Transcript Earnings Call related to JDE Peet's Half Year 2021 Results

Operator: Good morning, and thank you for joining JDE Peet's Half Year 2021 Earnings Call. 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. If you do have a question, please press zero one on your telephone keypad. And if you wish to withdraw your question, you may do so by pressing zero two to cancel.

At this time, I would like to hand the call over to our first speaker, Robin Jansen, Director Investor Relations for JDE Peet's.

Robin Jansen: Thank you, Nazanine. Good morning, everyone, and welcome to JDE Peet's earnings call related to the financial performance of the first half of 2021. 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 first half year business performance. After that, Scott will tell you more about the financial performance in the first half. Fabien will conclude today's presentation with our outlook for the full year. 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 two. We would kindly like to ask you to read this information carefully. Our press release was published at 7.00 am CET this morning. The release as well as the slide deck related to this call are also available for download from the Investor Relations section on our corporate website. A full transcript of this conference call will soon be made available in the same section of our website as soon as possible after this call.

With that, let me hand over to Fabien.

Fabien Simon: Thank you, Robin, and thank you everyone for joining the call today and for your interest in JDE Peet's. I am pleased to share with you our results for the first half of 2021.

Over the last six months, we have made good progress, against the refreshed strategic framework and priority that we initiated last year and presented at the end of March to the community. Today, I am not only pleased with our broad-based improved performance but as well by the quality way of its delivery.

These results reflect the focus, agility, alignment and hard work of our entire organisation that is fully energised by our new purposeful and disciplined growth-led ambition. And I would like to take this opportunity to thank all our teams around the world for their commitment through all the ongoing challenges and complexity that still persist, and for delivering this solid set of results.

Overall, our organic sales grew by 4.2%. It came from ongoing momentum in In-Home consumption, partially fuelled by continued lockdowns in the first part of the year, but as well by changing patterns of more work from home as the world progressively reopens. We shared at the time of our 2020 results our view that it may well take a few years for the Away-from-Home channels to return to pre-pandemic levels. It was, therefore, important for us to adjust our business model and we kicked off structural cost adjustment at the back end of 2020.

These initiatives are paying off, and the Away-from-Home businesses returned to profitability in H1, while the related sales base remained by and large at the same level as in the first half of last year.

The combination of operational leverage, innovation, premiumisation and disciplined cost management improved the organic gross profit margin by 26 basis points. The adjusted EBIT increased organically by 0.8%, as we re-invested in marketing, innovation, and digital capabilities to support and seed long-term growth opportunities. I believe that the positive read of our market share developments across our categories shows that these investments are paying off.

We also continued to make good progress on our sustainability agenda. In March, we connected €2.5 billion of our investment-grade facilities to our sustainability ambitions. That same month, we committed to adopt climate science-based target and we are on track to announce greenhouse gas reduction ambitions through SBTi in the second half of this year. In manufacturing, our facility in Gavle, Sweden, was the first one to achieve in March the PAS2060 certification for carbon neutrality. And in June, all our manufacturing facilities in Europe reached Zero Landfill status for the first time.

We also significantly optimised our financial position in the first half with our strong free cash flow generation, our leverage reduced to below 3 times, in line with the commitment we made at the time of the IPO and repeated since then. We also executed a successful refinancing and inaugural bond issuance that strengthened our debt profile from a diversification, maturity and cost standpoint. And our continued operational and financial discipline resulted in two additional investment grade rating from Moody’s and Standard & Poor’s in H1.

So bottom line, all the financial achievements I’ve just talked about, resulted in an increase in our underlying EPS of 12.9%.

In a couple of minutes, I will provide you with some examples of how we are gearing up on our disciplined growth ambition through portfolio management, innovations, as well as disciplined capital allocation.

The other thing that became a theme in the course of H1 is inflation, as many raw and packaging material, but also distribution costs, started to see substantial price increases. In a few minutes, I’ll come back to this topic and explain in a bit more detail what we are seeing there and how we are managing this, especially on the coffee side.

Based on the progress we’ve made in the first half of 2021 and the current expectations we have for the remainder of the year, we are confident that we will reach our outlook for 2020.

So let us now go to slide six, and take a closer look at our organic growth starting with the total company performance and per channel. Our organic sales growth versus the same period last year but also on a two-year stack basis, was ahead of our historical trend, as we enjoyed continued strong performance in In-Home at 4.9% while sales in Away-from-Home were stable compared to H1 2020 as lockdown measures remain largely unchanged in Q1 mostly. The Company growth was driven by an increase in the number of cups of coffee and tea sold, by continued premiumisation, as well as by positive pricing.

So let's now zoom in on the highlights of our In-Home performance on slide seven. The strong In-Home growth of 4.9% I just referred to, was supported by targeted re-investments, as anticipated and communicated earlier this year. A&P, for instance, increased by 31% from the same period last year, with particular focus on consumer-facing marketing investment that increased by 80% in H1 of this year. The organic growth was well-diversified from a geographic standpoint as both developed and the emerging markets delivered a mid-single-digit growth rate.

We did continue to perform strongly on the fastest growing categories, Single-Serve & Beans, that increased by 11% supported by strong momentum in our aluminium capsules in particular. E-commerce grew by 30%, above the elevated growth rate of 58% in the same period of last year already. And when we look at our performance relative to the market on the right-hand side of the slide, we are encouraged by the positive read across all categories.

On the next slide, I would like to share some of the most important developments we've seen in Away-from-Home. So our sales levels there remained largely unchanged in H1 at plus 0.7% and this is really a tale of two quarters. On one hand, Q1 still in lockdown is compared to almost a pre-pandemic Q1 of last year, while Q2 of this year witnessed very encouraging effects of reopenings in sub-channels in the US and Europe versus what was a heavily affected Q2 of last year.

Our Peet's stores in the US, for example, have recorded a positive 83% same-store-sales growth in the last quarter with strong recovery on traffic, as well as increase in the average ticket size. But yes, it is fair to say that uncertainty remains in sub-channels such as offices, but as well in some geographies like Asia and Pacific where many countries announced lately coming back to new lockdown measures.

So over the last six months, we focused on what we control and what we can influence. We are adapting our business model at pace with structural cost measures that already enabled us to return to profitability this semester, but as well by stepping up and leveraging investments in our digital and consumer engagement journey.

Additionally, we made good progress on another recent strategic shift, being the acceleration of the roll out of the Peet's coffee stores in China. We reached the 40 stores count mark in the course of H1, and we are well on track to deliver in the next two to three years what we originally planned to execute in the next five to six years.

Let's now switch gears and provide you with an update on the latest development in our business portfolio on slide nine. I think it's fair to say that over the last couple of years nothing really happened on the inorganic front. This had been another shift that we resumed at the back end of last year because we know that when it is executed with discipline, this supports further value creation.

Between January and July of this year, we sold our Dutch café stores, CoffeeCompany, as well as our French brand, Café Privilege. Although not that significant in size for us, these businesses were more of a distraction in our portfolio. And importantly, we were not the best home to them. So we are now pleased that they fit greatly with the business model of their new owners who do have the focus and expertise to develop them further.

Next to that, we announced the partnership on liquid coffee with JM Smucker in the US and a partnership with Pret A Manger to launch a new range of premium aluminium capsules in the UK market. And in June, we announced the acquisition of Campos, the specialty coffee leader in Australia available in over 600 cafes and present in multi-channels including direct-to-consumer, retail and its own couple of flagship cafés.

Let's now move to slide 10, where we can see a selection of our recent innovation. Innovation is another area that we are accelerating across products or packaging, but as well on coffee appliances and business models. And here you will see a couple of highlights.

Moccona introduced, for example, our first range of plant-based offerings in specialty mixes for Australia. In L'OR, we launched a bio organic range which contains 100% organic coffee beans and carries additional certifications. Russia, another example with Jacobs, we just launched a range of Origins and flavoured premium instants SKUs.

On the appliance side, which we presented as well as a further investment area, our Barista machine did win the Red Dot Design Award for espresso machines in the Kitchen Appliances category, and we launched new machines with new features for both Senseo and Tassimo. On these latter ones, I think these are the first new appliances launched in five years for Senseo and in three years for Tassimo. So besides those, we have just introduced a Tassimo subscription model in the UK, which will enable to get closer to the overall consumer journey and decision points.

Finally, besides these two new partnerships we already talked about, we continue to roll out our very successful partnership model with illy. And again, both portfolio management and innovations will play an important role to deliver our long-term ambition, and I am encouraged with the new pace and the pipeline at which we are operating now.

Now, before I hand over the call to Scott, I would like to take a couple of minutes to update you on the topic of inflation on the next two slides. So as you have seen in many charts and have heard from many companies over the last couple of weeks and months, inflation is on the rise, also for us, across a broad range of raw materials, packaging materials and distribution costs.

On the right-hand side of this slide, we call out those inputs that are the most relevant for us in this context. And you see the magnitude of the inflation these cost buckets have witnessed.

Now, let us distinguish the coffee commodity side and the non-coffee side. On the latter, the non-coffee side, a decent part of the impact of the inflation is actually already reflected in our first half-year performance, and we are taking all the necessary measures to manage the increasing part to come in H2. On coffee, it's different, and there, we do have some pretty good hedging in place, but given the very specificity of the coffee category, I would now like to move to the next slide and have a look at what happened in the past when the coffee market experienced volatility on the commodity side.

I think this chart might look complex at first sight, but they are really here to stress three key points. And we looked at the last 15 years of coffee commodities, consumer price and consumption in retail of the most sensitive Roast and Ground category historically. And what does the history tell us? Three key things. One, consumer prices closely follow the cyclical green coffee prices, on the way up, as well as on the way down.

Second, over that period of 15 years, the coffee consumption has proven to be inelastic to the consumer price evolutions. So in the year, here you can see, in the year 2011-2012 when Arabica reached the USD 3 per pound, the consumption of coffee in retail was not lower in these years despite almost 14-15% consumer price inflation.

And similarly, the consumption was not higher in the year 2013 than in 2012 when prices went down. And I think this is because coffee in home is an affordable and deeply rooted consumption, I mean, in the daily consumer repertoire. What we know and what the annual Euromonitor doesn't show here is that there can be a short-term pantry stocking effect for a quarter or two.

The third thing that the history told us, here you see more quarterly Nielsen data, available data with history, is that the consumer price increases or decreases tend to follow with a lag of about two to three quarters the commodity price inflation.

So as a conclusion on coffee, the answer to the commodity inflation is all about mutual pricing discipline, on the way down as much as on the way up. And the hedging in place is here to provide the appropriate level of visibility, timing necessary to implement these pricing actions. It is a pass-through mechanism category, and therefore, the indicator that matters the most, the one we monitor, is the absolute euro margin per kilo and not in percentage.

Again here, I'm not trying to say that this is an easy exercise to put pricing through, but coffee roasters and retailers have proven to be long-term and disciplined in the past, both on the price increase and the price reductions. This is our intention this time again as we have been, over the last few years, for instance, pricing through all the tailwind to the customers.

And while pricing actions could potentially lead to some short-term challenges for a quarter or two, historically, the innovation power and strong brand equity of the market leaders have been able to secure market shares over time.

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

Scott Gray: Thank you, Fabien, and good morning to all of you.

Let's go to slide 14 to take you through a few of the most important financial highlights of this semester and after that, I'll provide a bit more detail on the segment performance as well as first half year developments related to profit, cash and our financial position. Then I will finish with a quick reminder of our capital allocation priorities.

As mentioned earlier by Fabien, our overall organic sales growth of 4.2% was driven by an organic sales growth of 4.9% in In-Home and 0.7% in Away-from-Home. In terms of profitability, our adjusted EBIT grew by 0.8% versus H1 20 or 5.5% on a two-year CAGR. And our underlying earnings per share increased by 12.9%.

When it comes to cash and debt, one of our top financial priorities since the IPO has been to reduce leverage to below 3 times, which we achieved this semester on the back of strong free cash flow generation of €553 million in the first half of the year.

Let's now move to slide 15 to take a closer look at sales. Our organic sales growth of 4.2% was predominantly driven by a combination of volume and mix, but with 40 basis points coming from pricing. The negative foreign exchange impact of 3.5% was mainly driven by the appreciation of the euro against the US dollar, the Brazilian real, and the Russian rouble. And this, together with a minor change in scope, increased our sales by 0.5% to €3,254 million on a reported basis.

Let's now move to slide 16 to look in more detail at our adjusted EBIT performance. The 0.8% organic growth of our adjusted EBIT that I just called out was driven by an increase in gross profit, of which we reinvested a meaningful part back into A&P and other SG&A to support our brands and build other capabilities to fuel growth. Fluctuations in foreign exchange decreased adjusted EBIT by 2.3%.

On the next slide, slide 17, you will see an overview of the organic sales and adjusted EBIT performance by segment. Looking at the top line performance per segment, you can see that CPG Europe and CPG LARMEA continued to benefit from the continued strong momentum in In-Home consumption and that Peet's top line benefited from continued strong In-Home performance as well as from the positive effects the reopening of the US had on its coffee store network. The slight organic sales declines in CPG APAC and Out-of-Home are a reflection of the impact the restrictions continue to have on their sales performances.

In CPG Europe, sales growth was broad-based across countries with particularly strong contributions coming from countries like France, the UK and Germany, and continued momentum in premium categories like beans, aluminium capsules, and other single serve offerings like Tassimo T Discs. And despite a strong double-digit increase in investments in A&P and other investments for growth, the organic adjusted EBIT increased by 1.9% resulting in a two-year CAGR of 8.9%.

With an organic sales growth level of 5.4%, CPG LARMEA delivered a similar organic growth level as in 2020 with particularly strong performance coming from countries like South Africa and Brazil. From a category perspective, growth was driven by Roast and Ground, Instant, and Single Serve offerings. Organic adjusted EBIT decreased organically by 19.2% in H1 driven by higher A&P spend and other operating expenses. However, on a two-year CAGR, the organic adjusted EBIT growth was 4.2%.

In CPG APAC, various markets entered into new lockdowns in the course of H1 21, which in many cases were stricter than the initial restrictions in 2020, thereby further impacting the Away-from-Home business. As a result, organic sales performance in various markets in Southeast Asia were also in decline. China, on the other hand, delivered strong double-digit performance. The adjusted EBIT decreased organically by minus 14.8% in H1 driven by higher A&P spend to support innovations. On a two-year CAGR, the organic adjusted EBIT growth was 18.9%.

At Peet's, the CPG business continued to deliver solid single-digit organic sales growth resulting in a two-year CAGR of 18.1%. On the Away-from-Home side, Peet's Coffee stores started to see very encouraging same-store sales growth as the US started to reopen, which resulted in an 83% increase in same-store sales growth in Q2, as Fabien mentioned in his opening remarks, while the non-coffee store Away-from-Home businesses were still impacted by low returns to offices and universities. Adjusted EBIT increased organically by 10.8% in H1, largely driven by the recovery in Away-from-Home, which was partly offset by incremental investments to increase household penetration in CPG. Based on a two-year CAGR, the organic adjusted EBIT growth was 14.5%.

And as mentioned before, in most of our Out-of-Home markets, lockdown restrictions remained in place which prevented the segment from meaningfully growing its sales base in H1. The good news this semester was that although the sales base was by and large the same as the comparable period last year, the Out-of-Home segment was able to return to profitability as a result of various structural cost measures that had been implemented since the start of the pandemic to reduce fixed operating costs.

Now, let's take a look at our underlying profit in absolute terms and per share on the next slide, slide 18. Our underlying earnings per share increased by 12.9% or €0.10 to €0.89 in the first half of 2021. As you can see on the slide, the majority of the increase was driven by operational improvements which can be split between the increase in organic adjusted EBIT and a structural decrease of our adjusted net financing cost as a result of our deleveraging and the substantial reduction of our average cost of debt following the refinancing and bond issuance we completed in H1. I will come back to our debt structure in a minute. Next to these operational improvements, our underlying profit also benefited from fair value changes of derivatives which were partly offset by FX losses and by slightly higher underlying taxes.

Let me now share a bit more detail on our free cash flow and net debt developments. In the first half of 2021, our business delivered a total free cash flow of €553 million, which is almost €120 million more than in the same period last year, even after adding back €34 million of non-recurring payments related to the IPO to the free cash flow in H1 2020 to provide an appropriate comparison. Our cash conversion was 71%.

And as you can see on the right-hand side of the chart, it enabled us to reduce our net debt by €430 million as we maintained discipline across all the lines.

And on the next slide, slide 20, you see an overview of our debt evolution and how we have now reduced it by almost €2 billion since the combination with Peet's as our consistently strong free cash flow generation has enabled us to continue our debt reduction post the IPO. In turn, we were able to deliver on the commitment made to reduce our leverage to below 3 times as we reached our target by the end of June with leverage of 2.98 times.

Next to that, as you can see on slide 21, in the first half of 2021, we have substantially transformed our capital structure by successfully refinancing €6.5 billion of new credit agreements and by successfully executing a €2 billion inaugural bond issuance, both at very compelling terms as you can see on this slide. Our 2026 bond at a 0% coupon is a testament of the quality of our credit profile.

And these two corporate actions have resulted in an attractive new debt structure as you can see on slide 22. Our average cost of debt reduced from 2.4%, before we executed the refinancing and bond issuance, to around 1.5% now. We extended our weighted average maturity to about five years and we have no debt maturing before the end of 2023.

Next to that, we have doubled our total liquidity to €2 billion as compared to the end of 2020 and we have further diversified our funding sources and instruments.

Before handing back to Fabien, I'd like to briefly remind you of our capital allocation priorities as first shared with you during our strategic update meeting at the end of March. Our capital allocation framework guides us as we create long-term value. Our first capital allocation priority is to reinvest in our brands and the growth opportunities within our business. Our second priority is deleveraging as we target an optimal leverage of around 2.5 times. Our third priority is to continue to pursue inorganic growth opportunities but always in line with our highly selective business and financial criteria. Our fourth priority is to use excess cash to contribute to shareholder renumeration through stable dividend flows that we expect to sustainably grow over time. And while our leverage is above our optimal leverage of 2.5 times, we do not prioritise share repurchases.

If you look at the actions we have taken recently, you will see that they are very consistent with our capital allocation priorities.

Let me now hand back to Fabien for the outlook before we open the call for Q&A.

Fabien Simon: Thanks, Scott. And let's now turn to slide 25 to remind you of our outlook for full year 2021. I think we've made good progress in H1. And although uncertainty and volatility around us are not going to go away, we are confident to deliver the full year outlook that we communicated earlier.

I mean these are organic sales growth of 3-5%; organic adjusted EBIT to grow in the low-single-digit range as we continue to step up our investment for growth, while being intentional on managing inflations and navigating the ongoing uncertainty of the pandemic. Our commitment to reduce our leverage to below 3 times net debt to EBITDA has already been achieved by the end of June.

With that, I will now turn it over to the operator to start the Q&A.

Questions and Answers

Operator: Thank you. Ladies and gentlemen, we're now ready to take your questions. If you wish to ask a question, please press zero one on your telephone keypad. That's zero one on your telephone keypad to ask a question. And please remember you are limited to one question and a follow-up per round. Our first question comes from the line of Jon Cox of Kepler Cheuvreux. Please go ahead.

Jon Cox (Kepler Cheuvreux): Yeah. Good morning, guys, Fabien, Scott, Robin. Congratulations on a very solid print there. I've only got one question, but I'll manage to probably sneak in two. The first one is just on the pricing. When I use a sort of like a coffee model looking at coffee prices with the lag, etc., etc., it looks to me that you're going to need to increase prices by about 5% next year, maybe even higher depending on where the coffee price settles. Are you confident in the portfolio and your position to be able to do that? That's the first question.

Second question just on A&P. It's a pretty hot topic within the market. I see that your adjusted SG&A costs were up €61 million. Can we assume most of that is A&P or even can you just give us an absolute increased A&P figure? Thanks very much.

Fabien Simon: Yeah. Good morning, Jon. Let me give it a try and Scott can build. So let's start with your first point on pricing. As you might understand, we are mindful of not signalling our pricing strategy to competition and we want as well to, I think, respect the negotiations which are ongoing with our retail partners actually now.

But to your point, we are confident that the category has been really having a specific pass-through mechanism that we have been able, over the years, to exactly match that and we believe it's going to continue to be the case this time around. And I want to remind, maybe a good opportunity here, so we talked about the non-coffee and the coffee inflation, and I know there is a lot of attention now on the recent spike on green coffee. But I think maybe there had been forgotten a bit that if I look at what was the price of Arabica in the summer last year I think it was around $100 per pound. But in December of last year, it was already $120. So we already witnessed about 20% of inflation of Arabica, which is something that is, I would say, reaching our P&L in the second part of this year. And we have been taking all the appropriate actions. And despite this inflation, despite the incremental inflation which had been coming through the non-coffee side, we are very comfortable, very confident that we'll deliver our outlook. I think that probably gives you a good hint on our level of confidence on how we are managing with strong discipline on the pricing side, but as well on the hedging side, our specific coffee commodity inflation.

On your second question on the investment side. So we have been indeed communicating during, I would say, our 2020 result as well as during the Capital Markets Day, that we intend to step up our growth investment level, first to return to sufficiency level of our existing portfolio, but as well to seed incremental growth opportunities. And this to ensure we are going to get long-term growth momentum. And we shared that the ambition was to focus mainly on working media, on coffee appliances, but as well as digital, US and China capabilities. At the end of H1, we are well on track on our investment level, and you quoted our absolute organic SG&A by €61 million and the vast majority of that is really on the increase of the investment against our refreshed strategic priorities.

I see at the same amount of time last year our A&P was reduced by 32-33% if I'm remembering correct. And you've seen that we have increased to 31% already in H1 of this year. For H2, we plan to stay the course and we expect to continue to increase and we believe we'll reach the level that we had been communicating in the past, which is the one we feel appropriate to support our amazing portfolio of brand and appliances.

Jon Cox: Thanks for that. I wonder if I can just sneak one in. An effective tax rate for this year and effective tax rate going forward, Scott?

Scott Gray: Yeah. Our effective tax rate, we do expect to be a little bit lower now for 2021 and we would expect it to be closer to 20% for the year.

Jon Cox: Thank you.

Operator: And the next question comes from the line of David Hayes from Soc Gen. Please go ahead.

David Hayes (Société Générale): Thank you. Good morning all. If I could just follow up on that question first of all from Jon on the A&P spend. So just help me with the math a little bit, 31% up. I know it's In-Home, I assume most of the A&P spend is In-Home, then I guess that's about a €40 million increase. So I guess the question is to your point just then about the target, I think you're talking about sort of towards €100 million up year-on-year this year following the lower spend last year. So should we be thinking about sort of €60 million up on – in the second half which would be sort of a €250 million A&P spend number in the second half? Is that kind of a broad maths logic?

And then secondly, still related, I guess, in some ways, as you mentioned a couple of times, you've obviously developed these new machines and I think looked to be a little bit more aggressive with subsidies on the machines. What sort of effect is that having? Is there any kind of metrics you can give us in terms of Tassimo, Senseo or the L'OR Barista machine purchases this first half versus first half of last year? Thanks so much.

Fabien Simon: Yeah. Good morning, David. So just to follow up on the overall investment. It's true that we have been quoting a number which was around the €100 million last year, which was towards really advertising, promotions including the appliance investment you are quoting about but as well other growth opportunities such as capability build on digital, such as the footprint of stores in China, and this was the overall amount which we quoted.

We believe we are going to be at the end of this year really within the same range. And of course, we're always learning as we put some investment, what is working a bit more versus what is working a bit less. But we are going to remain in the same ballpark. And I think the overall amount was pretty well-distributed across, I would say, H1 and H2 overall.

On your second question on the machine development, so what I can say here and without signalling too much information as you can imagine from a competitive standpoint is we are clear that as the category got more complicated because consumers are more demanding, in particular, to get better coffee, to get more convenient and more individualized coffees, appliance is playing a bigger role. And we have seen in 2020 the sales of appliances or the growth of the sales of appliances almost doubling in 2020, in particular on single-serve and the full automatic machine.

And we see actually on the latest read that we see the same momentum and it really suggests we get a continued level of appetite from consumers on that level. We do have a great appliance park we can leverage on. We have Senseo, which is the largest used park in Europe, which is the most affordable and the most sustainable offer we can provide to consumers. We do have as well Tassimo and we have our espresso appliance, Barista. And we can as well leverage in the US market on the Keurig system with K-Cup.

You have seen that we are intentional on launching new appliances. We have a meaningful part of our SG&A increase which has been to sell more appliances. I don't want to quote a number, but we feel that we really have, in our hands, all the assets necessary be it the brand, but as well the appliance to be successful on the long trend to capture this disproportionate growth we see on Single-serve.

David Hayes: Thank you.

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

Faham Baig (Credit Suisse): Morning guys. Thanks for the question. Can I start by asking you to potentially discuss the latest developments in the Nespresso compatible capsule category in terms of what may be L'OR's growth was in H1 and maybe where your share reached in the half as well, particularly given that Nestlé continued to stress share gains in this segment? So I just wanted to see how L'OR is faring up. And also given Nespresso's pivot towards the Vertuo system, what impact has this had on the Nespresso compatible growth rate given there are currently no compatibles for the Vertuo machine?

Fabien Simon: Good morning, Faham. So let me try to – you have a couple of points. I will try to answer all of them. So we see a continued appetite from consumers on the Nespresso compatible category. Although we are comparing ourselves to already a heavy, highly elevated number last year, we don't see a slowdown. And we really believe in the long term of what I will call the classic aluminium capsules that consumers keep asking at the double-digit rates if we look at the beginning of this year.

And that's why, it's not surprising, you might have noticed that the two largest players on coffee globally have been announcing meaningful capacity increases over the last 10 months to be able to fulfil this consumer demand. You had a particular question on share, so no, we don't disclose our share. We have disclosed the share on capsules (previously), just to give you a hint or to ease some of the concerns sometimes we hear here and there. If I look at our year-to-date share in the first part of the year, I mean, Nielsen related shares, to see a potential impact on the share, you need to look after the comma. So, I think it tells you that we do participate and take our fair share of the fastest growing part of capsules in a very meaningful way and we are very, very pleased with that.

Then you had a particular question on Vertuo. So I think, again, I'm probably going to be consistent with what I have been saying in the past is, first, I do have a lot of respect for the company that you are quoting behind this coffee appliance. And I deeply believe that only two companies do have globally, at scale, what is now necessary to answer the increasing complexity from the consumer on coffee In-Home, and we are one of them.

And I'm not going to comment on an appliance that is not ours. I think it's a question you should ask to the owner of the service appliance. But we believe consumers want choice. They want choice in the type of coffee they want. They want choice in the various brands and appliances. And we feel very comfortable with the plan we have in place with our classic capsules, with our Barista machine to secure this growth on the long run.

Faham Baig: Thanks. And if I could ask a follow-up not to my question, but to a question asked earlier with regards to raw materials and pricing. I just want to maybe better understand the low-single-digit guidance that you've retained for organic EBIT. So I guess at the time when you set this guidance in March, you anticipated a certain sales growth trajectory that you've kept as well as the A&P reinvestment of around €100 million. But clearly since then, there has been increased raw material pressure, be it in coffee where I presume you're likely to be hedged this year. But also as you suggest as per chart in the presentation in the sort of non-coffee raw mats as well and quite significantly so. So, which you said has already begun to see your P&L and I'm sure the impact will be greater in H2 as other consumer companies have suggested as well. So I guess, the question is what is the offsetting factor to this COGS inflation that allows you to maintain the low single-digit increase in EBIT that you're guiding for?

Fabien Simon: So we have had, I would say, some anticipation already at the end of last year on some of the inflation. I've been talking earlier about coffee which had been already increasing by 20% during that time horizon with some lag in our P&L because we have some good hedging in place. But we anticipated some inflation, not to the extent of what has been happening.

And we have been doing last year a couple of changes. You might have seen being, I would say, the underlying strategic shift, we as well have some short-term programmes in place to be, I would say, a bit more aggressive on resetting our cost structure in Out-of-Home, but as well to launch a more disciplined approach to our cost management. And this is paying off in the first half of this year already.

You saw that despite all this inflation we have more than offset the input cost with cost management, with operational leverage from mix and with pricing. We will continue to do that in the second part of the year. If I look at our Away-from-Home business, for instance, we have been unfortunately had to make redundant a couple of hundred associates. So all the measures we have been taking, are really structural and we know we still have some opportunities and we have already well activated quite a broad-based cost agenda programme.

Faham Baig: Thanks, Fabien.

Operator: And the next question comes from the line of Jeremy Fialko from HSBC. Please go ahead.

Jeremy Fialko (HSBC): Hi. Morning. Jeremy Fialko, HSBC here. I have just a follow-up question on the sort of single serve question. When your main competitor was asked about this on their conference call last week, they said that the growth had been driven more by usage rather than machine penetration. So I just wanted to get your perspective on the growth that you’re seeing from single serve. So the degree to which the machine penetration has gone up which sounds like it’s been pretty good from what you’re saying, the degree to which growth has come from usage, and then how happy you are that the usage numbers can be maintained or whether they might sort of fall off a little bit as people go back to the offices.

And then, just one follow-up question on the single serve part of your business is the extent to which your H1 numbers were sort of limited due to capacity constraints, or whether actually as some of the new capacity comes on line, that can give you a further leg of growth because of the fact that actually you’re not able to keep up with the demand at the moment. Thanks.

Fabien Simon: Yeah. Thank you, Jeremy, for your question. So let me start with the first one on the appliance part. So the data we have, I think on the latest one we have from Kantar or other In-Home panel data, show actually a combination of both. One, a meaningful increase on single-serve appliances, and I’ve been quoting a bit earlier, we have been seeing double-digit growth rates of the appliance sales. Now, the question is is it all about incremental consumer? Sometimes it can mean what we hear, some consumers are having now two appliances at home, one on their office side, one on the main kitchen. Sometimes it’s about replacement of machines. But when you reach that level of magnitude, it’s for sure an overall increase of In-Home penetration.

It is fair that we have seen as well on what we track on the key appliances about a 10% increase on the usage per appliance. So it’s really the combination of both, at least on what the data tell us. And it’s true that we have been announcing very quickly at the end of last year a significant capacity increase because we were taken a bit by surprise actually during the pandemic about the surge of the consumer demand for aluminium capsules. And actually we’ve been very pleased that we have been taking these decisions because the momentum has not slowed down in H1. And now in July as we talk now, I’m very, very happy that half of the incremental capacity that we had been talking about, is already commissioned. And I think the team has been doing a spectacular job to operate that at a faster pace than historical levels. And this was really in the middle of a pandemic crisis, which was not easy to get either the supplier or the engineer really on site. But despite these constraints, we’ve been able to be even slightly ahead of what we thought on this capacity increase. And we do have the remaining part to come in the next six to eight months, so which means now we are very pleased that we are unconstrained from a capacity standpoint.

Jeremy Fialko: Okay. Thanks a lot.

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

John Ennis (Goldman Sachs): Hi. Good morning, everyone. I've got another question on coffee pricing. So I appreciate it's as a whole not a very elastic category but I guess by nature of guiding for organic sales growth to be in a range of 3-5% medium term, you will be assuming that volume/mix dipped, so pricing has to step up into a mid-single digit range to mitigate inflation. I guess is that a fair conclusion to jump to? Or would you expect growth to overshoot in high inflationary periods? And then related to that, where do you think elasticity is highest by region, even if it is inelastic as a whole?

And then my second question is on the LARMEA and APAC regions. I just wondered if you could explain the margin movement in LARMEA and APAC in a bit more detail as they obviously fell quite a bit year-on-year. And how should we think about the phasing of investments into the second half? Was the reinvestment, for instance, skewed to the first half in these regions, or was it overly representative for the full year? Anything you could give there would be helpful. Thank you.

Fabien Simon: Yeah. Let me give a crack at it and Scott will probably take the second point. On the elasticity, so we have been sharing how, I would say, on an annual basis, we don't see any impact really from inflation on consumption. But we said as well, it can well take sometimes a couple of quarters to adjust either because increases of pantry loading or there are some negotiations on pricing.

But then why no change on the top line outlook? I think there is – there are couple of reasons. First, we should not forget we are still into an uncertain moment on the Away-from-Home business. I am of the opinion that September will be a moment where we are going to have a better read on this channel post-vaccinations as well as post-summer on how people travel around, as well as kids returning to school, people returning to office, and what will be some of the steer from large companies. So this is the first one.

On the second point, I talked about the inflation which we have already seen since end of last year on Arabica. And this was already built in on our original organic growth target for the year, which we see happening in the second part of the year.

As far as a further spike on coffee price is happening or will be happening, this always happens with a lead time of two to three quarters, so not much really of an impact for this year. But then where you are right is at the moment we are, I would say, being exposed to much higher inflation as a normal run rate, it is not abnormal to see during this moment of time a bit of a higher role that pricing is playing on the growth equations. But I don't see that being beyond what we have been talking about for H2 of this year. And as far as next year is concerned, I think we will first focus on this year and we'll see when is going to be a good time to have a bit more read and sharing on the various components of our future growth outlook.

Scott Gray: Yeah. And in regards to your second question in terms of the margins on APAC and LARMEA. Of course, it's a snapshot in a moment in time. APAC is one of the regions and notably we've talked about in terms of our strategic priorities being China, but also as a focus region overall. And in the period with our step up in terms of total SG&A across A&P, but also other areas within SG&A to build capabilities and to support the innovation, we had increases there in the period versus the prior years, so that's on APAC.

On LARMEA, we also had higher A&P and also an increase in other operating expenses in the period. And that is also a market where we talked about that we also had taken some pricing in the period as well. And we continue to be very price disciplined as well. And sometimes the input cost lag a little bit the timing on pricing, but we continue to take price there. But in the period on snapshot, we had a margin decrease in LARMEA. So that's the main drivers between those two regional evolutions of the P&L.

John Ennis: Okay. Understood. Thank you both.

Operator: And the next question comes from the line of Tom Sykes from Deutsche Bank. Please go ahead.

Tom Sykes (Deutsche Bank): Yeah. Morning, everybody. Just first to further the point on price elasticity and the pricing potential. Is there a little bit more pricing power in the tail of the business in the smaller brands that we may expect, or is it better in the larger brands or in some of the smaller regional specialist brands? Is there a bit more pricing to have there, please?

And then just on the Out-of-Home or Away-from-Home, as that is recovering and what's happening to be at-home consumption. Do you have the right geographic overlap at the moment between those countries where you are seeing a reopening, and therefore maybe a little bit of a headwind in some of the at-home consumption? Is that something that, you said you'd get a better read in September, but is it something that affected Q2 and you're then expecting that gap to narrow a bit in the second half of the year? Or should we think of that as a little bit of a headwind to volume growth which is, as you said, maybe offset a little bit by pricing, please?

Fabien Simon: Good morning, Tom. Thank you for the two questions. So the first one on the pricing elasticity. So is it the same level of pricing power across portfolio of brands? I think it's not a one size fits all answer, I believe. And you have multiple angles of it.

So first, obviously, the more you go into the premium territory, the least the brand usually are exposed to commodity inflation because you have more added value. So of course, there is a bit less, usually, requirement to do some pricing and you might argue is it price elasticity, pricing power, I don't know how to qualify that best, but for sure, there is usually a bit less effect on a short-term basis. But on the other side, when you are confronted with big inflations, we should not underestimate that for a lot of geographies, price points matters a lot. And we think about emerging markets in particular. And it's where sometimes you would see that getting really a portfolio of brands with entry price points is very important and it's where you see overall much more pricing power than what you could think originally.

And I would say, at the end, where we feel we are in a very good position in terms of heart of our strategic belief is: to answer the broad-based consumer needs, you need to have a portfolio of brands. It seems going towards, the consumer thinks, okay, the overall price point of coffee at home is €0.07, so it's very affordable, but maybe the more premium one is a bit more expensive. If they would decide to trade-down on which type of product they will consume, we are in a fortunate position: we have a portfolio of offers across price points. Worst case, there could be some reallocation of consumers within our portfolio while a lot of other players are positioned in one area of the business. So we feel we are in a pretty good place with very, very strong premium offers where there is very big traction but as well a portfolio and some very affordable products.

On the second question on the Out-of-Home and Away-from-Home, I think if I look at where the centre of gravity of our Away-from-Home business is, it's mostly in Europe and in US. And it is where I would say there is from the read of Q2 at least a much better, I would say, level of optimism of what the reopening effect could look like. So I would tend to conclude indeed that I believe we are well-positioned with re-opening when it's going to happen in these two territories. At the same time because we have a higher market share even on this geography In-Home and Away-from-Home when consumers will still spend a bit more time than pre-pandemic to work-from-home who will benefit from that as well. So all in all, I feel we are in a pretty good place indeed.

Tom Sykes: Thank you. Maybe just a quick follow-up, and I didn't perhaps quite understand the previous answers on what the level of operational leverage you saw actually was within the Away-from-Home business at the moment? What sort of incremental margins and conversion could we perhaps expect in the Away-from-Home business that recovers over the next 12 months, please?

Fabien Simon: Yeah. What we have been communicating on that one is because we believe there will be some enduring effect on the Away-from-Home side, that we had to work on our cost structure a bit deeper than what we had originally worked on. And our agenda is based on the ambition to recover our absolute profitability that we had pre-pandemic on the Away-from-Home, also with possibly a slightly lower revenue and we give us 2023 as a target to bridge that. So which could lead indeed a bit of some operational leverage in the meantime.

But again, here we want to be cautious. I think nobody knows what will be the pace of recovery. I recall well when we communicated our results last year, we were seen as a bit conservative. Today, what we see is actually our assumptions for H1 has been proving pretty accurate. And we want to remain a bit cautious on that area which is still uncertain.

Tom Sykes: Okay. Great. Thank you very much.

Operator: And the next question comes from the line of Reg Watson from ING. Please go ahead.

Reg Watson (ING): Good morning all. I'd like to touch on this elasticity demand issue because when I look at CPG LARMEA, clearly you had good organic growth, but you didn't feel confident enough in the inelasticity of demand to push pricing up to compensate for the depreciation of the currencies in LARMEA. So that's the first question.

And then second question is, given that this is the last official opportunity we have to communicate with you until March next year, could you please give us some indication on what kind of operating leverage you expect in '22 because clearly this year you've highlighted the increase in investment behind the brands and that is why your EBIT growth is slower than your anticipated top line growth. But should we anticipate that for '22, we could see EBIT growth in line with organic top line growth? Thank you.

Fabien Simon: So let me first start – Reg, thank you for your question – on the emerging market side. I think the point we are trying to make was really a question of time, on your question. But maybe I can take a bit the opportunity to share with what we see on emerging markets.

So I think, overall, if I look at the first part of the year, I think they've been proving quite resilient. You've seen the mid-single-digit growth rate. And it was on the back of modest volume growth but with more pricing and mix as Scott has been talking about. But again, there are like always some differences in this part of the world.

You are quoting LARMEA. We see Latin America, Middle East, Eastern Europe are performing pretty well getting close to historical level, with a bit more pricing playing a role. But it's really a question of time and we are very, very comfortable there.

In Asia, we tend to be very optimistic on China. And it continues on a nice trajectory in particular when we see on the trend, which is happening online and on the premium side. But for other parts of Asia, Southeast Asia in particular, it's a bit more difficult. And I think we talked about it last time, it's an area where coffee is not an essential goods and it is a place which is quite hit now by the global pandemic crisis, plus there is a bit of a different level of infrastructure support. And we have been in slight decline in this part of the year. I think it's going to take a bit of time before it's recovering. But I know it's a part of the world which has been used to go through crisis and which will recover over time.

On your second question, I think you were talking around probably a frequency of our communication as much as some guidelines. On the frequency of the communications, we've been very disciplined on communicating on a two-year basis, I would say, because there is, in particular, the specificity on coffee and you can't have much read on a quarter-on-quarter basis. But it doesn't mean that we remain silent to give updates on the business. We have been proving that in March where we have been communicating in between, I would say, a semester, some updates on our strategic progress and priorities, and we'll continue to do similar exercises in the future.

You asked a question specifically about the future outlook. We remain committed to our mid- to long-term guidance that we have been communicating. As far as ~~H2~~ [2022], in particular and all the details of it, I think it's a bit too early to talk about it. As I've said, we first have to focus on managing well the second part of the year. See how the Away-from-Home business recover and we'll get a better read over the next couple of months than what we could do now. And as we've said, we have a good visibility, good level of security in front of us with some of the hedging we have in particular. And in due course, we'll communicate and articulate more the detail of our expectations for 2022.

Reg Watson: Okay. Thank you, Fabien. Can I just come back to your observations about the emerging markets where you're confident and where to quote you, it's a question of time. Are you implying then that any currency depreciation that you're suffering now can be earned back through price increases just in a more steady fashion than the immediate depreciation of the currency that you suffered?

Fabien Simon: Yeah. I think you're probably quoting it right. Yes, we are confident that – and actually, I even believe that pricing will probably come faster than the pace of the volume mix recovery. And we feel comfortable there. And it's what the history has been telling us on the emerging markets.

Reg Watson: Okay. Thank you very much.

Operator: We're now approaching the end of the call, so we'll take the last question from the line of Martin Deboo from Jefferies. Please go ahead.

Martin Deboo (Jefferies): Yeah. Morning, everybody, and thanks for taking the question. It's Martin Deboo at Jefferies. I'll try to keep it brief. Fabien, on slide 11, you've made some useful comments on hedging, which I didn't quite understand. What can you say about your current hedge position in coffee? Are your hedges running out such that you need to move into the markets to take pricing or are they more long-lasting? And I suppose the related question is, is your philosophy of pricing in H2 that you will look for price alone to recover inflation or are you expecting to recover inflation through a combination of pricing and offsetting cost savings?

And one quick question of clarification, the one you said to David Hayes. Did I hear you say you expect to increase A&P this year by about €100 million? Those are my questions. Thanks.

Fabien Simon: Good morning, Martin. So let me give a crack at the various questions. So on hedging and commodity. The development of green coffee prices depend on a wide range of factors, I mean weather, macro development, or even market speculations. That's why our role is not to predict how the coffee market may or may not develop, but to manage the volatility with great discipline and good protection with our hedging. We are not intending to create shareholder value from speculating on coffee. Getting it right one out of two or never, but really by driving sustainable growth from underlying quality demand and innovation propositions to customers and to consumers. That's why we do have good hedging in place and we are very disciplined. We are well hedged for this year. It's something we've maybe not communicated, but we are discipline to the extent to which we need time to be able to get the pricing through, which is a specificity of the coffee industry.

I take a good note on the comment you made as a follow up question from David and I believe I have well answered to that question, which we will keep the course of investing behind A&P as well as some other capabilities such as digital or emerging markets. And the overall investment on the year across all of these buckets, including appliances, I forgot, sorry, will really be around this €100 million mark investment.

Closing Remarks

Fabien Simon: So, that was probably the last question. I would like to conclude by reiterating that I believe we have made good progress against our refreshed strategic framework as well as against our financial outlook and commitments for 2021 by delivering a solid set of results, which show improved performance across all our key metrics, and have, importantly, been delivered in a quality way.

The volatility, the uncertainty, and the ambiguity that the world is confronted with needs us to stay humble and nimble. But it reminds us as well that we are fortunate to operate in the coffee and tea category, which is resilient with many possibilities ahead. And at JDE Peet's, we are committed to play our part into these possibilities and deliver a quality and sustainable long-term growth. And we know this is what creates predictable and higher shareholder returns over time.

So thanks again for joining us today, and Scott, Robin and I look forward to speaking with you in the next days ahead. So stay well, stay safe, and have a great rest of the day.

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

[END OF TRANSCRIPT]