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Greencore H1 FY2023 Results

Tuesday, 30th May 2023

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Operator: Hello, and welcome to Greencore Group plc H1 FY23 Results Presentation. My name is Valeria, and I will be your coordinator for today's call. Please note that this call is being recorded. And for the duration of the call, your line will be on listen-only. However, you will have the opportunity to ask question at the end of this call. This can be done by pressing star one on your telephone keypad to register your question. If you require assistance at any point, please press star zero and you'll be connected to an operator.

I will now hand you over to your host, Mr Dalton Philips, the Chief Executive Officer.

Dalton Philips: Thanks, Valeria. So good morning, and thank you for joining us today as we discuss Greencore's half year results.

I'll start with a brief summary of our performance, share a couple of overall reflections and then hand over to Emma, who'll provide a detailed analysis of the results, and then I'll return to discuss our strategic focus.

Before we get into that, though, I want to acknowledge that this will be Emma's final set of results with Greencore, and to thank her for what she has done for the business. Emma has made an immense contribution to Greencore over her 14 years here, and we're hugely grateful to her contribution. And on a personal note, I wanted to thank Emma for her support to me over the last past eight months in helping me settle into the business. So thank you, Emma.

Okay. If we move to the executive summary on page five, we saw encouraging revenue and volume growth in the period, demonstrating the resilience and underlying strength of Greencore. That said, our profits – our profit was impacted by a lag in inflation recovery. Without that lag, we would have seen a material profitability increase. Importantly, we do expect inflation to slow down in the second half.

My absolute focus and that of the wider team is on improving our core performance to drive profitability and returns and we're already deploying a series of commercial, operational and cost initiatives to do this. We also have a series of tailwinds that will support us in H2 despite being up against a difficult consumer environment.

These tailwinds include: firstly, a significant seasonal volume uplift in our food to go business; secondly, we also expect some easing of inflation combined with playing catch-up on our inflation lag; and thirdly, we will start to see the benefits flow through from aggressive cost of interventions we made in H1. Taken together, these three tailwinds will support the delivery of a significant increase in H2 profitability with a profile similar to the H1, H2 profile we delivered last year.

With that in mind, we expect the Group to generate an outturn in line with current market expectations.

Turning to page six. I thought it might be helpful to share a couple of perspectives as I close out my first set of half year results. I'd start by saying that Greencore is a really impressive business. Over the last eight months, I visited all our sites, I have met with all our main customers and with hundreds, if not thousands of colleagues and have tasted hundreds of our products. Across the board, I'm deeply impressed with a number of things.

Firstly, the depth of our customer relationships and the role we play in supporting our customer strategies. Secondly, we manage an incredibly complex supply chain that helps feed the UK. We have well invested facilities right across the country and deliver to each and every UK post code getting millions of fresh food products onto the shelf each and every day.

And thirdly, there's an incredible pace and work ethic amongst our people. We're making products today that will be in consumer hands tomorrow. So we need that muscle to make decisions quickly and simply and just get stuff done.

The next perspective I'd share is that Greencore has demonstrated real resilience in the face of enormous challenges over the past couple of years, whether it was COVID, the Brexit transition, labour availability, supply chain disruption or indeed significant internal people change, the business has just got on with it. And clearly, the single biggest issue has been inflation, a defining issue not just for Greencore's performance, but for the wider food sector.

It's higher in the period just closed in at any time in Greencore's history, and it's also the number one topic I'm facing in my discussions with our customers. We're acutely aware that never-ending price rises aren't a sustainable solution but we're also resolute in our commitment to recover or offset the inflation that we are seeing and to protect our long-term profitability.

The final perspective I would share is that I'm excited for the future. We've got a good handle on the issues that have challenged our performance in recent years. So we know the levers we need to pull to build a model that can really drive shareholder returns. We've already faced into a number of tough decisions to improve the operating efficiency of our model to give but a couple of examples.

In my first month, I signed off a decision to resign material business because we believe the pricing level to be unsustainable, and we've walked away from another seven contracts since then. Then in January, we took some difficult decisions in restructuring our management teams in the face of rising costs, which I'll talk more about later.

We've also got a number of new personnel in the business with a refreshed exec team and Board. So when I look at this new team, I see a Group with tons of ambition and a real energy to unlock our potential.

I'll say a bit more about unlocking this potential later. But first, I'll pass to Emma to take us through our performance in the half.

Emma Hynes: Thanks, Dalton. Good morning to everyone, and thanks for joining us in the room and on the call today.

As Dalton said, this is my last set of results for Greencore and after three years as CFO. It's my 12th quarterly update. But it's also, as Dalton said, 14 years in aggregate at Greencore in various senior finance roles. And the Group has completely transformed since I first joined in 2007. And given my long history and connection with the team and having transitioned Dalton well into the business, I'll continue to watch closely and support the new leadership team from the side lines.

As followers of Greencore will know, the last three years have been very challenging for the business with COVID impacting, when I first stepped in as CFO and having stabilised the balance sheet. Then being faced with substantial inflation and labour availability challenges.

My overarching focus through this time has remained very simple, focus on protecting the business initially through tightly managing cost and cash flow. And then through '22 and now into '23, ensuring the focus was on progressing our economic model to drive profitability and returns, as we focus on inflation recovery and margin rebuild.

So I'm pleased with our debt and leverage position. We turn in a much stronger position even than they were pre-COVID. We've also made significant progress on de-risking our legacy pension liabilities in this time, notwithstanding, the deferral of contributions through COVID. And we now have line of sight to being fully funded on all schemes in the near term.

As Dalton said, half one FY23 has been another period of substantial inflation, and our focus has been on recovering and mitigating this impact. So I'm pleased with strong revenue performance lower than half one, which demonstrates our ability to pass through inflation.

And while profit conversion was challenging during the first half as we experienced some lag effect on this inflation recovery, we do expect to mitigate this in the second half. So look, a lot of detail to cover in the next few slides. But I'll first reflect on our key financial metrics on slide eight.

We delivered pro forma revenue growth of 20.1%, highlighting our continued strong revenue performance. And this was predominantly driven by inflation recovery, supported by manufactured volume growth. Our year-on-year adjusted operating profit was £5.4 million behind FY22 at £11.8 million as we saw the impact of the inflation recovery lag and commissioning challenges in our new ready meals production unit.

And this, combined with a higher financing cost was reflected in a reduction in adjusted EPS to 0.5p, down 1.3p due to the earnings performance. With a free cash outflow of £24.3 million in the half, which is £6.5 million lower year-on-year. And the large working capital outflow in the half is as expected. So it's due to the seasonal working capital profile of the business, and we expect that to unwind in the second half.

Year-on-year, we continue to make progress on deleveraging with net debt, excluding our lease liabilities, flat at £219 million. Net debt to EBITDA of 1.9 times as measured under financing agreements compared with half one '22 when it was 2.1 times. And we have substantial undrawn headroom on our debt facilities.

And finally, ROIC at 7.5%. It has increased 120 basis points from FY22, 6.3%, but it remains a key area of focus for Dalton and the leadership team as we recognise it remains below the historic levels pre-COVID.

So moving to slide nine and detail of the income statement. We've already covered revenue and operating profit as KPIs. So our half one FY23 operating profit margin was 1.3% compared to 2.2% in half one '22. And that was impacted by both the lag on inflation recovery and the denominator effect of elevated inflation.

Our operating margin rebuild continues to be an area of focus for the team. However, the headwind of inflation does remain a challenge in that calculation.

And moving further down the income statement, adjusted profit before tax decreased by £8.3 million to £3.4 million due to the operating profit decrease and due to an increase in financing costs. The exceptional cost after tax in half one of £4.8 million was principally related to better

Greencore, the Group's change programme. And from an earnings perspective, we reported a basic EPS of minus 0.9p and an adjusted EPS of plus 0.5p.

Now over the next two slides, I look at our revenue performance. And as I said, we were delighted to deliver revenue growth of 20.1%, given the continued level of inflationary challenge in the trading environment and the disruptions, which impacted footfall periodically in the period. Inflation recovery delivered 14.5% of the revenue growth with manufacturing volume growth just under 3% and a mix benefit of about 2% as we simplify the portfolio.

The remaining growth was through our direct to store and Irish Ingredients businesses. The revenue growth highlights the continued successful execution of inflation recovery. And in addition to demonstrating resilience of the business model and category mix through volume growth, and that's despite the continued disruptions impacting footfall.

So moving on to slide 11. The Group saw revenue growth across food to go and other convenience categories, with food to go category growth of 15.6% and other convenience category growth of 28.5%. So food to go category's revenue growth was predominantly driven by inflationary increases, so just under 11% with the remainder through underlying volume growth in sandwiches and contribution of business wins.

Our other convenience categories, revenue growth was also largely driven by inflation. That's about 21% of the increase. And then other convenience volume growth drove about 6% of revenue growth. And that was due to the onboarding of new business wins in ready meals as well as underlying demand, which was marginally higher due to growth in ambient sauces.

Now slide 12 focuses on inflation. So half one FY23 saw an inflation rate of mid-teens and of total Group cost base. And that continued increase has been spread across a broad range of input costs once again. And despite the level of that increase, we've seen continued progress on inflation recovery and mitigation. So 85% of that has been recovered with a further 10% of that mitigated in the half.

And the recovery and mitigation has been delivered through the continued successful execution of inflation recovery mechanisms, constructive customer dialogue and delivery of operational efficiencies. The outstanding 5% represents a high-single-digit millions inflation lag in the half, and we expect the remaining inflation lag component will be recovered or mitigated in half two FY23.

So turning to slide 13, which outlines a waterfall of free cash flow movements in half one FY23. So as I said, working capital was an outflow of £32.3 million, as expected due to the seasonal working capital profile of the business. Maintenance CapEx at £8.8 million was up £2.8 million versus the prior year as we continue to increase our maintenance spend post COVID.

Exceptional cash flows of £2.3 million were largely due to Better Greencore. And then the other line items were really much as expected, which resulted in a free cash outflow of £24.3 million. So the half one performance brings our overall 12-month free cash flow conversion to 42.5%, which is just below the Group target of 50%.

And then bringing all this together on slide 14, there was a £39.4 million increase in net debt, excluding lease liability since the end of FY22. So we spent £4.2 million on strategic CapEx in half one FY23, which is down from FY22 following the completion of our investment to onboard

new business from a key customer. And we also completed a further £13.2 million of our share buyback programme in the period.

So as a result of all of that, we ended the year with net debt, excluding leases of £219.4 million compared to £180 million at the end of our last fiscal year and £219.3 million at half one FY22.

So if we move to slide 15 and our balance sheet leverage and liquidity position. So our leverage, as measured under financing agreements increased to 1.9 times at the period end, which was up from 1.5 times at the end of FY22. And that was largely driven by that seasonal working capital outflow and the impact of the share buybacks.

Our comparative leverage, as I said, at half one FY22 was 2.1 times. So our medium-term leverage target of 1 to 1.5 times remains a priority for the Group. And our balance sheet strength continues to be reflected in our cash and undrawn facilities, which stood at £278 million at the period end. Our weighted average maturity of debt was a healthy 2.5 years and our COVID RCF buffer facility of £75 million matured in the period.

We've also, in the half, completed buy-in of the Irish legacy defined benefit pension scheme, which had a funding surplus and continues to have a surplus after the buy-in and that means we've effectively insured the liabilities of that scheme. And we also continue to improve the deficit position of our UK legacy defined benefit pension scheme. So the triennial valuation is underway. And we see a route to fully funding the liabilities of that scheme in the near future at the current levels of cash contributions without any catch-up for the deferral of contributions through the COVID period as the investment strategy has proven sound in that scheme.

So as a result, having now returned £25 million of value to shareholders to-date, which is about 6% of the market cap. And that's half of the Group's £50 million commitment of value return over two years from May '22, and additional £10 million of share buyback will commence today.

So that concludes my section. In summary, although we've seen a challenging half one in FY23 in relation to profit conversion, I do believe there's a strong platform for future delivery across the remainder of FY23. And I'll come back into Q&A. But for now, I'll hand the presentation back to Dalton.

Dalton Philips: Thanks, Emma. So turning to Page 17. Let me talk about our major areas of focus for the months ahead. The bottom line is that our profitability is not where it needs to be. And as a consequence, our returns are not where they need to be.

I said earlier that Greencore is an impressive business, but we've not been fulfilling our potential in the last years. My absolute priority is fixing this by rebuilding our profitability. We're crystal clear on the drivers of our margin erosion. And I'm going to talk you through these and explain what we're doing to address them.

However, we also recognise that margin and profitability are only part of the picture. We've got to be disciplined about where we allocate our capital. This will be an important focus for me as well. And I'm confident that with the right capital base, we can create a strong platform for future growth.

Turning to page 18. I wanted to share this slide for some context on our current performance. We spent most of the last 10 years delivering margins of between 6% and 7%. But we've seen that drop significantly over the last three years. There are a number of drivers to this, albeit, the big theme here is inflation right across the P&L.

You can see that over three quarters of our erosion is at the gross margin line, which is a combination of two things. Firstly, we've had unprecedented inflation. And whilst we've done a pretty good job recovering on mitigating the majority of the impact, we haven't recovered margin on top of this, which is clearly dilutive in itself.

Secondly, we took a series of decisions through COVID to secure long-term volume both by onboarding new business at margins which were below our Group average and by investing in commercial terms with existing customers.

Look, you can't separate a decision from its timing. However, these decisions are now hurting us. We also have seen big increases in fixed costs that have historically fallen outside of our inflation recovery models. We've typically managed to offset pay increases of low single digits for our salaried population through productivity programmes. But in a world where medium salaries are up nearly 20% over the past three years, we've obviously had to raise our game to compete without having a direct recovery mechanism for these increases from our customers. And I think we're all familiar with energy inflation, which was running not far of 300% at times last year.

I said in my introduction that it was clearly – it's clearly been a challenging three years for Greencore, and this chart illustrates how those challenges have manifested themselves in our P&L. However, I want to be clear today that, firstly, we recognise the erosion in our profitability and the knock-on impact on our returns.

Secondly, we understand the underlying drivers of what has happened. And thirdly and critically, because we understand the drivers, we also understand what we need to do to rebuild each element over time, and we outlined this pathway on the next slide.

You can see here each of the seven levers that we need to pull to rebuild our profitability. I'm not going to present this slide in detail as I'll step through each component in the following slides. But the summary version is the following. On revenue, we've got a decent volume picture with space to grow in a number of categories, and we're combining this with firm commitments on inflation recovery mechanisms with our customers.

On COGS, we've seen a degree of easing in inflation whilst at the same time, we're working hard on our product portfolio and our conversion efficiency to accrete margin. And on our fixed cost, we've taken some big fast decisions early on, and we will continue to manage this tightly. If there are two things I'd like you to take from this slide, it would be: firstly, we're thinking about this in a comprehensive end-to-end way to rebuild profitability right across the P&L; and secondly, we're already at work right across each one of these levers to rebuild profitability, underpinning not just delivery this year but also our longer-term goals.

Turning to volume on page 20. I would say that we start from a position of strength, albeit, I would share a note of caution on the path from here. The strength is that despite the pressure that consumers are under, in around our categories that are outperforming the wider grocery market. Whilst groceries down year-on-year by over 4%, convenience food categories are outperforming slightly. And the real standout is food to go, which is up 4% year-on-year.

So structurally, despite a tough consumer environment, we're exposed to categories which are disproportionately outperforming. There are a couple of caveats I would add, though. Firstly, we're not seeing some – we are now seeing some moderation in food to go growth. The 26-

week view is modestly negative for the market as a whole. That being said, we've outperformed that market with positive volume growth in the half.

Secondly, I would flag that we are seeing significant differences across individual categories. In food to go, despite 9% retail price increases, the sandwich market is proving pretty resilient, showing 2% growth in the 26 weeks to mid-April. At the same time, other parts of food to go, so salads and sushi are moving into negative territory.

In other areas of our portfolio, there's also a mixed picture. Own label cooking sauce is flying, growing at 13% and stealing share from brands despite retail price increases of over 20%. On the flip side, the ready meals category overall is down 6% and Italian meals where we mainly operate is down 3%. But on balance, we feel reasonably good about the parts of the store that we're operating in.

However, there is no getting away from the overall market context with inflation where it is, the consumer is hurting. Having said that, we're satisfied with the picture we've seen and we are hopeful that with inflation peaking, we won't see a material worsening of this picture.

If we then look to our input costs on page 21, the message here is one of cautious optimism. We've obviously seen the tidal wave of inflation grow over the last 18 months, but we see that easing in the months ahead. Obviously, can't predict the global commodity markets with precision. However, the way we're seeing it, I'd say, firstly, we're encouraged by the easing on energy pricing. Secondly, we've got a reasonable read on materials and packaging for the balance of the year, which is moderating. We're not going to see massive deflation across the board, and we're not heading back to historic lows, but the easing of the pace here will give us some breathing space.

Thirdly, labour, obviously, will continue to be a challenge. We've seen the national living wage dropped by nearly 10% just last month. And it's 33% higher than in March 2020. So we don't see that direction of travel changing anytime soon. However, in the round, the picture on input cost is more positive in the months ahead than in the months just finished.

Turning to page 22. Clearly, inflation is only part of the picture. We're also taking a proact – we're taking proactive steps to manage what we make and how we make it to help offset the impact of inflation and rebuild margin. You can see some examples of this work on this slide.

In H1, our manufactured unit volumes increased by just under 3%, but the number of individual SKUs we make has actually reduced by 9%. In effect, that means that on average, we're selling 14% more units per SKU. That's so important for our efficiencies as it means longer runs, fewer changeovers, managing fewer ingredients and suppliers, all of which translate into more efficient production.

We will continue this work through H2 and beyond. One of the ways we can rebuild margins through reengineering our existing products, that's not code for reducing quality, by the way. It can mean switching ingredient suppliers to drive more efficient buying, process reengineering to help production efficiencies or indeed recipe reformulation to manage costs. We'll see this come through in the second half of the year, where our plan is that about three quarters of our new products will be reformulations of existing products, and this compares to about 60% for the same period last year.

So the message here is about generating even better returns from the efforts we and our customers put into our ranges. Developing products is expensive. It takes resource, raw materials and energy, all of which are more expensive than they used to be. We won't be putting at risk the secret sauce of our product development engine is one of the foundations for our deep customer relationships. But we will be more demanding of ourselves and of our customers so that when we touch products, we can clearly see a return on those efforts.

If we move to operations on page 23, this is going to be an area of real focus for us. Lee Finney joined us as our COO in H1. Lee brings a wealth of experience in operational transformation from many markets. He's been focused in the first few months on resetting our overall approach in operations. In the first phase of work, we've been doing a detailed assessment of our cost base right across our network, and we've now completed this in the vast majority of our sites. This is surfacing plenty of opportunities to work more efficiently.

We've also deployed a consistent measurement of OEE or overall equipment effectiveness across our network. For anyone not familiar with OEE, it's essentially a forensic measure across every production line in every plant to assess where we are running equipment and anything other than maximum output. This can be for a whole range of reasons, anything from matching our production windows with customers to stopping machines for allergen cleaning or simply losses in efficiency because of a machine breakdown.

Whatever the underlying reason, each one of these speed losses is open to challenge and improvement, and that is going to be a big focus in the months ahead so that we're able to drive more output from the capital we already have in the ground. It's very early days, so we have yet to see it flow through materially into the P&L, but we're starting to see some initial green shoots.

To give but a couple of examples. We've already seen a modest improvement of 2% OEE in our ambient grocery business in Selby, with a plan to get to 5% in the months ahead. These are small percentages but they're applied to a large base. A 5% OEE improvement in Selby equates to double-digit millions of additional units that we can go and sell without putting more capital down.

At our sushi plant in Crosby, we've done some neat automation, reducing the number of people on the line whilst increasing the line speed and in doing so, increasing units per labour out on that line by 30%. That's just one of a number of increases in labour efficiency across the network, particularly as we improve processes in some of our more complex product formats. It's early days, as I said, but we're expecting to see more of these benefits come through in the second half of the year.

The last driver of profitability improvement is our fixed cost base on page 24. This is an area where there's been a lot of work over the last year. We shared at the half year last May that we had launched our Better Greencore change programme. This programme aims to unlock £30 million of annualised benefit by FY24 with a view to offsetting the cost increases in our fixed cost base, which have not typically been recovered from customers through pricing models or other direct negotiations.

There's good news here. We've materially accelerated our ambition in recent months. The major component of this was work we did in Q2 to reduce our management population. And through that process, we removed some 250 salary colleagues from the organisation as well as

100 open vacancies. And for context, we did all of this in the space of 12 weeks from start to finish. We estimate that the impact of this intervention will be in the mid-single-digit millions in year. This is an important component of our confidence in being able to deliver this year. We also continue to tightly manage costs right across the P&L.

Indeed, we're in the process of refocusing our sustainability agenda with a real push in areas like waste and energy reduction, which will mean not just doing the right thing from a sustainability perspective, but also it drives cost out of our business.

The final point I would make regarding our profitability and returns pathways on page 25. I called out in November that we're a business that is barely covering our cost of capital, and this is not sustainable nor acceptable. I'm clear that the single biggest lever we have here for driving returns is to rebuild profitability. But I would also make the point that we are taking a disciplined approach to capital investment and capital allocation. It might not surprise you that our returns profile varies across our portfolio with some categories above our average ROIC and others below that.

I'm very clear that each part of our portfolio must generate an adequate return and my focus will be on improving the trajectory of any areas of underperformance. That will be a big priority for us through the summer as we set ourselves up for next year and look to raise performance across each part of the portfolio. And if for whatever reason, we don't believe we can do that, then we will explore alternative options.

My final point in that context is that we've got a strong balance sheet in time that will give us the flexibility to invest in longer-term growth. This is a good position to be in as an incoming CEO, albeit, I'm clear that our absolute near-term priority is on improving on what we have today.

If I move to the outlook statement on page 27. I hope you've heard a clear message that we've set absolute priorities around driving performance to rebuild profitability returns and cash generation and that we believe the foundations for that profitable – for that profit recovery are well established.

We've been hit by a lag in inflation in the first half but we're confident in the ongoing recovery and mitigation by pulling a range of levers. We've got a strong balance sheet, and we're continuing our returns to our shareholders. We've returned 6% of our market capitalisation to shareholders over the past year, and we'll continue with this approach. Against that backdrop, we expect to generate an FY23 outturn in line with market expectations.

Let me quickly add some further colour to that last point on page 28. Certainly, it's been a big focus for me to get comfortable with a trading profile that sees us making 85% of our profit in the second half. The way I get comfortable is the following.

Firstly, we have a significant volume uplift in the second half of the year. The reality is people buy more food to go when they're out and about and the sun is shining. So we see our volumes spike through the summer and the impact of that drops to our bottom line with relatively little additional fixed cost.

Secondly, we've talked about the lag in inflation recovery in the first half. So we'll see the efforts of our inflation recovery negotiations completed in H1 come through in H2. Thirdly, we made the headcount reductions I referenced at the end of H1, so we'll see that flow through in

H2. And fourthly, we continue to deliver a series of other commercial, operational and cost control measures to underpin performance. It's these four points that give me confidence that we can hit our outturn for the full year.

So in summary, we've had an encouraging first half in terms of revenue and volume. We believe we've got a great platform to build from. We've got strong constructive customer relationships. We play in attractive parts of the market. We make great products, and we're demonstrating a willingness to make difficult decisions. However, we're not satisfied with our profitability, and we're committed to rebuilding that over time. We're crystal clear about where our margin went, and we've made a good start on recovery with plenty more to do.

So I'll wrap up there, and thank you for your time and your interest in our business and being with us all this morning. So let's move on over to any questions you might have. Charles, do you want to go on? Because of transcript, we'll just do the names, if that's okay.

Questions and Answers

Charles Hall (Peel Hunt): Charles Hall from Peel Hunt. Dalton, thank you for the clarity in the presentation, and it's very clear that you've put a lot of emphasis into restoring the profitability and addressing the short-term issues. But how are you thinking about the business, medium and longer term in terms of either the shape of the customers or the products or the plants? Have you had a chance to think about that? Or is it really the short-term dynamics that are more important?

Dalton Philips: Look, Charles, it's been more the short term. I think about it in horizons. And so the horizon one is very much about just landing this year and hitting the expectations that are out there. And that's where there's been a lot of work. Horizon two for us, which we're spending a lot of time on really the next 18 to 24 months. And again, in that horizon, it's about doing what we do today but doing it even better. It's not about expansion in terms of new categories, channels or even geographies.

It's very much get ourselves really fit. So that horizon three, which is where I'll start spending more of my time once we get through this summer is looking at the longer three to five years. And clearly, there are – there's a lot of space in terms of both categories and channels we could play in, in the UK. And clearly, I'm sure there's the perennial question we'll challenge ourselves on, should we be looking at other geographies. But that horizon three is not even touching it.

Land this year, make us stronger in horizon two for the next 18 to 24 months, then that will give us breathing room to think about the future.

Charles Hall: And as you said, I can't remember the precise word, but the ROIC is not in an acceptable level at the moment. What would you see as an acceptable level for a business like Greencore. And you also said that you'd be addressing certain categories and product areas, what would an individual product area need to be to stay in the portfolio?

Dalton Philips: Well, look, at the moment, our profitability is just not where it needs to be. I mean we're talking the consensus is sort of £70-odd million. This is a business that used to make you saw in the chart, £105, £110. Margins of 6% and 7%. So look, we believe there's a huge opportunity to drive back our profitability in terms of what that ROIC could be.

Look, I think it would be naïve to put a number out there at the moment. Certainly, we've got some benchmarks, our own internal benchmarks that Emma would have led that significantly higher than where we are. So I think there's quite a lot of work to do just to get back to sort of historic averages before we put anything else out there.

What I would say is in terms of my point around assets, I mean every asset has got to carry its own water. We've got 23 different plants, and we have a number that have returns that are just not where they should be, Charles.

And so I think we're getting very focused now through the summer on looking at those assets. And saying, what do we need to do to bring those assets back to where they can sort of carry their own water. And if they don't, we'll have to make difficult decisions. I don't want to – if we have to divest assets, let's divest them, having really had a good go and improving that asset, because otherwise, somebody else is just going to come in and take the value from that.

And I think with the business with all the challenges that it's had over the last three years, it's right to really refocus on these assets, put a clear plan in place, resource them properly, go after it. If we feel that ownership should be – that site would be better served in another ownership, we'll discuss that at a future time. For now, it's turning those assets around.

Charles Hall: And one last question. You talked about seven contracts you've walked away from. What's the annualised turnover of those? And is there a pattern as are they in particular segments of the market that say salads that are very tough at the moment. And obviously – well, I say obviously, but presumably these are loss-making contracts, but there's a contribution anyway. How do you think about that contribution?

Dalton Philips: Yeah. And look, and I'll ask Emma to come in on this as well. So it's eight in total. The largest was a ready meals contract that we gave up just as I was starting actually. And we're trying to be very disciplined on this Charles because I think once you start wavering with your commercial team, I think you have to hold the line and say, "Listen, if you can't take it, if we can't hit these numbers, it's got to go". And I think if you start wavering, it's sort of like, it's the slippery slope. So we've been very disciplined on it.

It puts a huge amount of pressure on the operational team because they've got to pull cost out. And stranded costs, as you know, it can be very hard to get them out. I think so far, we would say that we're encouraged by what we're seeing. In terms of the annualised number, do you want to share – to what extent have we shared that number in the past?

Emma Hynes: Look, we would have said on the meals contract, it was over 50 million annualised with the others. You're getting above 50 million.

Dalton Philips: Do you want to add on anything else that I've missed by the way, in any of this conversation.

Emma Hynes: It is a case of being very disciplined on making choices around how we allocate our capacity. The challenge on something like a ready meals contract is looking at stranded overhead, and that's what we've been doing a huge amount of work on looking at that network in meals and making sure that we're minimising the level of overhead that is stranded, but being very disciplined about what we choose to have in the facilities.

And then the other parts of the business, it's looking at things like distribution, which is actually low margin in the first place. So we're not going to continue to distribute for customers unless

they're paying their way when it comes to that part of the business. So I think what Dalton has done has really backed the commercial team on those negotiations. And what it's doing is taking some of the tail out of the business as well, so helping with the mix performance. So we're serving fewer customers with a smaller number of SKUs, and that ultimately makes you more efficient.

Dalton Philips: Jason, and then we will go to Martin.

Jason Molins (Goodbody): Good morning. Jason Molins, Goodbody. Just on the inflation recovery. You've got quite a bit of inflation recovery through the other convenience business. That was actually quite a bit more than the food to go business. Can you maybe just help me understand what the drivers are there? And in terms of volume growth performance, the improvement from where you were in Q1 into Q2, with obviously another couple of months. I don't know if you want to maybe give a better commentary on current trading or the benefit of the weather outside and how that might look for the business in H2?

And then just final question in terms of onboarding some of the ready meals business, you mentioned before again, that you've had difficulty in some of the network optimisation around that. Just an update really on how that's progressing?

Dalton Philips: Okay. Well, look, why don't Emma and I split on those. Look, I'll start with current trading. We'll go into ready meals, and then we'll end with inflation. I know Emma will have some perspective there.

Look, this is my first H2 with the business and there was – as I said, it's an unusual split 15%, 85% between H1 and H2. And clearly, I had to get comfortable with that seasonal profile. The weather, the weather, the weather. Those of us who've been on the retail side of it know that you never talk about the weather. But clearly, on the manufacturing side, it really does make a difference.

And I was – last week, the dog – I was trying to see does this dog bark. And last week, the weather came, the volume just ramped up massively. And in fact, if you think over the weekend, we had sort of peak volumes out of salads, peak volumes out of sandwiches. I sat through all the salad calls, Saturday, Sunday, Monday. We were 99% service levels, Jason, out of our salad business, which – and I know it's something that Emma has really kept a lot of focus on through the last month.

Last year, our salads business really just didn't perform. So weather comes, people buy, factories are full, control your labour, manage variances, it drops down. So there is a large part of seasonality to this business. And if the weathers kind to us this summer, I'm obviously optimistic for our performance this summer.

In terms of the CRM network, look, we invested heavily in a state-of-the-art plant with Kiveton that's commissioned. It's up and running. We lost a large customer that we've talked about, Emma just mentioned. And now we're going to have to rebuild that network. We have a highly automated, highly efficient plant that's not at capacity. There are a number of customers out there that we are speaking to proactively that we believe that we can produce a high-quality product for them at terrific pricing, Jason, and that's the focus. You're not going to see it though in H2.

This stuff takes six months, and that's the focus. The other clear focus is rebalancing the network. So just moving products around. So in fact, there are a number of products in Kiveton that we've taken out we've put elsewhere in the network because it actually makes more sense to do it elsewhere in the network.

Do you want to add anything to those two before we go into inflation?

Emma Hynes: Yeah. We move on to inflation. Yeah. Look, Jason, I don't think there's a different dynamic in play between food to go and other convenience and inflation recovery. I think it's more to do with the mix of where inflation comes through, I mean, with high inflation everywhere. But there are certain commodity inputs where we're just seeing much higher percentages. So I think it's more an output of that rather than us looking at something specific on the dynamic with different customers or different categories in the business.

Dalton Philips: Martin?

Martin Deboo (Jefferies): Yeah. Thank you. Martin Deboo, Jefferies. I guess I'm firmly in horizon one, Dalton, so forgive the sort of slightly obsessive questions. I guess, I'm not going to ask you sort of what inflation recovery is going to deliver in H2. But I think the sort of moving parts, maybe it would be good to get a handle on are, what was the benefit in H1 from gross cost savings? And what was the disbenefit from Kiveton? And how do those develop in H2? Just to sort of get a handle on the bits, we maybe can get a handle on.

Dalton Philips: Do you want to?

Emma Hynes: Yeah, sure. Look, in terms of benefit from cost mitigations, we're sort of at a mid-teens millions number on mitigants in the first half. And about a third of that comes from our kind of normal operational efficiencies. And then the other two-thirds are really coming from all of the levers we're pulling on managing costs through Better Greencore through taking overhead out and we'd be looking at similar numbers as we go into the second half.

And then in terms of the impact of meals, there was a several million impact of meals in the first half, and we're going to look at probably another £2 million to £3 million impact in the second half of that contract coming out.

Dalton Philips: Is that okay, Martin?

Martin Deboo: Well, that’s very good. Thank you again.

Dalton Philips: Clive?

Clive Black (Shore Capital): Yeah. Clive Black from Shore Capital. A couple, if I may. One of bit of a unrelated question. But over what time do you think you can get to where you want to be on the UK pension? And then in terms of bigger picture, Dalton. Firstly, do you have an aspiration for Greencore in real terms to be a more profitable business than its peak over that five-year horizon? Or do you believe that Greencore can just be a higher-margin, higher-return business but within a more constrained nominal number? Thank you.

Emma Hynes: Okay, on pensions. I don't want to pre-empt the negotiations that are going on, right? And there are choices you could make around cash contribution. So if you think about the level of cash that we're paying in at the moment, I mean we're looking at 2025 as a realistic sort of end date on that, which would be much better than we would have thought previously.

Dalton Philips: And I have to say, Emma's done a fantastic job in this area and full credit to the work you've done and we'll all benefit from your hard work in the years to come now.

So look, I think I speak for the team and the Board, Clive, that there's real aspiration that on a business that does £2 billion, which has some really unique USP. So if you think about the depth of our customer relationships, if you think about the leadership we have in a couple of key categories, sandwiches, sushi, Italian ready meals, cooking sauces. The capabilities internally to turn huge numbers of SKUs to the product development skill set, the fact that we distribute to every post code across the UK and the fact that we have this great technical expertise because this is technically really hard as – well, I think you probably know probably more than any of us how technically hard it is from a food safety point of view.

So I think you say, right, you've got all of those ingredients. We've got £2 billion. I'll come back to the £2 billion. We have got to be able to drive profitability and returns in this business, where – to 7% margins, I don't know. It's really too early. But to be making more than before from a cash power note, 100%.

What I don't quite know is the time line, and I'd really like to be able to go back famous last words, but I'd love to be coming back at the end of this financial year and trying to be a bit clearer to the market on where we see those returns over what period of time. Having said that, we will need to give up business. We need to be prepared. We need to back the commercial team. And what we're saying to the team and Emma talked about is we're saying and the Board have been really supportive here, which is – we don't mind if you walk away from business. And I think that's a mantra that we haven't heard before in this business.

It's a slippery slope because it's so hard, we'll just walk away and you don't want to embed that into your commercial team, but I think a sense where the commercial team can say, no, we will walk away. So could we resign another £100 million of – I mean I'm just pulling the number out there, £100 million of revenue on a £2 billion base? I think those are the sort of – that's okay. I think if you give up revenue because it's not paying its way, that's fine.

So I don't see us being a materially smaller business, but I'm prepared to walk away. At the same time, walking away allows us to build cash reserves to invest where there's an opportunity. I think we're all pretty ambitious for this business. And I think we think making a consensus number that's out there is just really not acceptable when you've got leadership positions and these unique USPs that I talked about at the beginning. So I think there's more to do.

Andrew Wade (Jefferies): Hi there. Andy Wade from Jefferies. Just a couple for me. The first one, I think it was page 12 or slide 12, but I can't quite remember. You've got the pie chart there showing where you got to, where you were in the year on savings from or recovery from a recovery of inflation from price increases, recovery of inflation from cost savings and then unrecovered so far, I think it was 85%, 10% and 5%. Assuming that was a snapshot as at the end of the half. Is that correct?

Emma Hynes: Yeah.

Andrew Wade: So where would that – what would that pie chart look like as an average through the first half?

Emma Hynes: Sorry, that is the full half.

Andrew Wade: Yeah. So that's – so only 5%.

Emma Hynes: Sorry, that's the half one.

Andrew Wade: So not a snapshot at the end of the year then? It was –

Emma Hynes: Sorry, no, that's the half. So that's all of the first half.

Andrew Wade: That's what you achieved over the six months. So what would that snapshot look like at the half year then, questioning the other way around.

Emma Hynes: As in looking forward.

Andrew Wade: As in a snapshot right now. It says that 5% wasn't recovered.

Emma Hynes: Yeah.

Andrew Wade: Right? Is that at the half year – run rate at the half year or average through the first half?

Emma Hynes: I think actually – my answer is like definitely. So we've got a lot of the inflation recovery agreements in place now. So while there was a lag getting that agreement a lot of that lag related to the first quarter, so you are trying to catch that up as you go through the rest of the year. So what we will have is an awful lot of that agreed and locked in at this point. And then we've been pulling every lever we possibly can as Dalton has talked about on overhead, cost out, things like that as well as making sure we're focused on delivering our operational initiatives.

So we'd have said, we'd have delivered a mid-single-digit millions of operational initiatives in that first half. We'd expect to deliver more of that in the second half. So look, we're saying we'd expect to catch up and get full recovery in here.

Dalton Philips: Andy's not sure –

Andrew Wade: I'm not 100% sure if I understand the answer. 5% in – the pie charts says 5% up of inflationary pressure is unrecovered.

Dalton Philips: Yeah, which is the delta that's –

Andrew Wade: Is that the run rate at the half year? Or is that the average for the first half?

Emma Hynes: No, that is the first half, what we did not get in the first half of the inflation we experienced in the first half and we expect to catch it up. Yeah.

Andrew Wade: Okay. All right. Okay.

Dalton Philips: Well, it's – if you do the snapshot today, you'd probably still have a slight under-recovery. You've got to get it in the coming months. We've got four months left. And so – the guys owe us the money is what we're saying. I mean, i.e., the commercial and the ops folks owe Emma and I that money and the challenge is to go get it.

Andrew Wade: Lovely stuff. Okay. Thanks. And the second one, you talked about – and obviously, we're aware of the COVID protection sort of contracts and measures that you put in place. You mentioned that some other headwinds. How significant is that still? And what opportunities you – for you to change or recover or renegotiate to get that back?

Dalton Philips: Yeah. Look, I mean, part of the – I said we've resigned – we've come out of eight contracts and the majority of those are COVID contracts. Some of the contracts, Andy, Europe, I can think of one or two that actually have quite a material notice period that we're just trying to work through with those customers. But we're pretty clear that we can't make products and lose money on it.

And what was – as I said, what was a good decision at the time with the recovery we've seen today would suggest that we need to unwind those. So there's more to go in terms of total revenue, it's not – we're not talking more than 5% of our revenue, let's say.

Andrew Wade: Thank you very much. Valeria, is there anything on the call? If not, we can wrap up.

Operator: Yes, we currently have two questions. As a reminder, if you'd like to ask a question, or make a contribution on today's call, please press star one on your telephone keypad. To withdraw your question, please press star two. Our first question is from Gary Martin from Davy. Please go ahead.

Gary Martin (Davy): Morning, Dalton. Morning, Emma. Just a couple of questions for me. Just the first would just be on the 250 employee staff reduction. What's the best way to think about this just in terms of location of where the staff were let go and how that's going to affect we'll say, capacity utilisation going forward? So that's just my first question. And then just a second question, just on FY'23 net debt. Just as a reminder, I think the range for leverage was, I think, 1 to 1.5x on a go-forward basis. So then just in terms of cadence of working capital inflow for the rest of the year, is that a target that you're comfortable that you're going to hit? Thanks.

Dalton Philips: So Gary, look, let me do the first one, and maybe Emma will do the second. So we have a distributed model in terms of our management teams spread across the sites. We don't have a large central support office in the UK. So the 250 roles or people and the other 100 roles that we mentioned later, they have come out across the business in management roles. So no one specific area and all areas across the business were impacted by this.

Yes, all areas, but with a small exception possibly in IT where we did some – there were some areas that were protected, but in general, all areas were impacted.

Emma Hynes: Yeah. And look, that was the indirect cohort, yeah, so rather than direct labour. In terms of net debt, yes, the 1 to 1.5 times target sort of remains the range, and we'd expect the working capital to unwind the outflow in the first half unwinds in the second half. So I think it's safe to assume broadly neutral for the year.

Gary Martin: That's pretty helpful. Thank you so much. And if I could just get one more in just on food to go. I just see that along with supportive sandwich volumes, you also mentioned new business wins. Can I just get a bit of background on that, please? Thanks.

Dalton Philips: Yes. Look, the commercial team are active in a number of different areas in terms of challenging for those wins, be it in sandwiches, alternatives, salads and sushi. In many cases, it's picking up a small range here or a small range there. But I think they've been broadly very encouraging.

Emma Hynes: Yeah. What we're looking at in the first half is the full year effect of the salads business onboarded last year that was part of the at £60 million coming in from a new customer, of which one-third was in salads and the other two-thirds were meals.

Gary Martin: Got it. That's really, really helpful colour. Thanks so much.

Operator: We have another question from Karel Zoete from Kepler Cheuvreux. Please go ahead.

Karel Zoete (Kepler Cheuvreux): Yes. Good morning, all. Thanks for taking the questions. I have a question with regards to the choices you make in terms of head – the complexity reduction and reducing SKUs. Are there specific channels where you've stretched the portfolio too widely. Or is that across channel? Reason for asking, of course, is that you've taken on some new business not too long ago. Then there's a question on the capacity in the industry. Because you show on the slide, of course, that there's been some volume declines. Is there excess capacity in certain categories or is it more widely?

And then the last question is in relation to slide 21, where you show the energy or utility cost. Can you remind us on your hedging strategy for energy and the diesel component for the distribution activities? Thank you.

Dalton Philips: Right. Well, thank you for those three questions. And Emma and I can do a double act here. In terms of range reduction, I mean the reality is that there's an awful lot of work, and I talked about the resources involved in developing new ranges, but it's the tail of the range. If you think about the top ranges in terms of sandwiches or indeed ready meals, I mean, chicken and bacon, cheese and onion, BLT, prawns or spag bol, macaroni and cheese or chicken and bacon. There hasn't been a huge amount of innovation at the top end. The innovation is all around – the new innovation is in the tail, but the tail is very expensive and consumer habits are quite set in terms of their favourites.

So it's – there's a lot of churn going on there. We've reduced it by 10% in terms of new products flowing through and it just creates so much complexity. It creates complexity for us. And I think our retail customers now are recognising the complexity it creates for them to continue to having to change planograms, bring items in, take items out. So it's going to be a continued focus.

And I think, in general, we're very aligned with the retailers on that. And we can offer them better pricing by doing smarter innovation. So that's the first thing.

In terms of capacity, look, in aggregate, there's only possibly one other manufacturer out there that would have the level of capacity that we would have in aggregate. I think when you split it down into individual components, there's more capacity in certain areas than in other areas. I think in food to go, there's a lot less capacity, particularly in sandwiches.

There's not a lot of capacity out there. But if you get into something like ready meals – six manufacturers, each has somewhere between 10% and 20% market share. It's an industry that's had some volume decreases anyway from a consumer trend point of view. You've had increases in automation. We've been an example of that. You've had increases in capacity that's gone down. We'd also be an example of that. So overall, you've got a sector in terms of ready meals, where there's excess capacity.

So I think it's some and some in other parts of our portfolio. Grocery sources, very little capacity. So it really depends on the category that you look at. But I think in aggregate, there are very few other manufacturers that would have the footprint that we would have in the market. In terms of hedging?

Emma Hynes: Yeah. Look, on energy, I think what we had talked about it earlier in the year, we'd have covered the first half in line with the government cap. We were then adopting a wait and see approach for the second half. We had about 30% of cover that we put in place a long time ago. And we've been pretty disciplined about that taking cover gradually as we've gone through and benefiting from the reduction in energy prices as we went forward.

We're taking a similar view for next year. We've been quite measured in how we think about it. There's clearly a high risk – high premium attached to forward purchases and giving certainty at the moment. So we are taking some cover out, but we're being careful about it. I mean if you had decided last summer to cover for this year, you would have been sitting on very high premium to where the market is today.

So I think that has been a sensible approach, but we are reviewing it regularly as part of our energy steering committee internally to make sure we're making the right calls.

Dalton Philips: Yes, it's super expensive, isn't it? Look forward next year.

Karel Zoete: Thank you.

Dalton Philips: Thank you very much. Martin, did you want to come – okay. Okay. If there's nothing else, what we might do is wrap up. Thank you very much for taking the time to be with us this morning. I really appreciate it.

Emma Hynes: And just before we do that, it is Martin Deboo's last day or second last day in Jefferies. So look, we said goodbye to Nicola Mallard. It's not that long ago. It feels like the end of an era. Again, I'd like – look, I'd like to thank Martin for all of the work he's put into covering Greencore, over the years. I mean you've been close to us for a very, very long time. And that depth of knowledge. I'm sure that the team have been brought up to speed, but we will miss all of the depth of knowledge and insight and analysis that you brought. So best of luck in your retirement, Martin.

Dalton Philips: Well said, Emma. Right. We'll close the meeting. Thank you.

Emma Hynes: Thank you.

[END OF TRANSCRIPT]