Verallia 9M 2019 Results

Thursday, 7th November 2019

Financial Highlights and Key Initiatives

Michel Giannuzzi

CEO, Verallia

Good evening everybody and thank you very much for joining this conference call on the third quarter results for Verallia. I will start with the financial highlights and the key initiatives of the quarter and then after I will share this presentation with Didier Fontaine, the Group CFO who will go through the financial results and the cash performance.

So if we start with the most important event of the quarter, I think you will all recognise that the IPO of Verallia on Euronext Paris on 7th October was a great success. And associated to this IPO, we also put in place a new financing that Didier will comment in detail. In terms of revenue we have a very strong reported revenue growth of 7.2% and at the constant exchange rates and scope it's a 10.1% revenue growth for the first nine months of the year. This makes the first nine months of the year revenues at €1,976m. In terms of adjusted EBITDA again a very strong result leading to 12.9% increase of adjusted EBITDA for the first nine months at €478m. And if we look at the constant exchange rates and scope we see the 16.9% increase of adjusted EBITDA which means that our adjusted EBITDA margin for the first nine months reached 24.2% of sales, which is up 122 basis points versus the prior year. It's worth noting that this EBITDA margin has been also positively impacted by IFRS 16 by €16m which represents about 80 basis points of improvement. As you know, we are deleveraging this company quite significantly year-on-year and if we look at the last 12 months we have moved from a leverage of 3.3x to a leverage of 2.7x at the end of September 2019. And all these very strong results of Q3 2019 have led us to revise and upgrade our guidance for 2019, both for the organic growth and adjusted EBITDA.

So moving to page 4, just a few flashback on the IPO. It was the largest IPO since 2017 on Euronext Paris. I remind you the share price was €27 per share for a total offering size of €963m which represents 35.6 million shares. You have on page 4 the new board composition with new independent board members joining the board. Namely, Cécile Tandeau de Marsac, Marie-José Donsion and Virginie Hélias. And as you know, we also have welcomed in our share capital a very strong investor, BWSA that is being represented at the Board by Joäo Salles.

The capital structure at the time of the IPO, so one month ago, was split as mentioned on page 4 with still 61.6% of the shares being held by Horizon Parent Holding in which you know 90% of the estimate ownership is with Apollo and 10% with BPI. Managers and employees own 7.6% of the shares of the capital. BWSA, the Brazilian core investor owns 8.6% of the capital. BPI France has a direct participation of 1.3% on the top of the one they have in Horizon Parent Holding and the free float is 20.9% of the capital share. And you've got the list of the various committees. It's worth noting that we've also decided to put in place a Sustainable Development Committee led by Virginie Hélias as the Chairwoman.

The second highlight of the quarter has been the successful realisation of the €24 million investments made in the Lagnieu plant in France to modernise it. And we took advantage of the reconstruction of one of the two furnaces there to upgrade and modernise our five production lines, improve our performance and environmental impact and also to train our people with more than 1,000 hours of training being spent during the shutdown of the plant for repair. So with this being said, I will now hand over to Didier who is going to comment more in detail the financial results.

Financial Results

Didier Fontaine

CFO, Verallia

Thank you, Michel and thank you all for joining the call. As usual I will start my presentation by reviewing the revenue numbers and then we will move to the profitability for the Group. I will then finish with the evolution of the debt of Verallia for the first nine months of 2019 and I will cover the new capital structure as well. First, please note that we will be commenting on the nine months results as it is more representative of the current state of the activity than the sole Q3 taken separately.

Now, let's move to page 7 and as Michel stated before, the results are very satisfactory over the first nine months of the year. If we start with the top line, in Q3 alone we posted a 10.6% organic growth, showing a slight acceleration compared to the first half of the year, which was itself at 9.6% organic growth. If we start with the top line reported revenue increased by 7.2% over the first nine months versus the same period last year, reaching €1,976m. The top line over the first nine months remained significantly penalised by exchange rate evolution, as you might note, essentially owing to the continued depreciation of the Argentine peso against the euro not being offset by hyperinflation. The current political and economic instability creates in fact volatility on the currency. Let me also remind you, and I did that each quarter but I think each quarter it is important to emphasise on it. Argentina represents only 3% of our sales but we are very well positioned in this country with a very efficient industrial setup and our clients are wine makers and mostly exporting ones.

Consequently, at constant exchange rates and scope, and excluding the hyperinflation impact, the Group sales grew by 10.1% year-on-year over the first nine months. As I said, Q3 represented a 10.6% organic earnings growth, showing a slight acceleration compared to the first six months of the year, which was reported at 9.6%. This strong increase over the first nine months has been repeating what I have said since the beginning of the year. Number one, a significant volume expansion across all geographic regions and all market segments. In addition, the mix has improved, confirming the increasing premiumisation of our product range. And finally, we benefit from the full impact of the selling price increases carried out at the start of the year to mitigate the surge of cost (primarily energy and raw materials) and to cover the inflation in Argentina. Consequently, a significant price increase has been implemented in Argentina. The takeaway of that slide is that we have been able to consistently deliver a strong organic growth of over 10% over the past nine months.

Now moving to the page 8, going through the profitability of the first nine-month period. First of all, the adjusted EBITDA reached €478m which represents a 12.9% increase versus nine months 2018 or at constant exchange rates and scope and excluding hyperinflation in Argentina, 16.9%. This strong adjusted EBITDA increase has been driven by our three main pillars that you are familiar with. Number one, the operating leverage starting from the left-hand side, operating leverage leads to the robust revenue growth. Number two, we benefit from a positive mix as a result of our product range premiumisation associated to the same price increases. Altogether this enabled us to deliver a positive price cost spread. Operational efficiency, basically our PAP, the net amount reached €28.5 million and to be more granular we have presented in this chart the net productivity amount, which includes a pure PAP action plan of €33 million, more than 2% of the cash production cost, offset slightly by some negative industrial variances for €4 million. Those PAP achieved over the first nine months are exactly on track with our annual 2% production cash cost reduction target. It's worth noting that the activity contribution of the graph has been impacted by some inventory destocking. We have been mentioning that already in our communication in our first half results, therefore reducing the absorption of fixed cost. As you might remember, we have increased quite significantly our inventories at the end of 2018 to cope with anticipated top line growth starting 2019. The negative impact from the adverse exchange rate discussed earlier, and you know this is exclusively conversion or translation impact, weighted for €17 million and essentially coming from Argentina. Lastly, in the "other" bucket you can find IFRS 16 norm implementation impact. This is a €16 million impact. This has been partially offset by exceptional maintenance or specific service maintenance and one-off items that impacted positively in 2018 and are missing in 2019. All that together, the margin expansion reached 24.2%, up 122 basis points compared to the nine months 2018.

Cash Performance

Didier Fontaine

CFO, Verallia

Now let's talk about cash a little bit as we are moving to the page 10. Over the first nine months Verallia has again demonstrated a strong ability to deleverage consistently as net debt has been reduced by close to €150 million compared to the same period last year despite €50 million negative impact from IFRS 16 implementation. In terms of leverage we continue to deleverage and it dropped from 3.3x last 12 month adjusted EBITDA as of September 2018 to 2.7x end of September 2019. It was 3.1x at the end of 2018. And you can see that we have a very strong level of liquidity at the end of September, €496 million and remember our liquidity has been calculated as the cash plus the undrawn portion of the revolving credit facility minus the used portion of the commercial paper.

I'm going to resume page 11. We want to talk about the new financial or the capital structure that has been implemented on 7th October as part of the IPO process. We are enjoying an even more optimised capital structure. First of all, we have been implementing a new Term Loan A under a syndicated bank loan for €1,500 million, basically unsecured, five years bullet with a margin of 175 bps. And that compares very favourably to the former term loans that were priced at 275 bps and were secured ones. You can have access to those details on page 19 in appendix. In addition our revolving credit facility has been extended to €500m versus €325m at a margin of 135 bps versus 250 as shown on the same page 19.

And lastly it is very important to us because we have been one of the first companies under LBO to implement that last year in June. We continue and we are expanding our programme of negotiable European commercial paper, NEU CP. It's a programme of €400 million of which today we have drawn €192 million as of September 2019 at very competitive rates. The overall cost of our debt will be decreasing from 3% to 2%, including the swap cost. This refinancing will enable us to save €20 million run rate per year of cash interest cost, representing a 0.6

year of payback. Moreover, the cost package is very competitive with among other things a new leverage covenant at 5.0x adjusted EBITDA and all that gives us a very significant flexibility going forward. In term of liquidity and pro forma refinancing because some of the refinancing will be done through uses of cash, it amounts to €469 million which compares to our debt and is at a very comfortable level.

Now, thank you all for listening. I give now the floor back to Michel to cover the conclusion as our Group for the rest of the year.

Michel Giannuzzi: So thank you, Didier. So as you understand this is a very strong performance in Q3 in line with the first six months so we are very happy about this strong performance. Just two words to remind you about our strategy. It remains based on four pillars and you've been able to see and look at the results that are, I would say, coming from this strategy. The first pillar is disciplined growth which means for us both profitable and durable growth. The second pillar is about operational excellence deployment. Mainly the PAP is one of the big items in this chapter. The third pillar is to continue to invest very wisely in the business. And last but not least, the fourth pillar is to keep developing a strong entrepreneurial culture at Verallia. These four pillars have been very successfully deployed during the third quarter in line with what we did before. And these are materialising or evidenced by the results in the three financial areas that are the sustained volume growth, the positive inflation spread and the Performance Action Plan.

So the very strong performance of the first quarter has led us to upgrade our guidance as far as organic growth and adjusted EBITDA are concerned. So today we believe that we will end up the year in terms of organic growth between 8% and 10%, which is higher than the 6-8% we initially communicated. And in terms of adjusted EBITDA it will be above €610 million compared to the previous announcement which said around €610 million. These are not big changes, but I think it's more about giving you more precision about our landing results at the end of the year. The other 2019 objectives are not changed. We will end up the year with a net financial debt on adjusted EBITDA ratio at about 2.7x in December 2019 and we will of course have invested this year around 8% of the recurring capex in the business as we previously communicated. Of course, excluding the capitalisation of the right of use associated with the application of IFRS 16. And finally, we confirm that subject of course to the Company's Annual General Shareholders' Meeting we will propose an annual dividend for 2020 to the amount of €100 million based on the 2019 results.

So this is it for our presentation. Now I would like to open the floor to question and answers.

Questions and Answers

Matthias Pfeifenberger (Deutsche Bank): Yes, good evening gents and thanks for the call. Congrats to the IPO, to the strong Q3 and also to the guidance upgrade. A couple of questions from my side. Firstly, the Lagnieu plant €24 million renovation investment, just to clarify, is this part of the recurring investment? Could you also say if it's basically also including renovations of furnaces. I think you didn't change the capex guidance so that might be the answer. And then secondly, you didn't comment on the regions at all. Do you want to give us any colour there, especially on North America and maybe Brazil, or even Western Europe? Maybe some additional details on the regions. Thanks.

Michel Giannuzzi: Thank you Matthias for your questions. Yes, maybe I was not explicit enough. The example I gave about Lagnieu investment is part of the recurring capex so it is included in the 8% of recurring capex. It's a strong focus on this plant because it's a major event in France but it's really part of €200 million or more or less €200 million recurring capex, which is the 8% of sales recurring capex that we are targeting. Regarding your second question, we don't provide as you know detailed breakdown of growth by country or by segment of the markets. The one thing I can comment though is that all countries and all segments of the market have contributed to the growth in the quarter and basically in the first nine months. So we've not seen any weakness in any market or any segment or any country that would have lowered our results, our growth plan. It's really across the board, all regions. And as you know we are not in North America, just as a frequent of precision. 90% of our business are in Europe, including Ukraine and Russia, so Greater Europe, if you can say so. And 10% of the business is in Latin America, namely in Brazil, Chile and Argentina. But we are not in North America, hence we didn't suffer from any slowdown in the market.

Matthias Pfeifenberger: Thanks a lot.

Markus Remis (RCB): Good evening, a couple of questions please. Firstly, on the drivers for the upgrade, if you could provide a bit more granularity on where you see the stronger than expected growth coming from. Is it certain regions? Is it volume? Is it the price mix effect? And then also regarding the third quarter earnings bridge or nine-month earnings bridge, if you could break down the €96 million activity contribution into a volume pillar and the price mix pillar as you did it in the IPO presentation, that would be very helpful to track the process here?

Didier Fontaine: First on the upgrade of the forecast, we have been enjoying a very strong September. A very strong Q3, I mean, volumes have been pulling everywhere with a good mix. PAP has been carried out and we have the carry-over of the good performance, so you know, on the mix and on the price increases at the beginning of the year. So that – we were expecting perhaps, you know, the first half was very good, everybody was saying, 'Okay, this is pooling a lot. This has continued to pool. And the fact that we're been revising our forecast as well. As regard the activity contribution, you know we are not giving that kind of granularity on the quarterly basis. We are giving that of course on a half-year basis and on the full-year basis. But beware that it's still the same that we have been discussing at the IPO. It is a positive spread, significant because we are enjoying mix and price increase. And a strong volume contribution. Despite again the fact that we are destocking. And of course, the PAP is delivering a little bit more than I expected and has been a little bit impacted by some, like I said, industrial variances.

Markus Remis: Alright. Okay, let me add a question on the cash flow development. We're now at net debt of €1.63 billion. I think you initially kind of gave the guidance of €1.64 billion at year-end so how should we think about the free cash generation in the fourth quarter? I mean, is it – apparently it will be nil. Is it due to a spike in capex or?

Didier Fontaine: There are two things. When we say 2.7x it's likely that we could be slightly below because we've planned to generate cash in Q4 as well. On the other hand, you know we are investing on the two brownfield projects that are going to start mid-2020. Basically that's all strategic capex in Spain and Italy. And we will start spending for those capex.

Markus Remis: Okay. So would you share a capex figure with us, recurring including strategic capex?

Michel Giannuzzi: Well, the recurring capex is 8% of revenue. We confirm the guidance of 8%. And if you take the two brownfield projects altogether you are talking something around €85 million over two years.

Didier Fontaine: Basically, Q4 this year and the first half of next year. Over the coming nine months.

Francisco Ruiz (Exane): Hello, good afternoon and congratulation for the – for the great figures. Since some of the questions has been answer and some – we still have some blanks on this volume and price impact but I would like to insist a little bit if you could give us on the organic growth how much has been the contribution of Argentina? Because it's has distorted already in H1, you could give us what is the amount of price increases mainly due to hyperinflation that has impacted your organic growth. The second one is if you could give us the detail on what is the price cost impact in terms of EBITDA because we don't – only have the – the cost inflation. And the third thing is regarding seasonality. Do you have any seasonality on Q3 margins because last year were very strong as well as this year? And this is something that is going to be a small thing in Q4. Thank you.

Didier Fontaine: First of all on Argentina – first, good afternoon. In Argentina we consider that out of the 10.1%, 200 bps is linked to the fact that we are passing more than inflation to the local market. The inflation plus because the spread in Argentina stays positive today. So consider that 200 bps is coming from Argentina. It's still leaving a very, very strong 8.1% organic growth outside Argentina. Point number two, on the price impact I'm going to make the same as I did before. I mean, consider that the spread is positive thanks to the mix but thanks as well to the price which is over the cost. I cannot tell you more and you know that I'd be happy to comment that on the full year basis. Last year was very strong Q3 because if you look last year compared to this year, we built up inventory in Q3 last year. So last year was very strong, driven more by the build-up in inventory than by the volume pick-up. This year is a little bit the opposite. The volume are very strong and there's no build-up in inventory. It's more destocking than building up inventory. So, there is no real seasonality on that. Last year was specific inventory were all picking up. This year volume are driving it and we're not building inventories.

Michel Giannuzzi: if I may add something to this question that you might also have in mind is what could be the impact of our customers building inventory in advance of Brexit and maybe the tariffs of the US tariffs. Because we cannot exclude that some of our customers have at the end of Q3 built some inventory to face Brexit and to, if you want to try to imagine part of the US tariffs. So this could also have a little bit boosted the Q3 results. We don't know by how much, if any. But we know that some of our customers have tried to anticipate. Having said that, just a reminder about the WTO decision regarding the US tariffs. This decision has started to be implemented on 18th October. It concerns mostly still wine below 14° of alcohol made in France, Germany, Spain and the UK. Strangely enough, Italy still wine is excluded from this 25% import duty. Regarding the sparkling wine, they have been exempted from the tariff list right now. So no change for the champagne, the prosecco or the cava. And regarding liquors, the spirits, these are mainly concerning Germany, Ireland, Italy, Spain and the UK so therefore it's mostly Scotch whiskeys and Italian maybe liquors that are being impacted. Again, strangely enough, the French spirits are not included in the list so it's kind of a mixed bag of countries and categories of products. We estimate all in that the impact for us and for our customers is not really material. Compared to the 8% growth, I mean, that's I think the 10% growth we are imagining, then excluding Argentina 8% growth that Didier was mentioning, we don't consider this being seriously material. So but just wanted to highlight that – those last two months might have been a little bit boosted by our customers building inventory. We don't know for sure because nobody has reported very clearly anything on that.

Lars Kjellberg (Credit Suisse): Thank you. If I may just continue on what you just said. Could you elaborate a bit what you've seen, I mean October/November, in terms of any changes to the business on account of the, you know, tariffs etc.? You did mention of course then the reason really for why the operating leverage went down a bit in Q3 because your margin expansion is somewhat lower versus the first six months. I appreciate that destocking versus restocking. But can you give us any sort of sense of the quantum that destocking impact year-to-date and how we should think about that going into the fourth quarter versus last year?

Michel Giannuzzi: Okay good evening Lars. I will not comment November yet because you're only 7th November so it's difficult. And you know our business doesn't give us a lot of visibility. It's a recurring business but our order book is short-sighted, if you want. So but the reason why we revised upward our guidance in terms of organic growth is because, as Didier explained, we had a very strong September and strong October as well. And just taking into account those two strong month, knowing that there is a little bit of seasonality in our business, therefore November/December are every year lower activity month than the other months, this has mathematically showed – enabled us to increase upward our organic growth guidance. Regarding the margin, I will let maybe Didier…

Didier Fontaine: Yeah, I think on the stock, because we are talking about inventory impact. On the inventory impact, clearly last year, especially in Q3 but all over the year, we have increased significantly our level of inventories. So a very significant absorption. And by the way, it was the right thing to do. Even though it was penalising the working capital at the end of the year because it enabled us to address the very strong growth compared to last year as well. Much bigger, remember it's one level. This year basically today we are dropping our inventory since the beginning of the year by around 7%. So in volumes, in kilo tons. So this is just giving you the type of bracket today. The impact is highly negative from the unabsorption of fixed cost. But that is to address the growth from the higher sales.

Lars Kjellberg: I didn't quite capture the number you said involving terms you brought down the inventory, if you don't mind repeating that?

Didier Fontaine: I said this year we've been reducing inventories by 7%.

Lars Kjellberg: 7%. But if you know, of course that's a very good thing to have very strong demand. So how should we think about this year as we head into 2020? You were building inventory in 2018, you had a very strong year in 2019 and continue to have so. How can you match that continuation of let's say a decent growth next year with your own production so we can get a full contribution down to the bottom line?

Michel Giannuzzi: Well, two things. First of all, we have worked for many month now on improving our supply chain processes. Therefore enabling us to better serve our customers with lower level of inventory. So this is work in progress, I would say. We've enjoyed very important improvement in this area but still more to do on this area. So our own internal supply chain and planning efficiency is getting better and better. That's the first point and the second point is mid-next year we will benefit from the additional capacity from the Iberian and Italian new furnaces that will of course will help us in the second part of the year rebuild some inventory and accompany the growth that we are looking for.

Didier Fontaine: And do not forget as well that we will have the full-year impact of our new plant in Brazil, Jacutinga. We just ramp up in March this year. We will have before the full impact.

Lars Kjellberg: Right, very good, thank you.

Michel Giannuzzi: Well, if we have no further questions, I would like to thank you all for the attendance to this call and I wish you a good evening. Thank you very much.

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