Selecta Group Q1 2024 Results Noteholder Presentation

Thursday, 2nd May 2024

Introduction

Angela Cinelli

Head of Investor Relations, Selecta Group

So good afternoon all and good morning to those joining us from the United States. Welcome to Selecta's First Quarter 2024 Results Presentation. Please note that the call will be recorded. On the call today we have with us Christian Schmitz, who is our Chief Executive Officer, and Nicole Charriere, who is our Chief Financial Officer.

Before we initiate, I would like you to refer to the disclaimer that can be found on page two of the presentation. And as a reminder, after the presentation, a Q&A session will follow.

Moving on to the agenda page, today's presentation will cover essentially financial results, and before we start, I kindly remind the speakers to mention when they change slides as they progress through the presentation. And now I would like to hand over to Christian.

Financial Results Overview

Christian Schmitz

CEO, Selecta Group

All right, thank you very much, Angela. Good afternoon everyone. It is nice to have you again for our first quarter earnings call. And today's call is going to be relatively short. Just want to give you a brief financial update given that it is not too long ago that Joe and myself had the opportunity to take you through the broader picture when we did the full year.

Brief Overview

I want to start with a brief overview, where we are on our key priorities, foodtech growth, margin expansion, EBITDA growth, cash conversion, just talk you through that. And then the rest of the presentation will be taken by Nicole who is going to walk you through the usual set of slides with more details on the financials of the company.

So to start, I think if I go back to the full year presentation that we gave you, three months ago we said we are going to see a little bit a year of a story of two tales, first half and second half of the year. The first half of the year, you will still see some impact from our intentional churn programme, and you will see more and more muted revenue growth in total, but still strong foodtech growth. And then the second half of the year, we said you would start seeing strong overall growth in the company. And that is what you also see in the first quarter here. You see the Group sales down 4.5% year-over-year. There are three main points that contribute to that. First of all, substantial calendar shift. When you look at last year or this year in terms of Easter holidays, it is worth around 1.5 points roughly when you think about it. Where Easter last year was in April, this year it was in March, so the entire holiday schedule is different. We will get that back in April, and that evens out.

The intentional churn programme, as we mentioned, would last into the first half of the year. And then as we mentioned before, a couple of countries where we see a little muted volumes in the current overall environment, but we continue to see the path that we charted where we started the first quarter, and then we see gradual improvement and good growth in the half of the year.

From an SMD perspective, which is always a critical metric for us in terms of productivity, you see that that continues to go up, which is directly in sync with the clean-up programme that we have been talking about quite a bit by now, €13.1 SMD, up 4.9% year-over-year. So that is something that continues. And then as I mentioned before, we continue to bring foodtech into the market at an accelerated pace, over 30% of unit growth foodtech points of sale year-over-year. As you know, these units typically get larger revenues than our average vending or coffee machine, so it is something that we are fairly pleased with, but obviously there is always more opportunity here.

Good picture from a margin perspective in two ways. First of all, very strong on gross margin in the first quarter, 60.6%, up 150 basis points year-over-year. It is something that we like to see. I would not expect that same trend to continue throughout the year, so it is probably going to taper off, but again, I think good start into the year. And then as a result of the strong gross margin and discipline on costs that we have now demonstrated for the last four years, we got another quarter of EBITDA margin growth year-over-year, 18.6% adjusted in the first quarter and 17.4% reported. So it is up 1.4 percentage points on adjusted and 80 basis points on reported. Good discipline on one-offs and overall I think substantial improvement when you look at the earnings quality of the business.

The combination of strong gross margins and cost discipline and group sales slightly down gets us to a position where we still have a growth of the adjusted EBITDA, 3.5%, and reported EBITDA, slight growth, 0.3%.

So that is the combination. And then next point on the cash conversion, the first quarter, as you know from a seasonality perspective and the cash-outs that we typically have in the beginning of the year, traditionally a quarter that turns less cash and the remaining quarters turn more cash. So that gets you free cash flow, €7.5 million, 13.7% conversion. If you exclude the right sizing, it would be more substantial at 27.4%, but again, you have seen it now quarter-over-quarter, the first quarter is always one where we have higher cash-outs, and then it turns over the rest of the year. And a very comfortable liquidity hedge room of €102 million.

So that is the summary. I think there is a couple of things Joe and I said when we gave the full year presentation. We said the first half, we are going to see less revenue growth. You see more in the second half. For the full year, we are confident we will see machine park expansion, so we will be through that entire churn and down and up, turn that into an up. And so the quarter, on those expectations that we also alluded to in our previous call.

With that, Nicole, I will hand it over to you to give some more of the details.

Financial Results

Nicole Charrier

CFO, Selecta Group

Thank you Christian and warm welcome from my side as well to our Q1 results conference call. Q1 is another quarter of earnings growth and margin expansion, which continues to prove the successful transformation of Selecta. Let me quickly recap what Christian already explained on the main drivers of our sales development.

Continued Reported Earnings Growth

We continue to be impacted by our strategic intentional churn initiative. As we took you through in full year results presentation, the impact of intentional churn on full year 2023 sales was 3 percentage points. The intentional churn initiative is a significant driver of our transformation journey as it is increased the profitability of the business and creates a solid ground for the future. As we mentioned, we are on the tail end of that exercise. Alongside with the unprofitable machine reduction, we are accomplishing to build up a healthier machine park, which is reflected once again in the 4.9% increases in SMD, up to €13.1, a new record high this quarter again.

Regarding volumes, we continue to see some elements of volume softening versus last year, which is in line with what we communicated for Q4 2023. The reason for that is economic slowdown and some components of pricing. Additionally, in this quarter, the early timing of Easter has impacted sales growth negatively by 1.2 percentage points. If you go further down the P&L, we see that our pricing and procurement initiatives have led to a substantial improvement in gross margin, which is up 1.5 percentage points versus last year. Our strength in cost discipline led to an adjusted EBITDA of €54.9 million, up 3.5% versus last year. And together with gross margin performance leading to an increase in adjusted EBITDA margin of 18.6%, up 1.4 percentage points versus last year. We reported EBITDA of Selecta Group BV consolidation scope of €51.5 million, slightly up versus last year, also leading to slight margin expansion to 17.4%.

Cash conversion improved by 2 percentage points versus last year in a low cash generation quarter, mainly due to seasonality. Our liquidity headroom is at strong €100 million, taking into consideration that the minimum liquidity we require to run the business is around €25 million.

Strong SMD growth leads to a new record high

If we go to the next page, we see the components of the development of our SMD. So the group SMD, as already said, reaches again record high €13.1 despite having a negative impact from Easter, not only reflected in lower amount of working days. And also our foodtech growth continues to contribute to the expansion of SMD.

The private segment, as you know is the most impacted by the intentional churn and hence, reflects clearly in SMD growth, the removal of unprofitable machines, landing at €13.6, up 5.8%. In semi-public, we also see a significant impact from intentional churn. A sector which performs strongly this quarter is distribution, the SMD landed at €9.3, up 6.3%. Public SMD was already standing at a very high SMD with a very strong performance during the last year, and this quarter we see a slight impact due to mix and volume. SMD landed at €23.5, slightly down versus last year. Here we see a very strong contribution of the airport sector.

At the tail end of clean-up and transformation

On the next page, we can see the net sales development on a country-by-country basis. We have already mentioned that the intentional churn is impacting significantly our net sales growth. The Q1 growth for the Group is down 4.5% at actual rates and 5.3% at constant currency. Overall, the greatest FX headwinds continue to hit our Nordic countries, whereas we see FX tailwinds in the UK and Switzerland. We continue to have strong momentum in Germany, mainly in private and semi-public, but also Austria improving, driven by higher service quality, successful termination of unprofitable contracts and growth in railways and retail. Despite having a strong impact from strategic intentional churn, Spain is another country which is standing out in terms of growth, meaning it has even stronger underlying growth. The performance in Switzerland remains impacted by the intentional churn, together with some volume softening. As already mentioned, Sweden is strongly impacted by FX, but at the same time, also undergoes the strategic intentional churn initiative. In Italy, we continue our transformation journey towards building an efficient solution and service team, and we see positive momentum there. After this quarter, we still run behind the negative role from last year.

Margin expansion in Central and North regions

On the next page, we can see the regional breakdown of our numbers, and you find strong adjusted EBITDA development in Central and North region, whilst you see the Southern region impacted by the Italian transformation journey.

Gross margin improvement led by profitability expansion

At page 12, we can have a look at the total P&L. I already explained gross margin, as mentioned, performed very strongly versus last year, also benefiting by pricing implementation and procurement initiative. We also have played our strengths with regards to the cost ratio. We kept very strict control on costs, and with that we kept the cost ratio flat versus last year. Regarding our transformation actions, as we said, we expect them to come down this year. This quarter we invested €4.4 million, the main driver of that is the investment into the profitability of our Italian business. And just as a reminder, the 0.3% reported EBITDA growth is related to the Selecta Group BV cost base. If you add back the consolidation adjustment and look at the cost base of the full Selecta Group, you see an increase in reported EBITDA, which is even stronger and at 4%. Overall, our strong reported EBITDA performance is the result of our successful transformation actions.

Working capital will improve as transformation actions normalise

Having a look at our net working capital on the next page, our net working capital related cash outflow is mainly impacted by the amount of one-offs we paid, government-related repayments which come from the COVID period and seasonality impacts. As for example, a significant amount of vending fees to our client has to be paid in the first quarter. As our transformation action will normalise, we will also see a more stable working capital development.

Let me also quickly recap on the cash-out of one-offs. So as you will remember from our full year earnings calls, we had €4 million remaining from 2023, to be paid in 2024. Out of that, we cashed out €7.5 million in that quarter, hence €1 million remaining to be paid in upcoming quarters beyond what will be incurred on top what we had incurred up to Q1.

Capital allocation discipline

Then we have a look at the capital allocation on the next page. So we continue to be very disciplined in our asset funding. The most significant driver of our capital allocation is our client lease model to which we allocate €10.3 million, or 3.5% of sales, stable versus last year. As a reminder, client leases allow us, amongst others, to grow our foodtech with very limited cash CAPEX. The net cash CAPEX stood at €14.1 million, 4.8% of net sales, up 1.5 percentage points versus last year, which is mainly driven by phasing throughout the year.

We were also using more finance leases, this year we used €3.4 million, or 1.1% of net sales. This is higher than last year as we have optimised the funding strategy. And of course our funding strategy remains key for asset light and accretive growth.

Strong liquidity maintained

Then how has our leverage ratio developed, on the next page. As per March, our net debt is increasing mainly due to pitched interest while adjusted and reported EBITDA LTM slightly went up. This leads to a stable leverage ratio on both adjusted and reported EBITDA. After a seasonality driven low Q1 and higher note interest payments in January, available liquidity still stands at strong €102 million and consists of €40.2 million cash at bank and €61.8 million available RCFs. Cash at bank is composed of €46.1 million of cash and cash equivalent of roughly €6 million cash in point of sales. Out of the €150 million RCF facility, €61.8 million remain available, €85 million are drawn, and €3.1 million are used for bank guarantees.

Liquidity after step up of notes cash interest payment

On the next page, we recap the session by having a look at our liquidity bridge, so our liquidity started at the €145 million. Then we had the free cash flow in Q1 of €70.5 million, which is still impacted by rightsizing cash-out. So if I exclude those, the cash conversion goes close to 30%. And we also need to keep in mind, as we already had highlighted, that in terms of cash generation, this is our weakest quarter in the year.

Then we have a change in working capital which consists of the impact of transformation one-off, but primarily also the repayment of COVID deferred payments and various impacts coming from seasonality such as payment of vending fees or timing of invoicing. On top of this, this is the first Q1 in which we pay €30.6 million of notes interest, which is almost €18 million higher amount than it was last year.

With that, I hand back to Christian.

Conclusion

Christian Schmitz

CEO, Selecta Group

All right, thank you very much, Nicole. The conclusion is pretty straightforward. We have focused on profitable growth and free cash flow conversion for 2024, so a key priority here, we have mentioned it before, we are at the tail end of working through a lot of the issues we had to work through here in the last four years. And we feel very good about where the year is going to come in and, in particular, the development that we will see in the second half of the year. We are confident that that growth is going to pick up. So we see that and I think we continue to say what we set now. I guess this is the 15th quarter in a row where we had the bullet point on that set. Our transformation actions give us confidence of achieving our strategic plan. We said that in 2020. We said that in 2021, we said in 2022 and 2023, and we are going to say the same for 2024.

Appreciate everyone's attention and dialling in, and I think we can open up for questions.

Q&A

Wolfgang Felix (SARRIA): Yes, hello. Thank you for your presentation today. I will be honest, I was expecting a little bit more sales actually. I am wondering where I may have gone wrong. I see year-over- year, your SMDs, etc. are up, but they are probably not as far up as they have been in the last quarter, for instance. And yes, we can look back obviously on how strong perhaps Q1 2023 was, but I was wondering if you have adjusted your pricing strategy perhaps or something. Particularly on the private side, I was expecting perhaps a little bit more. So that is question one.

And question two goes in the same direction. I was wondering what effect maybe Easter might have had because I did not factor that in.

And then on the working capital, question three, last year we had a relatively large cash-out for vending machine fees to one large client. Is that going to be a feature going forward? I thought that was one-off occurrence at the time, and it was not going to recur this first quarter, but we have a large working capital outflow, and I think you alluded to it as much as that. So yes, that is my last question. Thank you.

Christian Schmitz: Okay, why do you not let me take the first two, and then Nicole can comment a little further on the working capital. First question on pricing, we have not taken any extraordinary action. What you see is inflation is tapering down, so our price increases are more moderate and in line with that. At the same time, I think we have done a pretty good job of managing the dynamic between cost increases and pass-through, as you can see in the gross margin, which came out quite favourably in the first quarter. But nothing out of the ordinary outside of that.

From a total top line perspective, I can only go back to what I said before, three elements: the Easter impact, the timing of the holidays and the shift, and less working days in March and more working days in April this year and the opposite the year before. I would estimate it probably somewhere around 1.5% that we have. There is always a little bit of dynamics. Private business goes down substantially. There is few countries where the on-the-road business picks up, but net impact I would say probably 150 basis points that you see in there. And then when you look at, historically, at the last quarter of our strategic churn, there is still a substantial element, as we have said before in first quarter. Year-over-year, second quarter, we should already see a different trend and then really have this taper off and then different trajectory in the second half of the year. So that is that.

And then the last piece on the volume side, there is a couple of markets where I think there is just some general headwinds that we see in consumption. So where we look at machines and we see they are properly filled, in service, where consumption is a bit muted - Germany would be an example - and where the dynamic of the economy isn't great, and we will see that in consumptions there. And that is going to turn at some point. It is a combination of the three things but with an emphasis on the first two that I mentioned here.

You want to comment on the working capital question, Nicole?

Nicole Charriere: Yes, absolutely. Let me quickly explain how that works with the vending fees and how that impacts seasonality, or the seasonal cash outflow. So we pay vending fees as a rent to our client, and those then have different payment patterns, but a very significant portion gets paid in Q1 of each year, so that is the case every year. You basically also see a higher outflow in networking capital the same quarter last year. It means you accrue that over the year, your liability gets higher. Then if you turn into the new year, you pay and your net working capital goes down.

Wolfgang Felix: Yes. Okay, thank you. So should we expect a similar size movement then every year going forward, or is the size still going to change?

Nicole Charriere: I think yes, that is the definition of seasonality that such patterns continue over the years.

Wolfgang Felix: Okay, and one last question, if I may, because I just have not been keeping track of it and perhaps it is long gone. There used to be a Autobar tax payment due in the Netherlands. I am not sure, have you already paid that or is that actually still outstanding?

Nicole Charriere: You are fully right. No, we have not paid that yet. There is no final decision taken and no final cash outflow defined, so we do not expect that to happen in the next quarter.

Wolfgang Felix: You do not?

Christian Schmitz: No, we do not. No.

Wolfgang Felix: Okay, thank you.

Christian Schmitz: All right, thank you.

Julien Martin (Aberdeen): Yes. Hi, good afternoon. Thanks for the presentation. I just had one question on the Lavazza-IVS transaction. Just wondered if you had any thoughts to share. I know sometimes it is difficult to comment on those competitors' transactions, but that is be much appreciated. And I just wondered if there was any impact as well on your business. Again, like it is been a while, sometimes I have not followed specifically some areas of Selecta, and I thought Lavazza was one of the deals you struck some years ago, so wondered if that new transaction had an effect on your side. Thanks.

Christian Schmitz: We do not see any impact on our business. We have a very different business here that we are building. We decided four years ago to pivot away from a traditional vending business and really turn this into a European foodtech business and turn ourselves in the European foodtech leader. We think that is where a lot of exciting opportunity is, where we can differentiate and we can bring different value to our clients. Also can differentiate on price. We get out of commodity game, and that is where our focus is. We take interest in what is happening outside of us. We do not see an impact of that for our everyday doing our business. We stay on course, turn this into foodtech player leading brands and we have decided that we think that for our clients, it is important that we can bring a broad range of brands and solutions and not just one. And what we do in our businesses, we reach out to a client, we sit down and really try to understand their needs. And that only makes sense if you have a broad range of solutions. There is other players out there that go mono brand, with one brand and one solution and one coffee machine. It is also an approach you can take, but obviously we have chosen a different one and will continue to do that.

Julien Martin: And does that mean that you are proposing yourself a Lavazza solution as well to some of your clients or are you not? Sorry.

Christian Schmitz: We serve all sorts of brands. There is no restriction on that, and we have got a broad portfolio today. We will have broad portfolio going forward. We bring to the people what they like and what they need. That is all we care about. And again, it is a different approach. There is no restrictions or anything, any brand or so that we do not use. What we do is with our clients, we try to understand what they need, and of course on the back end we look at, okay, what are the different margin profiles of different solutions. And then when a client is pretty open to different options, we will obviously look for what makes a lot of sense for us. That is why we have got our own brand, that is why we work with brands, we will continue to do that. So I do not see that being disrupted or changed in any shape or form.

Julien Martin: Great, thank you.

Christian Schmitz: Thank you.

Akshat Lakhotia (Knighthead Capital): Congrats on the good quarter. I just had a quick one here. When you think about the second half after rationalisation has come to an end, do you view the growth algorithm beyond that point as lower volumes and higher pricing just off of your volume softness comment and a few geographies? And then if volumes actually go down, do you think there is an opportunity to serve more number of machines with the same number of employees, resulting in, therefore, a potential EBITDA benefit? Thank you.

Christian Schmitz: Thank you. I appreciate the question. The main assumption that we have when we think about the second half of the year is better retention, more wins. That is what we can actively drive every day. The retention' has got two elements. First part of retention is that we do good service, and we listen to our clients and clients that need us, we get in touch with them fast and we have a problem and we fix it fast. So we made huge progress in that part over the last years, helped through technology, the telemetry, we know really where to go; all these things that we talked about a lot in the past. At the same time, what is really dragged us down is the fact that we have had a lot of contracts here in the portfolio that were not good, and we have got a clear philosophy here. We want to do business, we want to make people happy, but we also make money with these contracts. And that is what we had to work through and ultimately do.

So that part we have pretty good visibility into because we know our contracts, we know our profitability, which is why we are confident here that number is going to come down. When you look at the retention rate, without that intentional churn, it is already a pretty good retention rate. It can always get better, but it is a pretty good retention rate. So you take that, and then we look at our pipeline and the number of opportunities that we have, the signatures that we already have for business that will be coming in, I think that combination makes us confident that we will see a pickup.

And then also there is of course initiatives on the volume side, right? There is an overall economic climate, I would say, that is not great, at least in some of the countries. It is a little different by market and we have to work against that. We have to make our assortments more attractive. We have got to drive the SMD, we have open more food markets. What we see is food markets, the existing food markets, they are growing in revenue pretty substantially on a like-for-like basis. So it is that entire pivot that needs to continue and accelerate, and you take that together, then that is it. Pricing is not going to be the major driver. We do not do aggressive pricing actions, and so there is going to be limited impact from pricing on the growth that we expect to see in the second half of the year.

Christian Schmitz: All right, final remarks. Thank you very much. We appreciate the support. It is nice to see you all. If you have any questions in the meantime, please feel free to reach out to our team, Nicole, Angela, we are here, and look forward to seeing you for the first half year results in around three months from now. Thank you very much. Have a great day.

Angela Cinelli: Thank you all.

[END OF TRANSCRIPT]