, added to our already challenging supply chains. That said, I'm very pleased to report that our demand has been supported by unconstrained and effective service levels across our network, despite having to navigate ongoing, and, at times, challenging inbound supply.

I'd also remind everyone that our portfolio and customer mix is also strongly very defensive. This mix provides us with real protection from the worst effects of any recessionary market, where consumer choices around discretionary spend may come to pass in the coming quarters. We have a balanced exposure across customers, channels, categories and also trading tiers, which has helped our performance.

So going back to quarter three in a little more detail, where I'll start with food to go. In Q3, our pro forma food to go revenues increased by just over 31% versus Q3 in 2021. This is mostly volume-driven, with both underlying in new wins with pricing contributing a low double-digit percentage of this growth.

This revenue growth would achieve notwithstanding several factors. As I mentioned earlier, some disruption to demand caused by rail strikes across the country in late June, where footfall declined in all retail destinations but most severely in High Streets and city office locations were seen. There was a far greater drop in activity in Central London and in city centres around the UK, where the reliance on train travel was higher. And this looks likely to repeat again in July and August as it stands and maybe beyond.

We also have seen volatility over the last week resulting from the extreme temperatures across the UK. As you would also expect, we're starting to see some level of demand response to the on-shelf inflation, that Emma mentioned, manifesting itself in small demand changes by tier or more directly in overall volume terms, for example, as we've seen in our side of plate solids business.

And finally, there was impact from resigning some solid business recent – in recent quarters that is also evident in revenue during the peak summer period. When we look at the food to go market in total in quarter three, it continues to expand as new shoppers spend more per trip. Sandwiches grew faster than the total food to go market fuelled by new shoppers and a rise in trip spend. We've also seen an increase in the participation of consumers more broadly across the meal deal promotion, which I think reflects our changing trading environment as consumers continue to look for value.

Some growth will, of course, be due to inflation. However, as new shoppers continue to enter sandwiches, this remains an optimistic signal for the continued growth of our category. Salads are the only sector not to witness growth versus last year as all metrics by penetration have actually declined.

Looking at our food to go performance versus the equivalent pre-COVID levels in 2019, pro forma revenue was up 19%. Underlying like-for-like revenues were approximately 103% of this. And therefore, new business wins contributed approximately 16% to this growth, including the recent Costa, M&S engagement.

Moving to our other convenience categories. Pro forma revenue increased by just over 15% in quarter three, still well above the long-term trends we've seen across these categories. Pricing was the driver of growth in the period with volumes modestly lower year-on-year. Looking at this by product type, there was revenue growth in all areas in quarter three. About 40% of our overall revenue growth came from prepared meals, the largest component of which is our ready meal business.

We were very happy with our performance and it was strong relative to the overall chilled ready meal market, where volume was down 5% in the quarter. In contrast, our volumes were down modestly against a tough prior year comparison. This is before any material impact from new wins, where we would expect to see our share of Italian ready meals market to increase from approximately 36% today to overall 48% on a full year basis moving forward.

Approximately, 20% of the revenue growth came from ambient sauces, where we saw broadly unchanged underlying volume growth against what was a strong prior year performance, supported as consumers have started to switch more volume into private label ranges as branded promotional activity is starting to slow. And the remaining 40% of growth in other convenience revenue was from our Irish ingredients business, which was largely reflective of our pass-through of underlying pricing inflation.

If I now move to inflation, there were a couple of key observations that I'd like to make. For context, overall like-for-like price inflation at a grocery level in the UK is now running at around 10% according to last week's release from Kantar. So it should come as no surprise to anyone that as inflation has started to rise, the population has now started to look harder for value in the grocery market more generally.

Smaller grocery bills were the main factor behind a 0.5 percentage drop in retail sales in May. The 1.6% decrease in volume of food sold has been linked to inflation, with consumers spending less on their food shopping because of the rising cost of living overall. Our own proprietary research suggests that rising food prices is now the top concern for over 80% of shoppers, and that it actually overtaken the concern around rising utility and energy prices.

In addition to that, more people are actually saying they're going to eat out less than they did in February of this year. Notably, the recent Kantar data also indicate that supermarket-owned label lines are growing by around 4.1% currently, while sales of branded items have fallen just below 2.5%, which we are starting to see manifest itself in some of our categories. Examples of that would be soup and cooking sauce, most notably.

And the traditional discounters have continued to increase overall grocery market share by 1.8 percentage points combined in the last 12 weeks to mid-July, which is also being reflected in our own numbers.

So with that context, how are we managing this with our customers and our supply partners, as I've said before, these relationships up and down the supply chain are central to the way in which we operate this business, and we are continuing to work with customers in both a collaborative and constructive way. Our aim being to protect and enhance both our own and our their channel positions, and as such, we will see an ever-increasing focus on field to fork efficiencies as we move forward.

Areas that remain central to this are: working through evolving range efficiency, which involves simplifying the products on offer to manage inflation and to optimise output and margin returns without affecting core customer choice through managing a product set in a number of different ways, including reformulation of products, distribution methodologies and the ongoing focus on demand patterns by consumer cluster. In fact, our recent reorganisation that Emma touched on builds even more expertise into this space.

Finally, we've also ensured we've had a forensic focus on managing service and labour availability in line with demand, effectively in this peak period, whilst all of the time continuing to focus and invest with our customers for future growth.

I would also add that our purchasing expertise is also providing a hugely important pivot for us here. It's given us early visibility on pricing trends, providing us with flexibility to adjust rapidly across ingredients and suppliers as required to mitigate the challenges where we can.

So finally, to take a stand back on what has occurred so far this year and how it sets us up for FY'23 and beyond. I would advocate personally that we've done an incredible job on mitigating inflation so far, and we will continue to utilise all our internal and external levers to achieve this. Though the challenge remains a demanding one, I'm optimistic on our ability to succeed here for our FY'22 and into FY'23.

Driving improvements in profit conversion is built on strong demand profile across our categories, but also our ability to deliver efficiency and productivity improvements across our business. Better Greencore has been designed to support this, and as such, becomes even more critical in how we deliver profitable growth moving forward.

I'm more than happy to discuss these in any – on these topics and in any more detail in the Q&A. But for now, I'll hand back to Emma for outlook and Gary's closing remarks. Thank you.

Emma Hynes: Thanks, Kevin. Now bringing all of this together with some brief comments on outlook. The key message here is that we expect to deliver broadly in line with current market expectations for FY'22, and this is underpinned by good volume growth, recovery of significant levels of inflation and enhanced profit conversion. So we expect to deliver an adjusted operating profit outturn of between €72 million and €77 million for FY'22 and adjusted EPS of between 9.2p and 10p.

Net debt, excluding lease liabilities, is anticipated to be approximately £200 million, with net debt to EBITDA is comfortably under 2 times as measured under financing agreements.

Now we must manage several key moving parts to deliver on our guidance and first [inaudible] active inflation recovery. The second is monitoring and responding to consumer sentiment and demand patterns as inflation affects increase for the consumers.

And the third is our own efficiency and profit conversion. And these moving parts will carry into FY'23. We monitor the impact of inflation and consumer demand and sentiment, as well as working closely with customers and supply partners to mitigate the ongoing impact on consumer prices.

Kevin Moore: Thanks Emma. So let me conclude now with some final remarks. Our key focus this year has been to drive the economic model through effective profit and cash conversion across the business. In the near-term, this means the delivery to expectations in financial year '22 against the backdrop of the various macro challenges faced by us and the broader UK food industry.

In the longer term, this means continuing to improve profitability, cash flow and returns. We're optimistic and confident that we can achieve this, given our leading market positions, close customer relationships and our intense focus on efficiencies.

Finally, a reminder that our next capital markets update will be our FY'22 results that will be released on 29th November.

And with that, we are ready to turn the call back to the operator and to begin the questions and answers session.

Questions and Answers

Operator: Thank you. As a reminder, if you would like to ask a question, please press star one on your telephone keypad. To withdraw your question, please press star two. The first question comes from the line of Jason Molins calling from Goodbody. Please go ahead.

Jason Molins (Goodbody): Yeah. Hi. Good morning. Just firstly, Emma, wanted some clarity on the inflation recovery. I think at the time of H1, you mentioned you recovered about 95%. But today, you're mentioning 90%, at least, yeah, it's only a small chain. But just wondering if there's any change in your recovery mechanisms or reaction from your customers.

And then just the second question is really around the supply chain challenges that you've called out in the period. Can you just be a bit more specific on what they've been and whether they are ongoing and what financial impact does that had on the business so far? Thanks.

Emma Hynes: Yeah. Thanks, Jason. Look, in terms of inflation, when we were talking at the half year, I think was that 95% of the first wave. I mean, we are now in wave four. This is how we describe it, given how we've articulated each of the waves as we've worked through.

So I think, we're really pleased, Jason, with the recovery of inflation that we've delivered. We can see it in revenues. We can see it in top line. And I think as you get to this point, there's a big focus on how do you find other ways to mitigate that. So it takes a little bit more time. If you've got to do something to offset the inflation, if you've got to reformulate the product, if you've got to make changes like that, it takes a little bit longer to deliver.

So I'd say we're getting to a point where it takes a little bit longer. Therefore, there's more of a lag and taking more time to deliver. And Kevin might speak to that more in a moment.

I mean when we then talk about supply chain disruptions and what we see, there are a series of different things. I mean, Kevin alluded to the impact of the hot weather and the high temperatures and what that will have meant in the chilled foods distribution world, where the UK is not set up to deal with the temperatures that we were experiencing a lot of the temperature control equipment is set up to manage to a high of 30 degrees. And when you got 40s and even higher. That creates challenges in maintaining temperature of products right through the supply chain. So you're going to see a lot more ways to actually – because from a food safety perspective, you've got to maintain temperature control.

The rail strikes lead to a level of disruption as well. Whilst we're seeing tightness of availability of ingredients and disruption as a result, where you're not getting deliveries of what you wanted at the right time or not in the right format or the right quantity. So that creates disruption in our factory because we've got to pivot pretty quickly.

Now we're good at that. We're good at reacting to change. So there's a cost to doing that and having to reset production plans and reset what we're planning to make. And that leads to lower levels of efficiency. But I might let Kevin talk about inflation recovery mechanism.

Kevin Moore: Yeah. Hi, Jason. Just I'd probably like three very quick points, conscious of time. So that the first is that we're making nice progress around pricing overall. But I'd also say we're supporting that strongly by very discrete activity around end-to-end focus. That's continuing to be an area for us that we're going to continue to need to work on and continue to work very closely with our partners on. But I think we're doing that very, very nicely.

The second point I'd make is the market continues to be with us as it resets. We have to stay close to that. Obviously, we don't want to see a manifestation in demand drop. But at this point, the market continues to reset as that inflation sets through.

And then the third area I'd say that discretely in the background over the last 12 months, we've been resetting all of our models to both support both us and our customers in ensuring that more of the mechanisms that we have in place covers more commodity areas to ensure that we spend actually less time talking about price to our customers and let that model play through, and more time actually managing the category at a time when consumer changes demand and their consumption patterns are shifting. And that's where we need to spend the focus of our time.

So, again, as we've both highlighted in the commentary, we're pleased with the progress. It continues to be challenging, but I think we're very, very alert to it. And as I've said before, this is something we're used to seeing, the magnitude is larger, but it feels now like we have found a model for operating within that.

Jason Molins: Thanks very much.

Operator: The next question comes from the line of Ashton Olds calling from Berenberg. Please go ahead.

Ashton Olds (Berenberg): Hi, everyone. Thanks for taking my questions. The first one is just on the overall food to go to market. So I guess if you look at the business sort of being at 120% of pre-COVID levels. My sense is that once you strip out pricing, volumes might be at 90% of pre-COVID levels. I'm just wondering if you can give us a flavour of why you think that might be and whether you think that the much – the market is structurally smaller? Or if you think the volumes will recover?

And I guess secondly, just in terms of inflation for next year. Do you sort of have a sense of magnitude that you'd expect for next year, and maybe what areas you'd expect to contribute the most?

And then finally, just on inflation pass-through. Am I right in thinking that you're becoming a little bit more reluctant to pass this through to supermarkets just to sort of avoid this being passed onto customers and maybe having demand impacts on volumes, and you're looking more at internal mitigation of these costs?

Kevin Moore: So thanks for the questions. I might take the first and the last one and Emma might just touch on inflation for next year. So I think, put simply in terms of food to go, I'd say two things.

The first thing is that one of the things that has manifested itself materially since the beginning of the pandemic has been the shift of where we are selling volume. Right? Everyone on the call would understand volume in travel locations and in city centre locations have taken time to recover and they are still recovering. That is evidenced on a week-by-week basis for us. That continues to give us confidence and will continue to give us confidence. Whilst there are individual situations that occur with rail strikes, etc., that create challenges, I think what I'd say is that actually continues to give us confidence.

The second area that I'd say is that what we've got to remember is all of the customers, certainly our main customers, are continuing to invest in convenience formats. That particular set of formats is now the largest segment in grocery retail. It is the area for us that is seeing the most growth. It continues to see growth.

And then when you think we're also seeing ongoing evolution of things like petrol forecourts, food hubs. When you think about that overall, the ongoing progress we've seen in penetration versus where we were pre-2019 continues to give us confidence. There isn't any metric that is suggesting that we're seeing a market that is slowing. We're actually seeing a market that not only is recovering in certain elements of it, but we're also seeing growth in other elements of it. So from an overall perspective in food to go, we remain very encouraged by the progress and see that there is further progress to be made.

I might hand back to Emma on inflation into next year, and then I'll probably come back to answer the question on pass-through.

Emma Hynes: Yeah. Look, Ashton, I mean in terms of inflation into next year, I think it's clear we're in an inflationary cycle, and we would say that there will be substantial inflation again next year. I see across all commodity imports actually. We'll have talked about the top areas of inflation this year being cereals, poultry, packaging and clearly energy. I think the energy challenge is well documented and it's pretty volatile at the moment around where that's going to land.

But we're seeing things like cereal again, quite a lot into next year. We're seeing dairy a lot higher. We're seeing tomatoes substantially higher. There's been a real concentration of [inaudible] both in the tomatoes with the switch away from Xinjiang[?] last year. It's been concentrated in the UK – or sorry, in the EU, and there has been less availability in the UK. So we are seeing a come through relatively across a whole range of inputs again.

And in terms of sort of passing that through, we've got a substantial proportion of that in our commodity tracker model but there's still quite a lot that needs to get negotiated. And our caution is around what is the impact of those prices going to be on the ultimate consumer. If that goes into price, what are we going to see from a demand perspective.

If I just circle back to sort of where you started as well on the sort of pre-COVID volumes, what we'd say is, like-for-like pre-COVID, we're at, from a volume perspective, manufactured volume in food to go, at 87%. And we see different patterns flowing through, depending where stores are. So what Kevin has said around where consumers are shopping. It depends on [inaudible] and we'd also have reassigned some business as well as we've gone through this period. So it's not necessarily the case that you look at the overall market but we have made choices around some of the business that we will supply as we've looked at the inflationary environment and looked at prices of our ability to supply. So Kevin, do you want to take up the –

Kevin Moore: Yeah. I think you've covered most of it, Emma. I think the only point I'd kind of just compound to everyone. It would be madness for us to not be cognisant of [inaudible] patterns that inflation is naturally going to impose on our market that in no way reflects our reluctance to pass this through.

In fact, one of the reasons why we have changed those commodity models to include more in the basket is actually to make sure that that gets passed through. But actually, it's our role here to also make sure that demand continues to be progressive for our customers as well. And I don't think it's anyone's – in anyone's interest for that demand to drop. And actually one of the reasons why, as I mentioned at the beginning of the section on our position from both customers channels tiers why that it's so setup in the way in which it's set up is to make sure we're kind of protected on that. And I think it's our duty to be vigilant to those demand patterns and make sure that we manage them accordingly. And that's exactly what we'll do and we'll continue to do.

Ashton Olds: Excellent. Thank you very much, guys.

Operator: The next question comes from the line of Charles Hall calling from Peel Hunt. Please go ahead.

Charles Hall (Peel Hunt): Good morning, everyone. Kevin, you mentioned that service levels have been pretty good over the last quarter. Presumably, that means that you've got the right labour in the right places. And I was just wondering, is that due to better retention or you're finding it easier to recruit? And what sort of labour cost inflation are you seeing?

Kevin Moore: Thanks, Charles. I'll kind of cover the service position. I'd say two things. I think the teams have done an incredible job in terms of looking at the employee market, whether that be through age profile or particular locations or how the competitive set is operating. And I think we've just found a much more manageable model to understand our local markets really effectively is the first thing I'd say.

The second thing is that I think the teams have then put huge amounts of stock into a retention model and a lot of that is it won't be surprising for everybody on the call that that's about putting real stock into the basics of how you onboard someone, how you make their role straightforward, how you're building them up, how you ensure that all the basic hygiene factors for someone joining a new organisation are really effectively done and managed. And I think we've done that really, really well.

And as a consequence of that, I mean, it's – when you think about where we were kind of last November to where we are today to be able to deliver the peak volumes that Gary talked about at the beginning of this – the call kind of in the big week last week of over 14 million units across food to go, I think is an incredible reflection of not only the operational teams and what we've done in terms of running the factories, but also the way in which that labour pool has been managed.

Emma might just touch on in terms of where the overall inflation pieces. And all I'd say this before Emma gets into detail about it is, as I've said on previous calls, it really is not a national position. It is a location by location driven position. And I think again the skill of the teams to understand individual locations, availability of labour, what the pricing mechanisms need to be, what competitive set is around the local area and being on top of that every single day is one of the reasons why I think in those locations we've won. I don't know if Emma just want add a bit of flavour to that.

Emma Hynes: Yeah. Hi, Charles. Yeah. Look, I mean, as Kevin said, we've had still a lot of work to manage labour availability. And that has required interventions and incentives being put in place around different sites at different times. We've planned ahead for that. And actually, as far back as January, we're [inaudible] by site and what we needed to do and whether we would need to intervene and put incentives in place for summer peak.

So I wouldn't want to be overly precise about what the rate is around each site, but we will have also done things around looking at the labour markets locally and if it was tied locally looks at putting buffers in place to bring people in from further afield. So it's not all about rate actually. It's about making sure that we're accessible as a place to work and that all of the hygiene factors are in place at our site, things like lockers for colleagues, hot food, canteens, all of those offerings.

So there's still a lot of inflation coming through in hourly rates. Clearly, NLW[?] into '23 will lead to a significant increase again. And we'll have to look at overall salary inflation as we go forward. But I think we are looking at higher rates of inflation on labour than we've seen passed on, on average.

Charles Hall: And Emma, can you just give a Group level of your sense or give us site level?

Emma Hynes: Yeah. I mean if we're thinking labour inflation overall, you're looking at sort of mid to high-single-digit inflation percentage.

Charles Hall: Lovely. Thanks.

Operator: The next question comes from the line of Roland French calling from Davy. Please go ahead.

Roland French (Davy): Hi. Thank you, and good morning, everybody. Three questions, if I could. Just in context of inflation recovery, and maybe this one for you, Emma. Are you able to split out what you referred to, I think, as 90% of overall inflation recovery? Can you split up between the explicit raw material mechanisms and then direct negotiations and internal efficiencies?

And I guess the second question then is, how that shape of recovery might shift next year in context of what we're hearing from certain UK retailers? It kind of feels like the environment incrementally is getting more difficult.

And then finally, what percentage of your contracts – I know it could be quite small. But what percentage of your contracts include an explicit mechanism for NLW?

Emma Hynes: Yeah. Hi, Roland. Yeah. Look, in inflation recovery, in terms of direct pass-through this year, it would have been about 40%. So quite a lot to be negotiated ourselves, actually as we go into next year. As Kevin referenced, we have rebased the basket in quite a lot of cases this year, so you're looking at something closer to a 60% on pass-through. But I think what we'd say is we're going to have to do a lot of work to see are there other ways to mitigate that as well, given the scale of the numbers.

In terms of contracts, I'm not sure it's a percentage of contracts that have the NLW. There's – there are several of our major contracts once we'll have renegotiated in recent years that will have a component of labour that goes through. So it'll be a percentage – any increase over a certain percentage or tracking to NLW that type of mechanism.

Roland French: Got it. That's helpful. If I could squeeze in maybe a final one just on demand elasticity. I think you called out salads seeing some negative response. Are you able to give us a little bit colour around that dynamic, in particular in salads. And then I guess how you think about pricing strategy going forward? Are there other natural feelings around products that you're unwilling to kind of breach? Or is this very much kind of an iterative process where you price and test and see what the demand response is?

Emma Hynes: Yeah, Roland. Look, on salads, I mean, I know we'll have talked about before that in our salads business, we'll have seen substantial inflation in Europe [inaudible] see lower volume as a result. We are seeing now a bit of a mix impact actually within salads, where we were sort of more premium grain salads, are seeing lower levels of demand and actually much higher demand for our pasta-style salad, so which you compares to salads, things like that. So we are seeing a switch from the consumer into the more value end of that.

And then when we come to kind of thinking about pricing, I'll ask Kevin to talk about how we think about price points and that overall.

Kevin Moore: So, Roland, just a – kind of just a general sentiment. But we're seeing slight movements. It's very early, but a slight movement in some of where demand is sitting. So, interestingly, we're seeing an increase in certain categories at kind of what I would describe as entry range level. So if I take food to go as an example, anything between kind of £1.25 and £1.75 we're seeing growth in that area. In addition to that, in the premium tiers, anything kind of £2.80, £3, and above, we're also seeing growth in those areas, whereas we're also seeing the core, the centre kind of being squeezed a little bit.

In addition to that, we're seeing – as I mentioned earlier, we're seeing – kind of if I take the last four weeks, we've seen about a 7% increase in the meal deal redemption in food to go, which is, I think, reflecting people looking for value. But it isn't the fact that people are trading down, i.e., the fact that we're seeing premium tiers continue to expand in generally most categories says to me that there is still further to go from an elastic perspective.

We aren't seeing, with the exception of side of plate, where the pass-through really – the demand drop-off has mirrored the pass-through. Everywhere else, we're continuing to see progress in growth. But as I said earlier, I think it's really, really important for our category teams and our commercial teams to stay very close to that because clearly, it is important for us to think about that demand profile in the most effective way.

And I genuinely believe as we continue and move into this cost-of-living crisis, that one of the areas that will continue to come under pressure is food service. And I think when food service comes under pressure, we do naturally see consumers move back into core grocery and move back into premium tiers as well.

So I actually think we're well-positioned to manage that demand profile. What's key is that we stay close to it. We understand the supply chains because each of those channels are served in slightly different ways. And that's exactly what we're set up to do and we kind of did this part of Better Greencore as well. So that would be what I'd add to it at this point.

Roland French: That's great colour. Thanks for giving the colour. Thanks, Kevin.

Operator: The next question comes from the line of Damian Mcneela calling from Numis. Please go ahead.

Damian Mcneela (Numis): Yeah. Hi. Thank you for taking the call. Morning, everybody. The – my first question is just on the sort of the specifics of sort of the product or the scope of product reformulation that you're able to do, given that we're now in sort of moving into wave four. I don't know whether it's going to be wave five or resets. But I just wanted to understand how often can you reformulate the product? How many times have you done it this year and what can we expect next year? So I don't know if you can give me a percentage number of what products have been reformulated this year.

And then my second question is around the sort of longer-term margin aspirations. I think very clearly the second half is going to be a pretty decent, absolute number. But in the context of the revenue number, margins are still going to be relatively depressed versus historic levels. I was just wondering how we should think about that recovery over the next sort of two to three years?

Kevin Moore: So I might start, Damian, with the reformulation. So at a broad headline level – and obviously, this is an aggregated level because it differs by category. But we would touch in the space of a year between 70-80% of our portfolio in one way, shape or form. And that can be anything from a small tweak to a specification all the way through to a complete reformulation and new product development. So none of that has changed.

A number of cycles that retailers will go to on an annualised basis depending on the retailers three times to four times for each of the actual trading seasons. Obviously, again, that differs by category. But that gives us an opportunity in which to look at and reformulate as we move forward. Again, what I would also say, and I think this is really important to make a point, the retailers are very cognisant here that what we don't do is avert the effect quality.

Quality still has to remain. There is a reason why the tiers exist, and therefore as a consequence quality is a reflection of those tiers as opposed to all we do is downgrade quality within each of the tiers. It's not in our interest to do that because that's how consumer demand does get affected when you reduce that level of quality.

So what these are, are sensible levels of reformulation, whether that be thinking it's part of our sustainability plan, reducing the levels of protein that are in each individual SKU, whether that be changing the portion size as part of that sustainability plan. That'll be about increasing specification. So allowing us to buy ingredients from a broader set of suppliers, which gives us optionality and allows us to mitigate inflation. So there are a variety of different ways in which we've been able to do that and there will continue to be different ways across all tiers that we can do that.

So one, I'd say we're continuing to use that lever. And, two, there are still plenty of growth and opportunity for us in that space, should we need to use it.

The second area I'd say, just to add into that, is that the retailers have been very sensible and pragmatic with us around ranging decisions, where, for example, we'll have had, I don't know, different types of, shall we say, chicken SKUs that might have been 20% of the range would have been chicken SKUs.

When you're seeing the level of inflation on chicken, there is a sensible approach here where we decided there were certain SKUs that we're just going to take out the range and put greater volume on a smaller number of SKUs, which makes it more efficient for us, makes it better for them, allows us to mitigate a level of the inflation. And that kind of level of focus will continue to be the case.

There are certain SKUs where retailers have just not been able and didn't feel it was credible to absorb the level of increase that we wanted to put through, which would have manifested itself in big retail changes. A great example of that would have been on certain salmon lines this year, where we've seen ridiculous levels of inflation. And quite frankly, what the retailers have done is they've therefore changed either the protein or the amount SKUs that they've got.

And what I'd say as I said at the beginning in the script is the retailers are being very pragmatic here. There is no poor behaviour. There is very sensible discussions about this. They're very cognisant or we're very cognisant that we just can't put this all at necessarily the shelf edge. But it's also important that everybody makes a living from this process. So I'd say that those particular reformulations and those levers of reformulation are something that's at front of our minds and we'll continue to work on.

Damian Mcneela: That's very clear. Thanks, Kevin.

Emma Hynes: And Damien –

Operator: And the last question comes from - sorry. I do apologise. Please go ahead.

Emma Hynes: Sorry, Damian. I was just going to round out on margin that where really [inaudible] how we've delivered through the second half and how we're seeing the build back. There's a lot of work to do. And for us, there is a big focus on operational conversion. I think we're doing all of the right things for the business, resetting how we run the business.

Better Greencore is a big part of that, how we drive operational efficiency as we go forward. And I think we've been clear that our priority has been to get back to FY'19 profitability and margin will come thereafter. But you're right to make the point around inflation that those are the mathematical impact on margin.

And as we look into next year and see more inflation coming, that will continue to have an impact. And we just hope that inflation will come off at some point in the not-too-distant future, which clearly would lead to an improvement.

Damian Mcneela: Okay. Brilliant. Thank you, Emma.

Operator: And the last question comes from the line of Doriana Russo calling from HSBC. Please go ahead.

Doriana Russo (HSBC): Yes. Thank you very much. My question is on the new business wins and the onboarding of this business. What sort of level of profitability that you achieved, if any, come Q3? And are you satisfied with the amount of revenue in terms of volume you are reaching with this new business? And how do they compare with pre-pandemic levels? That's my first question.

And then I've got another question regarding the evolution of your pass-through models and mechanics. Historically, you will have sort of automatic recovery of raw material prices – sorry, raw material costs and increasingly of labour. How about other things like energy costs and utilities and any other things that you may be exposed to? Is that something that you have to still absorb internally? Or is that something that you have started to negotiate?

Emma Hynes: Hi, Doriana. Look, in terms of new business, I mean, we've clearly been going through a phase of onboarding substantial new business, which we'll have been talking about over the last sort of 12 to 18 months. Some of that is in the process of being onboarded as we speak as we're launching the meals out of our Wisbech and Kiveton sites.

And I'd say that we're pleased with how all of that onboarding has gone. There has been quite a lot. Even onboarded from March of this year actually in our food to go business. I mean, we wouldn't typically talk about exactly what the contribution is from various contracts. But depending on the channels that we're serving, there are different costs to serve associated with these and the volumes that are delivered need to build back up to where they were on a pre-COVID basis as well.

So still some work to be done but pleased with how they're onboarding and pleased with contribution that we're starting to see come through the P&L in the second half.

Kevin Moore: Hi, Doriana. I'd just pick up on the pass-through piece. I'd say two things. I'd say, as Emma has already touched on, there is now significantly more that is sitting in the models, elements of labour, some parts of the utilities, majority of lead distribution, those kind of areas.

In addition to that, we've also put into certain customers an additional fuel surcharge, which links directly to that particular position. These will continue to be fluid. It's in our interest to put more into that basket and we'll continue to do that. And with certain retailers that's been supported with certain other retailers, they want to do it in a different way. And we just continue to work with them on that. And I think the fact that we've seen a material level of increase in the amount of items that go into those commodity baskets, again, whether they'd be materials, packaging, or utilities, just reflects the changing environment in which we're trading. So we're very pleased with the progress that we've made on that and we'll continue to make progress on that.

Doriana Russo: Thank you.

Operator: There are no further – yeah, there are no questions. I will now hand you back to your host to conclude this conference.

Gary Kennedy: Good. Well, look, let's wrap it at that. Thanks, again, to everybody for participating and we look forward to talking to you on 29th November. Thanks very much.

Kevin Moore: Thank you.

Operator: Thank you for joining today's call. You may now disconnect. Hosts, please stay on the line and wait further instructions. Thank you.

[END OF TRANSCRIPT]