CCH – 2019 Half-year results
Conference call script – 8 August 2019

CORPORATE PARTICIPANTS

Zoran Bogdanovic – Coca-Cola HBC AG - CEO

Michalis Imellos - Coca-Cola HBC AG – CFO

Joanna Kennedy - Coca-Cola HBC AG - IR Director

Operator

Thank you for standing by ladies and gentlemen, and welcome to Coca-Cola HBC's conference call for the 2019 half-year results. We have with us Mr. Zoran Bogdanovic, Chief Executive Officer, Mr. Michalis Imellos, Chief Financial Officer, and Ms Joanna Kennedy, Investor Relations Director. At this time all participants are in listen only mode. There will be a presentation followed by a question and answer session and if you wish to ask a question, please press star one on your telephone keypad at any time and wait until your name is announced. I must also advise that this conference is being recorded today Thursday, August 8, 2019. I now pass the floor to one of your speakers, Ms Joanna Kennedy. Please go ahead. Thank you

Joanna Kennedy - Coca-Cola HBC AG - IR Director

Good afternoon everyone and thank you for joining the call today to discuss Coca-Cola HBC's results for the first half of 2019.

I am joined today by our CEO, Zoran Bogdanovic and our CFO, Michalis Imellos.

Zoran and Michalis will present our results to you and following that we will open up the floor to questions. As always, we will ask that you ask your questions one at a time, and that you wait for us to answer each question before you ask the next one. Rest assured we will keep your line open, until we have answered all your questions.

Forward looking statements

Before we get started, I would like to remind everyone that this conference call contains various forward-looking statements. These should be considered in conjunction with the cautionary statements on the screen. This information can also be viewed in our press release issued today.

Now let me turn the call over to Zoran.

Zoran Bogdanovic - Coca-Cola HBC AG – CEO

Half-year highlights

Thank you, Joanna. Good morning everyone and thank you for joining our 2019 half-year results call.

I will start by giving an overview for the first six months. Michalis will then take you through our financial performance, before I discuss our operational performance and outlook for 2019.

We delivered currency-neutral revenue growth of 3.4% in the first half, a pleasing result in the context of a tough comparative period for volume growth and the backdrop of unusually cold and wet weather for most of the second quarter which impacted all of our segments.

Volumes grew in all three of our geographic segments, up 2.2% overall with good momentum in Sparkling and Energy, up 2.9% on a combined basis.

Innovation continues to be core focus, in all 4.5 percentage points of our volume growth was attributable to new launches. This first half was a busy one for innovation, with several launches and announcements which we're excited about and which I will discuss in more detail later.

Currency-neutral revenue per case growth of 1.2% in the first half was driven by an improvement in the second quarter compared to the first, as price increases, category and package mix continue to drive sustainable improvements. Better price/mix is visible across our markets with the exception of Nigeria. To give you a sense of the underlying improvement elsewhere in the portfolio, excluding Nigeria, price/mix would have been up 2.5% in the first half.

We delivered a 50 basis point improvement in comparable operating costs as a percentage of revenues and our comparable EBIT margin improved by 10 basis points.

With that, I will turn the call over to Michalis to take you through the financial results.

Michalis Imellos - Coca-Cola HBC AG – CFO

Financial review

Thank you, Zoran , hello everyone.

In line with our practice, as I take you through our financial results for the first half of the year, I will refer to comparable figures which exclude the impact of restructuring costs, the mark-to-market valuation impact of commodity hedges and specific non-recurring items.

Financial performance overview

Here you can see the key lines driving our revenue growth and margin expansion.

As Zoran mentioned, we achieved volume growth of 2.2% in the first half. This, combined with currency neutral revenue per case growth of 1.2%, drove 3.4% currency neutral revenue growth. The impact of foreign exchange translation on revenues was positive by 40 basis points, driven by favourable movements of both the Swiss Franc and the Nigerian Naira versus the Euro, resulting in reported revenue growth of 3.8%.

Our Gross profit margin declined by 40 basis points, mainly as a result of the adverse transactional foreign exchange impact of 60 basis points. Comparable Operating expenses as a percentage of revenue improved by 50 basis points, of which 20 basis points was due to one-off benefits and the other 30 basis points was driven by operational leverage as we maintain cost discipline while growing revenues.

Comparable operating profit increased by 4.7% in the first half compared to the prior-year period.

We had a 19 million Euro currency headwind to our EBIT from currency depreciation, mainly associated with the weakening of the Russian Rouble versus the US Dollar, 20 million euros ofthis was transactional and impacted margin by 60 basis points as I mentioned earlier. The combined effect of the gross profit margin decline of 40 basis points and the OPEX as a percent of revenue improvement of 50 basis points led to an EBIT margin improvement of 10 basis points.

Financing costs increased 14 million Euros compared to the prior-year period, due to higher interest expense resulting mainly from higher overall gross debt and the increased lease liability from the adoption of IFRS 16.

Comparable EPS reached 61 Euro cents, 1.5% higher than the prior-year period. The slower pace of EPS expansion compared to operating profit growth is the result of higher financing costs, while the tax rate in the first half was stable.

We generated solid free cash flow of 79.3 million Euros in the first half.

Input costs

Turning to input costs:

Currency neutral input cost per case was up by 1.8% in the first half of the year, in line with the guidance we gave in February.

PET resin costs increased in the first half, in line with expectations.

Our sugar costs fell, despite a tighter sugar market in Europe, as we benefited from our hedging positions which fully cover our requirements for 2019. Sugar markets in the rest of the world remain stable.

Aluminium costs decreased slightly, keeping the trend of Q4 2018 and stabilising at levels lower than prior year.

Operating leverage

Turning to our OpEx performance in more detail:

Comparable operating expenses closed at 27.5% of revenue - a 50 basis-point improvement compared to the prior year.

We continue to use our infrastructure effectively and to invest in technology to increase our efficiency while growing the topline. In the first half of the year this well controlled and lean cost base allowed operational leverage to contribute positively to our OpEx ratio by 30 basis points, while the other 20 basis points of the improvement was one-off in nature.

Let me walk you through the key drivers.

Underlying sales expenses as % of revenue decreased by 20 basis points. In addition, we had a 10 basis point negative impact from cycling the one-off benefit of the partial recovery of bad debt in Croatia. The combined impact of these two effects was a 10 basis point improvement in sales expenses as a % of revenues.

Underlying marketing expenses as % of revenue decreased by 20 basis points. In addition, we saw a 30 basis point reduction as we cycled last year's FIFA related commercial activities. The combined impact of these two effects was a 50 basis point improvement in marketing expenses as a % of revenue.

Warehouse and distribution expenses as % of revenue decreased by 10 basis points.

Administration and other FX-related costs as a % of revenue increased by 20 basis points.

Segmental revenue and profit

Turning now to the key financial drivers on a segmental basis.

In our Established markets, currency neutral revenue growth of 1.9% was driven by 0.4% volume growth and 1.5% expansion in price/mix. This price/mix improvement is partly the result of passing through the sugar tax implementation in Ireland, as well as small price increases taken selectively in other markets. We have also experienced positive category mix from strong growth in the ready-to-drink tea and Energy categories together with favourable package mix from strong execution of our revenue growth management strategy, particularly in Italy, Switzerland and Ireland.

In terms of margin delivery, the positive impacts from operating leverage from this topline growth, OpEx improvements and a positive foreign exchange impact from a stronger Swiss Franc were offset by higher input costs and the adverse impact of the sugar tax implementation in Ireland. This drove comparable EBIT growth of 2.4 million Euros and stable EBIT margins of 9.1%.

In Developing markets, currency neutral revenues grew 5.3% with volume up 1.4% and price/mix growth of 3.9%. The segment saw strong category mix, partly helped by the slowdown in Water volume growth, as well as improved package mix across most countries. The impact of price increases in Poland, Hungary and the Czech Republic also had a positive impact on organic growth in the segment.

In terms of margin delivery, the main impact here is the cycling of the one-off benefits from the Croatian bad debt partial recovery. Overall in the Developing segment we saw a 2 million Euro decline in comparable EBIT and a 70 basis point decline in the segment's margin to 8.5%.

The Emerging markets saw currency neutral revenue growth of 4.0% with volumes up 3.4% while price/mix grew by 0.6%. There are two effects to be aware of here. First, the impact of the changes to pack/price architecture we have made in Nigeria to respond to a more competitive environment, drove negative price/mix in the country. Second, the impact from the discontinued Brown Forman contract in Russia which still impacts the first half.

Meanwhile, improvements in input cost per-case and operating expenses as a percentage of revenue drove margin improvement. This was only partially offset by the foreign exchange impact of a weaker Rouble. Overall, comparable EBIT was up by 14.2 million Euros and EBIT margins expanded by 50 basis points.

Efficiency programmes

Moving on to restructuring:

In the first half, we incurred restructuring costs of 30 million Euros, mostly focused on the Established markets.

We do not anticipate any significant restructuring opportunities for the rest of 2019.

We expect the restructuring initiatives already undertaken in 2019 to yield savings of 19 million Euros in annualised benefits from 2020 onwards.

Solid free cash flow

Turning now to free cash flow, we generated 79.3 million Euros in the half year, a decline from the prior-year period.

This lower cash flow generation was due to the phasing of certain working capital payments which we expect to normalize over the course of the year. It was also due to the timing of capital expenditure which meant that capex was up 9.7% in the first half. Again, this impact will normalize by year end and therefore we maintain our guidance of annual capex as a percentage of revenue between 6.5 and 7.5%.

We continue to invest in the business to support growth. The key area of faster increase in capital expenditure was the Emerging segment, specifically Nigeria, Ukraine and Romania.

Finance costs

In May 2019 we issued two new bonds and partially refinanced another. We raised a total of 1.3 billion Euros of gross debt in two tranches, one 700 million, Euro-denominated fixed rate bond maturing in May 2027 and another 600 million, Euro-denominated fixed rate bond maturing in May 2031.We used part of the proceeds of this new issue to repay 236.6 million Euros of our 800 million Euro 2020 bond, benefiting from the lower spreads on our new bonds.

As a result of this new issue, our average effective interest rates on our debt improved to 2.1% from 2.7%.

This new debt and early redemption of first half part of the old, as well as the adoption of the IFRS 16 accounting standard on leases led to financing costs increasing year on year by 13.7 million Euros to 33 million Euros.

Looking ahead we now expect net financing cost for the full year to reach 70 million euros approximately 10 million less than our expectation at the begging of the year.

EBIT margin development

Finally, a few words on margin delivery and our second half expectations.

The first half achievement of 10 basis points of comparable EBIT margin expansion was in line with our expectations. As I outlined on our last results call, we had expected margin delivery to be weighted to the second half of 2019. Let me reiterate why this is the case:

First of all on the transactional FX impact: Based on the current favourable spot rates, we expect this impact in the second half to be minimal compared to the 20 million Euro adverse impact in the first half which drove a 60 basis point drag in the first half margin.

Secondly, we will be consolidating Bambi in the second half of the year, which is expected to contribute positively to margins by 20 basis points in H2 and 10 basis points in the full year.

Finally, since we expect an acceleration in volume growth in the second half, this will drive faster margin expansion through operational leverage.

In light of these factors, we are reiterating our guidance for another year of EBIT margin expansion, although, as we've said before, not at the pace of the last couple of years.

With that, let me now pass the floor to Zoran, who will take you through the operational performance for the year.

Zoran Bogdanovic - Coca-Cola HBC AG – CEO

Operational review and strategy

Thank you, Michali.

Volume by segment

Overall first half volume was up 2.2% with growth in all three segments. As we've said, weather was a head-wind this quarter, and as you know, we were cycling a tough comparative period, particularly on the volume front, in the second quarter. In this context, we are pleased with this result which leaves us on track to meet our targets.

Now looking at the segments:

In our Established markets, volume growth of 0.4% was a very solid result, and we have observed some really encouraging trends in key categories. We're pleased to see faster growth in Sparkling, up 80 basis points, and Trademark Coke growing by 2.3% with ongoing strong results from Coke Zero and a return to growth in Coke Regular in Ireland. Energy continues to grow double-digit and ready-to-drink tea is seeing high single digit growth, while colder, wetter weather impacted Water volumes, which declined.

Developing markets grew volumes by 1.4%, lapping a very strong result of 8.9% growth in the prior-year period. Here again, Sparkling is growing faster than the segment, up 1.7%, with Trademark Coke up 3.5%. We're also pleased to see ongoing momentum in Adult Sparkling with Schweppes up 3.3%. Water and ready-to-drink tea both faced challenging comps.

In the Emerging markets volumes were up 3.4%. We're seeing strong results from Trademark Coke in the segment, which was up 6.5% contributing to 3.5% volume growth in Sparkling. Water volumes were up mid single digits, driven by strong results from the Category in Nigeria, while Juice volumes declined mostly due to our decision to focus on the premium end of the market in Russia and this strategy is generating revenue growth.

Volume growth by category

Looking at our performance by category on the Group level now:

Sparkling volumes, excluding Energy, increased by 2.4%, growing across all three of our segments. We're encouraged to see transactions up 2% and currency-neutral revenues up 3.2% in the category.

Trademark Coke continues to do very well with volumes up 4.5% and ongoing excellent results from Coke Zero which was up by 35% in the first half. This 35% growth is on a base of 25% growth the prior year, so we're seeing very strong momentum from the brand. And in fact, Zero and no-sugar variants are driving volume growth throughout the Sparkling category with growth of 36%.

We are also particularly pleased that the Adults Sparkling portfolio is growing faster than the overall category with volume up 6%. Schweppes contributed volume growth of 7% with an excellent performance in Russia, Romania and Ukraine where our premiumisation strategy continues to drive results.

One of the categories that we are most excited about is Energy. In the last three years we have delivered a volume CAGR of 26% in the category, and the first half saw similarly strong results with volumes up 28%. The energy category is ripe for innovation and further segmentation to really unlock its vast potential. In the first half we made several exciting steps in this regard including launching Coke Energy in the premium segment and Predator at the more affordable end of the market.

Water volumes grew by 2.2% driven by the Emerging segment. In the Developing segment we are cycling very strong growth of over 21% in the prior-year period and this year volume growth was stable year on year, while volumes in the Established segment declined slightly.

Juice volumes declined by 2.5%. We are seeing growth in the category in the Developing segment, however it was more than offset by volume declines in the Established and Emerging segments.

RTD tea volumes declined by 6.2%. Strong growth in the Established segment continues with volumes up 8.6% in the first half. In the Developing and Emerging segment, however, volumes declined. Our acceleration programmes, including a new visual identity and new, disruptive packaging are being rolled out across our markets.

Let me also give you an update on innovation which continues to contribute an important part of our growth. In the first half of 2019 we sold 49 million cases of new products, flavours and packages, representing 4.5 percentage points of our first half volume growth. Let me pull out a few examples to give you a flavour: in the first half of 2019 we launched two new variants of Coca-Cola. These were Coca-Cola Energy in three markets and Coca-Cola Plus Coffee in six markets. We also launched new flavour variations in all the key Sparkling brands and premium packaging in FUZE. I'm also proud to say that we launched 100% recycled PET packaging in water brands in 3 of our markets, as well as 50% recycled PET packaging in Coke and Coke Zero in Switzerland and Austria; we won't stop here, you can expect more developments in that regard as we progress towards achieving on our 2025 sustainability commitments.

We also announced in May that we will be launching Costa coffee in a variety of formats throughout our markets, starting with 10 in 2020. We're excited about the opportunity to leverage the expertise our teams have developed in coffee to sell this great brand.

Established markets

Turning now to our performance by segment and focusing on some of the bigger countries:

As I said at the start, we're seeing some very encouraging trends within the Established segment which increase our confidence in the future.

If we look at Italy first, volume grew by low single digits. We're achieving stable volumes in Sparkling after several years of declines, as well as growth in value of the overall category, a significant increase in transactions, improvement in revenue per case and value share gains. We believe that this positive performance is due to the changes we have made to our pack/price architecture in the country in the second half of last year and from changes we made to our route to market to focus on improving our coverage in out-of-home. This improved coverage, when combined with some of our premium offerings and the broader portfolio, particularly with the introduction of brands like FUZE TEA, is having a very positive effect. FUZE TEA alone is up 60% since last year. Now, clearly, it's still early days for the turnaround in Italy, but we're very encouraged by this ongoing positive momentum and that we can pinpoint the driver of the performance to actions we have taken.

In Greece, volumes continue to recover, up by low single digits in the first half. Both the Sparkling and Energy categories continue to show strong momentum which is spurred by new flavour and variant launches including Coca-Cola Plus Coffee, Coke Zero Lemon and a range of exciting flavours in Schweppes including Bergamot Hibiscus Lemon and Pink Grapefruit.

Switzerland had a very wet start to the summer, actually it was the wettest May on record, and this had a dampening effect on growth. We introduced a new pack/price architecture at the start of the year which is yielding good results so far. Overall, we saw an improvement in revenue per case in the country, while volumes declined by mid single digits.

Developing markets

Turning to our Developing markets:

In Poland, volume grew by low single digits. We are cycling our Water acceleration plan from the first half of 2018 which presented a challenging comparative. At the same time, we have dealt with adverse weather conditions Nevertheless, we are very pleased with the overall currency-neutral revenue growth we are generating in Poland. Our successful execution of our revenue growth management strategy, including pack/price architecture changes in Sparkling in the first half of 2019 helped to drive a 6.4pp improvement in single-serve mix in the country. This, as well as pricing taken in the third quarter of 2018, drove very good revenue per case expansion and mid single digit currency-neutral revenue growth.

Volume in Hungary increased by low single digits in the period. We saw growth in all categories apart from Water and ready-to-drink tea, which are more sensitive to weather. Trademark Coke is seeing strong growth, up 6.6%, very much supported by strong performance from the flavours launched in Zero formulations. On the topic of innovations, Hungary is one of the three markets where we launched Coke Energy this quarter. Early indications show that the product is attracting new consumers to the category, which is a powerful proof point that this premium brand is doing what we intended. This launch helped to drive high single digit volume growth in Energy.

We took some price increases at the start of the year in the Czech Republic which are helping to drive good revenue per case expansion in the country, although, volume declined by mid single digits in the first half. We saw a volume decline in Sparkling overall, but Coca-Cola Zero and Fanta continued to put up good growth numbers and we also saw strong performance from Energy, which was up mid teens.

Emerging markets

Focusing now on our Emerging markets:

In Russia where we are cycling a strong prior-year volume performance which benefited from the FIFA World Cup combined with good weather, volumes were up by low single digits. We're pleased with the mid single-digit volume increase we are seeing in Trademark Coke, and at the same time Adult Sparkling continues to have very strong momentum with Schweppes up double-digits. We are also seeing healthy improvements in currency-neutral revenue per case, up mid-single digit, if we strip out the impact of the discontinued contract with Brown Forman.

Moving to Nigeria. We're pleased to see another quarter of volume growth in the mid-single digits. The environment in Nigeria is extremely competitive and we are seeing aggressive pricing actions from both local and international players. Since the end of 2018 we made the decision to adjust our pack/price architecture across our Sparkling brands to ensure we have offerings at every price point, this change is driving a decline in our price/mix in the country. We believe though that it is a necessary decision to maintain our long-term position in the market and we are able to do it profitably given the significant work on efficiency we have done in Nigeria, combined with our inherent scale advantages.

Volume in Romania increased by low single digits. We are cycling a very strong prior year growth rate in Romania and also had the headwind of poor weather in the second quarter. Nevertheless, Sparkling volume grew by mid single digits, with strong growth from Zeros and low-teens growth from Schweppes where our premiumisation strategy continues to drive results. Romania was one of the markets where we launched Coke Energy in the second quarter with positive early results.

Looking ahead

In the second half of 2019 we expect to see an improvement in revenue growth compared to the first half in all three segments and especially in Emerging. We would anticipate this improvement to be driven by faster volume growth in all segments, while the growth in revenue per case on a currency-neutral basis is expected to continue at the pace of the first half.

We expect input costs per case to increase at low single digits, in line with our previous guidance.

We have seen slightly more stable currencies than anticipated during the first half period and for this reason, and taking into account our hedged positions and current favourable spot rates, we believe that the adverse impact from foreign exchange movements on our P&L in the full year will be 20 million Euros, 30 million Euros lower than originally guided. We will take advantage of this more benign FX environment to support our for top-line growth.

With all this taken into account, looking forward, we expect to deliver currency-neutral revenue growth within the range of 5-6%, with another year of margin expansion. And we believe 2019 will be another year where revenue growth and EBIT margin expansion will put us on track to deliver against our longer-term commitments to the market.

With that, I will now hand over to the operator, and Michalis and I will be happy to take your questions.

Q&A

With that, I will now hand over to the operator to take any questions you may have.

[Q&A transcript will be available on the Company's website on Friday 9th August]

Zoran Bogdanovic - Coca-Cola HBC AG – CEO

Thank you everyone for joining our call today, your questions and the discussion. Let me leave you with a few final thoughts.

We are pleased with this solid first half given a challenging comparative period for volume growth, combined with adverse weather conditions in the second quarter of the year. As we look to the rest of 2019, we're encouraged by both the exit rate from this quarter, positive recent trading and our strong plans for the rest of the year. We are pleased to confirm our expectations for the year.

Thanks again, and we look forward to speaking to you next quarter.