Selecta Q1 2022 Results Noteholder Presentation

Wednesday, 11th May 2022

Introduction

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Welcome

Good afternoon and good morning to those joining us from the United States. Welcome to the first quarter 2022 results presentation. Please note that the call will be recorded. On the call today we have with us Christian Schmitz who is Chief Executive Officer of Selecta Group and Philippe Gautier who is Chief Financial Officer. Before we initiate I would like to invite you to please refer to the disclaimer which can be found on page two of the presentation. As a reminder, after the presentation a Q&A session will follow.

Agenda

Moving on to the agenda page today's presentation will cover business performance and financial results. I kindly remind the speakers to refer to the individual page numbers as they progress through the presentation. Now I would like to hand it over to Christian.

Business Performance

Christian Schmitz

Chief Executive Officer, Selecta Group

Good afternoon everyone, it is great to have you here again. We are excited about the opportunity to present our quarter one results today. We will keep things pretty short today from a broader update strategy perspective, given that Joe Plumeri and myself gave everyone a very detailed run down on where we are heading with our transformation and the individual initiatives and action in our full-year 2021 earnings call a couple of months ago. We decided that we will just focus on the financial highlights for today and then we will give you another update on transformation for the half-year earnings, just so that everyone is aware.

Significant Improvement in Selecta's Business Performance

Sales

I will keep it short here with a brief overview. If you go to page nine in our presentation, quarter one was clearly a quarter that was characterised by a strong recovery from a top line perspective. That in the context of a time where we still had a relevant impact of the Omicron variant in Europe that affected attendance in offices and some countries even soft lockdowns. Despite all that we have delivered a sales growth of 17.9% in the quarter. That is something that we think is a good result here. It is driven by multiple components as Philippe will show you in more detail. The regions that have been struggling in the past have started catching up. There is additional business coming into play. We are working on improving the sales with each individual client. There is certainly a pricing component in there as well which is a reflection of the overall inflationary environment and the actions that we are taking here in order to mitigate and protect the company in that environment. Overall we are pleased with the outcome that we are seeing here and expect that trend to continue.

Sales per machine per day

From a machine per day perspective obviously there is the size of our portfolio machines and Philippe is going to look to that a little bit as well. If you look at the sales per machine per day you see firstly a recovery that is really across all segments. Also the Private segment is gaining momentum. In the past we have had a stronger recovery on Public and we had more people staying away from the office and also restrictions on hospital visitors, etc. We see a broader trend now of traffic coming back. I think it is fair to say that people are eager to travel and to fly. We all see it when we are at the airport these days. They are pretty crowded, the planes are full and the momentum is clearly there. We think it is going to be a strong summer ahead of us in that regard.

Adjusted EBITDA

Adjusted EBITDA continues to be up. It was up around €12 million to €46 million in the first quarter. The first quarter is traditionally our weakest quarter if you look at the seasonality in our business and how it is constructed. EBITDA margin is up 2.3 percentage points and that gets us to first quarter margin close to 17%. We are also pleased with that and obviously working hard to continue the trend and each time deliver a better quarter compared to the corresponding quarter in the previous year and continue that work.

Strong liquidity

Liquidity is at €128 million so we have got ample headroom. We did invest more in the business with a higher capex spend in the quarter and there is momentum from that perspective. However, of course we will continue to focus on free cash flow conversion throughout the year and working capital, etc. It is something that we are very much aware of.

That is basically the punchline where we are. We are pleased with the quarter. We are pleased to see the momentum. After Philippe's details on earnings I will talk a little bit on our outlook and also how we see the broader economic environment and the potential impact from that. For now I want to hand it over to our CFO, Philippe Gautier to take you through the detailed financials. Thank you.

Financial Results

Philippe Gautier

Chief Financial Officer, Selecta Group

Q1 2022 Financial Summary

Strong sales growth and profitability in a quarter still impacted by the pandemic

I will start with the snapshot that you find on page 11. As Christian mentioned, a strong quarter with sales up 17.9%. Improving also within the quarter, reaching 81% on 2019 levels in March. Adjusted EBITDA up 2.3 percentage points and 36% versus last year, so growing twice as much as the top line. Reported EBITDA increasing even more and then free cash flow has been impacted by one-offs. We paid €10.5 million of one-off cash out which were mostly driven by the right-sizing action that we took in 2021. Then we maintained our liquidity.

Q1 Group – Sales by Segment

Strong sales growth driven by SMD recovery across all segments

If I go to the sales performance on page 12 that refers to our operated business. We saw very strong sales growth driven by sales per machine per day recovery across all the segments. SMD is up 31% which is much more than offsetting a reduction in the machine park which was down 10.2%, resulting in a +20.2%. You have products in all the segments. Private segment continued to gain momentum despite companies working from home. That is mostly Services & Administration and Manufacturing & Logistics sectors. Then you have the strongest increase in Semi-Public which is where it is +54%. That was the hardest-hit sector where you have education, hospitals and retail. Lastly, Public had recovered already more or less in line with the 2019 level but it continued to progress up 14% with particularly strong bounce back of airports which was the lagging sector in this segment.

Q1 Private – Sales by Segment

Private segment gaining momentum

If I go into a bit more detail on page 13 and starting with the Private segment. Here you see our sales improving. It is driven mostly by Services & Administration, the recovery versus temporary lockdowns prior year, as well as some progress in Manufacturing & Logistics. The SMD is up 27% from recovery and then the machine park has been reduced by 11.5%, consistent with our approach. We continue to look at underperforming assets in the segment and we will continue to do so.

Q1 Semi-Public – Sales by Segment

Strong recovery of Semi-Public being the hardest hit

Moving to page 14 you can see as well what is going on with Semi-Public. It was the hardest-hit segment. Here you have even higher bounce back at 54% so the strong SMD is very much higher at +68%. Here as well you see machine park reduction that we continue to trim down some of the underperforming assets there.

Q1 Public – Sales by Segment

Continued positive trading in Public

On page 15 Public continued to trade positively and that is really in all areas. Here you have railways, you have the energy segment and the airports more than doubled their activity versus last year. You have SMD which is up 15% and you can see here that the machine park is more stable here.

Q1 2022 Net Sales by Country vs Last Year

Positive development of sales across all countries

Moving to the geographies and that is page 16, to give you a bit of a flavour by country we show you how the countries compare versus the average. The average for the quarter was 18%. March was 21% versus last year and you see on the left side some of the overperforming countries. You have for example Belgium and the UK which are bouncing back versus prior year which was very tough in terms of lockdowns: hospitals in Belgium and also healthcare and return to offices in the UK. France and Spain are in the middle in line with the Group average with also some strong contribution from pricing. Then on the right-hand side you have the countries which have been growing more slowly. You have

Switzerland where the lockdown conditions were pretty tough in the beginning of this quarter, as well as in Italy. However, everywhere we are seeing progress.

Q1 2022 Net Sales and Adjusted EBITDA by Region

Gradual activity pickup across all our regions

On page 17 we have a view by region and the short message is that we have see progress in terms of activity as well as EBITDA margin improvement across all of our regions. I will not comment on that but you can see it is a very balanced situation.

Q1 2022 Adjusted EBITDA

Strong EBITDA performance

Now moving to the EBITDA and this is page 18. I will go a little bit down the lines. Christian mentioned the big actions that were executed in terms of pricing so you see a very small decrease of our gross profit at 61.2%. We have seen inflationary pressure in general like the environment now. We have had the pricing power to execute very strong price increases which were implemented from the start of the year. There is a little bit of ramp-up because it needs to be implemented machine-by-machine but it has enabled us to maintain a very high level of gross profit.

In terms of cost, you have a strong improvement in the total cost ratio which is reduced by 4.8 percentage points of sales versus last year and that comes from basically cost growing less than the top line. Basically they are growing less than half of the top line. Interesting to see that in the personnel expenses this was achieved despite the fact that we are using much less furlough. Now it is €3 million. It was €18 million last year and that showed that the gain that we got was structural and we intend to maintain this advantageous and leaner cost base. That applies as well to the overheads which are down 2.4 percentage points versus last year. As you know, we had implemented zero-based budgeting. We are also performing various actions in terms of inflation mitigation and this is paying off.

The one-offs have been €4.2 million this quarter. It continues to be related to some right-sizing activities but now much lower than what we had done last year. That is where the reported EBITDA is growing 57% versus prior year.

Q1 2022 Working Capital and Capex

Discipline in working capital management and capex

What happened in terms of cash? I will move to page 19. We have maintained this quarter as always. This has been in the working capital management and in the capex. You see trade working capital which is minimally positive. We had a little bit of a reduction of payables and then you have the gradual pickup of activities impacting the accounts receivable and the inventory. As I mentioned, we had one-off cash out of €10.5 million.

In terms of the cash capex we had cash capex of €17.4 million. This is 6.4% of sales. As you know this is mostly driven by new business gains because when you gain new clients or we gain new business with existing clients we are installing new machines. We did that much more than last year which was partially low. Then interestingly we continued to develop our client lease solutions. We believe that they are a great value added for our clients and that is €8 million of capex that we avoided during the quarter.

Q1 2022 Leverage and Cash Liquidity Evolution

Continuous reduction in leverage both on adjusted and reported EBITDA basis

Moving to page 20 you can see how the profitability gains that we talked about. This has combined with the discipline in cash and led to a continuous reduction in our leverage, be that in terms of adjusted EBITDA or reported EBITDA. Substantial gains here and we have the availability of €128 million. We are not drawing from our RCF as well as cash at bank. You have for sure noticed that this positive evolution was also accompanied in the quarter by the change of outlook for Moody's. Moody's evolved their rating from negative to stable outlook which is positive.

Strong Liquidity Due to Daily Cash Discipline Maintained

Now moving to page 21 you can see a bit of a waterfall of our liquidity evolution and that shows you how we generated the €1.3 million of free cash flow despite the €10.5 million of one-offs with relatively sustained capex and evolution in working capital. Then we had two interest payments which mostly related to the note payment that was happening in January. Second, as well as maturity of financial lease leading to the €128 million. We feel good about this in terms of providing the necessary headroom.

Selecta is Focused on Free Cash Flow Conversion in 2022

One-offs

Going forward and moving to page 22, as Christian mentioned, we are very focused about free cash flow conversion on the top of EBITDA generation. We are working on three main aspects. One is the one-offs. In terms of one-offs the rightsizing cash outs are going to continue to reduce and as most of the rightsizing has been done, they were mostly in 2021, they are still reducing in 2022. There are some smaller actions of rightsizing in certain countries, such as France, Italy and Spain and then we had some legacy topics like tax liabilities that we are going to settle at some point in time, but probably more into H2 of this year.

Capex

We continue to focus on capex, optimising the capex, optimising the payback, making sure we use recycled machines or we use client lease.

Working capital

Then working capital, we feel that there is still some opportunity here where we can improve both our inventory as well as our accounts receivable management. We are working on that. That is it for the description of the financial performance from the quarter and now I will hand over to Christian for some concluding remarks.

Conclusion

Christian Schmitz

Chief Executive Officer, Selecta Group

Thank you very much, Philippe, that is great. Obviously, as Philippe alluded to, we see the recovery in the business. We are happy about that, but it is an environment where we have got to be very vigilant and very careful, especially when it comes to the inflationary pressure in the market which continues. You see so far it has been more on the direct side and now it is on the indirect side with fuel, energy and logistics. There is just headwinds hitting the market. Then there is also a risk that if the whole economic climate gets worse that lower discretionary spending also impacts us. For example, people spending a lot of money at the pump and then not buying the additional coffee at the gas station. There are many more examples of that. We keep on focusing on that and making sure that we are taking the right actions for that to deliver that. We are obviously focused on our free cash position to make sure that all that is looking good and run properly.

That is really the environment we are in. Then now we are also finally at the spot where we are able to do some of that final assessment of certain client relationships where it has been unclear for a while what that recovery is going to be in certain office environments and where it is now time to say, 'Look, the pandemic is over and now we are in the new normal' and what that means for certain contracts that are in environment that are still only 30-40% of the people are back. That is being addressed as well, as we speak.

Overall, we are very confident in achieving our strategic plan for 2022 and beyond despite the things that have happened in the outside world. I want to open up for questions now. Thanks for listening in.

Q&A

Toby Hanson (Boundary Creek): I had three questions if possible. The first one was just on the personnel costs. They look to be up quite a bit quarter-on-quarter, around €10 million and I think you had a €3 million furlough benefit in this quarter versus €2 million in the fourth quarter. If you could give us some colour on why that is up quite so much off on % revenue figure. The second one is the trade receivables figure looks unchanged from Q4. Third, Can you give a sense of how the quarter trended January, February, March? Listened that was a decent impact in some of the sectors that you serve but it would be good to know entry versus exit rates if that is possible.

Philippe Gautier: Okay, Toby. The last question in terms of what was the performance January, February, March, you start to remember now that we are talking about Ukraine all the time but the start of the quarter was very, very tough in terms of pandemic. It was much tougher than what we saw in Q4 of 2021. We start the quarter around 72% of 2019 level and moved to 75% and then the exit in March was 81%. A gradual improvement is what we see every single month.

On the tax I did not get all the detail of your question. I guess it was on the overall cost. What I would say is we had €3 million of furlough this time so that is relatively marginal. This is countries like France and Switzerland primarily. That is a very big reduction compared to what we had seen prior. We had €18 million in Q1 2021 so that means that we are operating with a much lower level of FTEs. Right now we have a level of around 6,500 and compared to end of quarter we were at 7,000. As mentioned, we continue to do a little bit of adjusting here and there. The important message is that savings come from very structural actions. Then as the business is bouncing back what we do is obviously we are not going to pile a tonne of additional resources. We are very, very disciplined in the way we are adding back resources which is delivering leverage in our EBITDA, as you have seen.

Toby Hanson: Thank you. Sorry, the specific numbers I was referring to were on personnel expenses. You were at €87.4 million this quarter and last quarter in Q4 2021 you were at €78.5 million. In that quarter I think you disclosed you had a €2 million benefit from furlough versus the €3 million benefit, so the underlying cost has gone up by €10 million quarter on quarter. That was the question, just why it has gone up so sharply versus Q4?

Christian Schmitz: Philippe, if I just add to that, if you have substantially stronger business. If you have got an 18% uplift from revenue top line obviously you have got to add some resources back on routes in order to generate that business. That is not all just SMD single machine. There are machines to switch on. There are routes that you have got to recover. I think very important to mark is that the personnel cost ratio as a percentage of sales is at 31.6% versus 34% in quarter one 2021, which I think clearly shows the productivity improvement in relation to our baseline.

Toby Hanson: Okay, thank you and the third and final question I had was you mentioned the liability expected to cash out for this year. Is it possible to give a guide for the quantum of those and then also how we might view the one-off cash costs going forward?

Philippe Gautier: Okay. In terms of the one-off cash costs going forward, as we mentioned, we expected around €34 million of cash out related to one-offs. That is mainly coming from what we booked in 2021. Here we have had €10 million of cash out this quarter so that leaves about €24 million remaining. That is one thing. Then the other major thing that we would say that we have this liability with Pelican Rouge which is the Pelican Rouge acquisition. That is all the legal case which at some stage we will have to pay €27 million. We just do not know when and the timing is uncertain although we continue to monitor, but this will not happen before H2.

I think your other questions were on the receivables. I think if you look at the quarter December to March receivables are not moving that much, depending a bit as well on the mix between the countries where we actually have an invoicing business. However, what I would say in general is we still have some room for improvement in the accounts receivables and we are working on that. Accounts receivables are higher in countries like the UK and France, for example, and then you have much lower levels elsewhere. It depends a bit on the structure of the business.

Toby Hanson: Thank you very much.

Koushik Karthikeyan (Alcentra): Hi, thanks for the presentation. In this inflationary environment we are in I just wanted to get an idea of contractual pass-throughs that you guys have and whether you have index-linked within your contracts or whether there are negotiation clauses. I was wondering if you would give a bit more colour on that.

Christian Schmitz: Yes, I am happy to do that. I would say there are three types of business structurally that we have in Selecta. There is full operating business where we do everything from the ingredients to the service in contract. There are different arrangements there. There is different component pricing. There is index clauses. There is review clauses. Some contracts have nothing. Unfortunately, it is a little bit of a wide that Philippe and I inherited in the portfolio, which we have got to tackle individually.

Then we have got a very substantial business which is the traditional OCS coffee business where you get list prices of ingredients and then technical service that goes with it. That one is much easier to address. You just list prices and basically issue those so it is live and you see the benefits come in the next day. Then you have got some trade business which is a deal-by-deal business and you can also adjust. Basically, the answer is on two parts of the business it is fairly easy to manage, the other one is pretty tedious and you have got to work through one-by-one, which we started at the beginning of October last year. It is something that we started at the beginning of the year and it is a constant programme. Now in some segments we are getting into wave two.

One more answer to help you get your head around how this whole thing works. The important thing is when you look at the entire business there is the part of the business where the company pays. In a lot of corporate environments where the coffee is free that one is whatever you negotiate. It does not really have a sensitivity with volumes. Then we have got Public businesses, the Semi-Public business, airports, train stations, hospitals where obviously you have got to weight what this means also for the consumer because in a lot of those environments we can change the price whether at a certain point also it impacts. There is some elasticity there. We are weighing all those things and I think get a pretty detailed tracking model out there to make sure we strike the right balance. As I said, the pressure continues in the market. I think everyone sees it daily in the news in every business. There are also going to be additional weight that we have started to roll out throughout the market.

Koushik Karthikeyan: Yes, thank you for that.

Christian Schmitz: Sure.

Alright, thank you very much. We appreciate you joining for today. Any further questions that might be out there and come to your mind a little later Angela is standing by and is running Investor Relations here. She is very happy to get in touch and talk in more detail. I wish you all a great day and we will talk to you soon next time. Thank you.

[END OF TRANSCRIPT]