Transcript Earnings Call related to JDE Peet's' H1 2022 Results

Operator: Good morning and thank you for joining JDE Peet's Half Year 2022 Earnings Call. My name is Nazanin Bayati, and I will be your operator for the call. For the duration of the presentation, all participants will be in a listen-only mode and the conference call is being recorded. And following the presentation, there will be an opportunity to ask questions. If you do have a question, please press zero one on your telephone keypad. And if you wish to withdraw your question, you may do so by pressing zero-two to cancel.

At this time, I would like to turn the call over to our first speaker, Robin Jansen, Director Investor Relations for JDE Peet's.

Robin Jansen: Thank you, Nazanin. And good morning, everyone, and welcome to JDE Peet's earnings call related to our financial performance of the first half year of 2022. With me are Fabien Simon, CEO, and Scott Gray, CFO.

In a moment, Fabien will take you through the operational and financial highlights related to our first half year business performance and will update you on our outlook for full-year 2022. After that, Scott will tell you more about the financial performance in the first half, and after that, we will be happy to answer your questions.

Our press release was published at 7.00 a.m. CET this morning. The release as well as the slide deck related to this call, are also available for download from the Investors section on our website. A full transcript of this conference call will also be made available in that same section on our website as soon as possible after this call.

Before I hand over to Fabien, I'd like to direct your attention to the disclaimer regarding non-IFRS measures and forward-looking statements on slide three. We would kindly like to ask you to read this information carefully.

And with that, I hand over to you, Fabien.

Fabien Simon: Thank you, Robin. Welcome, and thank you everyone for joining the call today. Looking back at the first six months of 2022, I am pleased to report a very solid set of results, despite the unprecedented economic and geopolitical backdrop the world faces.

It is now the third consecutive year of operating in external crisis conditions. Yet, I believe that our performance is a clear testament to the resilient growth profile of JDE Peet's, as well as to its competitive advantage of being a pure-player in a growing category, with leading market positions, and with a powerful portfolio of brands that enable consumers to navigate across evolving needs and price points.

Our results would not have been possible without our talented teams and our 20,000 associates around the world, and I would like here to take the opportunity to thank them all, for their remarkable commitment, agility, and perseverance in navigating these difficult external conditions.

Let's now have a look at our performance highlights of the first half of 2022, starting on slide 5.

Our performance reflects another strong set of quality results, which contributes to the track record of performance-delivery that we started to build over the last two years. On top line, we delivered organic sales growth of 15.7%, which is well above any level we've achieved in the past. And on bottom line, we increased the underlying earnings per share by 18.3%, with about half purely coming from operational performance. These results were achieved by tight management of the short-term challenges, but at the same time by keeping course of our mid to long term value creation agenda. Both are reflected here with an increase of gross profit by 1.4% vs a year ago, and with a targeted increase in our investments for growth, that I will detail a bit later in the presentation. Combined, it resulted into a minus 2.1% evolution of our adjusted EBIT.

Over the history of the company, we built a robust and leading cash conversion model. It was visible in 2021, and is again this year, with almost €700 million free cash flow generated in H1, which enabled us to seize an attractive share buy-back opportunity of €0.5 billion, without a real noticeable impact on our leverage ratio versus December of last year.

Basically, all these results need to be put into perspective of an exceptional level of cost inflation, as well as global supply chain disruptions. Despite those, we kept our customer service levels high. We protected our absolute euro margin per cup sold, and we are building quality volume and value market share, at a time that we have been leading on pricing in the market.

Finally, on sustainability. It was obvious two years ago, that we were really falling behind, and it was not enough on the company agenda back then. Last year, we shared the defining shift we initiated there, which, in my view, was a catch-up on the basics. I am very proud that this year, we are now leap-frogging, and with the latest progress we communicated earlier on responsible sourcing, I believe that we are setting-up a new standard for the coffee industry, with a commitment to measurable impact.

Let's now move to the next slide and provide a bit more detail on our top line performance, in light of historical results.

Over the period 2017 till 2020, which was characterised by modest deflation in green coffee prices, our compounded average organic sales growth in the first half of those years was only 0.6%. About two years ago, we shared our agenda to elevate organic growth, with positive signs already in the first half of last year at 4.2% growth, driven by higher volume/mix than before, and by a modest price increase. This semester, obviously, pricing has been playing a bigger role, with record organic growth at 15.7%, that came with stable volume/mix of minus 0.2%, despite the unprecedented high level of pricing of 15.9%. Together with the positive effects of currency fluctuations and changes in scope, our reported sales increased actually by almost 20%.

So let's now go to the next slide, slide 7, and go into a bit more detail on how we have been dealing with this unprecedented level of inflation to date.

In H1 2022, we have most likely been among the companies most hit in the Food & Beverage space, as far as cost inflation is concerned. In H1 of this year, the inflation on our cost of goods sold was 36% on an organic basis. This was driven by a broad range of impacts across our cost base, starting obviously by the most meaningful in absolute terms which is Green Coffee, inflated further by ocean freight costs, and joined by energy and packaging material inflation more recently.

But because, if you recall, we called out broad inflation risks in Q2 of last year already, we, since then, organised ourselves to pull all levers, in a disciplined manner, to protect our absolute gross profit, and therefore avoid pulling back on growth investments. We knew that we would have to play our part in the inflation challenge, and we accelerated our cost efficiencies programme, kicked-off a simplification agenda with, for example, a double-digit reduction of our number of SKUs.

And besides the opportunity we had to play with our unique portfolio of price points, we were very realistic about the absolute necessity to increase prices as well, and we've started to implement those in multiple waves, starting in Q3 of 2021.

As I called out in the previous slide, our year-to-date net pricing reached 15.9% which is the highest level of pricing, as far as we could track, in the history of the company. But to put things into perspective, this historically high level of pricing translates into a very responsible increase of well below €0.01 per cup, on average. Of course, we need to be mindful with the concept of average here, but let's say that you would consume 500 cups of coffee per year, at home, of JDE Peet's products. The overall cost inflation would then be about €4 to €4.3 for the entire year for these 500 cups.

€4 is about what one caffe latte would cost you today in a coffee store. Just drinking one less of it, would offset the full year inflation of in-home coffee of JDE Peet's' products on average. This is why our category has been showing resilience historically at times of choices for consumer, and we saw that in our volume/mix growth in H1 that it remained stable year-over-year.

Let's now go to the slide 8 and have a look at how our market shares have evolved over the last 12 months in a very transparent way.

Consistent with H2 of last year, the external data suggests that we have been, again, leading on price increases across all our geographic segments and categories during the first half of this year. There was zero possible ambiguity on the way we are preparing to manage this historical inflation cycle, with priority to protecting the absolute gross profit, avoiding value destruction in the category, and then focussing on quality market shares over time, and not on a very short-term horizon.

And I believe that this is the responsibility that falls on the shoulders of a category leader with strong brand and pricing power. What this slide highlights is that we initially lost a bit of share during the phase of leading on pricing. But because those pricing were absolutely justified, given the commodity pressure that everyone in the industry is confronted with, the various players progressively implemented similar levels of pricing. As a result, our market shares are now normalising back, and on the latest Nielsen read, we are pleased to report that both our volume and value market shares are back, and even higher than what they were before the cycle of price increases that started in Q3 of last year for us.

This is the case in the U.S., in Europe and in LARMEA. To be transparent, this is not the case yet in APAC, and this is something that we are monitoring closely. But this overall dynamic of leading on pricing with short-term impact on market shares that are coming back is something we were prepared for and intentional about.

On this slide here, while we navigated through the challenges I mentioned, we also continued to invest behind our long-term strategic growth opportunities. Our SG&A expenses were up 4.2% organically, with low single-digit increase in working media, a double-digit increase in consumer-facing advertising, while pure promotional spend slightly reduced year-on-year.

In the U.S. and emerging markets that we defined as priority areas, SG&A was up double digits as we are increasing our capabilities and brand equity investments there. In China, we kept investing, as the number of coffee retail stores increased at a double-digit rate too, from 70 in December of last year, to 81 now, despite lockdown constraints.

And here on this chart, you can see two pictures actually of progress on our strategic priorities, with a new Peet's coffee store in the city of Shaoxing in China, and the two awards received this year by our newest version of the L'OR BARISTA coffee machine. In CapEx, close to 80% of what we spend is related to investments for growth, while OpEx and CapEx related to ESG increased by 74% and 93%, respectively.

Just mentioning ESG, let's go to slide 10 and share some highlights in sustainability.

I am pleased with the continued progress we are making on ESG, as you can note here on the right side of the page, such as the increasing use of renewable electricity from 3% in 2020, 17% in 2021, and now 40% in the first half of this year. I am pleased as well with the step-up in gender diversity of our Board, and with the ESG rating upgrade we received from ISS in April, and I would expect more to come, as our ESG progress is getting noticed.

But where I believe that we are making most inroads is on responsible sourcing. At Peet's, we have been pioneering a verification programme with a third-party, Enveritas, over the last couple of years, that has just resulted in Peet's achieving 100% responsibly sourced coffee. Just to give a perspective on this programme, which is a programme recognised by the reference coffee platform GCP. It implies 18,000 annual audits, farmer projects across 24 countries of origin, with commitment to impact, and is verification based.

We will now globalise this programme to the entire JDE Peet's portfolio, with a significant step-up to already achieve 80% responsibly sourced coffee by the end of this year, from only 30% last year. This comes with a meaningful financial commitment, in our journey to responsibly source 100% of our coffee by 2025, and directly supporting more than one million smallholder coffee farmers. Again, with JDE Peet's being among the largest buyers of green coffee beans in the world, we have the responsibility to play our part to elevate the authenticity, inclusiveness and therefore the standard in the coffee industry. And we are doing so.

Now, as an introduction to my last slide, and before concluding with the outlook, I would say that our brands and products are very well known by consumers and drunk about 140 billion times per year. But as a company, we are a bit less known. Although our heritage goes back 269 years, JDE Peet's in its current form only exists since January 2020, and more visible since the IPO in May of that year.

But even from there, and now having the honour to lead the company since Q3 of 2020, we clearly communicated that many shifts were necessary, for JDE Peet's to unleash the power of its portfolio as well as the possibilities that the coffee & tea category is offering to us. And therefore, becoming a recognised leader in the industry.

Now that we are exactly two years down the road, I thought it was a good time to take stock and look back on our track record since the IPO on the next slide.

I would summarise it by saying that we are a very different company than two years ago, much more agile with our brands being stronger. We are quite bigger in size with revenue 21% higher, all organically, and more profitable, 33% higher EPS than at time of the IPO. And while we work hard to raise the bar on short-term operational performance, we became far more growth and mid- to long-term focused, turning historical trends of lowering investments into a higher gross profit mindset to fuel strategic growth investments that we increased by 11% since H1 of 2020.

Finally, we generated about €2.5 billion of free cash flow since the IPO, that we, in good part, returned to shareholders in the form of dividends and a share buyback, while in parallel still reducing the absolute net debt and leverage ratio to the level we committed to at the time of the IPO.

Obviously, there had been some attention on our shareholder structure and liquidity level, but even there, some improvements are noticeable, with progressively increased float happening in a good and coordinated way with our main shareholders. So I would say that, after two years, many things to be pleased about, with quite competitive results, and again, at a time of exceptional macro-economic disruptions.

I think that this track record built credibility for JDE Peet's to be recognised as one key and strong global leader in the coffee category, a leader in pricing, a leader in market share, a leader on financial deliver and a leader on sustainability. Rest assured that we do remain humble in light of these results. We don't consider those as the end of a journey, but rather a start, and we intend to continue to build a track record of performance and attractive returns over time to shareholders and stakeholders.

Now before handing the call over to Scott, let's flip to slide 12 and remind you of our outlook for full-year 2022.

The business environment has not gotten easier since the beginning of the year, when we first shared our outlook for 2022, and we expect it to remain volatile for the remainder of the year. Nevertheless, and encouraged by our first half results, we continue to expect to deliver double-digit organic sales growth, with disciplined pricing for inflation, while aiming for a stable level of absolute gross profit compared to last year. We will continue to invest in our people and strategic growth opportunities, while keeping a tight focus on other cost items, and we expect to deliver free cash flow of at least €1 billion in 2022.

With that, I will hand over the call to Scott, and I will be back when we start the Q&A.

Scott Gray: Okay. Thank you, Fabien, and good morning to all of you.

Let's now go to slide 14 and I'll take you through the most important financial highlights of this semester, and after that I will go into a bit more detail on our sales, adjusted EBIT, the performance by segment, as well as our performances related to profit, cash, and our financial position. I will then finish with a quick reminder of our capital allocation priorities.

Our overall organic sales growth of 15.7%, as mentioned by Fabien in his business highlights, was driven by an organic sales growth of 12% in In-Home and 33.7% in Away-from-Home, reflecting both the resiliency of the category against a high comparable base, as well as the continued rebound in Away-From-Home consumption as lockdown measures were gradually lifted in most markets.

In terms of profitability, our adjusted EBIT declined by 2.1% versus H1 21 on an organic basis, which brings the three-year organic CAGR for adjusted EBIT to 2.9%. Our underlying earnings per share increased by 18.3% to €1.05.

When it comes to cash and debt, we generated close to €700 million of free cash flow, which we allocated, amongst other things, to the €176 million dividend payment in January and to the €500 million share buyback from Mondelez that we executed in early May.

Let's now move to slide 15 to take a closer look at sales. As Fabien already mentioned, our organic sales growth of 15.7% was driven by strong pricing of 15.9%, while volume/mix remained stable, which clearly reflects the resilience of the category. The positive foreign exchange impact of 3.7% was mainly driven by the appreciation of our main currencies versus the euro, such as the Brazilian real and US dollar, and this, together with a minor change in scope, increased our sales by 19.7% to €3,896 million on a reported basis.

Let's now go to slide 16 to look in more detail at our adjusted EBIT performance. What you see in the bridge on this slide is that despite the unprecedented level of inflation we are facing, we managed to increase the level of gross profit compared to last year. During this semester, our overall A&P was flat, as we spent more on advertising and less on promotions, while other SG&A costs increased, as we continued to make investments behind our strategic growth priorities.

Fluctuations in foreign exchange increased adjusted EBIT by 80 basis points, and changes in scope and other small non-organic items contributed another 30 basis points of growth to the reported adjusted EBIT growth of minus 0.8%.

On the next slide, slide 17, you see an overview of the organic sales and adjusted EBIT performance by segment.

Looking at the top-line performance per segment, you can see that all five segments delivered strong organic sales growth, which was driven by strong pricing across the globe that varied from around 9.5% in CPG APAC, Peet's and Out of Home, to almost 13% in CPG Europe and 44% in CPG LARMEA.

In CPG Europe, while the organic sales growth is supported by double-digit pricing related to inflation, the lower volumes in CPG Europe reflect a high base of comparison as lockdown measures continued to be lifted, the impact of negative effects during retailer negotiations in certain markets, and by a lower level of promotions.

The overall growth performance was broad-based across countries, with notably strong performance in countries like Germany, Poland, and the Nordics and from brands like Jacobs and Gevalia.

The organic adjusted EBIT decreased by 17.9%, to €468 million in H1, due to lower volumes, as well as the timing of price increases. The three-year organic adjusted EBIT growth was virtually flat at minus 0.9%.

In CPG LARMEA, prices started to go up relatively early in 2021 and continued to increase in H1 to compensate for high input costs and foreign exchange effects on product portfolio with a relatively high proportion of Roast & Ground. This led the organic sales to increase by 45.2% with a notably strong performance in Brazil, where recent portfolio optimisation in Roast & Ground, and the continued expansion in Capsules through L’OR, Pilao and illy, is fuelling growth.

South Africa and Turkey delivered record growth, driven by strong activation of Jacobs both in-store and online. Organic adjusted EBIT increased by 57.8% in H1, which reflects a low base of comparison due to the timing of price increases last year and was driven by higher pricing and operational leverage that was partly offset by higher operating expenses. On a three-year CAGR, the organic adjusted EBIT growth was 19.6%.

In CPG APAC, various markets were either confronted with new lockdown measures and/or continued to be impacted by the aftermath of previous measures, which limited performance and most notably the recovery in the Away-From-Home business. Along with pricing, the organic growth of 9.2% was supported by strong volume/mix performances in countries like Thailand and Malaysia and from brands like OldTown, Moccona and Super. China also continued to deliver a strong performance despite the lockdown measures.

The adjusted EBIT for CPG APAC increased organically by 8.2% in H1, driven by higher pricing and operational leverage, which was partly offset by targeted marketing and other investments behind strategic growth opportunities. On a three-year CAGR, the organic adjusted EBIT growth was 15.2%.

At Peet’s, the Away-from-Home business continued to benefit from the ongoing rebound in Out-of-Home consumption, delivering mid-teens same-store sales growth in its coffee retail store network in the US as well as continued strong growth in China, despite lockdown challenges. At the same time, Peet’s CPG business delivered high single-digit organic sales growth in H1, despite a relatively high base of comparison. On a three-year CAGR, Peet’s CPG business delivered low-teens organic sales growth.

Adjusted EBIT increased organically by 2.8% to €60 million in H1 22, reflecting increased strategic investments to increase household penetration. Based on a three-year CAGR, the organic adjusted EBIT growth was 10.4%. The Out-of-Home segment significantly benefited from the continued lifting of lockdown measures in the first half of 2022.

As a result, the organic sales increased by 40% with particularly strong performances in countries like Germany, The Netherlands and France and from brands like Douwe Egberts, Jacobs and Gevalia. As a result of this strong, volume-driven rebound and the structural cost measures that have been implemented since the start of the pandemic, the Out-of-Home segment organically increased its adjusted EBIT by 134% to €53 million, compared to €22 million in H1 21.

Let's now take a look at our underlying profit in absolute terms and per share on the next slide, slide 18.

Our underlying earnings per share increased by 18.3%, or €0.16, to €1.05 in the first half of 2022. As you can see on this slide, almost half of the increase was driven by operational improvements, fuelled by a structural decrease of our adjusted net financing cost as a result of deleveraging, the substantial reduction of our average cost of debt following the debt refinancing we completed last year, and an increase in interest income due to higher interest rates. I will come back to our debt structure in a minute.

Next to these operational improvements, our underlying profit also benefited from positive fair value changes of derivatives and FX favourability which were partly offset by slightly higher underlying taxes.

Let me now share a bit more detail on our free cash flow and net debt developments on the next slide.

In the first half of 2022, our business delivered a total free cash flow of €696 million, which is €143 million more than in the same period last year, taking our three-year average free cash flow conversion to 77%. And as you can see on the right-hand side of the chart, without the €500 million share buyback we did in May, our strong free cash flow would have lowered our net debt by more than €300 million to just below €4 billion as we maintained discipline across all the lines, including lowering our net interest obligations while investing behind our strategic growth opportunities and adhering to our capital allocation priorities. Including the share buyback, our net debt was €4,435 million at the end of the first half of 2022.

On the next slide, slide 20, you see the overview of our debt and leverage evolution, which shows that our leverage is relatively stable since year-end 2021, increasing only by 0.1 time since year-end 2021 to 2.78 times, including the €500 million share buyback I just mentioned. At the time of our decision to proceed with the share buyback back in May, our leverage was around our optimal leverage, and without it, our leverage would have been 2.47 times, just below our optimal leverage midpoint.

Furthermore, as shown in slide 21, our debt has a strong maturity profile, with an average maturity of 5.4 years and no bonds maturing before the end of 2024. In other words, we currently have no funding needs for 2+ years, which positions us well in the current rising interest rate environment, as most of our debt is fixed rate.

Also, each year of annual maturities is significantly below our average annual free cash flow generation. And our average cost of debt has been reduced further, coming down from 240 basis points at year-end '20, which was before our refinancing, to only 50 basis points as of the end of H1 22. As a reminder, none of our debt contains financial covenants.

Also, our total liquidity increased slightly from €2.1 billion at the end of 2021, to €2.2 billion at the end of H1 22, consisting of a cash position of over €700 million and available committed and fully undrawn RCF facilities of €1.5 billion.

Before concluding and moving to Q&A, I would like to briefly remind you, on the next slide, slide 22, of our capital allocation priorities as first shared with you during our Strategic Update Meeting last year.

Our capital allocation framework guides us as we create long-term value. Our first capital allocation priority is to reinvest in our brands and the growth opportunities within our business. Our second priority is to deleverage, as we target an optimal leverage of around 2.5 times.

Our third priority is to continue to pursue inorganic growth opportunities but always in line with our highly selective business and financial criteria. Our fourth priority is to use excess cash to contribute to shareholder remuneration through stable dividend flows that we expect to sustainably grow over time. And while our leverage is above our optimal leverage of around 2.5 times, we do not prioritise share repurchases.

In this respect, the €500 million share buyback we executed in May was in line with our capital allocation priorities, as it not only presented a unique opportunity to buy back shares from our second largest shareholder at an attractive price without negatively impacting our free float, which has been increasing over time, but it was also transacted at a time that we were around our optimal leverage.

So this brings me to the end of our prepared remarks. And with that, I will now turn it over to the operator to start the Q&A.

Questions and Answers

Operator: And ladies and gentlemen, we are now ready to take your questions. So if you wish to ask a question, please press zero-one on your telephone keypad. That's zero-one on your telephone keypad to ask a question. Please remember you are limited to one question and a follow-up per round. Our first question comes from the line of Jeremy Fialko from HSBC. Please go ahead.

Jeremy Fialko (HSBC): Hi. Morning. So a couple of questions from me. First of all, can you talk about the payables number in your working capital? There looks to be an incredibly strong inflow from that within the period.

And then, secondly, can you talk about the Russian business? I know that is where you are still operating. Can you talk about the performance of that business within the half the extent to which it contributed to the results? Thanks.

Scott Gray: Sure. Thanks for the questions, Jeremy. So this is Scott. Why don't I start by answering the first one and then Fabien want to complement, and then maybe I'll let Fabien answer and start on the second question in regards to Russia.

So on working capital and specifically on payables, as you know, there is an increase there. I mean, let me just step back a little bit to working capital and the contribution there in terms of cash flow. So we did not have – and I think the important thing is to look at the beginning of the period, which is the end of 2021.

Actually, if you look at our working capital overall in terms of what it contributed into cash flow, actually when you look at it and you adjust for the currency reval, the working capital overall was unchanged more or less from the year-end level, which means that we've been able to sustain what we built over last year in the first half of this year. So no major changes on working capital overall.

If you look at payables, there is an increase. Now again, you have to adjust for the currency reval as well. But there is an increase. And this is mainly related to price inflation on our raw material inputs. And also there's an impact of more safety stock here because with the supply chain disruptions, we're being very intentional to carry further safety stock. And you see that coming back in inventories as well as you also see the increase there by both price inflation as well as the safety stock.

No major change on receivables. And as you net out those, you can see that this is roughly flat, so it's tough to compare H2 versus in H1, but if you look at the end of the year period not too many changes. But again, the payables and the inventory is driven by pricing as well as the increased safety stock as we hold more inventory. And you see that also coming through in the payables as you build that. So hopefully, that addresses your question there.

And on the second question, I'll let Fabien start on that.

Fabien Simon: Hi, Jeremy. Good morning. Thanks for your questions on Russia. Look, so we have been communicating very clearly our positions at the AGM we have had in May of this year, and we continue to operate in Russia and be in full compliance with all applicable sanctions. And the reason to keep business was not a financial or political motivated reason, but simply to keep providing essential food to the population.

You should know that in Russia, one egg, one glass of milk, one piece of bread or one cup of coffee and tea is qualified as essential and cost around €0.02 to €0.15. And coffee when at the lower side, I think that's €0.03 or €0.04 if my memory is correct. But of course, I mean, it's different than before without any doubt, and we have been taking measures.

So we stopped all advertising since day one in Russia, but as well in Belarus. We stopped capital expansion that we had there. But we have as well reduced some sales activity. And as a consequence, we have even been losing some market share in Russia to local, but as well to international players.

But what we are doing now is, of course, we are monitoring very carefully the situation. And we are taking actions to ensure that the business is structurally ringfenced that could give us options for full flexibility in the future, depending on how the situation evolves.

Jeremy Fialko: Okay. Thank you.

Operator: And the next question comes from the line of Jon Cox from Kepler Cheuvreux.

Jon Cox (Kepler Cheuvreux): Yeah. Good morning, guys. Jon with Kepler Cheuvreux here. A couple of questions for you. Just on the volume/mix, specifically in the European market, just wondering what you saw towards the end of the period, as you mentioned that market share is coming back. Are you seeing some of that volume decline we saw in Europe actually look a bit better as we got towards the end of the period if everybody else is now increasing prices and maybe you're getting back on to some of the lists there?

Second question, just on – and I know you're not looking at the adjusted EBIT margin. But it tends to be a bit of an obsession, I think, on our side of the table. Just given all the price increases you've done, you had a 16.2% adjusted EBIT margin in H1. I guess that's the worst of it because some of your stuff is starting to roll over in terms of price increases. Any reason why you can't get to that 16.2% in the second half of the year?

And then just a last question on sort of margin rebuild in the future. Will you be looking to rebuild that margin, which obviously you've lost a fair chunk over the last year or so well over 300 basis points or so as some other companies out there, some of your competitors are saying they'll be looking to rebuild the margin in the medium term? Or will you just maintain this sort of like mid-single digit adjusted EBIT growth? I just wanted trying to work out, is there some sort of catch-up factor we should think about? Thank you.

Fabien Simon: Good morning, Jon. So let me give a crack at it. So first question is on Europe, second on margin. So – and actually on Europe I might give a bit of a broader perspective in European performance. And Scott has been touching already on quite a few of them.

I think there are four reasons that explained the performance in Europe, that's what you see in H1 of this year. So the first part is the comparison to last year, which was still greatly boosted by the In-Home retreat at the time of the pandemic. But if you look, we got some like-for-like volume downside in H1 for this year in the European segment. But we got it back fully on the Out-of-Home segment, which is mostly in Europe as well on our side, as you could notice with more than 30% growth.

And when you look at Europe on a three-year compounding basis, the top line is growing meaningfully but – and top line – bottom line, sorry, is stable with increasing marketing investment, which is a very good performance.

The second reason is short-term volume impact, lower promotions to be transparent at kind of pricing negotiation and implementations. But there again, we shared that our market shares are back, even in Europe on the latest Nielsen report.

The third reason is implementation of price increases, and you called it out, took a bit more time than in some other markets with later impact on the P&L than the cost inflation hit, which was a bit earlier.

And finally, we refused to cut marketing investments this year in Europe and even slightly increased the advertising spend. Maybe I'm going to share too much data here, but by more than 6% in H1 of this year. So there is, for me, nothing worrying about the European performance because what matters most is the good exit level in June on price increase, on P&L, and on market share.

And you are right to call out, our Q2 performance in Europe was greater than in Q1. And I am really proud of the rigour that our GMs in Europe, what they've been displaying to get solid double-digit pricing, which we know is something very difficult to implement in Europe, and we have never been able to deliver in the past in the company.

Yet, it might not be the end of the story. We know inflation is a non-ending – cost inflation is a non-ending journey as we speak. We might have to replicate some similar experience in the second part of the year. And if we have to, we will. And we know that the performance at the end will get stronger than before we started.

On your question on margin, I know you called it out as an obsession in some communities. We have been saying since the day of the IPO that on a pure-player coffee company with the volatility of the green coffee, it is the wrong indicator on the margin and on the EBIT level, at least when you look at the performance on a short-term basis. Of course, over time, as the volatility normalises, you always operate in a similar range.

So what you have seen today is not at all for me something that has to be rebuilt because it's a word you have been using, but more something that will naturally normalise. Look, today, the coffee price is much higher than the cost of production. We know it in the natural – it will come back to what it is. So we – do I know when? H2 of this year, H1 of next year or in 2023? I don't know. But I know it will normalise, which means that our margin will come back to where they were with the same level of green coffee. And us, I don't know, in the meantime, continue to have a very resilient cash flow and absolute profit in the meantime.

Jon Cox: That's very reassuring, Fabien. But just to push you, on the 16.2% margin here in H1, is there something coming down the pipe in terms of more SG&A spending we should expect in H2? Otherwise, given where we are in the cycle, you would imagine that you can just maintain somewhere around a 16% margin in H2?

Fabien Simon: Yeah. What I can say on A&P because I understand it's more on marketing investment. It's a good set of questions. You know that it was a commitment to reinvest, which I made starting in 2021 because it is what our brands deserve and what our brands need. And we started to do that in a very meaningful way last year with, if I could remember, 30% increase in our A&P in 2021 versus '20.

And I'm really glad we did it, not only it proved to drive higher organic growth but as well increased our brand equity, which is important at the time of price implementation. I don't see we would have had the ability to put pricing through without the support we have been doing last year with our brands. But as well, it's going to be very important to continue to drive long-term growth.

I believe that the level of investment we had in H2 of last year was competitive. And I'm pleased we continue to increase the level of advertising and working media in H1. And if I look today, we are what I will call an inch below the 2019 level, which is a pretty good performance that we have been doing over the last two years. And today, the data suggests that our shares have virtually improved because while we refused to reduce our investment, some other players of the industry did.

So naturally, the exposure of our brand is greater. So as far as H2 is concerned, would we spend more in H2 that we had in H1? Yes, we will. But of course, we will be reasonable. And we will look at places where we see incremental growth opportunities; and sometimes growth opportunities require you to invest a bit ahead of the curve. But we will be very reasonable. And it's something that's why you have seen on the outlook again, we have been dealing with shaping in the same way of beginning of the year. And I trust that people realise that we have been very disciplined in the way we've executed that including on our marketing investment.

Jon Cox: Thanks for that. I want to just have a quick follow-up, just more of a technical one, maybe for Scott. Just on CapEx for the year. It looked a bit lower in H1 than it was a year ago. Any – is it just more seasonal and you should be somewhere around the €260 million, €270 million by the end of the year for both tangibles and intangibles?

Scott Gray: Yeah. I would say on CapEx, I mean, there is nothing intentional on our side in terms of the reduction versus last year at the same period of time. And there is always going to be a little bit of different phasing that you have in the years, particularly this year with all the supply chain disruptions, as a lot of our CapEx, as Fabien mentioned, is growth CapEx. And some of these projects where it’s actually more challenging to get the delivery of the equipment on time, so we do have some delays in CapEx. But this is more on the supplier side than on our side. So we do expect to have higher CapEx going forward in the second half than the first half.

But it’s – I think, overall, the level of CapEx can be a little bit below full year ‘21. But again, that’s not intentional on our side. So we’re going to continue to put our strategic investments there on CapEx. But just explaining a little bit why it’s lower in H1.

Jon Cox: Thanks very much guys.

Scott Gray: Sure.

Operator: And the next question comes from the line of Faham Baig from Credit Suisse. Please go ahead.

Faham Baig (Credit Suisse): Morning, guys. Thank you very much for the questions. A couple from me as well. Can I go back to Europe, and are you able to shed a bit more light into the performance by technology? I’m particularly interested in the performance of single-served and Nespresso compatible capsules in H1. And if you could shed light on market share, that would be helpful.

And the second question is the input cost inflation or the cost inflation you’ve seen in H1 of 36%. Is that a reasonable estimate for the second half, or do you expect it to be higher or lower? And if we – and just with regards to that, I guess, you will have better visibility on second half costs and outlook. Why are you not able to give an EBIT guidance for this year? And would you, for example, be able to comment on where consensus is of €1.23 billion? Is that a number you endorse? Thank you.

Fabien Simon: Good morning, Faham. So I noted three questions: market share in Europe, input costs and a challenge on the outlook guidance.

So let me start with Europe, and your question was specifically on market share on capsules. Our single serve business in the first part of this year grew at a low single-digit level. This might sound low, but in reality, it is really a comparison basis to a very elevated level last year, if you look on a three-year basis, and it’s a compounding average growth of capsules, as you were calling out, have been double-digit level.

And when we look at the latest period market share, which was your question on NCC, it stayed firmly in the low 40s, quite aligned with those of Q2 of last year and makes us a firm leader in modern retail. And given the pipeline of innovations activities we have, I’m pretty confident that we do have what it takes to secure this level of market share.

On input costs, I will probably answer at – first at a generic level and then shine a bit more light on JDE Peet’s. At least at generic level and again, not JDE Peet’s, but I’m really talking broadly. I am of the opinion that the peak of inflation is not behind us.

But yeah, still inflation to come with some coming directly or indirectly from energy inflation, from salaries, from weakening of the euro that increased the level of imported inflation on commodities, and possibly as well cost inflation from more insourcing in Europe, for instance, over time.

But then now if I look at JDE Peet's, I would say we are not immune from some of the changes I have just been quoting. And we foresee, for instance, today already some more increase in energy costs, but as well on green coffee because of the weakening of the euro. I mean landed cost in euro, we see still further inflation. Yet, and in a certain extent, it might be strange for me saying that, but it was almost a blessing for us that we were the first and the most hit by inflation with our main input cost being green coffee, because future costs increases beyond coffee, likely weigh much less on our cost of goods sold than at most of food and beverage companies.

But as well as a consequence, we had been already putting the majority of the pricing necessary through. As I have answered earlier to Jon, coffee is tracking above its cost of production. So some input costs will go further up, but coffee at some stage will go down. And net-net, we should be better than many other players, where cost inflation is catching up at a greater level. But we can't really exactly predict when.

And if you look at – and your question the 36% again on the inflation we have had in H1 of this year, this 36% were on the base of very modest inflation in H1 of 2021, which was around 4%. We don't see this 36% going down at least a similar level. But it's going to be as well on the basis of a higher level of inflation already happening in the second part of last year, which was almost double-digit level.

So you can read between the lines that it means that inflation is not going down but is likely going to go up. And that's why we know we will have to go for another wave of pricing. But definitely, I would say, the big bang is behind us, if I can use this language.

Your last question was on outlook – on the outlook. Look, I think I would love to be helpful here. But we are not operating in calm water anymore. Like a few years back, where it was pretty easy to give six months of your outlook without much risk. And I would say even with a lot of contingency to ensure we would deliver. We are now in a highly volatile environment. And it's difficult to really to give precision on things we control maybe a bit less.

Yes, we feel very comfortable to guide with the same framework we gave at the beginning of the year, as I think it reflects the way we are operating the business in the volatile environment.

And to be fair, I think it gives a very good level of comfort on the most important metrics at time of elevated inflation, which is resilience of cash flow, resilience of gross profit. But at the same time, a good level of comfort that we continue to support our brands, which means that we will continue to invest and to fuel longer long-term growth.

But as I was alluding to a bit earlier, we are very reassured by H1. But we know that six months doesn't make a year either. We'll have a tough year comparison in H2 versus last year because last year, we already started to deliver the very elevated organic growth of about 8%. We had recovery on the Away-From-Home, where we are already reaching quite an elevated level at this stage. And we are going to have more inflation and more pricing to put through.

So we know we still have some work to do. We are geared for it. We are prepared for it. And we believe we will deliver it.

Faham Baig: Thanks, Fabien. That's a very helpful answer.

Operator: And the next question comes from the line of John Ennis from Goldman Sachs. Please go ahead.

John Ennis (Goldman Sachs): Hello. Good morning, everyone. Yeah, a couple for me as well. So I want to come back to the European volume/mix trends. So within the 7% decline in 1H, you didn't call out delistings in your four buckets to a previous answer, Fabien. But was that a driver? And if so, can you maybe quantify the impact from retailer delistings within the 7%? And it would be helpful maybe if you could break that down between volume and mix? I know it's a lot of additional detail. But it would be helpful for us to understand the breakdown between those two components, even just roughly speaking.

And then my second question is coming back to the gross profit guidance. I suppose in answer to the question just before, you've effectively said that you're at least passed the peak for inflation on a year-on-year basis. I appreciate inflation is still going up but given that some of that's already in the base on a year-on-year basis, it sounds like it's not going to be as bad as the 36%. So on that front and given that a lot of the pricing momentum, I guess, sustains, you're really guiding the gross profit down in 2H relative to modest growth in the first half.

I mean, what's the big driver of why you think that's going to be negative? Is it because you think volume/mix could be a little bit worse, is it because you're a little bit more nervous about taking the additional price increases that are needed? A little bit of context as to why gross profits are going to be down 2H versus the sort of positive momentum in the first half would be helpful. Thank you.

Fabien Simon: Good morning, John. Let me start with Europe. Yeah, I want to be helpful, but as you can imagine, I can't give that level of granularity you're looking for. But maybe to help a little on more public data, the volume in Europe – I'm not talking JDE Peet's, but all players in Europe on the geography where we operate was down about 6-6.5% in H1 of this year. So it can put into perspective our performance.

And again, that's why I've been quoting some short-term challenges with some volume disruptions. We have not had delistings. We've had moments where product were not on shelve , but things have been coming back. It was not linked on the delisting. But what matters for us most is how we have been outperforming and getting back our market share at the exit level of June.

On inflation, I think I've been answering that question. Yes, the majority is behind, but there's still inflation to come. And I would expect the level still to be at or above the one we have had on a percentage basis in H2. And we have not been giving an outlook or quoting decline on our gross profit in H2, because we've not been giving any guidances other than the full year outlook with, I'd say, at least a stable gross profit for the full year.

John Ennis: No, I understand that. But I guess, given that you grew gross profits in the first half, I guess the implication for the second half is for gross profit, modest declines to get to flat? Or are we being a bit too explicit about the term flat for the full year?

Fabien Simon: Look, I don't want to play much on the margin on the percentage here. As I said, we are still living in a difficult environment. We know we're going to have more pricing to go through in H2. We don't know yet what will be the consequence to consumer of the entire inflation on the food basket and how that will turn in the second part of the year. And I think here, we are talking really on the margin. But I'm really expecting to deliver, I would say, at least a positive year-on-year gross profit level.

John Ennis: Okay. Perfect. Thank you very much.

Operator: And the next question comes from the line of Celine Pannuti from JP Morgan. Please go ahead.

Celine Pannuti (JP Morgan): Yes. Thank you so much. Good morning. First of all, I wanted to thank you for the added disclosure and giving us back the volume and price mix by division too. Thank you for that. That's very helpful.

So my first question is on rebounding a bit on Europe. Maybe two questions in that. First, you – promotional level, my understanding is that you said, in fact that they were coming – they have gone down in H1 and that contributed to your profit performance, operating profit. So am I right to expect it to go up in the second half? And just to clarify, you mentioned promotion in SG&A; but is it fair to assume that it's netted off the sales price level in your reporting?

The second question that is maybe corollary to that. What is your best guess about what could happen in terms of either supply chain disruption for you in Europe from the higher energy level? Is it just about high-cost inflation or are you expecting potential packaging disruption? And what do you think will be the impact on volume from consumption? I'm quite surprised to hear that the volume in coffee was around 6%. I mean you've been saying that the category was quite defensive. So could it be even higher as we go into the second half?

And just lastly, a subsidiary question. Can you – you had a big hedging gain in net income. How do we model our net interest line, please, for the year? Thank you.

Fabien Simon: Good morning, Celine. So I will answer the first part and then pass it over to Scott. So thank you for the positive feedback we have been – we are learning, and we have been listening to some of the feedback we have been receiving over the last two years and have increased our disclosure in H1.

And maybe one thing to be more clear about when I was quoting the volume decline in Europe, I was not quoting a volume decline, which is a consequence of the price inflation. I was quoting the market volume decline comparing to an elevated level of growth last year, which was still boosted by In-Home drinking. And I think it's a very important distinction, because so far, we have really not seen any trade-down or trade-off across geography or across categories. And that's why we love this category very much.

And on Europe, you were asking some precisions around promotions. Yes, the promotional level went down for a few reasons. First is the first two usually you use in some places to manage pricing inflation. But as well, it's a tool which is used either by us or by the retailer during the negotiations. So the overall quantum of it has been reducing with some negative impact on top-line with some positive impact on the – below the gross profit.

But also our promotional level below the gross profit is slightly down in Europe, our absolute A&P advertising went up, which means our A&P was broadly stable.

And this has not been a driver or a positive driver that could explain the bottom line in Europe. And we'll continue to monitor that carefully and continue to invest at the right level behind our brands.

You quoted energy. I think it's obviously a big theme at the moment, where the tragic war in Ukraine has had a lot of implications, including on energy. But today, energy is a small part of our cost base. And we believe that the exposure for us should not be that significant, I would say, manageable, is significant for everyone, but it's manageable on the cost side. And we believe it's going to be mostly a cost-question on a short-term basis.

Yes, we don't want to take any risks, because at the end, nobody knows if there will be some form of rationing of gas, for instance. So we are already increasing our inventory level to ensure it will be good for the winter to come. We are investing and looking to transition some form of energies in some of our plants, in particular in Germany.

We do have some other plants in Europe, which are absolutely not exposed at all to gas, for instance, coming from Russia. And we will leverage on this network of factories to help in case there will be some short-term disruptions.

So overall, we feel good. But we have as well to stay humble. Nobody can really predict what will really happen there. But we take on our side the necessary actions on what we can do to avoid the possible disruptions.

Scott Gray: Yeah. And then I'll take your last question in regards so into the hedging gain and what you can expect to continue. So you're right that in our net profit, we did benefit from derivatives. And actually, one of the things that we did was we excluded that positive contribution from our underlying profit. And that was mainly driven by legacy derivatives that no longer need to be in place on the back of a refinancing, and it was also related to quite a strong view that we had on rates. So we have terminated those and we have locked that positive impact. But again, we removed that from the underlying profit and consider that a bit of a one-off.

Now one of the things that you see that we did, and we have been doing that for a period of time, is we always split all our underlying profit and EPS between operational improvements and other improvements. And there are some things on the operational improvements related to financial income and expense that we believe are structural. And of course, a lot of those are a consequence of the multiple refinancing transactions that we executed in 2021.

Now there are some other improvements that come from the financial line as well. And that's mainly related to non-FX derivatives and net results related to some of our natural mismatches that we have in our operational hedges as, of course, the exact timing, percentage cover, things like that, can vary and sometimes that can trigger results in the P&L. But I think the main takeaway there is we've put that in other improvements because those are things that are more market-driven and that we can't count on. So the structural items, we expect to continue with some benefits. The other items are subject to market, and that's why we've split them out into other. Hopefully, that helps.

Celine Pannuti: Thank you.

Operator: And we will now take the last question from the line of Tom Sykes from Deutsche Bank. Please go ahead.

Tom Sykes (Deutsche Bank): Yeah. Morning, everybody. Thank you. Just following on from the comments that you made on energy. I mean you're broadly 60% natural gas. So what level of energy cost increase are you expecting in the second half of the year at the moment? And what degree of hedging or forward buying do you have on your energy costs, please?

And then just on the Out-of-Home business, sequentially, the profit was down. Although year-on-year, it was up quite a bit. Sequentially, it wasn't down – it was down – in euro terms. So what is the operational leverage that can still come from Out-of-Home? And to what extent will there be some – yeah, some operating profit improvement in Out-of-Home in the second half of the year, please?

Fabien Simon: Good morning, Tom. Let me start with the energy. So I am afraid I'm not going to be able to answer really in detail that level of information, as you can imagine, it's rather competitive level of questions here.

But you have seen in H1, the energy being for us increased by 100% because all the numbers we have been quoting on the presentation are not market costs but really what has been hitting our P&L. So we are going to be more transparent than many players there. We can't push the envelope to get more transparent on our hedging and cost inflation for H2.

But I hope we have been building the trust over the last couple of years that we have been proving to be pretty disciplined on the way we are managing costs, but as well the relative impact on gross profit. On the Out-of-Home side: you might recall that at the back end of 2020, we shared the view that it might take three years to get Out-of-Home back to recovery to pre-pandemic levels.

So far, we are on the path towards it. On the revenue side, we crossed the 70% mark pre-pandemic level in the full year 2021. In the beginning of this year, we noted another strong step-up. And we're well crossed the 80% on a like-for-like basis with the very meaningful operational leverage. You can see how much faster our bottom line is recovering than our top-line in Out-of-Home.

Obviously, there is still some work to be done. It's still some way to go to full recovery, especially on areas like offices, and like on healthcare places where we are exposed. But I would say that, so far, we are on track. We see very solid accumulated progress. And we are still on the three-year time horizon and still some work to be done up to the exit of 2023, where we would expect still some recovery to happen even on the bottom line.

Tom Sykes: Okay. Thank you. Could I just ask very quickly, is the energy intensity or the gas usage, if you like, similar across all technologies, so Single Serve versus Roast & Ground or so? Is it a higher use of natural gas in certain technologies, please?

Fabien Simon: No, it's not. And again, I will be careful to not talk too much. But I think where you have a higher level of intensity is mostly on roasting, which you have to do on whatever type of technology you use. So it's the same for absolutely everybody, and more use of gas in instant technologies than you would have in Single Serve. And I think that already saying that

I've been sharing a lot. And try to appreciate as I can't go more far than that.

Tom Sykes: Yeah, sure. And I appreciate it. Many thanks indeed.

Operator: Thank you very much. And I would now like to hand the call to Robin Jansen. Please go ahead.

Robin Jansen: Thank you, Nazanin. Ladies and gentlemen, thank you very much for attending today's earnings call and for taking part in the discussion about our results. If you have any additional questions, please do not hesitate to contact the IR team. We're happy to answer your questions. And again, thank you very much, and enjoy the rest of your day.

Fabien Simon: Thank you.

Operator: This concludes our conference call. Thank you all for attending. You may now disconnect your lines.

[END OF TRANSCRIPT]