Lindt

MAÎTRE CHOCOLATIER SUISSE
DEPUIS 1845

TRANSCRIPT OF WEBCAST PRESENTATION ON TUESDAY 27 JULY 2021

LINDT & SPRÜNGLI HALF-YEAR 2021 RESULTS

<u>Slide no. & title</u>

1. Half-Year Results 2021 (cover slide)

Ladies and Gentlemen, it is my pleasure to welcome you to the Lindt & Sprüngli telephone conference on the occasion of our Half-Year Results 2021.

During the presentation, I will provide some additional comments on the charts that were uploaded this morning to our website, and where a transcript of my speech is also available.

I will guide you through the slides via webcast. The presentation will take approximately 30 minutes. Following the presentation, I will hand over to the operator, who will then manage the Question-and-Answer session.

2. Agenda

The agenda points of the presentation can be seen on this chart and include:

- a detailed review of the first half,
- an update on the important topic of sustainability,
- our expectations for the full year, for 2022 and in the medium term,
- and a chance for you to ask questions at the end of the presentation

I would also refer you to the disclaimer at the end of this slide deck.

3. Review of Half-Year 2021 (section slide)

Despite the exceptional and volatile nature of this epidemic, our systems have continued to cope extremely well in the first semester of 2021.

You will remember that we decided last year not to fundamentally change our plans, but to continue with our usual advertising investments behind our core brands.

This year’s first-half results are proof that this strategy was the right one and that our brand can rightly be regarded as one of the winners in these difficult times.

Over the past 18 months, we have continued to invest in projects that drive efficiency, with some tangible benefits already visible. From 2022 onwards, we shall be able to fully leverage these assets.

I will now provide the usual detailed review of our results.

4. Overview – Half Year 2021

In summary, the Lindt & Sprüngli Group has got off to a strong start in 2021.

The organic top-line result for the Group was very positive with a growth rate of +17.4%. It is fair to say that group sales have almost returned to their pre-Covid growth trajectory.

If you compare this year's growth with the first half of 2019, you will see that we grew over the two-year period at a compound annual rate of almost 4%.

This exceptional double-digit first-half growth was spread fairly evenly across all three regions, Europe, North America and the Rest of World.

EBIT came in at CHF 138 million delivering a record first-half EBIT margin of 7.7%, surpassing even 2019's margin of 7.2%. This margin expansion was driven by the sales increase and the positive impact on cost absorption.

Net income was CHF 102 million with a net income margin of 5.6%, again a first-half record. The tax rate in the first semester was 22% which, by the way, is also our full-year assumption.

Free cash flow reached CHF 228 million in the first 6 months, an increase of CHF 40 million over first half 2020, coming in at about 13% of total group sales. We had a one-off cash outflow of CHF 43 million from exiting a multi-employer pension scheme in the US. Without this one-off payment, we would have delivered an increase of CHF 83 million, roughly equivalent to a 15% free cash flow margin. As expected, we saw a slightly negative impact from capex, but are on track to deliver a low double-digit free cash flow margin for the full year.

Our net debt position, which includes a lease liability of CHF 505 million, increased to CHF 326 million. This is slightly higher than in December 2020, but lower than one year ago when net debt was at CHF 567 million.

It is worth stressing at this point that our equity ratio remained strong at 58% which compares to 57.2% at year-end 2020.

Thanks to the rebound of the business and our healthy top-line growth, our balance sheet remains healthy and robust with a strong liquidity position.

5. Organic Sales Growth

The total Group achieved an exceptionally strong organic sales growth of +17.4 % in the first half. This development should be viewed against the following background:

- The chocolate markets on a worldwide basis have been recovering well and demonstrating very positive momentum.
- On a global basis, the premium chocolate segment was again clearly outperforming the total market.
- In all key markets, we continued to gain market share with our core brand franchises, Excellence and Lindor, and with the important Easter seasonal business.

As mentioned above, we achieved a 4% 2-year compound annual organic growth compared to the first half of 2019, which is slightly below our pre-Covid growth rate and below our medium-term target. It should however be borne in mind that many of our retail stores were closed during the Easter season and that the global retail business is still lagging 2019. Also, our Travel Retail channel sales are still far from 2019 levels.

In the first half of this year, our online business continued to perform very strongly with a high double-digit growth. We benefitted from the general consumer trend towards online purchasing, but also from our strong strategic focus on this channel over the past 3 to 4 years.

Our “streamlining for growth” initiatives are also starting to pay dividends in the US where our three brands, Lindt, Ghirardelli and Russell Stover, all grew organically at double-digit rates and faster than the market. I will give you some more details later in the presentation.

Overall, we are pleased that underlying consumer demand has remained buoyant, and this strong first-half recovery persuades us that future demand for our premium chocolate remains intact.

6. Reported Sales Growth

On slide 6, we see that Swiss Franc growth has typically been negatively impacted by the strengthening of our reporting currency. In the first half of 2021, the negative effect has been smaller than usual with just 0.7 percentage points. Compared to the first half of 2019, sales in Swiss francs are just 2% higher.

7. Sales Analysis – Markets

On slide 7, we see sales in Swiss francs split by market. Please bear in mind that these numbers are shown in Swiss Francs. Therefore, the percentages are impacted by currency fluctuations.

North America, Germany and France remained our largest markets.

Worthy of note within Europe is the UK, at 7.5% of group sales, which has increased its relative size not only compared to the same period last year (+70 basis points) but also relative to the first half of 2019 (+120bp). Italy also made a very strong recovery this first half but also suffered the most last year and, relative to 2019, it is still lagging. The Rest of Europe continued its positive trajectory.

The Rest of the World was the region most impacted by COVID-19 in 2020. At 13.2% of group sales in the first half of 2021, it was able to make a good recovery but was still held back by Travel Retail. By contrast, we saw a nice rebound in markets such as China, Japan and Brazil.

8. Sales Analysis – Growth Drivers

Details of the drivers of sales growth are shown in the chart on slide 8.

The volume went up by +11.2% and when adding the Price/Mix effect of +6.2%, we arrive at the organic sales performance of +17.4%.

- As already highlighted, average annual organic growth over the past two years was roughly 4%, slightly below our pre-Covid running rate. Important to note, however, is that all this growth was volume-driven while the positive price/mix effect this half year has merely brought us back to 2019 levels.
- The positive impact from price/mix in the first 6 months is mainly coming from the channel mix thanks to the rebound of our global retail channel as well as lower sales returns and participation in markdowns from supporting the trade sell-through of unsold Easter products.
- Finally, we had a positive impact from an acquisition in Italy of 0.5% and, as we have already seen, the foreign exchange effect was negative by -0.7%, reaching the +17.2% growth in Swiss Francs.

We now turn to slide 9 to review the key regional segments.

9. Sales Analysis – Segment information

Europe

In our biggest region, Europe, organic sales came in at a positive +16.4% (compared to negative -4.9% last half year), representing a very good performance for this region. Europe's two-year CAGR was roughly 5%, identical to the region's growth in the first half of 2019, demonstrating that we have achieved a full post-Covid recovery in Europe.

We delivered good growth in all European markets and double-digit growth in important markets such as Germany, UK, Italy, Austria, Russia, Eastern Europe, Netherlands and Scandinavia. We achieved these results even though in key Easter markets, like the UK, Germany and Italy, lockdown measures were in place during March and April and all of these markets suffered from a complete absence of tourists.

North America

North America grew by +18.8%, with Lindt USA, Ghirardelli and Russell Stover all enjoying a very positive first semester and growing in double digits. Lindt in Canada and in Mexico also grew double-digit in the reporting period. The overall region's 2-year CAGR was roughly 4.5%, indicating that we still have some upside potential relative to our pre-Covid trajectory.

Total chocolate market growth as a whole was very solid in the last 52 weeks with growth of about +6%. The Lindt, Ghirardelli and Russell Stover brands were able to outpace this strong market growth creating positive momentum and market share gains.

The Wholesale channel was particularly strong, as was the important Ghirardelli foodservice business which was very positively influenced by the reopening of most restaurants and cafes. The extremely positive performance in e-commerce was an important sales driver, and the online channel is a strategic priority for our business worldwide and particularly in the US. Furthermore, our own retail business showed a very solid performance in 2021 even though we are still below 2019 levels and so still have some upside potential.

Russell Stover's core business is focused on gifting and sharing, mainly during the important Valentine's Day, Easter and Christmas seasons. The start to the year was very strong with a good Valentine's and Easter performance. Additionally, we saw good sales momentum with the Russell Stover sugar-free range using Stevia extract as a sweetener.

Also in the US, we have continued to make good progress on various projects to further leverage the Russell Stover acquisition and on our overall streamlining initiatives, mainly in the areas of production, merchandising, logistics, procurement and IT. Bottom-line benefits have already started to kick in this year and we expect more from these projects in the coming years, which will in part be reinvested in our brands and future growth.

Overall, we are extremely pleased with our progress in the US and convinced of our strategy.

Rest of the World

In the Rest of the World segment, we have also grown faster than the markets and slightly above group average with +18.0%, compared to negative -18.4% in H1 2020. The Rest of the World's 2-year organic CAGR of negative -2% suggests that the region's recovery is not yet complete. Indeed, this region was the one most impacted by COVID-19, not least of all because we also report Travel Retail in the segment.

In the first half of this year, Travel Retail continued to be a drag as the first two months of 2020 were very strong. Otherwise, growth came from all countries within this segment.

It is particularly pleasing to see that important new markets, such as Japan, China, South Africa and Brazil grew in double digits. Also included in this reporting segment is our distributor business, which accounts for sales to a large number of third parties who distribute our products within smaller countries. Here too, we achieved double-digit growth.

Given that there are many large traditional chocolate markets within the Rest of the World segment, we see significant premiumisation potential for Lindt. As a result, we remain convinced that this region can achieve double-digit growth in the medium term.

In the second half of this year, we expect a slowdown across all three regions in the growth rate of the overall chocolate market as a result of tougher comparisons. We will discuss this later when I present our revised full-year guidance.

Let’s move on now to the important topic of ‘costs’, category by category. We will start with material costs.

10. Material Costs

Material costs – which have been adjusted for changes to inventories – came in at 33.1% of sales, 220 basis points lower than in 2020 and more or less in line with previous years.

There are three factors behind this overall positive development, one sales-related and two cost-related:

- As explained earlier, our sales volumes increased by +11.2% compared to an overall organic growth of +17.4%, meaning that we achieved a far higher net sales per ton, net sales being the denominator in this calculation.
- On the negative side, we have seen increases over the past 6 months in the cost of packaging materials and some raw materials such as milk and certain tropical oils.
- On the positive side, and as shown on the next chart, cocoa butter prices have come down over the past 12 months leading to positive effects on the overall material cost ratio.

Looking forward, we believe that our overall material costs will be slightly higher in 2022 compared to 2021, also driven by additional sustainability costs over the coming years.

11. Cocoa Price

On slide 11, I would just like to take a quick dive into our most important commodity, cocoa.

As ever, the development of the cocoa market remains uncertain. The outlook depends heavily on the positioning of market speculators who have a disproportionate influence on the cocoa market.

Currently, the market expects a surplus of around 250,000 tons for the 2020/21 harvest season but a small deficit of around 15,000 tons for the 2021/22 crop. The surplus predicted for the current crop is a key reason why cocoa futures have slightly declined over the past three months.

By contrast, the ‘Living Income Differential’ of USD 400 per ton implemented by Ghana and Ivory Coast has continued to push overall costs for cocoa beans from West Africa in the opposite direction.

Overall, as can be seen from this chart, cocoa bean future prices in London are currently trading at around GBP 1630 compared to around GBP 1700 in March this year.

At the same time, cocoa butter ratio has declined to about 2.2 compared to 2.6 one year ago. This is also one key reason why our material expense ratio is lower in 2021 compared to 2020.

Based on current market expectations, and including the ‘Living Income Differential’, we assume that cocoa bean prices for the 21/22 crop will increase only slightly while cocoa butter prices in 2022 may be slightly below 2021 levels.

12. Personnel Expenses

Despite an absolute increase of CHF 36 million, personnel expenses increased at a much lower rate than sales. Consequently, personnel expenses decreased by 200 basis points to a new first-half record-low cost ratio of 25.5%.

A large part of our personnel expenses are fixed costs and so the increase in the overall sales reversed the diseconomies of scale experienced this time last year.

The outsourcing of sales merchandising force in the US was the main factor driving further down the personnel cost ratio to below 2019 levels.

However, once the global retail business is again operating normally, we expect personnel costs to increase slightly as a percentage of sales. While Global Retail has a higher gross margin, it also has disproportionately high personnel expenses.

13. Operating Expenses

Although operating expenses increased by CHF 56 million, the ratio decreased by -110 basis points, driven down by economies of scale from fixed expenses, such as warehousing costs.

It should be noted that we continued to increase advertising investments and to invest in our brands across all geographies with the objective of emerging from the pandemic as one of the structural winners.

14. Depreciation and Impairments

Depreciation and impairments remained in absolute terms at the same level as in the first half of 2019 and 2020, returning to 2019 levels as a percentage of sales. The key driver for the increase of depreciation in recent years has been our capex programme aimed primarily at satisfying future volume growth. As a reminder, in line with the new IFRS 16 standard effective from 2019, the reporting of depreciation for right-of-use assets caused a step change upwards.

One of our biggest capital investments relates to the Lindt factory in Stratham, New Hampshire in the US, which is going to absorb planned medium-term increases in volume from gaining market share. As already reported, the slowdown in 2020 due to COVID-19 persuaded us to slightly rephase overall capex in that factory leading to lower capex in 2020 and 2021 than originally planned. I will discuss capex in more detail later.

15. Operating Profit (EBIT)

The EBIT figure at CHF 139 million or 7.7% of sales set a new first-half record, increasing by 660 basis points compared to the first half of 2020. The increase of more than CHF 120 million is due to the factors discussed at length in the previous slides and are primarily the result of strong organic growth leading to a reversal of last year’s diseconomies of scale.

16. Net Income

Net income also reached a new first-half record, coming in at CHF 102.0 million or 5.6% of net sales. Net financial expenses came in at CHF 10.9 million compared to CHF 13.4 million one year ago. This was mainly due to the lower US dollar interest rate and related lower hedging costs for subsidiary financing. The applied tax rate was 22% which is also in line with our full-year outlook. Over the medium term, we consider a tax rate of around 22% to be sustainable, assuming no major changes in tax legislation. Of course, we are closely following the OECD debate around a minimum 15% tax rate as well as US tax developments.

17. Capital Expenditure

Capital expenditure in the first half came in at CHF 134 million, just CHF 17 million higher than last year. This is in line with our revised plans which postponed certain growth-related investments in 2020. We now expect capex to reach around CHF 300 million for the full year. As communicated above, we have been rephasing capex where appropriate and now expect to spend around CHF 300 million annually over the coming 2 to 3 years.

18. Development of Net Financial Position

As I take you through the ‘bridge’ of the main cash-relevant developments of the first half, my key message to you is that we are focused on cash generation, now more than ever.

Indeed, in the period under review, we managed to generate a positive free cash flow of around CHF 230 million, over CHF 40 million more than this time last year.

When reviewing our net debt, please also bear in mind the ongoing impact of IFRS 16 on our lease liability with a negative impact of CHF 505 million.

At the end of the first half, net debt reached CHF 326 million, much lower than the CHF 567 million of one year ago but higher than the CHF 209 million at the end of 2020.

The increase in net debt of CHF 117 million was mainly due to the dividend paid out in May to our shareholders as well as the start of our share buyback program in June 2021. In total, we returned CHF 321 million to shareholders in the period.

Given today’s assumptions, end-of-year net debt should be around CHF 300 million. Before the lease accounting change and on a pure cash basis, we would therefore be targeting a net cash position of around CHF 200 million.

That concludes my review of half-year results. Before we discuss our outlook, I should like to review with you our progress on sustainability.

19. Sustainability Update (section slide)

Sustainability plays a key role in ensuring our business success. Our history of over 175 years demonstrates that we are a long-term-oriented company that continues to deliver exquisitely manufactured, high-quality products.

20. The Lindt & Sprüngli Sustainability Plan

The Lindt & Sprüngli Sustainability Plan – our commitment for a better tomorrow – equips us for external developments and helps us to foster successful collaboration within the company; improve the livelihoods of farmers in our countries of origin; contribute to an intact environment; and delight our consumers. These four components and the eleven corresponding focus areas form the framework of our Plan. Each focus area covers at least one material topic (as identified in our most recent sustainability materiality analysis) and has a corresponding commitment which we report on annually in our Sustainability Report.

21. Sustainability Highlights 2020 – New Medium-Term Targets

Despite the extreme and exceptional nature of the epidemic, we still managed to fulfil and advance important commitments of our Sustainability Plan in 2020.

Since 2008, the Lindt & Sprüngli Farming Program has supported decent and sustainable livelihoods for our cocoa farmers and their families while fostering sustainable agriculture, conserving biodiversity, preventing child labour and improving communities.

Today, we are proud to say that all our cocoa beans are now 100% traceable and verified. In addition, we have met sustainable sourcing targets for Turkish hazelnuts, palm oil, soy lecithin, and eggs. In fact, our palm oil has been 100% RSPO certified since 2015.

We are now working on sourcing all cocoa ingredients and other raw and packaging materials through sustainability programs by 2025.

Child labour in cocoa farming is a widespread and complex human rights issue that is deeply rooted in poverty and sociocultural factors. We are pleased that, by the end of last year, all Lindt & Sprüngli Farming Program cocoa bean farms were covered by our Child Labour Monitoring & Remediation System. This includes training and awareness-raising for farmers as well as the monitoring and elimination of child labour.

Our aim is that by 2025, we will cover farmers for all cocoa products.

Furthermore, we reached key environmental milestones with more than a 20% reduction in greenhouse gas emissions as well as a 22% decrease in municipal water consumption per ton of production in our factories compared to 2015.

Having successfully reduced emissions from our production facilities, we decided as a responsible company to tackle climate change on a broader basis. In May 2021, we committed to define science-based targets for our entire value chain with a long-term goal to reach net-zero emissions. We aim to publish our targets in 2023. Over the next two years, we will critically assess our emissions reporting for Scopes 1, 2 and 3 to ensure it is in line with the GHG Protocol and develop a roadmap of actions. We will regularly report to all stakeholders, including shareholders, on our progress, including potential actions and required investments.

Consumer and customer awareness of waste and plastics has increased sharply in recent years, along with NGO and media attention and a proliferation of legislation globally. So, improving how we source and use our packaging material is another essential way to minimise our environmental footprint.

22. Sustainable Packaging 2025

We are therefore proud to announce several new sustainable packaging targets. By 2025, we aim to:

1. Source 100% of our pulp- and paper-based packaging from certified sustainable supply chains,
2. Make at least 50% of all our packaging from recycled materials,

3. Continuously and proactively challenge our entire packaging portfolio and strive to reduce packaging materials used,
4. Eliminate 100% of non-recyclable plastic and reduce total virgin plastic use by 20% and
5. Make all our packaging 100% recyclable or reusable.

This initiative integrates environmental criteria in the design process of product packaging while maintaining other aspects such as food safety, quality, and cost effectiveness. We look forward to introducing excellent, and more sustainable packaging solutions over the coming years.

23. ESG Reporting

The aforementioned achievements and initiatives are just a few of our ESG highlights. For more details, we encourage you to review the 2020 Lindt & Sprüngli Sustainability Report, which is our main communication on ESG performance. In it, we report on the context, management approach, evaluation and outlook across all focus areas of the Sustainability Plan. The report is available on the sustainability section of our website, along with details of our sustainability policies and the Lindt & Sprüngli Farming Program.

That concludes my update on sustainability. Let us now look at the Group’s financial outlook.

24. Outlook (section slide)

We are extremely pleased that, in the first semester, we were able more or less to re-establish group sales onto their pre-Covid growth trajectory.

In the medium term, we expect to reap significant top- and bottom-line benefits from our ongoing streamlining initiatives in the US. At the same time, we will continue to invest in advertising to stimulate growth and in production to satisfy that growth.

And as we look further into the future, we see unchanged fundamentals driving demand for our products. As a result, we will continue to focus on our leader products, such as Lindor and Excellence, on premiumisation in developed markets and on expansion in growth markets. We see online channels as an additional important growth lever across all products and geographies.

25. Outlook – Full-Year 2021

As we look towards the second half of the year, we face tougher sales growth comparisons, and the Group now expects low double-digit full-year organic sales growth. This represents significantly increased guidance compared to our previous growth forecast of 6-8% in March and is justified given that group sales have recovered sooner than we expected.

There is no change to our EBIT guidance of 13% to 14%, though our progress this year to date suggests that we shall now land at the upper end of this range. Although we reached record profitability in the first semester, the second half of the year is much more important to our full-year performance. And we need the flexibility to increase investments in advertising and consumer promotions if we see an opportunity to enhance our growth trajectory.

Finally, and as mentioned earlier in the presentation, we plan capex of around CHF 300 million and a tax rate of roughly 22%.

Of course, everything depends on how the pandemic develops. Currently, the most important assumptions in our 2021 forecast are that:

- Overall chocolate market growth will slow to low single digits
- There will be no major new COVID-19 waves that require further widespread lockdowns and Travel Retail gradually gathers momentum
- The majority of our own retail stores will remain open from now until the end of the year with an ongoing recovery in like-for-like store sales growth

26. Outlook – Medium-Term

Our medium-term guidance is unchanged, though we are obviously starting from an improved base in 2021.

In light of the strong sales recovery this year to date, the Group remains confident for 2022 and over the mid to long term in achieving its goal of an organic sales growth between 5% and 7%.

In 2022, we continue to expect EBIT margin to recover to around 15%. Thereafter, we expect to deliver an average increase in EBIT margin of 20 to 40 basis points per year.

And as mentioned earlier, we expect capital expenditure to remain at around CHF 300 million and see a tax rate of around 22% for the next couple of years.

27. Q&A (section slide)

With this, I come to the end of my presentation and hand over to the operator who will manage the Question-and-Answer session. We ask you to limit yourselves to a maximum of three questions, so everyone has the opportunity to ask questions. Please note that questions that will be asked via the web in writing will be answered by email after the meeting.

Thank you.

28. Disclaimer