FY 20 Earnings Call, Tuesday, 9th March 2021

Operator:

Good morning and thank you for joining JDE Peet's Full Year 2020 Results Webcast. My name is Nazanine Byetti, and I will be your operator for the call. For the duration of the presentation, all participants will be in a listen-only mode, and the conference call is being recorded. Following the presentation, there will be an opportunity to ask questions. At this time, I would like to turn the call over to our first speaker, Robin Jansen, Director Investor Relations for JDE Peet's.

Robin Jansen:

Thank you, Nazanine. And good morning and welcome to the JDE Peet's earnings call related to the financial performance of full year 2020. With me are Fabien Simon, CEO; and Scott Gray, CFO. In a moment, Fabien will take you through the operational and financial highlights related to our full year business performance. After that, Scott will tell you more about the financial performance in 2020 and the dividend proposal. Fabien will conclude today's presentation with an update on our medium- to long-term targets and the outlook for full year 2021. And after that, we will be happy to answer your questions.

But before we begin, I'd like to direct your attention to the disclaimer regarding non-IFRS measures and forward-looking statements on slide 2. We'd like to ask you to please read this information carefully. Our press release and the related slide deck were published at 7:00 AM this morning. Both documents are now available for download from our Investor Relations website. A full transcript of this conference call will be made available as soon as possible on our website as well.

With that, let me hand over to Fabien.

Fabien Simon:

Thank you, Robin and thank you, everyone, for joining the call today. I am pleased to share our 2020 full year and H2 results with you.

Needless to say that 2020 was an eventful year for JDE Peet's and an unprecedented and tumultuous year for the world. Behind our solid achievements that we will share today are people and I am very proud and grateful of the effort of our teams and of our partners who rallied together to enable business continuity, across the six continents where we are present, and who ensure every day the health and safety of our employees.

JDE Peet's is for me a growth story, built on strategic choices that have been proven powerful this year again, but as well with the fundamental belief that quality of delivery is a guarantee for its long-term success. I trust that you recognize these key themes of growth, quality and long-term success throughout this presentation and in the performance of 2020.

Moving to slide 5.

I think during this pandemic, the coffee and tea category demonstrated once again it's resilience and looking back at our performance in 2020, we can conclude that our focus, discipline and agility have played a crucial role in managing our business during this unprecedented time.

Government lockdowns and restrictions resulted in a significant reduction in Away-From-Home consumption as entire sector such as offices, hotels, restaurants and cafe were closed. At the same time, a significant part of the Away-from-Home consumption shifted to In-Home.

As a result and helped by our global pure-play focus and our powerful portfolio of brands, our In-Home sales increased by a record-high 9.1% with an average consumer price per cup in retail that increased by 4.3% in just a year, supported by our premiumization strategy as well as our over index on the most attractive subcategories of coffee and tea.

All in all, we were able to sustain our organic sales level with only a slight decline of minus 0.2% while increasing our organic adjusted EBIT by 6.2% through innovations, premiumisation and a disciplined approach to cost management.

Another thing I would like to call out is related to our capital structure. In November, Fitch assigned an investment grade rating to JDE Peet's, underscoring our operating strengths, strong financial discipline, high cash flow generation and the continued progress we've made on deleveraging.

I'm very pleased as well with the further steps we've made on our sustainability agenda in 2020 about which I will share a bit more detail later in the presentation.

Overall, it is clear that the combination of our portfolio of brands, technology and channel strategy is powerful and allows us to build scale and to reach consumers with coffee and tea offerings across price points to meet their diversity of needs, occasions and budgets. That was our strength before the pandemic, during the pandemic, and we strongly believe will continue to be a great advantage in a post-COVID era.

As such, we look at the future with great confidence on our growth and value creation opportunity. And therefore, the board proposes to pay a cash dividend of €0.70.

Let's zoom in on our organic growth now starting with the total company performance per channel and per half year.

Because in Q4 of last year new movement restrictions and lockdowns were announced across most markets, the recovery of the Away-from-Home channel was stalled with similar challenges and impact in H2 as in H1. But on the backend of the third quarter of 2020, we took initiatives to reactivate some working media, online and in-store investments. Additionally, the second part of the year saw a return to pricing discipline, which supported revenue growth on both In-Home and Away-from-Home.

All this enabled us to return to growth in H2, with a total organic sales growth of 0.7% during the second half of the year with a historical high In-Home revenue performance which was close to double digits at 9.8% organically.

Let's now turn to slide 7 to look at the highlights of the In-Home performance. The strong In-Home growth I just referred to was actually broad-based across categories, brands, geographies, and channels. We witnessed increased penetration in the most attractive categories. Like, for instance, Single Serve and Beans growing, respectively, at 18% and 28% year-over-year as well as a strong double-digit growth in Tea. We leveraged on the power of our brands either local or global.

And here, we are just highlighting a few of them. Peet's, for instance, our flagship brand in the US and a brand that is among the top most premium In-Home brand of scale in the largest global coffee market that is US and a brand that has been growing well ahead of this market at 27% in 2020. We are referring as well to L'OR, now present in 58 markets, which is our flagship brand on aluminium capsules, growing at 24% globally. And finally, our partnership brand, Illy, for which we do have a global trademark licensing agreement on aluminium capsule, again, growing by more than 100% versus last year. And in 2020, we expanded the presence of aluminium capsules Illy by 12 markets, bringing the total number of markets where Illy aluminium capsules can be enjoyed to 26 markets.

The emerging markets were pretty resilient and kept overall a good growth momentum in 2020 while the strongest uplift came from the developed markets where home was recast as the new coffee shop with consumer more than ever looking for a high-quality cup of coffee at home. And finally, from a channel perspective, we saw a surge in e-commerce for in-home consumptions going by just over 70% in 2020.

These positive developments in our In-Home business also resulted in solid market performance, of which I would like to call out a few on this slide.

As you can see here in the middle box at the bottom, we continue to gain share in the most attractive coffee category being Beans, Capsules and Pads on a full year basis. The Nielsen data do confirm as well our underlying momentum with value market share increase of 50 basis points in H2 2020 versus H1. The above-market growth in these attractive and premium categories helped us to further increase the average retail value price per cup of our brand by 4.3% in just one year as premiumization trends accelerate with desire for consumer to access better and more convenient coffee at home, as they used to experience and appreciate in Away-from-Home channels.

On the next slide, we would like to share some of the most important development we've seen in Away-from-Home.

As mentioned before, the Away-from-Home businesses started to be severely impacted by the lockdown measures imposed by governments across the globe in the course of H1. In the second half, we noted some meaningful improvement in Asia-Pac, while the performance in the US market remained broadly in line with the second quarter as consumers did not return yet to offices or to universities. In other part of the world, most notably Europe, we started to see signs of recovery in Q3 once lockdown measures were eased. But this initial improvement, however, were soon offset by new ways of lockdowns across countries in Q4. Having said that, we do believe that once lockdown measures will be gradually lifted, we will be a net beneficiary of the re-openings in the next few years. Although at this stage, it's difficult to predict the exact shape and pace of this recovery.

Last but not least and before I hand over the call to Scott, I would like to provide you with some of the highlights of the good progress we have made across our sustainability agenda. When I alluded to the fundamental belief of quality delivery earlier on, sustainability is part of it, too. Our growth strategy is built on a robust corporate responsibility framework which is based on three pillars that cover our entire value chain.

Under our Common Grounds program, we increased the share of responsibly sourced coffee. And despite the pandemic, we extended technical assistance and support to approximately 80,000 additional farmers which keeps us well on track to surpass our goal of supporting 500,000 smallholder farmers by 2025.

When it comes to packaging, 87% of our primary and secondary packaging in 2020 was either reusable, recyclable or compostable while 33% of our packaging came from recycled materials, which is not an easy task as the use of recycled material is restricted by current regulations which limit the use of recycled content for packaging which is in direct contact with food.

We also successfully relaunched our leading brand, Senseo, with an industry first compostable coffee bag containing 100% certified coffee and low environmental impact appliance to create a truly sustainable offering for our consumers. In 2020, we donated more than 30 million of cups of coffee and tea to food banks, healthcare professionals and frontline workers.

With that, I will hand over the call to Scott and I will be back to discuss the outlook before we go to Q&A.

Scott Gray:

Thank you, Fabien, and good morning to all of you.

Let me now take you through a few slides that call out the main financial highlights of the year and provide a bit more detail on the segment performance.

As Fabien already mentioned, our strong sales performance of In-Home which represents around 75% of our total sales pre-pandemic, up 9.1%, was able to almost fully offset the steep sales declines we encountered in our Away-from-Home businesses as a result of the lockdown measures across the world and throughout the year.

On adjusted EBIT, we delivered organic growth of 6.2% reflecting the strong growth of In-Home and the successful execution of our premiumization strategy as well as disciplined cost management company-wide.

One of our other top priorities is to reduce leverage and we made excellent progress. We reduced our leverage by 1 full turn from 4.2 times at the start of 2020 to 3.2 times by the end of 2020 as we generated free cash flow €877 million for the year.

Let's move to slide 13 and take a closer look at sales.

Our diversified portfolio of categories and brands across price points positioned us well as we experienced strong In-Home sales growth.

The minimal decline of minus 0.2% in organic sales consisted of a slight volume mix decline of 1.0% which was largely offset by a positive price effect of 0.8%.

The foreign exchange impact in 2020 was primarily driven by the appreciation of the euro against the Brazilian real, the Russian ruble and the Turkish lira. We had total sales of almost €6.7 billion for the year.

Let's now move to slide 14 to take a closer look at our adjusted EBIT growth.

As mentioned earlier, we increased our adjusted EBIT by 6.2% organically and what stands out is that four out of our five segments increased their adjusted EBIT contribution to our growth, with CPG Europe being the strongest contributor.

Across all segments, our EBIT was supported by disciplined and proactive cost management. Early on at the start of the pandemic and the subsequent stay-at-home measures, we quickly identified areas where we could and should adjust our cost base, like our discretionary SG&A and traditional promotional and marketing investments. At the same time, we accelerated our investments and some focus areas such as e-commerce.

And when we started to see signs of recovery in channels in the second half of the year, we increased our marketing spend accordingly. As a result, we spent 41%, or €55 million, more in A&P in the second half compared to the first half.

Despite a 4.2% negative effect from FX and some other small changes, we managed to increase reported adjusted EBIT by 1.9%.

Moving to the next slide, slide 15, you will see an overview of the sales and adjusted EBIT performance by segment.

While CPG Europe and CPG LARMEA delivered strong organic sales growth, you can clearly see the effects the lockdown measures had on the Away-from-Home activities within CPG APAC, Peet's, and Out-of-Home.

Our CPG business in Europe performed very well with 7.0% growth in organic sales. We saw high growth in our main markets in Europe including France, the UK, the Netherlands, and Spain. During the pandemic, the multi-year trend of premiumization was fuelled by the lockdown measures which had resulted in increased momentum in, among others, single serve offerings as well as premium Beans.

CPG LARMEA delivered organic sales growth of 5.3% in 2020 with resilient growth in our key markets despite a more challenging economic environment. Freeze-dried instants and Single Serve were strong growth drivers across markets. The region also delivered strong adjusted EBIT growth above 20% behind higher sales and strong cost control.

The organic sales performance in CPG APAC reflects the impact of the pandemic on the Away-from-Home part of the business as well as a less favourable macro environment in the developing countries within CPG APAC. Australia, New Zealand and China experienced strong In-Home growth while the Away-from-Home businesses including coffee stores and food service were impacted by the COVID-19 lockdowns. The very strong EBIT growth reflects lower operating expenses and a relatively low base of comparison.

As you know, Peet's is active in the In-Home as well as in the Away-from-Home segments. In In-Home, Peet's sales delivered strong double-digit growth throughout the year behind the strength of the brand, the premium products and our DSD system. On the other hand, Peet's coffee stores and its other Away-from-Home businesses were significantly impacted by the lockdown measures. Most stores remained open throughout the pandemic but could only offer limited pickup or delivery services which had a profound impact on the coffee stores' activity levels. The strong EBIT growth of Peet's was driven by growth in CPG and the associated channel mix while further supported by the transition of the ready-to-drink business to a licensing partnership with Keurig Dr. Pepper.

Clearly, our Out-of-Home segment was heavily impacted in unprecedented ways by the effects and movement restrictions of COVID-19. Many customer channels were fully or partially closed during a significant part of the year including offices, education, bars, restaurants and cafes, travel and tourism. In our coffee stores in the Out-of-Home segment, limited service was maintained where possible through alternative business models including for instance takeaway and pickup and delivery.

In the second half of the year, activity levels in Out-of-Home were more resilient as customers, consumers and our teams adjusted faster to subsequent lockdown measures. And despite the unprecedented dramatic drop in top line, the Out-of- Home segment diligently managed cost and customer service to stay profitable for full year 2020.

We believe our financial strength, deep capabilities and flexibility will be an advantage as lockdown measures are eased or lifted and of Out-of-Home channels resume business at different paces.

Now let's take a closer look at our free cash flow performance on slide 16. Our business also delivered very steady and consistent cash flow in 2020, driven by strong operating profit and an improvement of our operating working capital by 270 basis points.

The underlying drivers of our operating working capital were consistently strong delivering again a positive contribution to cash. This was led by our discipline on receivables while our inventory levels were deliberately higher during the course of the year as we prudently built a bit of additional safety stock during these uncertain times.

In 2020, our free cash flow included two non-recurring events that you see coming through in the cash flow. Firstly, we paid €84 million of costs related to our IPO. Secondly, we paid €193 million of future tax payments early as economically it made sense to do so. Excluding these two one-off items, we delivered a cash conversion of 73%.

Moving to slide 17. One of our top priorities is deleveraging. In the first half of the year, we materially reduced our leverage by 0.8 turns to 3.4 times net debt-to-adjusted EBITDA from 4.2 times at the start of the year. In the second half of the year, we lowered our net debt by an additional €462 million which further reduced our leverage to 3.2 times by the end of 2020. This shows the effects of our strong EBIT and robust cash flow generation even with some currency headwinds.

And as Fabien mentioned in his opening remarks, the combination of our operating strength, our strong financial discipline and the continued progress we've made on deleveraging was rewarded with an investment grade rating from Fitch in November.

Reducing our leverage will continue to be a top priority in line with our capital allocation priorities, and we will continue to be well positioned to reach a leverage ratio of below 3 times in the course of 2021 as we move towards our optimal leverage.

We continue to have a very strong balance sheet. Our liquidity position at the end of December was over €1 billion. We had €389 million of available cash on hand and €675 million of capacity under our committed revolving credit facilities. Furthermore, our average cost of debt is about 2.4%.

Before handing back to Fabien, I would like to briefly share our dividend proposal with you on slide 18.

Based on our performance in 2020 and the confidence we have in our future performance, the board will make a proposal to the AGM to pay a dividend of €0.70 per share in cash related to full year 2020 and to being paid in two instalments of €0.35 each in July 2021 and January 2022.

Moreover, we expect future dividends to be stable or growing over time while the pace will be determined by our capital allocation priorities.

Let me now hand back to Fabien who will update you on our medium- to long-term targets and share our outlook for 2021.Then, we will open up the call for Q&A.

Fabien Simon:

Thanks, Scott. So let me first share our thinking about the medium to long term on slide 20 and then tell you more about our outlook for the full year 2021.

It goes without saying that unfortunately the unprecedented developments related to the COVID pandemic have created a lot of uncertainties and long-lasting effects on society at large and on consumer behaviour in particular. Against this backdrop, we have reviewed our strategy and medium- to long-term targets in recent months. The conclusion from this review is that our strategy will not be subject to any material changes.

As a matter of fact, we are actually further encouraged by the future growth opportunity we see. Having said that, we feel it is extremely important to focus on the long-term quality and sustainability of growth, profitability, and market share where it matters. And therefore, we have decided to link our profitability target more closely to our organic sales growth target. As a result, our target is to deliver over the medium- to long-term an organic sales growth of 3% to 5% and mid-single-digit organic adjusted EBIT growth with quality margins. Next to that, we will continue to target free cash flow conversion of approximately 70%.

We will use the virtual Strategic Update meeting on Thursday, the 31st of March to provide you with more information about our strategy and future growth opportunities as well as our improved sustainability commitment.

So turning now to outlook for 2021. While uncertainty remains regarding the effect COVID-19 will have on global markets, we believe that vaccination programs around the world will lead to a gradual lifting of lockdown measures in the course of 2021 and 2022.

With this context, we expect organic growth to grow in the range of 3% to 5% in full-year 2021 assuming a moderate recovery in Away-from-Home. To fully capture the growth opportunity we see in the coming years, we will step up our investment in 2021 with a notable increase in marketing and innovation investments towards the 2019 level. With the catch-up of this investment for growth, we expect our organic adjusted EBIT growth to be in the low single digit range in full year 2021. And last but not least, we remain committed to reducing our leverage to below 3 times net debt-to-adjusted EBITDA in the course of 2021.

Thank you. And I will now turn it over to the operator to start the Q&A.

Operator:

Thank you. Ladies and gentlemen, we're now ready to take your questions. Our first question comes from the line of Tom Sykes from Deutsche Bank. Please go ahead.

Tom Sykes (Deutsche Bank):

Yeah. Good morning, everybody. Thank you. Just on the guidance of 3% to 5%, I believe this does include the commodity cost movement now. So given we should have been – that volume mix commodity price and price, I wondered if you could give some more details on what you expect at the group level for each of those, please? And maybe just as an adjunct on to the Out-of-Home expectations, are you leaving the cost base in Out-of-Home where it is for an expected rebound or are you looking to address that cost base further, please?

Fabien Simon:

Thank you, Tom, for your questions. Let me give a bit of flavour here and I'll hand over to Scott to complement it. First, starting with the part of your question around Out-of-Home recovery but as well cost base.

What we can say is, as you know, that recovery is dependent on how the pandemic situation and consumer confidence will evolve. It remains relatively unpredictable at this stage. And we believe it might take 18 months to 24 months for the Out-of-Home environment to return to pre-COVID levels. And we are tracking it very closely with mobility data, but as well with actually more than 10,000 connected machines that we have placed in office environments.

In the first few weeks of this year, we've seen a similar activity level than in Q3, Q4 of last year, which will weigh on the full year average even if there is a recovery. With some improvement expected towards the second part of the year, we do consider that our Away-from-Home level should not go much past the 80% of what it was pre-pandemic. And it means that we have been taking very early on the necessary actions to adjust our cost base to be a less fixed-cost intensity business and to ensure we could adjust our business model to this new reality. Do you want maybe, Scott, to complement the other part of the questions?

Scott Gray:

No, I would just say that on Out-of-Home, just on the cost base to complement what Fabien said, I mean, if we look back at what we discussed in H1, you'll recall we closed some less profitable stores that were already under discussion but became clear that the traffic levels would remain suppressed for a while, right? So that was further reinforced by COVID but not driven by COVID. Second of all, we reprioritized and started redeploying resources. This is something we continue to do. So, we've been shifting our resources to channels and focusing on technologies that we expect will come back faster.

You saw some of those channels in the presentation as well. Third, we announced a few reorganizations and we've already stated that as we have to right-size some areas of the business. And then lastly, we're very diligent in terms of reviewing contracts, et cetera, and we have exited some less profitable customers. So, at the end of the day, as Fabien said, our overall objective is to adjust our operating model by moving from this higher fixed cost intensity to a leaner, more flexible operating model. So, we are adapting.

Tom Sykes (Deutsche Bank):

Okay. Thank you.

Operator:

And the next question comes from the line of Celine Pannuti from JP Morgan. Please go ahead.

Celine Pannuti (JP Morgan):

Yes. Good morning, everyone. My first question is following up on this change of the midterm guidance. Because if I look, even if you take the view that you have a modest recovery in Out-of-Home, it is likely to be accretive to the EBIT growth as we recover from a very, very low level over the next couple of years. So, that would suggest that CPG, you expect to be weaker. So, first question is, is it right that you expect that you need to spend more money on A&P and CapEx? You didn't discuss, but if you could tell us your CapEx for your growth opportunity? Is that the right way to look at it? Thank you for that.

And then my follow-up question is on CPG Europe. Could you explain why the margin benefit was less in H2 versus H1 despite a stronger top line? And could you confirm whether Single Serve margin was flat, up or down? Thank you.

Fabien Simon:

Good morning, Celine. Thank you for your two questions. I will probably take the first one around the mid-term guidance both on the In-Home and Out-of-Home, and then Scott can probably then take the second part around CPG Europe margin and Single Serve in particular. So maybe to put a bit of context on the mid- to long-term guidance slight adjustment, first, I do believe that what drives value on long-term is growth and that growth requires investment.

And the second important belief that comes with that is quality of delivery is a guarantee for a sustained, profitable and repeatable growth. And quality in both sense, of course, quality of product we offer to consumers, it’s quality in our gross margin executions that create space to invest in talent capabilities, in R&D, marketing investment or as well in CapEx. It creates your market share. It's as well quality in operating in an inclusive way with our ecosystem partners and with the planet, I would say.

And our adjustment in our targets, I do not see them as fundamentally different in particular when you factor as you were referring to uncertainty in recovery of Away-from-Home which was 25% of our business pre-COVID. That may take two to three years to come back to where it was. And I do see our mid- to long-term targets consistent with what the global pure-play has the ability to deliver on growth and value creations year-over-year. And I think that when you like quality assets, you're always rewarded on the long-term with the benefits of the compounding effects of healthy level of year-on-year total shareholder return.

Scott Gray:

And then maybe I'll take the question, Celine, on terms of – I believe the question if I understood correctly was on CPG Europe margins. Overall, we had good performance of CPG Europe as we continue to have strong margins. Of course, as always, a mix across technologies and countries within CPG Europe but I can confirm that Single Serve continues to have very strong margins.

Celine Pannuti (JP Morgan):

Great. Thank you. Can just I come back on my first question? Could you comment on what do you think is the right level of CapEx and A&P investment for this business going forward?

Fabien Simon:

So, I think on CapEx, the right level of investment is probably around 3.5% to 4% level of revenue. And we have seen that in coffee and tea, I would say, technology has become an interesting barrier to entry, so it's important to sustain this level of 3.5% to 4% to continue to support growth and to build this technology knowledge which is critical.

On A&P, I think we have to look at it not on a total company level but clearly on what is the level of A&P in the percentage of our In-Home business because we should exclude the revenue of the Out-of-Home segment. And with what we are contemplating for 2021, we believe we will be at sufficiency level to deliver our mid- to long-term growth, and very competitive if you look at what's happening in the retail CPG environment. And as we've been alluding to earlier some increase of A&P investments next year, what I would say – as we have been doing strategic refresh that we will share at the end of March, we will ensure that our step-up of investment will be fully aligned with our strategic priorities either at geography or category or brand levels, and that will be mainly around working media, around appliance investment which play an important point of penetration of Single Serve. And it's going to be around performance in digital marketing, especially as we see a significant growth beyond e-commerce. And we will add as well some capabilities in emerging markets where we see long-term growth opportunities as well as some e-commerce capabilities beyond performance marketing and centrally and in geographies.

Celine Pannuti (JP Morgan):

Thank you.

Operator:

And the next question comes from the line of Jon Cox from Kepler Cheuvreux. Please go ahead.

Jon Cox (Kepler Cheuvreux):

Yeah. Thanks very much, guys. A couple of questions for you just on what your expectations are for net working capital this year? Basically, you said you built up inventories, just wondering do you need to maintain that or would you presume that you'll go back to negative working capital and maybe there'll be a full reversal of what we saw this year. On the target for your definition of free cash flow and a 70% conversion. The 70% conversion is on, I guess, adjusted EBITDA still. There's been no change to that.

And then maybe just to come back to Celine's question on the A&P side of the equation and obviously there's been a lot of discussion in the industry generally recently. I'm just wondering what you think about the competitive intensity of coffee at the moment. Is it probably more competitive these days or not? And even if we start to factor into account the 25% of sales which are not related to A&P because it's Out-of-Home and then you think you're pretty comfortable with that. That is only going to be from 2019, that was around 7%, 8% which seems to be a bit low overall in the CPG industry, maybe you can talk a little bit about that.

And then just lastly on emerging markets, I want to know what your thoughts are on that given the sort of more fragile economies in certain parts of the world and what you think about the growth dynamics there particularly as maybe coffee is seen more as a luxury product in some parts of the emerging markets, like Latin America. Thanks very much.

Scott Gray:

Sure. Jon, thanks for the question. I noted you have several questions in there so maybe I'll start on your first couple of questions. And then Fabien can take your last couple questions in regards to A&P and emerging markets. So the first question that I noted was on working capital and our continued progress on operating working capital and do we expect it to continue to be negative.

Yes, we do expect it to be negative as a percentage of sales. And the performance that we had this year in terms of improving our operating working capital came across lines. When you look at a more granular level and across markets as we're always looking to optimize across drivers and across markets. But was led this year by continued optimization and improvement on the receivables side. And as you noted, we had a bit higher inventory. We did bring that inventory down a bit over the course of the year but we continue to carry a bit higher inventory because that's prudent during this time of uncertainty and as we get more certainty, we'll bring it back down to normal levels.

But we do expect to be able to optimize and improve that. So, we don't expect it to go backwards in terms of OWC. Of course, you always have to – you always have some uncertain items like FX, et cetera, that you don't control. But we continue to believe that we can maintain and optimize our OWC. In terms of cash conversion, the 70% cash conversion, medium to long-term guidance that we give and that we maintain that continues to be as a percentage of adjusted EBITDA. So, you're correct.

So I think that was your first two questions. Now maybe I'll give the third and fourth question to Fabien to start on A&P and emerging markets.

Fabien Simon:

Thanks, Scott. So I took two questions. A&P competitive intensity on coffee and emerging markets. So let me start maybe with emerging markets. I think in 2020, there had been no market in the world which has not been affected by COVID. But overall the emerging markets, and here I am commenting more on the In-Home side, have been proven to be pretty resilient, which for us on the emerging markets where we are present reached about 5% organic sales growth. I mean it's slightly below the historical trend but really not much. I would split actually the emerging market into four different groups.

I will have China, which is unaffected – we see unaffected consumptions on coffee and tea, continuing to grow at a strong double-digit level and continuing to emerge as a very promising market for long-term for coffee consumptions. I see a second group where coffee is not an essential good and in crisis, it's where people would prioritize more essential food like eggs, rice, noodles or sometimes even tea in some hot beverage markets. And these markets for me would be like Southeast Asia or eastern markets like Russia that moved from growth to flat or slightly negative decline in 2020.

Then you have the third group which is markets where hot beverage, coffee and tea are among the fastest consumed per day and do play a very important social role like in Middle East or in Africa. And there were not many changes actually there. If anything, we pretty much see a slight increase where coffee is going at a faster pace than tea. And finally, we have Latin America which is broadly stable but with some bifurcated growth. On one hand, you see some cutting down and on the other hand we see premiumisation growing faster for some part of the population. So, we see this for different groups.

Having lived even myself in emerging markets, I know there are markets that have always been proving pretty resilient even in difficult times. And we have seen some encouraging pickup in momentum at the back end of last year and I'm reasonably positive for 2021. But of course, we have to realize that it will not be uniform across the geographies, with some markets more exposed to some social unrest as we are seeing today, or some markets being differently exposed to currency changes, for instance. So, I feel pretty positive in the emerging market for 2021 overall.

On your other questions more around intensity on coffee, I think what we see during the pandemic on the In-Home consumption is that there are some consumer preferences towards favouring more trusted brands over what we'll call more tier-2 or private label brands, which has been very positive and reinforcing for us. And we see, actually, the quality players continue to invest in A&P, and to be fair, they've been investing ahead of us although we have not seen much effect on that if you look on our in-market performance on the critical battles for us which are Beans and the overall Single Serve, on Pads and in Capsules. But we want to ensure that we will continue to resume support for our brands and our long-term innovations to the level where they should be. And that will be, in our view, pretty competitive with what we see in the industry.

Operator:

And the next question comes from the line of John Ennis from Goldman Sachs. Please go ahead.

John Ennis (Goldman Sachs):

Yeah. Good morning, everyone. My first question is on the inflation outlook. I guess what is the magnitude of pricing that you think you need to take in 2021 to offset inflation, both on the raw material side and in terms of other cost increases such as logistics? And then sorry to come back to the A&P point but should we think of your comment as implying around €120 million of A&P increase next year to get back to the 2019 levels? Or are you saying it's going to get towards that rather than in absolute terms getting back to the 2019 level? And then could you actually quantify maybe some of the spend by channel and by region? Thanks.

Scott Gray:

Sure. John, why don't I take the first part of your questions in regards to inflation. So, inflation, if I talk a little bit about non-green coffee, there's two components but if I look there in terms of inflation, inflation in 2021 we don't expect based upon what we know, will not be materially different than previous years. You even noted a little bit in logistics. I think it will be a little bit higher in some inputs like logistics cost but a little bit lower in some of our other inputs in terms of raw materials.

And as you know, we're very disciplined on our pricing but also on our productivities to control the impact of inflation. So, we will control with productivities and price accordingly.

In terms of the other side which is on the coffee side of raw material inputs, actually if you look at coffee prices across both Arabica and Robusta in terms of underlying, they're at relatively low levels based upon historical context. Of course, we will always price accordingly as we have market movements. It's always a volatile commodity. So, for example, recently we've seen a little bit of volatility and that's normal and then we will price accordingly for that.

So, we will treat it the same way that we always do, but that's just to give you a bit of an overview and hopefully that answers your question in terms of inflation and raw material input prices.

John Ennis (Goldman Sachs):

Yeah. That's very helpful.

Fabien Simon:

So back maybe to your questions on A&P in particular, so I think we don't want to disclose really the allocations across geography, also I've been giving a bit of a hint earlier on. What I would say is the number you have been quoted, I mean close to the €100 million is not far off indeed of what we are expecting to step up our investment which would, as I've said, again very importantly bring us back to where we were before. And we know it is the level we need to sustain our existing growth pool, but as well at the same time to prepare some very attractive new growth pools in new geographies and into new product development in some existing growth pools. And we will feel them being on a very good level going forward with this adjustment.

John Ennis (Goldman Sachs):

That's great. Thank you very much.

Operator:

And the next question comes from the line of Faham Baig from Credit Suisse. Please go ahead.

Faham Baig (Credit Suisse):

Hi. Good morning, guys. Thank you for the question. Can I just, for clarification, go back to the earlier question on your medium-term top line expectation? I appreciate the 3% to 5% I guess organic sales growth probably falls in line with other CPG companies giving organic sales growth guidance. But as I understand that previously, your target was ex commodity prices and we have seen some inflation in the green coffee price. So, does your target now imply a slight downward revision in your underlying volume-mix expectation? Secondly, could I come back to single serve capsules and a key success factor in that has been the compatibility with the Nespresso-installed machine base. But as I understand it now, Nestlé's new Nespresso Vertuo machine is a closed system that will only work with the Nespresso capsules. How much of a threat do you think that represents?

And one final question if I may, earlier this year I believe the EU opened an anti-trust investigation into whether Mondelēz restricted competition which also kind of goes back to the old Mondelēz coffee business that you acquired.

Could you maybe give us an update there and the potential impact from that on business? Any provisions that you'll be able to quantify would be very, very helpful. Thank you very much.

Fabien Simon :

Yes. Good morning, Faham. So let me take your three questions. Starting first with the mid- to long-term organic sales growth, you should not see that as a downgrade revision actually of our growth ambitions. When we were in the IPO disclosing our first guidance, we had to explain how the history has been built, I mean three years before that, and it was really tying with green coffee volatility.

And because we are very disciplined on the pricing up and pricing down, because that's the rule of the game of the industry, we feel that we thought it was necessary to share the view on how much volatility can sometimes impact your top line, with sometimes much greater than 3% to 5% or a bit lower. But what's fundamentally important is this pricing discipline as well as a continued momentum in our what we'll call underlying organic sales growth of volume-mix as well as pricing discipline on non-green coffee related. What you could read in this guidance is if you have a year with significant coffee inflation, we will be well above this 3% to 5% of course. So, don't see that clearly as a revision.

Your second question was related to NCC . What I would say here is a couple of things. So definitely, we've seen despite some new machines that have been launched that you were alluded to, we've seen actually an acceleration of the classic aluminium capsule growth which was on one hand boosted by, of course, stay-at-home measures but as well an increasing traction from consumers in this category. And we believe that consumers now buy most of the capsules in modern retailers, which are online and offline, where we have a very strong market leadership positions at about 43% even including the US market. I think we are now present in 58 countries, and we have been deploying that technology across 20 brands.

And what we have seen this year is actually the two largest global players in coffee have been the ones driving the growth on these classic aluminium capsules and have been taking a disproportionate share of that upside, while other players and private label brand have more been losing share actually. And we see that coming from really an increase in household penetration as well as an increase of consumptions per household while they have had their appliance. And when we look across, actually, we have even seen some continuous market share gains, for instance, on the largest aluminium capsule markets being France and Spain, they are the largest consumers in the world. Even in these market, even with the new appliances, we have seen a continued growth in market share momentum. Of course, we have high respect for competition and we are watching, of course, what is happening in the landscape. But we have already anticipated some of the potential evolution by launching our own appliance system which we call Barista machine, which we have already launched in four markets that we have been, I would say, allocating more investment behind and will continue to do so. And we believe that that will drive a strong resilience of the category as well as future growth opportunities.

Your last question, I think, was around was anti-trust. So, I think what we can say here is you're right, the European Commission have been announcing, I think it was in January of this year, that they had opened a formal investigation into Mondelēz regarding possible breaches of EU Competition Law. But this investigation concerns Mondelēz and does not involve JDE Peet's. Although they include multiple categories including coffee.

And these proceedings are at an early stage and the commission has made it clear that opening a formal investigation does not prejudge its outcome and that they have not made yet a definite finding on any infringements. So, should the commission believe there is a case to answer, it will issue a statement of objections to Mondelēz. And this is, I think, what we can say at this stage.

Faham Baig (Credit Suisse):

Okay. Many thanks.

Operator:

And the next question comes from the line of David Hayes from Société Générale. Please go ahead.

David Hayes (Société Générale):

Thank you. Good morning, all. So just two for me, one on ESG and one on A&P spend. So on the ESG side, firstly is, on the ESG commitments, obviously, you're doing a lot of work in this area, increasing the costs to operate, is that part of the reason for the slightly more modest outlook on margin?

And I guess related to that, you mentioned these contracts or these relationships with farmers, 80,000 I think you mentioned moving to 500,000. Does that include price contracts? And I guess the reason I'm asking that is does your coffee price outlook get less volatile if you're kind of working more closely with some of these coffee farmers and therefore perhaps are you less exposed just to the spot price?

And the second question on the A&P spend, I guess the back-end of last year, fourth quarter last year, through the holiday season we felt was going to be a critical one because a lot of people obviously still at home, drinking coffee at home, lots of machines we assume bought for consumers due to lockdowns. When you look back on that, do you think you spent enough money in that period to be as competitive and as effective in that critical consumer acquisition time or is that something that you think you're catching up on now as you go into 2021? Thanks so much.

Fabien Simon:

Thanks, David. So I think two questions on ESG and on A&P again but relative to the machine side. So on ESG, I think we've been sharing our program which was really based around the three pillars. But what we can share as well is we have refreshed our ambition and our ESG framework and we will be sharing that at the end of March but be reassured that the related investment attached to it also are going to be, I would say, accelerated and more compelling ambitions. They are all embedded into our outlook in 2021 as well as in our adjusted mid- to long-term guidance. And as far as our small holder farmers reach of more than 500,000 which is our objective, we don't see that as having any implications on pricing or contracts.

On A&P, I think very good questions, I mean it's – you can see that as consumers are increasing significantly their attractiveness for Single Serve, it is important that you are playing well on the appliance park. You see today, we believe that it's only around 8% of the cups globally which are served to Single Serve. So, we see there is still a lot of opportunity in front of us. And that's why we do have actually a couple of appliances either that we own or that we do leverage on.

We have been accelerating our investments in the second part of the year because I don't think we have been spending enough before that. And it has been pretty significant, it was a very good double-digit increase on our investment behind this. And what we can share is in the second part of 2020, we have been increasing our machines sold at a more than double digit in H2 versus last year and that's why we have seen already some very compelling results. For instance either in-store or even online. And here, I would like to give the example of the UK market, where we have had one SKU under Tassimo Americano actually, which has been, over the last four weeks, among the top three in total grocery sale in Amazon. I mean, all categories included, it was in the top three SKU. And I think even last week, it was the number one SKU sold online in the UK and actually, there were no other coffee SKU on this palmares (*leaderboard*). So, it highlights again how critical it is for us to invest behind our appliances being Senseo, being Tassimo, and being Barista. We will continue to do so, and that is well embedded into our increasing of investments going forward that we have been alluding to already.

David Hayes (Société Générale):

Thank you.

Operator:

And the next question comes from the line of Martin Deboo from Jefferies. Please go ahead.

Martin Deboo (Jefferies):

Yeah. Morning, everybody. Martin Deboo at Jefferies. Just one question, one follow-up. Just on cash and leverage, you're effectively deferring your leverage target from H1 to somewhere in H2. Also, I note that the rate of deleveraging in H2 this year was slower than in H1 and also, the dividend proposal is quite heavily deferred. So, I think the question I'm asking is what's happening to cash flow that's leading to that caution? Is it purely the mechanical effects of the profit downgrade or are there other moving parts of cash flow that we should be aware of? And the quick follow-up is to Faham's question on the Mondelēz anti-trust, I understand that's an investigation to all aspects of Mondelēz, but can you confirm in respect to coffee you have to indemnify Mondelēz for any damages that you might find in the coffee category? Thank you.

Scott Gray:

Sure. So, Martin, thank you for the questions. So, this is Scott. Why don't I take your first question on terms of deleveraging. I mean, we had a very good performance this year in 2020 I should say on deleveraging, as we reduced our leverage from the 4.2 times to the 3.2 times. And also in the second half of the year, I mean, if you look at kind of our historical organic deleveraging, I mean, we deleveraged by 0.2 turns in the second half of the year which, like you say, is a little bit less than in the underlying in the first half of the year if you adjust for the primary, et cetera.

However, you also have to note that in the second half of the year we also made an early tax payment which is just a timing issue. So, we moved that into H2 which, of course, is in that deleveraging trajectory as well. So, actually our underlying performance in terms of free cash flow and deleveraging was quite strong also in the second half.

In terms of the commitment to deleveraging, we're very committed to deleveraging and we expect to get below 3 times in the course of 2021. And as I mentioned and I referenced the tax payment, just an example, if we had changed the timing of that payment, which made economic sense to do so, or we'd had just a little bit less FX headwinds in the second half of the year which is a little bit more than the first half, we would have been below our 3 times target already at the end of the year.

So, we're very close in terms of leveraging and we're going to get there during the course of 2021 and there's always some things we don't control the exact timing of, its FX, et cetera, and also just in terms of timing of capacity, CapEx deployment, et cetera. But we are well on track to getting to our 3 times and on our way to getting towards our optimal leverage which is a little bit below 3 times. So hopefully that answers your question there. And I'll let Fabien take your second question.

Fabien Simon:

Yeah. On your question again on indemnification. So, yes, there could be some indemnification pending the type of possible infringement but that still needs to be assessed and to be concluded on by the commission.

Martin Deboo (Jefferies):

Okay. Thank you very much. Thank you.

Operator:

We're now approaching the end of the call. We will take the last question from the line of Jeremy Fialko from HSBC. Please go ahead.

Jeremy Fialko (HSBC):

Hi, Good morning. Jeremy Fialko, HSBC here. Thanks for this final question. So, two for me. First of all, can you just talk a little bit more about your expectations on Single Serve in 2021? When I look at the kind of high penetration in 2020, the machine sales in Christmas of 2020 as well, all of this would suggest that Single Serve would have another very strong year even if the Out-of-Home side does start to come back a bit. So, a few more comments about that.

And then, secondly, maybe you could just talk a little bit more about Peet's and your expectations there for 2021, in particular what evidence you've seen from the stores where maybe they're located in areas where restrictions have been eased a little bit earlier. And what sort of traffic you're seeing there? So there's the two. Thanks.

Fabien Simon:

Hey, good morning, Jeremy. So two questions. The first one on Single Serve. So, I think we are very, very confident in the long-term growth of Single Serve. I have been alluding to, earlier on, on the 8% only of cups which are consumed through that category.

And without disclosing too much but in 2021, we see again double-digit growth projections on Single Serve, which is why we have been coming with an increasing investment that we communicated at the end of last year to ensure that we will have sufficient capacity to fulfil all these long-term demand which is for me something that will stick. I have zero doubt there.

On Peet's, actually I would say two things on Peet's. You have the In-Home side and the Away-from-Home. I think if you look at total Peet's performance that we have been sharing today on a slight negative level, it totally undermines the strengths of Peet's. If you look on the In-Home side, it has been growing at nearly 30% and they have been gaining I think more than 1 million new households. And we are really waving on the premiumisation on Beans, on K-Cups, on even aluminium capsules which is happening in the US market. Today we only have 5.5% worth of market share with Peet's. We see a long leeway.

And Peet's is seen today as really, I don't want to say the most, but among the most premium and fastest growing brands in the space both online and offline. If you say online for instance, they are growing today at two times the rate than the category – coffee category in the US market, which is really phenomenal. And as we are going to see some, I would say, recovery on the Away-from-Home, I would suspect that the strong performance and differentiated propositions with their unique freshness is going to be made even more visible when we look at the average top-line growth of Peet's.

On the Away-from-Home, I think the jury is still out. I mean like it is in the rest of the world because it's really going to depend on the rollout of vaccines across the various states in the US market. I think some people believe that the UK and US will probably going to be the one coming out first from it. So it could well be already in the second part of the year.

But for us, it's something that is still an uncertainty of projections. But that we will of course going to look at very, very carefully. And we are very glad with the actions we have been taking both in the cost structure but as well in the footprint of stores that we do have in Peet's because we have been closing I think 88 stores permanently to ensure that we will have, I would say, the best stores out of the crisis and that will put us back in some very encouraging and strong growth momentum well ahead of the average of the company.

Jeremy Fialko (HSBC):

Okay.

Operator:

Okay. Thank you very much. I would like to hand the call back to Fabien now.

Fabien Simon:

Thanks, Nazanine. So thank you again for joining us today. So Scott, Robin, and I look forward to speaking with you in the next day as well as in the next probably few weeks and for some of you, at the end of March. So having said that, stay well, stay safe, and have a great day.

Operator:

This now concludes our conference call. Thank you all for attending. You may now disconnect your lines.

[END OF TRANSCRIPT]