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Nomad Foods Ltd. (NOMD)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Nomad Foods' Second Quarter 2023 Earnings Call. Please note this event is being recorded. I would like now to turn the conference over to Anthony Bucalo, Head of Investor Relations. Please go ahead.

Anthony Bucalo
Head, Investor Relations, Nomad Foods Ltd.

Hello, and welcome to the Nomad Foods second quarter 2023 earnings call. I am Anthony Bucalo, Head of Investor Relations. And I am joined in the call by Stéfan Descheemaeker, our CEO; and Samy Zekhout, our CFO.

Before we begin, I would like to draw your attention to the disclaimer on slide 2 of our presentation. This conference call may include forward-looking statements that are based on our view of the company's prospects, expectations and intentions at this time. 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 2022 and 2023. All adjusted figures have been adjusted for exceptional items, acquisition-related costs, share-based payments and related expenses, as well as non-cash FX gains or losses. Unless otherwise noted, comments from here on, we refer to those adjusted numbers.

With that, I will hand you over to Stéfan.

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

Thank you, Tony, and thank you for joining us on the call today. Nomad had another strong performance in the second quarter, as our sales momentum from the first quarter carried over into the second. This was our fifth consecutive quarter of accelerating organic sales. Our world class teams delivered another great set of results, and we're well on our way to fully executing the commercial and supply chain strategies we announced at CAGNY earlier this year. Today, we are raising our 2023 EPS guidance, boosted by our solid first half operational performance and second quarter share buyback.

Nomad has navigated many challenges over the course of our history and each time we've come out as a stronger organization. We adjusted nimbly to Brexit and the COVID-19 pandemic. And last year, the outbreak of the Ukraine war led to raw material supply challenges. We worked closely with our retailers to adjust our pricing to recover inflationary costs. This was necessary to ensure that we would have the right resources to continue investing in our business over the long-term. We also successfully de-risked our supply chain, adapting our fish supply to include new species and geographies, while adding new sources of high quality farmed fish.

Our new farmed fish products have become a cornerstone of our innovation platform this year, with our exciting Basa launches fast becoming consumer favorites. We have more launches planned in the second half of the year across several new markets. Importantly, we extended our debt maturities to 2028 and 2029, further strengthening our balance sheet and providing us more long-term flexibility. For 2023, our strategic plans include leveraging supply chain cost savings to fuel growth, building our revenue growth management capabilities to maximize the value of our portfolio, and deploying new A&P investments to rebuild volume and market share momentum. We're pleased to share that we have accomplished our first two goals in the first half of this year. Our supply chain savings program is now in full swing, helping fund top line growth. Additionally, we have taken great strides in developing our revenue growth management capabilities, helping drive positive mix and manage costs.

We are now laser focused on the execution of the third leg of our strategy, our new A&P investment program. Our A&P will increase significantly in Q3 versus the same time last year. Additionally, we will return to more normalized annual rates of A&P this year, consistent with our history. This rollout will be aligned with the back-to-school schedule starting in mid-August and building momentum into September.

This increased A&P investment will help drive our volumes and our market share in the back half of the year and beyond. And we expect improving results in the coming quarters. In addition to our A&P investment, we're also normalizing our compensation levels to ensure that we properly reward our great people.

Nomad's fundamentals remain strong. Our cash flow performance is on target and our balance sheet is strengthening. Looking ahead to the rest of the year, as our new A&P investment reaches the market, we expect to see improving market share and volume trends that should carry into 2024 and beyond.

With that, I'd like to recap our second quarter key financial metrics, beginning with revenues. Quarterly revenues grew 6.9%, 8.6% organic with the high teens pricing offsetting high single-digit volumes and mix declines. Gross margin was flat at 28.2%, held by our pricing initiatives and cost control programs. Adjusted EBITDA grew 4.5% to €132 million, while adjusted EPS came in at €0.40 per share, flat versus last year due primarily to rising interest costs.

At current dollar spot rates, our Q2 adjusted EPS was $0.44 per share.

Our strong revenue performance in the quarter benefited from the double-digit price increase that rolled over from the second half of last year. As we observed in our Q1 reporting, some of our most important raw material prices are moderating. But we have yet to see real deflation. Our supply chain continues to deliver excellent results. And we are in a virtuous cycle of customer service and cost management that should support our second half A&P push. Our service levels for the quarter rose to 97.8%, up 90 basis points. Maintaining this level of service has been crucial in defending our market share and high service levels will be key in our push to regain momentum in the second half of the year.

Additionally, our procurement remain disciplined and we are covered for more than 90% of raw materials for the year. We've learned a great deal from the raw material inflation over the past few years, and we have become much more flexible and strategic in how we acquire key inputs. We've left a percentage of our raw materials uncovered to take advantage of some favorable price trend developing in the market and we just started the process of covering for 2024. We lost about 1% value share this quarter, consistent with our expectations and due primarily to our pricing strategy. We expect our new A&P strategy for the year to address this challenge. With increased media and more intensive promotional activity, we expect an improving volume and share performance for the rest of the year, setting us up for a return to volume growth in 2024.

Finally, with increasing visibility on our business and our return to share repurchase, we are raising our 2023 adjusted EPS guidance to €1.54 to €1.57 per share from our previous €1.52 to €1.55 per share. This represents an adjusted EPS range of $1.68 to $1.72 per share at current dollar spot rates. This guidance excludes the impact of any potential future capital allocation.

The post-pandemic pressures and macro environment over the past two years have challenged us to become a leaner and more efficient company. I'm pleased to say that the execution of our 2023 plans to drive commercial and supply chain efficiency has been excellent so far this year. Additionally, I'm excited about our upcoming A&P investment.

A great example of how we are successfully leveraging the power of our brands across markets is Goodfellas pizza in Continental Europe. Last year, we successfully rolled out distribution outside of Goodfella's traditional strongholds of Ireland and the UK, specifically in France and Spain. We launched Goodfellas in France in October last year, with exclusive distribution in Carrefour until the end of 2022. That exclusivity is done. And we are now extending our distribution to other large food retailers in France and expect to reach half of total distribution points.

We are leveraging promotion support for the range and where possible, using dedicated promotional freezers managed by our sales force. Our Adriatic region is shaping up for another great summer. And our supply chain is meeting the challenges of high seasonal demand. We had a good summer last year due to hot weather and the end of COVID travel bans. We are also benefiting from new media and product innovation. This year, we are even better prepared to meet high seasonal demand. We built stocks through Q2, ensuring we have inventory to cover peaks this season and that is now pulling through to consumers. Our service levels in the region remain in the high 90s.

Building our revenue growth management capabilities is another core pillar of our 2023 strategy. We made significant progress in rolling out our RGM systems across the company in the first half. We are building dedicated RGM playbooks resulting in more robust standardized reports and descriptive analytics. This is supporting our end-to-end RGM processes in each market, ensuring greater fact-base support for strategic decisions, further enhancing portfolio value.

We are boosting A&P spend by more than 20% year-on-year with the bulk of that coming in the back half. We expect A&P in aggregate to reach roughly 4% of sales by year-end, a significantly higher level when compared to 2022, which was closer to 3% of sales. This combination of promotion and advertising is being helped by a milder inflationary environment, putting less pressure on margins. As our new media reaches the consumer and our price gaps with competition narrow, we are already seeing green shoots of improvement in both volume and market share, especially in many of our Must Win Battles.

In the Q2 Nielson period in markets where we compete, we saw frozen food volumes at flat. Finally backed by a good cash flow performance, we repurchased shares for the first time since the first quarter of last year. We bought nearly €53 million worth of shares this quarter, roughly 3.3 million shares in total. We have been and will remain opportunistic on share repurchase.

We continue to be optimistic about our second half outlook and beyond.

First, the frozen food category across our markets is in good shape, outperforming the overall food category. Frozen food sales are up double digits year-to-date and category volumes have turned positive in more than half of our markets, improving sequentially in most others. Second, we kept up our strong consumer messaging in the second quarter, emphasizing our broad-based superiority through revamped advertising campaigns across the majority of our Must Win Battles. This includes UK Peas, Italy Fish and Belgium Spinach. In the Adriatic region, our summer sales have been boosted by our innovation with the new Pistachio King brand and our new campaign for Macho ice cream.

Green Cuisine remains a great source of innovation in plant protein, and we won two awards this quarter in Germany for new products and media. With initiatives like this in place, we are seeing our value share trend flatten or improve in half of our markets. We expect this to pick up in the back half.

With that, I will now hand the call over to Samy to review our financial results and guidance in more detail. Samy?

Samy René Zekhout
Chief Financial Officer & Director, Nomad Foods Ltd.

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

Turning to slide 7, I will provide more details on our key second quarter operating metrics, beginning with reported revenues which increased 6.9% to €745 million, up 8.6% organically with pricing offsetting volume losses as Stéfan discussed earlier.

Second quarter revenues were negatively impacted by 1.7% of unfavorable FX. In an improving but still challenging cost environment, we delivered a solid gross margin performance in Q2. We delivered a gross margin of 28.2%, flat versus last year. This margin performance reflected higher pricing, strong RGM execution and moderating costs. As we look out to the back half of the year, we expect to deliver flat gross margins, supported by price increases, cost discipline and RGM execution.

Moving down to the rest of the P&L. Our gross profit grew 7% to €210 million in the second quarter with a stable margin. Cost of goods sold increased to €535 million, an increase of 7%, up €35 million versus last year. Adjusted EBITDA of €132 million grew more than 4% versus last year. Adjusted EBITDA margin landed at 17.8%, a decrease of 40 basis points.

Finally, our adjusted EPS of €0.40 per share was flat in Q2. This translates into $0.44 per share in US dollar terms at current spot rates.

Turning to cash flow on slide 8. Cash generation remains a top priority and our performance improved materially from the first to the second quarter, more in line with our historical averages. This should help keep us on track for our annual guidance target of 90% to 95% conversion. And we expect adjusted free cash flow of roughly €250 million for the year. This is crucial as we consider our capital allocation for this year and beyond. In the first half, we generated €86 million of adjusted free cash flow for a conversion ratio of 58%, a significant step up versus our conversion rate of 25% in the first half of 2022.

As was expected some unfavorable working capital phasing from Q1 reversed to our benefit in Q2. As a result, working capital decreased €57 million to €68 million in the first half. CapEx of €40 million was up €6 million versus last year. We continue to support strategic investments in the business. Changes in cash tax increased €5 million to €30 million, while cash interest was up €17 million to €55 million. As we flagged in our Q1 earnings report, we are now seeing the full impact of higher interest charges from our November 2022 refinancing in Q2.

With that, let's turn to slide 9 to review our 2023 guidance, which we are updating today. This guidance is based on foreign exchange rates as of August 3, 2023. First, we are maintaining our organic revenue projections of up mid single-digits for 2023. We expect pricing will more than offset volume declines. And as we approach 2024, we expect to develop a more traditional and balanced mix of price and volume with significantly less pricing and better volumes driving the top line. We project cash flow will be in line with our historical averages. We expect our cash conversion ratio to be in the range of 90% to 95%. We expect overall adjusted free cash flow of roughly €250 million for the year.

As Stéfan mentioned earlier, given the increased visibility on our business and our return to share repurchase, we are raising our 2023 adjusted EPS guidance last updated in Q1 reporting. We now expect adjusted EPS in a range of €1.54 per share to €1.57 per share, or $1.68 per share to $1.72 per share at current US dollar spot rates. This exclude any additional impact of potential future capital allocation.

I will now turn the session over to Q&A. Operator, back to you.

QUESTION AND ANSWER SECTION

Operator: Thank you. We'll now begin the question-and-answer session. [Operator Instructions] The first question comes with John Baumgartner with Mizuho. Please go ahead.

John Baumgartner
Analyst, Mizuho Securities USA LLC

Q

Maybe first off, Stéfan, wondering if you can speak a bit more to the A&P increase you have lined up for the back half? Aside from the pure increase in spending amount, is there anything else that you're addressing differently this year? Is it more Captain, sort of communications refreshing the Captain campaign? Are you trying to convert more consumers to fresh to frozen from fresh? How are you thinking about the actual, I guess, sort of messaging in the back half?

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

A

Thank you, John. Yes, it's a excellent question. The first thing is timing, by the way. Starting with the timing, Q3, it's really something like a preparation of back-to-school. So, it's really going to start, let's say, in less than a week actually to have the maximum impact. So, that's the first piece independently from where we're going to go. The second piece is more than ever, we're going first with the Must Win Battles in countries like UK, Italy, where we have the highest rate of return on investment.

Then, quantitatively speaking, it's really to your point, I think it's for example, Captain, which is an iconic figure for us, is going to be, obviously a hero for us, especially in countries like Italy with Captain FINDUS or in the UK with Captain Birds Eye. And then obviously, we're also going to be more aggressive in terms of claims, in terms of value and quality security, which is already something we start, we're doing right now. So, that's going to be the the global pattern for 2023 and also more to come, obviously, for 2024. But the key message is big increase.

Second, it's really going to start in something like a week to have maximum impact and then Must Win Battles, and then the best return on investments.

John Baumgartner
Analyst, Mizuho Securities USA LLC

Q

Okay. Thanks for that. Just a follow-up coming back to innovation, and the innovation pipeline. Prior to the inflationary environment we have now, you had some pretty good momentum increasing emphasis on frozen meals, sort of that premium single serve space, the veggie meals, and so on. Given the environment now and your enhanced focus on that sort of opening price point consumer, how are you assessing the opportunities in premium single serve from here. Does that remain as attractive going forward? How do we think about sort of that mix and margin accretion from innovation?

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

A

Well, the thing is, to your point, I think we have a good momentum, that's the first piece. You also remember that last year, we were facing this question about supply chain in fish, and we've really taken the opportunity to do two things at the same time, which is really to let's say step up the innovation in fish, but also go with something which is farmed fish with Basa, high level, high quality farmed fish coming from Asia, which is doing two things. First is, we obviously stepping up innovation in fish. And second, we are diversifying away from, let's say call it white fish only. So, that's a big piece for us this year.

Second piece is, we also taking a more, let's say, opportunistic approach compared to the past. You may remember when we acquired the business with Goodfellas, that we said, well you know it's mostly UK and Ireland. Well, because basically, it's going to focus on our mantra which is Must Win Battles. And but when we see that there is a dislocation of a category like Pizza, in France, for example, we believe that we can play a role. And that's what we've been starting to do. Even last year, exclusivity with Carrefour and then really starting to develop in all the other retailers. And this with pizza, with basically with Goodfellas. So, because for us, basically innovation is also the ability to move. We have such a fantastic number of SKUs.

The richness of our portfolio is amazing. What we can do then is obviously to move from one country to another. So, you don't need to just lifting, then moving to another country. And that's the kind of things we are doing right now, in pizza, by the way. So, in terms of the affordability is a great example of kind of how can we be more affordable during price crisis environment, in crisis environment. So that's the kind of things we're doing. But obviously, more to come in the coming weeks and months because yes, we, our portfolio is moving well and innovation is really the key piece for the future – for our future algorithm as well.

John Baumgartner
Analyst, Mizuho Securities USA LLC

Q

Okay. Thanks, Stéfan.

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

A

You're welcome.

Operator: The next question comes with Peter Saleh with BTIG. Please go ahead.

Peter Saleh
Analyst, BTIG LLC

Q

Great. Thanks. Sorry, if I missed this comment on. But just curious on the A&P investment. It sounds like that is pushed out a little bit further than I anticipated. I thought it was going to start a little bit earlier. Can you guys comment on that? And has the amount of investment changed your thinking there? Thank you.

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

A

No. The amount of investment has absolutely not changed. We remain committed to substantially our A&P in the year. What we've done is simply preparing our campaigns in sync with the in-store activity and the intervention we would do on some of the activity relating to the Must Win Battles, we are clearly focusing on. So, for us, there is an intent to up the game. We clearly want to regain the share momentum. We have a great momentum going on right now. And so, with the incremental A&P that is about to come let's say in the second half of Q3, moving forward in Q4, which is going to be substantial together with intervention in store. And at some category level which we expect that there would be a sequential improvement of our share pattern as we move forward.

Peter Saleh
Analyst, BTIG LLC

Q

Great. And can I just ask on Green Cuisine and plant-based meat. What are you seeing these days in this category? Are you seeing any improvement or is it kind of more of the same on just kind of lackluster growth in this category? Thank you.

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

A

Well what we see is, is more stabilization of the sales across the board. Our market share, where we are present is slightly increasing with, UK decreasing a bit, and Germany increasing quite, quite, quite substantially. And well, we always believe that Green Cuisine is in plant protein is remains a great category. We never dreamed of, the kind of somewhat expectations in the past which we still believe that there is something that is going to stay after a while. The difference also for us is we're not limiting ourselves to meat, we have chicken, we have fish, we have vegetables. And that makes us, in terms of plant protein, I'm talking about plant protein, it's what makes us very different from some other players in the category. So, overall, for us, it's more stable than anything else. But we still keep investing in the category. We believe in investing in this category. And at some stage, it's going to come back and we will be present.

Peter Saleh
Analyst, BTIG LLC

Q

Thank you very much.

Operator: [Operator Instructions] The next question comes with Jon Tanwanteng with CJS Securities. Please go ahead.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Hi, good morning. Thank you for taking my questions. I don't know if you mentioned this in your prepared remarks, but did you talk about your pricing differential versus the private labels and how that's evolving, in Q2, and how you expect it to trend over the next couple of quarters or so?

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

A

No, I don't think we have, as such, we've responded to that question. But let me come with the fact. You may remember, Jon, that we were talking about the 10% pricing difference in, I mean, in terms of price difference compared to pre, let's say, inflation. Just let me be specific. Then, last time, we mentioned it was more in the region of 7%. The latest that we see right now is more in the region of 5%. But again, it's a bit volatile as things are moving. We believe that it may change again because, as you know, what we want to do in H2 is not only a substantial increase in terms of A&P, but also starting in September, some very surgical promotion where needed. And I think that part will also help us to reduce the gap. That together, obviously, with something that we see coming, which is a milder pricing environment for the future.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Got it. Thank you very much. So, the improvement so far in that gap, or the closing of that gap so far has been from private labels increasing price. But as you go forward, you may be targeting some pricing action of your own to get that gap closer. Is that fair to say?

Samy René Zekhout
Chief Financial Officer & Director, Nomad Foods Ltd.

A

That's fair. And I think Jon just to be super clear, it's closing the gap, I just want to make sure that there is no confusion, it's again reducing a gap that had widened. There has always been a gap, and there was a gap which we've been operating and clearly growing share with that gap together with the rest of our business model activation. But that gap has increased. And now the good news is, I think that gap is starting to narrow down, and to Stéfan's point on that one, it's exactly and your interpretation is correct.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Got it. And then second, you've mentioned that last year was an exceptional year for you, especially in the Adriatic due to heat wave. We're seeing that again, obviously, this year, maybe even more severe. Are you seeing similar performance in those regions or are there differences this year? Given specifics and underlying geographies and inventories and how you change the businesses over the years?

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

A

Well, we're still very pleased, and more than ever pleased by this acquisition and the performance. That's the headline. To your point, I mean, you remember, well, last year we were a bit caught by surprise in terms of inventory building and we missed some sales despite obviously, I mean, obviously a great season. And we've learned a lesson. So, we already started last year in Q4 to build inventory, so that our service level would be perfect. The service level at this stage is 99.5%, so that's not bad to be in that way. And the team is doing a fantastic job. So, Q1, Q2 was a bit – let's say Q1 was a bit lower. The weather was not great and the weather was not great until something like, I'd say, mid-June, since then you know the weather we see, which came at the right time, let's say the temperature has increased substantially. And what we see is the countries are doing a really great job operationally, sales-wise. So, we're expecting another very, very good year.

Jon E Tanwanteng
Analyst, CJS Securities, Inc.

Q

Great. Thanks, guys.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Stéfan Descheemaeker, for any closing remarks. Please go ahead.

Stéfan Descheemaeker
Chief Executive Officer & Director, Nomad Foods Ltd.

Thank you for your participation on today's call. After a challenging 2022, we have delivered strong organic sales growth and protected our margins in the first half of the year. We continue to provide excellent service to our retailers, and we have a compelling innovation pipeline for the second half of the year. As we deploy new A&P into the market, we expect our volume and market share performance to improve sequentially. Frozen food remains a great value for our customers and consumers, and we are proud category leaders. We're on track to deliver our ambitious financial objectives for 2023 and beyond.

Thank you all. Operator, back to you.

Operator: Thank you, sir. This conference is now concluded. Thank you for attending today's presentation. You may now disconnect. Have a great day ahead.