Transcript Earnings Call related to JDE Peet's' H1 2023 Results

Operator: Good morning, and thank you for joining JDE Peet's Half Year 2023 Earnings Call. My name is Marion McCarthy, 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 is being recorded. Following the presentation, there will be an opportunity to ask questions. If you do have a question, please press star one on your telephone keypad. If you wish to withdraw your question, you may do so by pressing star two to cancel.

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

Robin Jansen: Thank you, Marion. Good morning, everyone, and welcome to JDE Peet's earnings call related to our financial performance for the first half year of 2023. 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 2023. 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 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 gladly hand over the call to you, Fabien.

Fabien Simon: Thank you, Robin. Welcome, and thank you everyone for joining the call today.

Looking back at the first half of 2023, I believe that we delivered a pretty satisfactory set of results. In a context where the business environment very much reflected a continuation of the second half of 2022, with both inflation and a post-pandemic transition with consumers spending less time In-Home, our financial results are showing a meaningful improvement compared to H2 on both volume/mix and adjusted EBIT.

Additionally, we are very encouraged to report that the transformation we initiated 2.5 years ago, is bearing fruit, with now market share outperformance of JDE Peet's in the coffee category globally. Delivering this, at a time of historical cost inflation and where we made the difficult choices to lead on pricing, I think is a testament to the strength of our portfolio and of our pure-player competitive advantage.

Here, I would like to take the opportunity to thank our teams across the globe for their passion, dedication and drive to make this solid set of results possible.

It is important to say that we are, and will remain humble, as we want to perform and create value for the long term, and we are cautious that some areas are not at the standard level we have set for ourselves, such as the pace of recovery of our European performance.

So in H1, we delivered an organic sales growth of 3.5%, driven by strong growth in our premium product portfolio, in Away-from-Home, in eCommerce, in the US and overall in the emerging markets.

We saw a moderate decline in volume/mix, while pricing was up 6.8% in H1 on the back of 16% pricing already taken last year. The volume/mix decline is caused by Europe, where we did see improvement versus H2 of last year, but the recovery progressed somewhat slower than expected. Our disciplined approach to pricing, cost control and mix management, increased our absolute gross profit. This helped to absorb part of our advertising spend that increased at high single-digit level, which is a much lower level than last year. I think this reflects our inflexion point on the investment reset, as we now have our spend higher than the 2019 level, which is where we wanted to be and where we needed to be. As a result, our adjusted EBIT declined by 3%.

In the first half, we also saw the anticipated normalisation of our working capital coming through, however, our net leverage remained well below three times. I will come back a bit later on the market share developments, but wanted to highlight here three key geographic topics we communicated over the semester.

First, in a category with increasingly blurring channels, we are replicating our global model, by moving to an integrated omnichannel organisation in Europe. This will drive simplicity, efficiency and is a reconfirmation of our commitment to leverage on Away-from-Home as a channel of brand building.

Second, in Russia, after the first steps we took in 2022 right at the start of the war in Ukraine, we are now transitioning to a local portfolio, that we expect to be completed by the end of the year.

Finally, we are excited with the prospect to expand further in emerging markets, with the intended acquisition of Maratá Coffee & Tea that we announced a week ago. Here as well, I will come back to both Russia and Maratá in a few slides.

But let me now go to the next slide, slide six, and provide a bit more colour on our top line performance.

As I alluded to earlier, and besides the ongoing discipline on pricing across all geographies, H1 witnessed another step of transition post-COVID-19. Globally, the industry reported about 4% volume decline in In-Home consumption, and further traffic gains in Away-from-Home.

In other words, consumers do not drink less coffee and tea when at home, but are just spending less time at home versus last year. Our revenue per channel is reflecting this trend, with Away-from-Home growing almost double-digit and now back to pre-COVID in absolutes, while our In-Home organic sales growth was 2%.

Outside Europe, we compensated the In-Home category decline with market share gains, which explains why three out of our four segments reported revenue growth between 5% and 10%. It is worth noting that, globally, we grew aluminium capsules, which is always an attention point from this audience, at double-digit level with solid mid-single-digit volume growth.

Similarly, our eCommerce momentum continues with, for example, over 30% growth in DTC. We believe that in H1, we see the inflection point of the post-COVID transition that started in 2022, and as such, explains why we are anticipating some growth acceleration in the second part of the year. But before putting back our H1 in light of our strategic priorities, and with more details on key regions, I would like to share how we see cost inflation evolving.

Although many could have hoped that this year would show a meaningful reversal in inflation, the first six months have clearly shown that this is still a meaningful reality we have to deal with in 2023. After two years of elevated levels of inflation, as high as 30% of COGS in 2022, we, again, had to deal with a double-digit level of inflation in H1. Besides high green coffee prices, we are witnessing a spill-over of inflation into packaging, salaries and services.

Lately, on the coffee commodity side, in front of some softening of Arabica prices, the market for Robusta is now trading around a 15-year high level, and the cost premium for responsibly-sourced coffee is increasing double-digit. Net-net, we are expecting now a high-single-digit COGS inflation for the full year.

As we demonstrated since 2021, we will be disciplined on how to manage inflation. Further cost inflation will mean further pricing going forward, but basically more modest as we are entering into disinflation.

Let's now go the next slide, and have a look at the three strategic imperatives that we are focussing on.

As part of building a unique and stronger pure player, one of our objectives is to become more global, from a legacy-anchored European business. In H1, Europe represented 57% of total revenue, from 70% in 2019. And let me provide a couple of examples of what we are doing on this front.

First, and this is key to me, we focus on building quality market shares as opposed to buying short-term market share. To do so, we have reset how much and where we invest in brands, in innovations, in capabilities and in sustainability. We are building new growth pools in the US and Greater China, as well as in some selective emerging markets that are all together growing at a much faster pace than Europe.

Next to the organic way, acquisition can accelerate the transition as well. And here, the intended acquisition of Maratá in Brazil is an excellent example of becoming even less dependent to Europe.

In a more fragmented world, global development can also lead to local adjustments, like in Russia. Transitioning to a local portfolio will lower our overall exposure there on both top line and bottom line.

Additionally, in a world where the use of distinct channels by customers and consumers is blurring, where consumer-facing and relationship is key, we had to adjust, and we are doing it at pace. At the end of H1, 40% of our media spend is digital, and I am very pleased with the acceleration of our eCommerce capabilities and performance, visible with our revenue growing multiple times faster than off line.

We had to adjust our organisation in Europe as well, in a similar way as in our other regions, to leverage our brands on wherever consumers go. The transition is well under way, and is expected to be completed by the beginning of Q4.

Third, we had to play our part to embed and ensure an inclusive ecosystem, as this is the only way to guarantee sustainable value creation over time. We came from far, with not much agenda, other than a long term intention in the past. But I am now proud to get ESG embedded throughout the organisation, and now visible into our innovation pipeline and brand meaning.

Next to that, we acknowledge that it is important for the equity and debt holders to get visibility on where companies stand on ESG. And here again, we made solid progress with holistic external ratings and regular updates on our progress and objectives.

Now let me go to the next slide, and share how much our strategic focus and the disciplined execution of our plans is paying off.

The slide shows the last three years market share evolution, tracked by Nielsen, in all the JDE Peet's geographies. So at a time when we took the lead on pricing, and when private labels are gaining momentum across geographies, we are very pleased to report a slight total market share outperformance. With 5% compounded value retail sales growth since H1 2020, it confirmed that we reshaped JDE Peet's from an historical underperformer, to now growing at par, if not slightly ahead of the attractive coffee market.

I shared a few times the view that there are likely going to be two long-term global scaled winners in this category, with JDE Peet's, and the current global leader that I do greatly respect, because it sets high standards. And there will be some moments when one will grow ahead of the other and vice versa.

Today, we are humble to share that against the high-performing global coffee leader, our share performance can be very competitively benchmarked over the most recent history as you can see on the right side. I read in these numbers the strength of our portfolio, from consumer appeal, to pricing power, but as well as the result of the choices we made, with a discipline in execution. I guess the next slide will reinforce that point further.

On this page, you can, in a very transparent way, see JDE Peet's' market share evolution per geography on the left side, and per category on the right side. We have been losing share in Europe, on the back of retaliations in H2 of last year, that we are slowly rebuilding, but is not yet completed.

But in parallel, our strategic acceleration in the US, in APAC and in LARMEA is more than compensating the share loss in Europe. Not only we did grow more than in Europe in these regions, but as well outperformed competition there. What we see lately in LARMEA, is negative share performance on the back of recent shares lost in Russia, of about 200 basis points last two periods, coinciding with the start of our transition to a local brand portfolio, where we noticed very aggressive competition to get volume from us.

In Europe, a good proportion of our share loss is coming from our drive to build quality market shares, and refusing to participate in value destructing activities, especially on the Roast and Ground category, visible on the right-hand chart. Actually, we are focussing our resources on the highest priced and higher margin category. Here again, we are very satisfied with the outcome and share gains in Single Serve, share gain in Instant and share gain in Beans, while accepting without any regret, share losses on some unattractive parts of Roast and Ground.

Now let me provide you with a bit more colour on the post-COVID normalisation that impacted category growth in H1.

Many industry players, including ourselves, assumed that the post-COVID normalisation was out of the equation by the end of 2022. However, we started to realise in the course of H1 this year, that the post-COVID normalisation, together with a focus on less consumption waste and some hunkering down by consumers, was impacting volumes in many parts of the world.

In Europe, our volumes were further hampered by the fact that it took longer to rebuild the distribution that we lost following the retailer negotiations at the back end of 2022. And because we continued to focus on quality market shares, some volume were under pressure as we said no to unattractive promotional propositions in various European markets.

So from here onwards, we believe that, overall, the post-COVID normalisation is now behind us. Similarly, consumers' focus on limiting spoilage and pantry-loading will most likely be less significant going forward. In Europe, distribution is now restored at the end of Q2 2023, however, more gradually than expected.

What is less clear to us at this moment is whether or not there will be an additional volume rebound on some promotional activities that we refused to participate in H1. So saying differently, if the requirements remain similar and players accepting to entertain what we consider pure volume game-play, we will not get volume back as we will continue to prioritise quality of market share and financial shape.

Now let's now zoom on other regions on other two strategic areas, US and Greater China.

In the US, Peet's continues its successful trajectory, and recorded almost 0.5 point of additional household penetration from H1 of last year in hot coffee, and is gaining shares in the majority of the states on the premium segments. Additionally, and leveraging on the successful results of our L'OR barista appliance in Europe, we have initiated a new venture, with a pilot launch in the US market, which we hope to share more on a later stage, either this year or next year.

In Greater China, we continue to roll out our successful omnichannel strategy. We do not witness slow down there. Coffee is still at the early stage in the penetration curve, and JDE Peet's' portfolio seems appealing to consumers.

Our business is growing ahead of many other competitors, at a high-teens level in H1. We mentioned in the past that Greater China has the potential to be one of the top five largest markets for JDE Peet's. In that journey, H1 marked a nice milestone, with Greater China joining the top 10 markets for the first time of JDE Peet's in revenue. We also continue to expand in emerging markets through inorganic initiatives, as you can see on this chart here.

So last week, we announced the intended acquisition of Maratá's coffee & tea platform in Brazil. There are many things we like about Brazil. It offers an attractive macro-economic landscape, it is the largest coffee market in the world, based on the number of cups consumed, and a market that we do know pretty well, with our nationwide-leading coffee brand, Pilao.

Within this attractive market, Maratá is the number two player in the north, northern regions, and generates, on a 3-year average, more than BRL $1.1 billion of net sales per year. This acquisition would represent a complementary proposition to our existing business in Brazil, which is mainly centred around the southern regions.

It will also allow us to serve more cups around a full range of price points, in a market that will offer a reservoir of premiumisation over time. As a result, the acquisition offers long-term value creation potential with attractive revenue and cost synergies. This will come with a minimal impact on our pro forma net leverage, as Maratá is a well-run company today. The transaction is subject to regulatory approval and other customary closing conditions, and is expected to be closed in 2024.

Let's now move to the next slide, slide 14, and update you on where we stand with respect to our operations in Russia that I mentioned a few times already.

First of all, I would like to reconfirm what I shared at the Dutch Parliament hearing, back in February, where we explained the three reasons why we decided, since the start of the war, to stay in Russia.

First, our products. Coffee and tea are essential products for consumers. And selling coffee and tea remains fully compliant with any existing sanctions.

The second reason is that we have an ethical responsibility for our employees around the world, including the teams in Russia. We employ a bit more than 900 people in Russia, who have no part in this war and who would be severely punished if we would shut down our business.

Third, if we would decide to leave the country, we would face the real risk that our assets and intellectual property would be nationalised by the Russian state or given to third parties in Russia. And if this were to happen, valuable manufacturing and intellectual property would in effect permanently benefit a person, company or state institution in Russia.

The other thing we did from the start was to run our Russian business as much local for local as possible to create as much flexibility and optionality going forward. And following the actions we already took in 2022, we have recently moved to the next level and have started to transition to a local portfolio of brands, which resulted in a goodwill impairment of the Jacobs brand of €185 million in H1.

We expect this brand transition to be completed by the end of 2023 and anticipate that this will lead to a substantially lower sales and profit contribution from Russia in the second half of this year, like we started to notice in May and June already.

Now before going to our outlook, I would first like to go to slide 15 to share some highlights on Sustainability.

I am very pleased with the continued progress we are making there on a topic which is well-anchored in our growth and purpose-led strategy. Let me call out a few highlights of this semester here.

Following the announced introduction of a fully compostable capsule that will be available at the beginning of next year, we lately communicated the upcoming launch of a new paper pack for our soluble coffee ranges, which is fully recyclable and is the first of its kind in the coffee market. The related SKU will generate the lowest carbon footprint within the existing range of JDE Peet's products In-Home, at about 17 grams of CO2 per serving.

During this semester, we also deployed carbon & packaging accounting that we introduced at our Capital Markets Day in January, and we published our policies on Water Stewardship and Nutrition. And as another testament to all the progress what we have been doing over the last 18 months, ISS increased our ESG rating and gave us Prime Status, which moves us right up to the first decile in our industry.

So before I handover the call to Scott, I would like to update you on our outlook on the next slide.

We expect the business environment to remain volatile for the remainder of 2023. Nevertheless, and encouraged by our topline in the first half of the year, we continue to expect to deliver organic sales growth at the high end of our medium-term range of 3% to 5% for full-year 2023, with growth acceleration and a more balanced contribution from volume/mix and price in the second half of the year.

However, as there is uncertainty on the impact of the transition from international brands to local brands in Russia, we believe that it is more appropriate to guide our full year organic adjusted EBIT growth in the range of a low-single-digit increase and a low-single-digit decrease.

Next to that, we expect our net leverage to remain below 3 times, with a free cash flow of around €400 million, post normalisation of working capital, and confirming an ongoing run rate of €1 billion on a 3-year average.

Lastly, we continue to aim for a stable dividend.

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

Scott Gray: Thank you, Fabien, and good morning to all of you. So let's go to slide 18 to take you through the most important financial highlights of this semester, and after that I will go, as usual, into a bit more detail on our sales, adjusted EBIT, the performance by segment, as well as our performance related to profit and cash, and then an update on the status of our balance sheet. I will then finish with a quick reminder of our capital allocation priorities.

Our overall organic sales growth of 3.5%, as mentioned by Fabien in his business highlights, was driven by an organic sales growth of 2.2% In-Home and 9% in Away-from-Home. In terms of profitability, our adjusted EBIT declined by 3% versus H1 22 on an organic basis, which brings the 4-year organic CAGR for adjusted EBIT to 1.4%.

We delivered underlying earnings per share of €0.85. When it comes to cash and debt, we generated €14 million of free cash flow, and our net leverage stood at 2.8 times.

Let's now move to slide 19 to take a closer look at our sales. As Fabien already mentioned, our organic sales growth of 3.5% was driven by continued strong pricing of 6.8% as we continue to pass through the necessary pricing for the continued inflation, while volume/mix declined by 3.3% as positive volume/mix growth in LARMEA, Peet's and APAC was offset by a volume/mix decline in Europe.

The negative FX impact of 1.6% was mainly driven by the depreciation of our main currencies versus the euro, such as the Turkish lira, the British pound and the Russian rouble, which, together with a minor change in scope, increased our sales by 2.4% to €3,988 million on a reported basis.

Let's now flip to slide 20 to have look at our sales performance by geography, channel, brand and category. Developed markets delivered 1.7%, while emerging markets grew by almost 10% organically. And channel-wise, our In-Home channels grew sales by 2.2% while our Away-from-Home channels increased sales by 9% organically, partially reflecting a further normalisation of the balance between In-Home and Away-from-Home consumption in the aftermath of the pandemic.

To put the normalisation into context, In-Home is still growing organically at a 4-year CAGR of almost 7%. Brand-wise, our global brands grew by 11.7%, while our regional and local brands together, delivered 1.4% growth organically.

And when looking at sales performance from a category point of view, sales of Single Serve, Beans and other premium categories like premium instants, together increased by 6.3% while the rest of the brand portfolio grew by 1.1% organically.

Let's now go to slide 21 to look in more detail at our adjusted EBIT performance. Our organic adjusted EBIT declined by 3%. What you see in the bridge on this slide is that, at total company level, we were able to increase the level of gross profit compared to last year despite continued inflation headwinds impacting our cost of goods sold. As anticipated, total SG&A increased moderately reflecting higher advertising investments and inflation. Fluctuations in FX decreased adjusted EBIT by 90 basis points and changes in scope and other non-organic items decreased adjusted EBIT by 4%, resulting in a reported adjusted EBIT growth of minus 7.9%.

On the next slide, slide 22, you see an overview of the organic sales and adjusted EBIT performance by segment.

Looking at the topline performance per segment, you can see that all four segments delivered positive organic sales growth. In three out of four segments, the organic sales growth was driven by a combination of positive volume/mix and price growth. The only exception was Europe, where positive volume/mix growth in the Away-from-Home business was offset by negative volume/mix growth in the CPG businesses.

When it comes to profitability, the picture is a bit more mixed, with LARMEA and Peet's delivering good growth, while Europe and APAC actually saw a decline in profitability.

Let's therefore now take a closer look at each segment one by one.

Europe saw a sequential improvement versus H2 22, although slower than originally anticipated. While the organic sales growth was supported by high-single-digit pricing to offset ongoing inflation, this was offset by a high-single-digit decline in volume/mix.

There are three primary reasons for the lower volume/mix.

First, demand in H1 last year was, on average, still elevated in the aftermath of the pandemic, so this semester includes some normalisation with increased mobility. Second, it took longer to rebuild distribution with the retailers following the intense price negotiations at the back-end of last year. And third, we declined to participate in certain promotional activities in Roast & Ground markets such as Germany.

At the same time, strong performance was delivered by countries such as France, Switzerland and most Eastern European markets and by brands including L'OR, Kenco and Pickwick.

The organic adjusted EBIT decreased by 8.4% to €476 million in H1, due to lower volumes, inflation on the cost basis, as well as increased marketing spend. The 4-year organic adjusted EBIT growth was minus 4.4%.

In LARMEA, organic sales growth was driven by 7% volume/mix and 3% price growth, with particularly strong organic sales growth performance in countries like Ukraine, Morocco and Mexico. Organic adjusted EBIT increased by 17.4% to €125 million in H1, which reflects good operational leverage and mix. On a 4-year CAGR, the organic adjusted EBIT growth was 19%.

In CPG APAC, various Away-from-Home businesses only started to recover from COVID-related lockdown measures in the first half of this year. As a result, positive volume/mix and organic sales growth performance in most CPG businesses was partly offset by relatively soft performance in select Away-from-Home businesses.

Overall, sales performance was geographically broad-based and supported by strong brand performances from brands including Campos, Moccona and Super. The adjusted EBIT for CPG APAC decreased organically by 21.6% to €51 million in H1 23, primarily due to one-off costs related to a temporary supply chain disruption connected to one of our main manufacturing facilities in the region. On a 4-year CAGR, the organic adjusted EBIT growth was 4.7%.

At Peet’s, the Away-from-Home businesses continued to benefit from the ongoing rebound in Away-from-Home consumption, with same-stores sales and ticket size up in Peet's' US coffee retail stores. Peet’s’ In-Home business delivered competitive growth on the back of a high base of comparison, resulting in double-digit organic sales growth on a 4-year CAGR. In China, Peet's continued to deliver strong double-digit organic sales growth.

Adjusted EBIT increased organically by 10.1% to €67 million in H1 23, driven by operational leverage. Based on a 4-year CAGR, the organic adjusted EBIT growth at Peet’s was 10.3%.

Let’s now take a look at our underlying profit in absolute terms and per share on the next slide, slide 23.

Our underlying earnings per share decreased by 19.6% to €0.85 in the first half of 2023, caused predominantly by the fair value changes of derivatives and FX, which positively benefitted the first halves of 22 and 21. When excluding those fair value changes and FX effects, the underlying EPS actually increased by 4.6% in H1, supported by lower net finance cost and lower underlying taxes.

Let me now share a bit more detail on our free cash flow and net debt developments on slide 24.

In the first half of 23, our business delivered €14 million free cash flow, which was below what the business has been delivering in the first halves of the last two years, which is primarily due to the normalisation of working capital that we anticipated and already called out at the start of the year during our full year 22 results call. As we explained before, our working capital has benefitted in 2021 and 2022 from historically high levels of broad-based inflation across raw material inputs, including elevated coffee prices.

Next to that, inventories also increased in 2022 as a result of building higher safety stocks for business continuity and the delays in the supply chain, further benefitting payables due to the additional spend. As the global supply chain dynamics have improved, notably in coffee, enabling us to lower safety stocks, and we have been buying less green coffee, this led to a net cash outflow from working capital, as anticipated.

So the cash flow in the semester is a mechanical adjustment due to this normalisation as well as the lower volume in Europe over the last two semesters, while the underlying fundamentals of our superior free cash flow generation over time remain unchanged.

When taking a multi-year view, as we always do, and averaging the last 12-month period of free cash flow of the last three years, the free cash flow totals €1.72 billion, which corresponds with a 3-year average free cash flow conversion rate of 69%.

And looking at the net debt bridge on the right-hand side of this slide, it shows that our net debt position increased slightly, mainly because of the normalisation of working capital, but all other lines remain as expected.

On the next slide, slide 25, you see the overview of our debt and leverage evolution, which shows that our net debt and leverage has been relatively stable since year-end 2021. We finished the semester at 2.8 times net debt to adjusted EBITDA, slightly above our optimal leverage target.

And as shown on slide 26, our debt has a strong maturity profile, with an average maturity of 4.5 years and no bonds maturing before the end of 2024. In other words, we currently have no funding needs until the end of 2024, which positions us well in the current interest rate environment, as most of our debt is fixed rate and was executed before the rise in rates. Also, all future maturities are below our expected 3-year average free cash flow level of around €1 billion.

Our average cost of debt is 0.5% and none of our debt contains financial covenants. Our total liquidity remained high at €2.2 billion at the end of H1 23, consisting of a cash position of over €700 million and available committed and fully undrawn revolving credit facilities of €1.5 billion, which also does not mature until 2028.

Before moving to Q&A, I would like to briefly remind you, on the next slide, slide 27, of our capital allocation priorities, which remain unchanged. 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.

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

Questions and Answers

Operator: Thank you. Ladies and gentlemen, we are now ready to take your questions. If you wish to ask a question, please press star one on your telephone keypad. That's star one on your telephone keypad to ask a question. Please remember that you are limited to one question and a follow-up per round. Let's wait for the first question. We'll take the first question from Patrick Folan from Barclays. Please go ahead.

Patrick Folan (Barclays): Yeah. Good morning, Fabien, Scott and Robin. And thanks for taking my question. My first one just on Europe. How much more time is needed to rebuild distribution? And I suppose what is the drag from your choice to not engage in those non-competitive promotional activities? I'm just trying to understand the dynamics we should be looking to in the second half.

And then just more broadly on Europe. Is there a timetable when we should expect market shares to get back to levels that we saw in the first half of '22, especially if there's more price increases – I mean, all the smaller price increases coming down potentially in the second half? Thank you.

Fabien Simon: Yeah, good morning, Patrick. Thank you for your questions. I think I will start with the good news. The good news is the distribution is fully back at the end of Q2. As I've said earlier, it took us a bit more time. We really thought it would have been happening around February-March, but it was more happening around May-June. That's why actually our market share, even in the last months, is greater than the one we have been sharing in an average, but we did not wanted to play with that and be very transparent.

So which makes me confident that the market share will improve in H2. And actually we have seen, I would anticipate, probably between a third and a half of the market share we have not yet recovered, to already happened.

What I don't know is, what I have been alluded to, is how much of promotional, which we don't want to participate, will still be happening in the second part of the year. But it is not everywhere in Europe. It has been concentrated mostly in countries with high Roast & Ground weights sitting in particular in Germany, in the Nordic regions.

And we are very clear. We are not here just to show a good level of market share, but really a quality one. So I just want to be transparent. It is the part I don't know. But if we look at what has been happening in the history, in the past, we always came back.

Is it going to be turning exactly the same way? I think time will tell. But I am absolutely re-ensured that our market share, our volume/mix and our profitability in Europe in H2 will be greater than the one of H2 of last year. This I'm absolutely sure.

Patrick Folan: Thank you.

Operator: The next question comes from Jon Cox from Kepler Cheuvreux.

Jon Cox (Kepler Cheuvreux): Yeah. Good morning, guys. A couple of questions. Sorry, one actually. Just on Russia. You sort of said it looks like everybody's focused today on the fact that Russia will be the main sort of drag into H2. Can you just talk a little bit about it? Is there any more potential impairments to come? Now that you've written down Russia to zero, either Jacobs or what else you have? Because I know – I think the amount of goodwill in that LARMEA segment at the end of last year was over €600 million. And I think you mentioned a lot of that is Russia.

And then just in terms of why don't you just deconsolidate that business or look to offload it? This is what others have done. You've seen other companies actually have their assets seized in Russia. I'm wondering if you can just talk about Russia and what your thoughts are? And I guess, it's still around 4% or 5% of Group revenue, probably lower than the Group margin. Thank you.

Scott Gray: Maybe I'll just comment on the impairments, and then I'll let Fabien add on. On the impairment, no, we don't expect further impairments at this time because we believe we took the appropriate level of impairment. Fabien?

Fabien Simon: Yeah. And maybe what I could say on Russia is what I've been trying to say during the prepared comments is, we have been, in my view, one of the few companies who have been extremely transparent from the beginning, and we said what we would do and we did what we said we would do. And I think that's been very well fed back recently to us.

And what we have said is we want to stay in Russia because our products are essentials. But we said at the same time that we have to ring-fence it as much as possible. Between us, I believe that the weight of our Russian business was too big in our total portfolio, given what's happening. And you don't want to have that for long.

And we want to ensure we can have optionalities. And when you're having your global brands totally, I would say isolated from a potential further exposure, I think it's a great thing to have. It takes a bit of time.

And why do we believe it could lead to a lower top line and bottom line is, first, we see competition is going to take the opportunity, and we see that happening already significantly now. But as well, when you change from a global appealing international brand, it's most likely that you're going to have some less pull from consumers. But as well over time, the portfolio will not be able to leverage on what is a continued innovation coming from our global platform that we roll out in our global brands, which we most likely have to make that a bit less relevant going forward.

But as well, when you move to a much more local brand, we know there is much less scale efficiency benefits, which will make, on top of volume, the profitability lower. It's a painful process, but I think it is the right thing to do. And what we want over time is, although we want to stay in Russia, is to grow much faster, to improve profitability much faster as a priority on the remaining part of our business, which in case things will turn even more negative, we will have a much lower impact.

But we are not today at a stage where we would – I don't remember what is the word you used exactly, but deconsolidate because we still have control and ownership of this asset, and we have to follow international rules. But we are not ruling out being a bit more transparent on what will be our organic performance going forward and with or without Russia because, of course, you've noticed how we have been updating our guidance.

And Russia is playing a significant part. And when I say significant, I'm not talking about 5% or 10% difference year-on-year. I am taking something likely more important, which I think will make visible how much we are strengthening further our underlying business.

Jon Cox: Okay. Just as a follow-up then. So you can confirm there's no further goodwill left on the books regarding Russia. And it seems to be you're looking at a gradual decline. So should we be expecting maybe a point Group impact this year, another point next year and a point afterwards? That's the way you're sort of running on a medium-term sort of thoughts about the whole process? Or should it – like you say, there's going to be actually a couple of points on Group growth this year and maybe a point or two next year and then it's dialling you down to – Russia is maybe 1% or 2% of your business?

Fabien Simon: I think there – I think we have to be open of what we know, what we don't know, I would say, at this stage. What we know when you transition brands, it very often comes with a significant impact at the moment you do it. And this is something we do now. So that is why we expect most likely the biggest impact to happen in H2 and possibly some effect in H1 of next year.

Then beyond that, I would say time will tell, but we will expect a much lower impact than the one we will see this year. But it is possible that it will be more gradual. But for sure, as we want to perform in the other parts of the world, the weight of Russia overall will be lower over time.

Scott Gray: And Jon, just to clarify on the goodwill and the impairment there. I mean, the impairment that we took was related to the goodwill appropriate for the international brands that we have in Russia. And as we're transitioning fully out of international brands, we took the appropriate impairment to reflect the impact on goodwill for that contribution from that market. So there is no longer any goodwill associated with Russia in regards to the brand goodwill.

Jon Cox: Okay. Thank you.

Operator: The next question comes from Celine Pannuti from JP Morgan.

Celine Pannuti (JP Morgan): Good morning, everyone. I have a few questions on Europe CPG. First of all, I wanted to understand – I mean, I would think that it was a double-digit volume decline for you in Europe CPG in H1. Could you confirm that? And given what you said, would you expect to be close to flat or even positive in the second half of the year in CPG Europe volume?

My second question on Roast & Ground. If I understand your priorities to not entertain high promotions. But I just wonder how sustainable that is, like, at which point you will have to maybe go into that site? Or will you be happy to keep adding a lower and lower Roast & Ground business?

And lastly, could you update us on what's going on in the other categories, especially Single Serve? How you see the market dynamic? Is the category in volume terms as well under pressure? And how consumers are moving around the different price points, and what is the highest price points in coffee in Europe? Thank you.

Fabien Simon: Hi. Good morning, Celine. Let me go through the questions. I hope I don't forget any. So talking about Europe. So to be transparent, because I know we had to change our reporting between the Away-from-Home and the CPG, but I don't mind to be absolutely transparent. The volume in our European business was almost a double-digit decline, and that was something very visible in the Nielsen report. But again, a significant part of that decline is really on the Roast & Ground. And we expect a further normalisation in H2.

Would it be up to a positive volume in H2? It is very possible. That for you is the best way I want to position it. I don't want to disappoint. But today, as I've said, I'm quite optimistic for Europe in H2 versus last year, and it may well be in the range of what you have been talking about.

But there is a big question you have been raising. How sustainable it is to not participate in some Roast & Ground, what we call volume game and not value game. I think the approach we have taken so far is working. Look at our market share performance. Look at the sequential recovery on our EBIT margin in Europe. So if it means going forward that the rules of the game on this promotion remain like today, I don't mind having a lower Roast & Ground business in Europe. And I want to make that very clear.

It was a painful transition to get there and maybe it is a reset of our business. But if I look at what has been happening in the history, at the time of inflation – high inflation on coffee price, it has always happened. And most of the cases, it turned back to more profitable activities in a more normalised price.

It may happen. But today, I don't want to get our strategic priorities based on hope, but based on what we can control. And what we can control is to not participate on activities we believe are not good for us.

You had a question around consumers. I think what we do see on the consumer side, I see a lot of good news. The first good news is we don't see consumers trading off coffee or tea. So they still consume it. We don't see consumers moving from a bit more expensive category to trading down to another category. When you are a bit anchoring your habits into one category, you'd like to stick to it.

But what has been more visible is a gain on private label. You've seen that in the US. You see that in Europe. But again, it may likely be some post-COVID adjustment as well, because if you look at the market share of private label today in US and in Europe, it is still lower than what it was in 2019. So it is going up, but it's most likely from some of the adjustment as well.

But anyway, despite that, we are gaining market share overall. So we feel good despite that momentum from private label. We do see consumers being a bit more cautious on buying less big volumes and probably because they go more often to stores and looking more on out-of-pocket purchase, but as well loading much less the pantry than what they have been doing in the past.

And what's interesting is really linked to the Roast & Ground decline as well is consumers are looking for lower waste. You know in coffee, there is always this joke that the biggest consumer of Roast & Ground is the sink. And what we hear from consumers is while before they would have gone through their volumes through a filter and throwing away the rest, now they would more reheat their filter, which probably is leading as well some form of volume decline.

But what we see, I would say, between this is the ongoing growth on what were the fundamental premiumisation drivers of the category of convenience and taste, which led to higher growth on Single Serve, on premium beans, on premium instant is still there, and we are very, very pleased to be the one who is gaining a disproportionate positive market share on this underlying trend while being affected on the Roast & Ground effects.

Celine Pannuti: Thank you.

Operator: The next question comes from Tom Sykes from Deutsche Bank.

Tom Sykes (Deutsche Bank): Yeah. Morning, everybody. Thank you. Firstly, just on the volume/mix and price. Could you maybe just allude to what has been happening in mix? You mentioned that people going to perhaps buying in smaller sizes. So has mix been more positive? Maybe you could sort of talk about mix versus H2 last year? And do you expect to hold on to that mix game when volumes come back as you have stated that you expect to in Europe?

Just on the free cash flow. For argument's sake, if EBIT was flat next year, where would you think your free cash flow would be? So just to remind us of the normalisation dynamics and how quickly you expect that to happen?

And just finally on ESG costs. You mentioned the kind of increased cost of certification. Do you expect ESG transition for you to be a little bit more costly over time? And is that at all a drag on profitability versus expectations, please?

Fabien Simon: Yeah. Good morning, Tom. Thank you for your questions. So on volume/mix, I would say, indeed, as we have been, I would say, very intentional on, I would say, mostly the category mix that we have been talking about from Celine's questions, it is true that there had been supportive mix in H1, but I would say that has started already last year. You may recall a bit our depressed results in Europe in H2 of last year.

It was, I would say, across categories, but even more started and visible on the Roast & Ground, which means that – are more considered H1 being a new base and us going forward as we continue to premiumise, as we continue to grow in the good part of our profit pool geography and category level to still benefit from mix level.

On free cash flow, I think it's too early to talk about 2024 obviously, but I want the team to be absolutely reassured that the fundamentals of our free cash flow generation is totally untouched. And it is one of the very successful ones in the CPG universe. What we do have now is just a normalisation. And people who have been in coffee for a long time knows this is always happening, but there is nothing linked to a change on the fundamentals. But for ongoing, I'm not concerned.

What will be the exact level next year? When you have a normalisation, it's hard to see. It's starting on 1st Jan and finishing on 31st December. It's as clear as that. So as things develop, we will have to see how 2024 will be impacted.

On ESG, thank you very much for the question on ESG that I don't have - I think - enough. For me, ESG is like growth. It is not coming for free. I know a lot of people would like to hear that ESG is cheap and doesn't require any investment. It does. But I think it is where we have been doing a lot and probably makes our number on a like-for-like basis stronger than what people may see, is we have been significantly stepping up our ESG investment. Our run rate investment now on ESG is about €100 million per year with OpEx, CapEx and a big part is OpEx.

And I believe we have been doing most of the work of what needs to be done for the future. So I feel very pleased with that. But it is something we had to do, like what we had to do on resetting our marketing, our appliance and e-commerce capabilities. So I much prefer to be in the situation where I am today with what we have done than where I was three years ago where a lot of catch-up had to be done.

It doesn't mean it's going to be free going forward, but I think most of what we had to do has been happening. Just as a big reminder, now 77% of our coffee is responsibly sourced, and we want to go to 100%, while we were, I think, at about 13% or 17% when we started three years ago. That came with a bill. But I think a good part is done by now. But now it's more probably modest – moderate investment to do on ongoing basis going forward.

Tom Sykes: Many thanks.

Operator: The next question comes from Robert Jan Vos from ABN AMRO-ODDO BHF. Please go ahead.

Robert Jan Vos (ABN AMRO-ODDO BHF): Yes, hi. Good morning all. A couple of questions from my end. You already talked a lot about working capital being an important cause of the free cash flow shortfall basically in first half. I appreciate that you didn't want to comment on next year. But is it fair to assume that there will be no further major deltas in working capital in the second half? And can you relate to this maybe also, say, what your expectations are for CapEx in the second half?

And then my second question. You talked about disinflation in the presentation. Of course, we already saw a materially lower contribution from prices in H1 this year compared to H2 last year. And when I listen to your sales growth guidance and also what you say about a more balance between volumes and volume/mix and price, is it fair to assume that the price contribution will drop to around 3% to 4% in the second half of this year? Those were my questions. Thank you.

Scott Gray: Yeah. Maybe I'll start on your first couple of questions. I think, in regards to working capital, our expectations for the second half, no, we would expect it to be more stable in the second half based upon our current assumptions here, and our normalisation is more H1 focused.

In terms of your second one in terms of CapEx level, we would expect the CapEx level in H2 to be roughly around the same level as H1. H1 is a step-up versus last year, because remember, H1 last year we had some constraints in terms of being able to source some of our equipments, given supply chain constraints. So it looks like a bigger step-up. But in terms of absolute spend levels, should be somewhere consistent with H1.

We tend to give a range on percentage of sales, which is a little bit less relevant now, but it comes more to something like 3%-ish on that. And then maybe I'll let Fabien take care.

Fabien Simon: And I think by the way, that's why I wanted to be as well, very transparent and forward-looking there. When we guided €400 million free cash flow for the year, I think it's a reinsurance as well of some normalisation happen more in H1 than coming in H2.

On the inflation side, I think we said very clearly, inflation has not gone away. It is much lower than what we have been experiencing over the last 18 months to two years, but it's still there, which means that we still have to do some pricing. But of course, we are comparing ourselves to periods where we were increasing by almost 16% pricing, which, of course, you can only expect the level to be lower, and it is most likely that the H2 level will be lower than the H1 level, without answering into much more detail on your questions.

But we feel that we have well-managed inflation and slight more pricing is most likely necessary in light of the cost inflation we continue to see in our P&L.

Robert Jan Vos: That's very clear. So if I can squeeze one more question in. What is the amount of the one-off costs related to the manufacturing issue in APAC?

Scott Gray: Yeah. We're not disclosing exactly what the one-off cost is. I mean, most of that is in H1. And that factory is also not open yet. So we still have some impact on APAC in H2. And just to clarify, it's not impacting on the top line. This is really about adjusting on our supply chain. So we have costs as we have to move it from other locations.

Robert Jan Vos: Clear. Thank you very much.

Scott Gray: But it's the main driver of the negative EBIT in APAC region.

Fabien Simon: But we know exactly what has to be done. It's well underway. It's taking a bit of time, but it's not a structural issue that we are going to have but some really one-off temporary cost increase we had there.

Scott Gray: Absolutely.

Operator: We'll take the next question from Jeremy Fialko from HSBC.

Jeremy Fialko (HSBC): Hi. I've actually got one question for you. So if we look at the CPG Europe, you've had a kind of – sort of 7% volume decline in H1 last year, followed by around 10% this year. So I guess, over two years, you're looking at not far off a 20% reduction in volumes. And could you talk about what that means in terms of your kind of utilisation, your cost absorption and also what that might mean for your network of manufacturing as well, so maybe that's the issue?

Fabien Simon: Yeah. Good morning, Jeremy. Yes, indeed, we have seen volume decline now for about 18 months from the choices that we made. Of course, it has been putting some pressure on the utilisation of the factory on the negative side. But I think we have been proving very agile to manage that very well, because you have seen the sequential improvement on our EBIT margin while continuing to invest on marketing in Europe.

So it's really doing what we had to do on the mix and on the cost side. And what we have been doing over the years, where we always see a mismatch between demand and supply, we adjust. But maybe back to the question of Celine, we will not adjust by filling in factory with volume we don't like.

If we believe some of the volume will be enduring volume lost, we will continue to act on adjusting our capacity, like we have been doing over the last four years. Last four years, we have been closing four factories in our network. So it is one of the measures that we have been making. And if we have to take more, we will take more, and we will know with time. But today, it's not a real or significant issue, but it's something that we are monitoring very closely.

Robert Jan Vos: Thank you.

Operator: Thank you very much. And I would now like to return the call to the speakers.

Robin Jansen: Thank you, Marion. 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.

Operator: This now concludes JDE Peet's earnings call.

[END OF TRANSCRIPT]