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Nomad Foods

Fourth Quarter 2020 Earnings Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Andrew Olsen, *UBS Investment Bank*

William Chappell, *Truist Securities*

Peter Lukas, *CJS Securities*

PRESENTATION

Operator

Good day, and welcome to Nomad Foods Fourth Quarter 2020 Earnings Conference Call.

At this time, I'd like to turn the call over to Taposh Bari, Head of Investor Relations. Please go ahead.

Taposh Bari

Thank you for joining us to review our fourth quarter 2020 earnings results. With me on the call today are Chief Executive Officer, Stefan Descheemaeker, and Chief Financial Officer, Samy Zekhout.

Before we begin, I would like to draw your attention to the disclaimer on Slide 2 of our presentation. This conference call may make forward-looking statements that are based on our view of the Company's prospects, expectations and intentions at this time, including consideration related to the impact of COVID-19. Actual results may differ due to risks and uncertainties, which are discussed in our press release, our filings with the SEC, and this slide in our investor presentation, which includes cautionary language.

We will also discuss non-IFRS financial measures during the call today. These non-IFRS financial measures should not be considered a replacement for and should be read together with IFRS results. Users can find the IFRS to non-IFRS reconciliations within our earnings release and in the appendices at the end of the slide presentation available on our website.

Please note that certain financial information within this presentation represents adjusted figures for 2019 and 2020. All adjusted figures have been adjusted for exceptional items, acquisition-related, share-based payment and related expenses, as well as noncash foreign exchange gains or losses. And all comments from hereon will refer to those adjusted numbers.

With that, I will hand the call over to Stefan.

Stefan Descheemaeker

Thank you, Taposh, and thank you all for your participation on the call today. I hope you and your loved ones continue to stay safe during these unprecedented times. It has been nearly a full year since our lives changed following the onset of the COVID-19 pandemic. At Nomad, our entire organization has risen to the challenge of supplying Europe with our iconic brands while ensuring the health and safety of our employees.

As you may have seen, we reported our fourth quarter and full year 2020 results this morning. Consistent with our announcement at CAGNY last week, we ended the year on a very strong note with Q4 results ahead of our prior expectations across all key metrics. Here are the headlines for the fourth quarter.

Organic revenue growth of 9.5% driven by an 8.6% increase in volume and mix and a 0.9% increase in price. We achieved 160 basis points of gross margin expansion to 31.5%, marking our strongest quarterly gross margin rate in over two years. Adjusted EBITDA of €119 million and adjusted EPS growth of 19% to €0.38 per share.

Here you see the financial highlights for the full year 2020. For illustrative purposes, we're showing these figures in both euros and U.S. dollars, the currency in which our stock trades. Overall, an incredible year of performance as we completed our fourth consecutive year of organic revenue, Adjusted EBITDA and adjusted EPS growth.

Turning now to the highlights of the quarter and the year. As I mentioned, organic revenues grew 9.5% during Q4, ahead of our recently updated guidance of high single-digit growth. We were pleased to end the year on a strong note as demand for frozen foods began to accelerate in late October. That momentum built throughout the quarter and has carried over into 2021. We continue to see broad-based strength across our portfolio with fish fingers, coated fish, poultry and plant protein among the strongest performing subcategories.

We've managed the business by focusing on both long- and short-term priorities throughout 2020. A great example is our strategic decision to allocate €10 million of investments behind Green Cuisine, our core and new consumer retention. Most of these investments were deployed during the fourth quarter, resulting in a 30% increase in A&P spend year-on-year.

Near term, we dedicated a lot of our energy in chasing demand and fulfilling orders to the best of our ability and converting strong profits into free cash. And as you see in our results, I'm pleased to say that we generated €345 million of adjusted free cash flow in 2020, an all-time record and nearly €120 million higher versus the prior year.

Our strong operational performance in 2020 was complemented by a series of capital allocation actions. We initiated a $300 million share buyback program in March 2020, at the onset of COVID-19, and were quick to repurchase a significant amount of our stock under $17 per share. We followed that up by tendering nearly 500 million of our stock in September. In aggregate, we repurchased over €600 million of our stock, resulting in a significant reduction in our share count as we enter 2021.

We have also been active on the M&A front. At the time of our tender offer announcement in August, we clearly articulated our focus and priority on the European frozen food acquisitions, where we believe we have a strategic advantage. Since then, we successfully completed the acquisition of Findus Switzerland, which further expands our European geographic footprint. And just last month, we entered into exclusive discussions with the Fortenova Group to acquire their frozen food portfolio. This is a business with strong brand positioning and a significant operational footprint across the Balkan region. We're making good progress in the Fortenova process, and look forward to updating you in the coming weeks.

So that was the past, an unprecedented 2020 that many of us will never forget. And for us at Nomad, our fourth consecutive year of sustained robust financial performance. And as you can see here, we plan to continue building on our strong foundation and momentum by growing our top and bottom line again in 2021. As Samy will outline in his remarks, we have a strong set of plans that will underpin our ability to achieve what will be another exciting year for Nomad Foods.

Before I conclude, I'd like to remind you why we are as excited as ever in the growth prospects of our Company in both the near and long term. Here, you see our three pillars of growth.

First, our core portfolio, which is anchored in frozen fish and vegetables. COVID or not, these are growth categories that are aligned with a more nutritious diet and a more sustainable food system. Demand for these categories have been growing for years. COVID, which introduced millions of new consumers into our portfolio last year, has only accelerated that movement. We have brands that are local jewels across Europe, and thanks to the support of our R&D and marketing teams, remain as relevant as ever with today's consumers.

Second is our commitment to breakthrough innovation with Green Cuisine. This is a business that we have taken from €0 to €30 million in less than two years. And we won't stop there. We have plans to grow revenues to over €100 million by the end of next year. As we presented at CAGNY last week, Green Cuisine is now in all of our markets, and was Europe's fastest-growing frozen meat-free brand in 2020. We're developing fantastic new products across a variety of need states and seeing strong response from retailers and consumers.

And third, our efforts around M&A as we complemented our core with strategic acquisitions into new geographies, categories and channels.

Putting it all together, we have the white space opportunities to continue to generate top-tier performance in the packaged food space in 2021 and beyond.

And with that, I will hand it over to Samy to discuss the results in more detail and outline our guidance for the coming year. Samy?

Samy Zekhout

Thank you, Stefan, and thank you all for your participation on the call today.

Turning to Slide 8. I will provide more detail on our key fourth quarter operating metrics, beginning with revenues, which increased 4.7% to €658 million, driven by 9.5% organic revenue growth. As expected, this was offset by 3.2% relating to a calendar shift and 1.6% of foreign exchange translation. Organic revenue growth exceeded our prior expectations and was once again driven by our branded retail portfolio, which grew 12% during the fourth quarter.

Growth continues to be most pronounced within our core products, namely fish fingers and coated fish, where demand is particularly robust. Strong growth in our branded retail business was offset by our non-branded channels, which represent approximately 10% of sales. Specifically, we experienced mid single-digit growth in private label sales and nearly 30% declines in foodservice due to the impact of restricted movements across Europe.

Our gross margins expanded 160 basis points to 31.5% during the fourth quarter, reflecting favorable mix, pricing and promotions. Moving down to the rest of the P&L, adjusted operating expenses increased 15% year-over-year. This includes a significant increase in A&P, which grew 30% or €10 million versus the prior year. You may recall our decision to allocate part of our incremental profits in 2020 towards strategic investments. Most of this investment was indeed deployed during the fourth quarter.

Adjusted EBITDA increased 3% to €119 million, and adjusted EPS increased 19% to €0.38 for the quarter, reflecting the significant share repurchase activity we have conducted since Q4 last year.

Turning to cash flow on Slide 9. We generated €345 million of adjusted free cash flow in 2020, equating to 131% cash conversion. As Stefan mentioned, we had an exceptional year of cash performance in 2020, which set a new record for our Company. This was driven by higher EBITDA and disciplined working capital management, which more than offset year-on-year increases in Capex and taxes.

While COVID certainly played a factor last year, specifically regarding inventories, which will need to be rebuilt over the coming months, this performance was also largely driven by cash breakthrough interventions that we have been making since 2019 around structurally improving our working capital efficiency.

As we look out to 2021, we expect to deliver another year of strong cash performance, in line with our longer-term target of 100% conversion. Based on our share price today, this would equate to a free cash flow yield of approximately 7%.

With that, let's turn to Slide 10 to review our 2021 guidance, which is based on foreign exchange rates as of February 23, 2021. We expect to achieve another year of double-digit adjusted EPS growth in 2021 as we look to build on our strong momentum exiting 2020. This guidance is based on the following factors. Total revenue and Adjusted EBITDA growth of approximately 3% to 5% and organic revenue growth of approximately 1% to 2%.

For modeling purposes, we are assuming a weighted average share count of approximately 179 million for the year. In aggregate, we expect 2021 adjusted EPS to be in the range of approximately €1.50 to €1.55, which equates to a U.S. dollar equivalent of approximately $1.83 to $1.89 earnings per share.

As a reminder, this guidance does not reflect any potential accretion that may result from our exclusive discussions to acquire the frozen food portfolio of the Fortenova Group. These discussions are ongoing and we expect to have an update for you in the coming weeks.

On Slide 11, we outline 2021 guidance relative to history. What you can see here is our commitment to delivering sustainable financial performance every year. 2021 will mark our fifth consecutive year of growing organic revenues, Adjusted EBITDA and adjusted EPS. And importantly, this performance builds on the strong year that we have achieved in 2020, representing robust growth on both a one- and two-year basis.

As we outlined at CAGNY last week, you see here the building blocks supporting our robust plans for 2021. We expect to achieve these goals through a combination of the macro tailwinds, operational levers and capital allocation actions outlined here on Slide 12.

That concludes our remarks. I will now turn the session over to Q&A. Thank you. Operator, back to you.

Operator

Our first question comes from Andrew Olsen with UBS.

Andrew Olsen

I just wanted to dig more a little bit into the drivers of the top line, the organic sales guidance that you gave at CAGNY and are reiterating again today. Where do you have the most confidence in that guide? And how much does it depend on maintaining some of the COVID gains that you had in 2020? Just trying to think through kind of the underlying growth of the base business versus maintaining some of the lapping effects.

Stefan Descheemaeker

Okay. Let me take that one, Andrew. Let me stand back a bit first.

I think where we're quite different is that when you see a bit of our journey before COVID, we had the three consecutive years of growth, and it doesn't come by chance. I think we worked a lot on our brands, we worked a lot on our business model and it paid off. And then obviously came COVID one year and obviously we grew nicely, like many other people. But very importantly as well, we've also reinvested, as you know, another €10 million at the end of the year, which obviously serves us well for the beginning of this year and later. So that's a bit of what we have accomplished over the last years.

I think where we are quite different is we have just fantastic categories. When you think about fish, which is 40% of our business, nice margin; vegetable, which is 20%; plant protein up and coming; and this in frozen food, which is doing very well now and obviously, beyond, it's obviously a natural, it's a natural tailwind. They're all growing, which is very nice.

Then you have COVID, obviously, which gave opportunity to all these people, new consumers, millions of consumers to try. That's why, by the way, we invested behind retention, which was very important. You remember, that's a kind of program we put together last year. We announced this year, we explain why we're doing this, and we see the results. And that's very nice.

Then on top of that, obviously, you have Green Cuisine, which has also moved from €0 to €30 million in less than two years. And as you know, we have the plan to increase up to €100 million or beyond the €100 million in the next two years. So with all these things on top, obviously, of the plan that we put together business model, yes, we believe that 2021, we're going to grow by 1% to 2%.

It's obviously ambitious because it's on top of 8.5%, but that's the cultural organization we're delivering. And I think we have the best plans we ever had. So that's why we think you will be going to make it work. And then beyond 2021, I would put it that way. We think, again, that with all the things we have, it's—the growth is only starting. So we have—we know what we have ahead of us in 2021 and beyond, and we're very excited with this.

And then obviously, we also have things that are coming like Switzerland that we just completed end of last year, obviously, Fortenova is an option, obviously, that we—as we announced, it's an interesting plan also in the back end.

A lot of good things between, let's say, the natural growth of our must-win battles, as we say, Green Cuisine and also, obviously, a very focused M&A plan behind frozen foods. So that's all the reasons.

Andrew Olsen

Okay. Great. And then just as a follow-up, just specifically on the marketing spend. It was good to see that 30% increase come through in 4Q, which brings a high single-digit for the year in terms of that advertising line. How do you think through your kind of overall marketing levels? Do you think that you'll have to increase even further for—to support Findus Switzerland?

Stefan Descheemaeker

Samy?

Samy Zekhout

Yes. Sorry, excuse me, I was on mute. Sorry.

SG&A will be about flat, I mean, year-on-year in 2021. So we have upped the game in 2020 for the reason that we have mentioned, investing behind the Green Cuisine, must-win battles, which we know are paying off. And the other piece, which was important for us to protecting behind retention, as we have mentioned. But we—clearly, the intent is to continue to invest behind our brands.

We have strong plans behind the core business and behind Switzerland, and we will always try to balance, secure the need for supporting the brands and driving the appropriate ROI, I mean, on investments we're making in advertising for sure.

Operator

Our next question comes from Jon Tanwanteng with CJS Securities.

Peter Lukas

It's Pete Lukas for Jon.

Just how have industry and trade negotiations progressed so far this year in terms of pricing, shelf space and promotions, any meaningful difference? And also, any meaningful difference you're seeing between trends on the continent and the U.K., given all the dysfunction that we've seen with Brexit and various different lockdowns?

Stefan Descheemaeker

Listen, it's a good question, the Brexit. Let me handle the Brexit first because it's been our favorite topic for, well, so many years. The good news is its behind us. We’re still more than ever in a tax-free zone between Europe and U.K., which is great. We always said it's great for us. That's the best result. And quite frankly, I can tell you by when the deal was announced on December 24, it was a very nice gift.

Is it perfectly smooth at this stage? No, you have—you can imagine, you have, obviously, some logistic issues here and there, which makes the things a bit complicated. But as we've been extremely well prepared, we know that it's going to be fine. So that's a big thing for us, it's Brexit. And we're so pleased, by the way, we can always also think about more productive things, more interesting things than just playing defense with Brexit, which is absolutely great.

And then back to your question about the negotiations. Well, let's say, negotiation with the trade is negotiation with the trade. It's not going to change. Sometimes you have a bit more inflation. Sometimes you have a bit less inflation. This year, we have a bit more less inflation, which I would say, ultimately make things a bit easier.

I don't think there is anything specific compared to previous years that are worth mentioning. Obviously, we need to deliver. We also said last year that it was a year of high demand. It's still a year of high demand, which makes, to some extent, that piece of the conversation with the trade a bit easier.

And yes, that's where we stand. I think our conversation with the trade is all about brand building, about their trade margin, which is overall is in good shape as well. So nothing specific to mention and no real difference between U.K. and Europe.

Peter Lukas

Helpful. And just one more for me. Can you talk about synergy and accretion potential from Findus Switzerland? Do you think you realized most of that this year? Or do you think it will be a longer-term process as you exit '21?

Samy Zekhout

If you're completing the year 1 transition, I mean, as we get into that visibility start of the time of year now. We have the year 1 investment always with, let's say, that is playing for us in terms of planting the seed. So if you think about the playbook that we have been applying in the past for our base here or Goodfellas, which has been working really well when you look frankly at how the business is doing today.

If we apply simply our playbook around, frankly, where we are clearly having a strong competitive advantage, I mean, the focus on the must-win battles. Clearly, the extra thing that we can give to our top line through NRM, the focus on our cost and we will actively drive the synergy that we have planned for in the years to come. So clearly, the plan is on track. And clearly, the economics have been, let's say, put together in that context.

Stefan Descheemaeker

It's very much in line with what we've been doing, to your point, Samy, with Goodfella's and Aunt Bessie's. First, investment behind sometimes assets that are a bit of open assets under invested, and we're starting with that, which is, I think, in the long term is the right thing to do.

Operator

Our next question comes from Bill Chappell with SunTrust.

William Chappell

Just want to talk about kind of the surging demand for frozen in kind of the end of the year. And also, what has it done for other categories? I mean I remember this three, four years ago, one of the thoughts from Nomad was to move into breakfast items, and that didn't really work so well because Europeans didn't particularly like frozen breakfast items, they like fresh.

But kind of wondering if that's changed as people have been locked down and accelerated and whether there—maybe it opens up other categories within frozen for you to expand as we've kind of had behavioral change over the past 12 months.

Stefan Descheemaeker

Yes. Well, it's a very good question, Bill, but it comes back to the very essence of our strategy, which is about resource allocation and where we want to play in frozen food. And hence you know our definition of must-win battles. Must-win battles are our core categories, our categories where we have leadership, we have good margin and we have growth potential.

And back to this breakfast question, I think it would have taken ages and take so much resources to get there that it didn't make any sense, and it wouldn't serve the category—the other categories well. That's why we've gone to these core categories that we're calling must-win battles.

I can tell you, they're doing extremely well year in, year out, and it's mostly in fish, in vegetable and then in some local categories, obviously, like, for example, pizza with Goodfella's or other categories in local categories. And we're not going to deviate from there.

So we need market share. We need growth potential, and we need gross margin. So that's that. But besides that, we remain also extremely focused behind frozen. As we know, last year, we've just confirmed that frozen is where we are, where we are winning, and where we want to play. And we are the leaders.

By the way, it's an extremely good category for a variety of reasons between, let's say, obviously, good for your health, good for your health—good for the planet, combined with categories like fish, vegetables or plant protein, on top of also e-commerce that is doing well.

We definitely believe that it would be just a mistake today to move away from this combination of focus behind frozen and within frozen behind must-win battles, including, obviously, Green Cuisine. It serves us well. We have a lot of tailwinds. We have developed, let's say, our modus operandi of our business model for the existing business and also for the business we want to acquire within, obviously, the same frozen food category.

William Chappell

Got it. I appreciate the color. And just on Green Cuisine, help me understand kind of the thought process on the marketing and advertising and that it's certainly done well and have quick, but it seems like there are a lot of competition jumping in and will be more.

Are you looking at this, we just need to build out the brand equity and grow and build brand awareness? Or are we getting into a land grab where you really need to make a splash in terms of getting the brand out there before there's so much noise in the category where it will be tougher for consumers to understand it?

Stefan Descheemaeker

Well, the good news, Bill, is it's—the category in chilled and in frozen, by the way, is growing very fast. And we, as a category leader in frozen, we need to make sure that we're going to have the category to grow even faster. So that's the starting point.

So how we—and this Company in the past, years and years ago, did the same with other categories, we need to do the same. First is, obviously, to make sure that we're going to grow the category.

It's starting with, obviously, differentiation with the others. We believe, and that's what our consumers and the retailers are telling us, that we have a product superiority. The products are great. You know that, for example, last year or let's say, in December, we got the award of the best product—frozen food product in the U.K. with our nuggets. They're great, there is a product superiority. And so—but that's one element. The other element is, obviously, we have also a superiority in terms of distribution network. We're covering—we have the vast network across—of food retailers across Europe. So that's another element.

The third one is, to your point, we're deciding—we decide, as you know, to focus a lot. And to put quite a considerable amount of money behind the category, behind Green Cuisine in terms of brand, brand building, which is also what it is. So all these elements are part of the flywheel that we have developed.

The only difference is probably even more aggressive because it's a new category, and it's a category which has a lot to offer with also, by the way, very nice margin. And we're making very good progress. So that's that. But it's a big focus for us, as you know.

William Chappell

But you don't see it as a land grab right now? It's not a—try to get anywhere and everywhere as fast as possible?

Stefan Descheemaeker

Well, you need to make sure that people understand, all the consumers understand what it is. So it's a whitespace to some extent. So that's what it is. But it's how to increase—how to develop a new category, and we've been good at that in the past, and we're going to do it again.

Operator

There are no further questions at this time. I would like to turn the floor back over to Stefan Descheemaeker for any closing comments.

Stefan Descheemaeker

Thank you very much, Operator.

And thank you for your participation today. We're pleased to have completed our fourth consecutive year of strong financial performance, underpinned by consistent organic revenue growth and complementary M&A and share repurchases. We have a well-defined playbook and a strong set of plans to continue our momentum into 2021.

As you've heard me say, while we're proud of the performance that we have delivered since 2017, we strongly believe that Nomad Foods is still in the early stages of value creation. So thank you for your time and have a great day.

Operator

This concludes today's program. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.