Haleon 2023 Half Year Results Q&A Conference Call

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Introduction

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Welcome

Good morning everyone and welcome to Haleon's Half Year 2023 Q&A conference call. I am Sonya Ghobrial, Head of Investor Relations, and I am joined this morning by Brian McNamara, our Chief Executive Officer, and Tobias Hestler, our Chief Financial Officer. Just to remind listeners on the call that in the discussions today the company may make certain forward-looking statements including those that refer to our estimates, plans and expectations. Please refer to this morning's announcement and the company's UK and SEC filings for more details, including factors that could lead actual results to differ materially from those expressed in or implied by such forward-looking statements. We have posted today's presentation on the website this morning with prepared remarks running through the results in detail. With that, we will go straight to opening the call for Q&A. Thank you.

Q&A

Iain Simpson (Barclays): Good morning everyone, two questions from me please. Firstly, that 7-8% full year 2023 organic sales growth guide implies 4-6% in the second half, which is obviously in line with your medium term guidance. Is that how you should think about it? You are basically booking the strong first half and just delivering on the algo in the second half. In terms of the moving parts within that second half, there was some nervousness that tough cold and flu comps in Respiratory might be an H2 headwind. Do you feel more relaxed about those now or do you expect strength elsewhere in the business to offset tough Respiratory comps in the second half? Then in terms of the second question, I just wondered if we could unpick the moving parts in the margin? You are guiding 7-8% organic topline, 9-11% constant FX EBIT so margin is adding 2-3% to EBIT but then in terms of FX impact on the business we seem to be looking at sort of 4% topline, 6-7% EBIT so a 2-3% drag from FX. In terms of margin for the year should we be thinking underlying margin delivery a little bit better than expected, FX headwinds maybe a little bit worse than expected and net-net margin is probably staying flat in line with your previous guidance? Thank you very much.

Brian McNamara (CEO, Haleon): Thanks Iain, I will take the first question and I will pass it to Tobias on the margin. As you said, we had a very good first half and we feel good about the growth in the first half and the fiscal year outlook. I think there are two things in the first half that will not repeat in the second half and the first one you mentioned is cold and flu. If you look at the 22% growth we had in the first half, that contributed about two points to our overall growth. In this outlook we are expecting an average season, which would be below last year from a volume perspective. Now, I want to be clear. It is hard to predict cold and flu season these days but we have taken an assumption that we believe is right at this point. We are talking about volumes being down but pricing largely offsetting that so roughly a flat category in the second half. Also in the first half we did see strong growth in China with over 20% growth. We had good performance across the portfolio but Fenbid and Contac in particular, which is our pain relief brand and a cold and flu brand saw a significant demand coming out of Covid lockdown. As a reminder, in zero-Covid those brands were actually on sales restriction because they treated Covid symptoms. In zero-Covid they did not want that.

There are two dynamics. One was lockdowns coming off and getting back to a normalised level for those brands. Then some incremental demand based on Covid actually going through the country. That is where the full year guidance comes. You are right that the back half would imply a 4-6% more thinking about the dynamics in the back half and what we are seeing.

Tobias Hestler (CFO, Haleon): On the margin, clearly we have said 7-8% on top line for the year 9-11% on profit so I think that gives you a very strong underlying improvement and strong underlying margin improvement. Also, just to clarify, that includes offsetting the transactional FX losses in the business. As you have also seen in my prepared remarks, we have 60bps of margin improvement operationally that fully offsets the transactional losses in that. Underlying, absolutely an upgrade and an improvement coming through on the margin from the strong performance in the business. Then yes, FX depends a little bit on where you build it from but ultimately the consensus was around 5-6% CER growth. Our improved guidance is 9-11% so you should add at the midpoint 4-5 points of profit growth and then you deduct from that the incremental translational which is 6.5, so a slowdown on AER profit growth and again, if exchange rates would stay where they are in June, and I have given you a little bit more colour on how to model that in the appendix of the slide deck. We have added a few more of the currencies to help you model that out.

Guillaume Delmas (UBS): Morning Brian, Tobias and Sonya. Two questions for me please. The first one is on pricing. I was wondering what the outlook was for pricing as we think about the second half. In particular, are you planning additional pricing actions or kind of the opposite, would you be looking at some price downward adjustments maybe increasing promotional activities to maintain your level of competitiveness and maybe improve your volume share momentum? I think it is more a value share number that you are looking at but I notice that 55% of your portfolio was gaining or holding share at the end of the first half versus two-thirds at the end of last year. Any colour on that would be helpful. Then my second question is on translational FX because it is looking like it will be a significant headwind this year that you will be able to mitigate. However, big picture-wise how should we think about this impact? Is it a case of trying to offset it when it goes against you and letting some of the benefit fall through to the bottom line when translational FX is more favourable? For instance, if it were to see some reversal next year should we expect better than moderate margin improvement in 2024? Anything you can say about your mindset when it comes to translational FX would be very helpful. Thank you.

Brian McNamara: Great, thanks Guillaume. Let me address the question on 55% share and then I will pass it over to Tobias to talk pricing in the back half and big picture. Year to date we are 55% of the business maintaining or gaining share. We have seen that number strengthen in recent months so we think there is a positive trend there. You mentioned it but this is a value share measure so we were impacted a bit earlier in the year by the phasing and timing of price increases. Just to bring that to life, if I give you one example, Tums for instance at our US business we took pricing at the end of Q1. Some competitors happened to take pricing earlier in the year so we did not grow share in Q1 and now we are back to strong share growth. There is a bit of that dynamic happening. On promotions we tend to be a lower promoted business even in categories that can be high promotion like Oral Health because of our strategy of therapeutic oral health, we invest more behind the dental detailing and the marketing in connection with consumers than we do promotion. We do not anticipate changing that strategy. OTC in general also tends to be a lower promoted category so we do not anticipate any change. Tobias, on pricing and big picture?

Tobias Hestler: Thanks, Guillaume. On pricing for the half two probably mostly rolls over from what we have done in half one. Also, do not forget we took increased pricing throughout half two of last year as well. Of course, in emerging markets we would keep pricing up as we can and as we have always done. Then, look, here or there when we see there is an opportunity to do something we would do it but I would not expect widespread further pricing increases. Brian has already answered you on the promotional question on pricing so I would not expect anything going backwards on that either.

Then on translational, I cannot plan for translational and I believe in the way we have guided and the guidance change we have made, we are giving you the CER growth on profit and then I will update you on a quarterly basis around what the translational impact is. This might go in one direction or it might go to the other and I hope with the additional colour I have given you on more currencies in the backup, that helps you also model it through yourselves and have a bit more upfront visibility on that. Thank you.

Guillaume Delmas: Thank you.

Rashad Kawan (Morgan Stanley): Good morning Brian, Tobias and Sonya. Thanks for taking my questions, just two from me please. The first one on VMS, obviously positive in Q2 but in the presentation you mentioned you expect continued pressures on immunity in the US with Emergen-C specifically. Does that alter your mid term outlook on VMS of that mid-to-high single digit growth overall? Then just a second question on the consumer broadly. Are you seeing any changes in terms of behaviour, any change in terms of downtrading trends or shifts to private label, especially in Europe as you have taken more pricing? Volume dynamics still seem to be robust but any colour you can share there would be great. Thank you.

Brian McNamara: Great, thanks Rashad. First on VMS, as you said, we were down 3.7% in Q1 and up 2.7% in Q2. For the year we were down 0.5% and if you just break that down across regions we were mid-single digit growth in Europe, Middle East, Africa and Latin America and in APAC but we were down double-digits in North America. Two things impacted that. One was the lapping capacity coming onstream last year where we built inventory so that was a negative impact. Then on immunity subcategory, which you mentioned, we are seeing a bit of a change in consumer behaviour of the immunity category going back to more pre-Covid type levels. Now, we saw incredibly strong demand in the base period, as you know, as Covid spikes came in. That was a category that always had good mid-single digit growth so it was a healthy category pre-Covid. It was fully expected to be a healthy category post-normalising but in our outlook we are assuming that that will still be a drag on the VMS business as we look at the back half of the year. Nothing has changed in my medium term outlook and obviously we would update for next year when we get there but we feel like it is still a very good category. 35% of our business is the US and we like our geographic footprint and we are seeing good growth outside that.

On consumer behaviour and you specifically asked about Europe, to date we are not seeing that. A reminder in Europe is that we have very little private label dynamic because there is very little private label dynamic on oral health, which is in mass market. Obviously there is lower priced brands and we are seeing good dynamics on our Oral Health business. Then in the OTC business we are sold through pharmacies and there is really no private label to speak of. There is generic products in pharmacies. They tend to be behind the counter in the drawer so people are not going up to the shelf and doing comparisons. To date we have not seen that shift. Obviously, unprecedented times and we are keeping a close eye on it to see if anything changes there but to date we have really seen the categories hold up.

Tobias Hestler: I think you asked on the US. Private label no change visible in our categories so I think when you look in aggregate private label share is actually slightly down across all of our categories. Of course you have some subcategories where it is slightly up/slightly down but no shift visible in consumer behaviour when they are in front of the shelf vis-à-vis the private label that is there.

Rashad Kawan: Thank you very much.

Brian McNamara: Thank you.

Chris Pitcher (Redburn): Good morning all. A couple of questions. Firstly on China, thank you for the extra detail in the presentation. Can I just make sure I have got the messaging right for the second half? Growth moderated but was still double-digit in Q2 based on your disclosure. You are talking about a normalisation in Fenbid but it does look like there is still strong opportunity amongst VMS. Could you talk a bit about Oral Health and how you look to grow that in terms of strength of local and international competitors? In terms of your raised full year guidance, does that still imply double-digit growth in China in the second half? Then secondly, on the Lamisil divestment obviously it is helping the deleveraging. Can you give us a bit of a feel for the sales and profit impact, cash impact on that? Thanks very much.

Brian McNamara: Thanks, Chris. I will take the first question and pass it Tobias. As you said, we had a good first half in China. We grew over 20% and obviously we benefitted from the Covid lockdown or the zero-Covid policy going away for Fenbid and Contac. The VMS business also is growing, so in good shape. We continue to see trends there. Then on the Oral Health business what we saw was the category declining as we entered into the year. We are still seeing the category declining although declining less. In most recent periods we were growing share so we were declining less than the category. We expect that to in the back half continue to stabilise. We feel good about Sensodyne in China. There is no question that there is a competitive environment in China that can be a bit different in the sense of local competitors and they are not to be taken lightly. However, we have been there and we have been competing against them. That is something that has always been something we look at but we feel good about our business in China. On the back half we would not give specific guidance on China but we expect to be able to see growth in China as we go into the back half. Obviously we will see less of that Covid impact. The lockdowns were still in place, zero-Covid was still in place a year ago so sales restrictions were still on things like Contac and Fenbid. However, obviously in the first half we saw Covid waves coming into the country which drove demand above that. Tobias, Lamisil?

Tobias Hestler: Yes, on Lamisil it was about £54 million of revenue last year. I think with a very healthy gross margin. It is an OTC brand with small A&P so I think you get clearly a negative hit from that on the OP and from the margin with the £54 million. I think we sold it at a very healthy sale price so that is about four times seven times revenue multiple that we get. Of course it was declining in sales so it was very slightly dilutive to sales growth but that is really tiny. Then we would of course expect to offset the negative impact from the divestment on profit with the benefits from the productivity programme next year.

Chris Pitcher: Maybe just a follow-up. Would we expect similar brands potentially to come out or are you done now for divestments?

Tobias Hestler: We said at full year we are going to be active in our portfolio. You have seen us do two things this year so far. We have divested Lamisil at a very good price and this was a classic example of we think there is a better owner out there for that brand. We got good value for it so it makes sense to divest that because I think it is clearly above our own keep valuation that you see from the price. We have also agreed the deal with Futura so we brought something into the portfolio. You would expect us in a company with about 100 brands to look at things if they create value or not. We do this but you have to test the market to see if you get value for it or not. That is exactly what we have been doing and Lamisil is an example. Expect us to be active but if something comes true or not, we do not know. We cannot plan for it and we would of course always tell you when something is coming through.

Chris Pitcher: Thank you very much.

Alicia Forry (Investec): Hi, good morning Brian and Tobias. A couple of questions from me. I wonder if you could update us on the inflationary picture that you are seeing across the operating cost base, beyond COGS. Any colour would be helpful. Then on the A&P spend I assume given the market share performance that remains quite positive, that you are happy with the current rate of A&P spend versus sales. Should we expect any change in the growth rate of A&P relative to sales going forward over the near term? Thank you.

Tobias Hestler: On inflation let me maybe start with commodities. We have seen some stabilisation but we have not seen prices massively come down. Sorbitol price is still very, very high. Packaging comes down a little bit but still way above before where the inflationary headwind was. I think outside of that it is mainly on people. We need to see where inflation rates are. As you have seen, I think we have strong operating leverage in half one. We were able to offset that. From that point of view the ability in our model should be able to offset that through pricing and efficiencies.

On the A&P spend, first of all I think we are happy with the level we are as a percent of revenues. We do not think there is a major shift in any direction. We have increased our consumer facing A&P spend 8% if you exclude Russia, where we stopped advertising last year. We are healthily invested into the brands and you should expect us to continue doing that going forward. Of course, if you have a year with tenish sales growth like we had you would not expect us to spend A&P ahead of that ratio. I think we spend heavily and we also look for efficiencies in the non-consumer facing A&P spend as well.

Alicia Forry: Thank you.

Iain Simpson (Barclays): Thank you so much for allowing me a follow-up. I am going to be cheeky and ask another two questions if I may. Firstly, could you just remind us how we should think about working capital seasonality as something to get our heads around with you being a relatively new company? Typically we see working capital as an outflow in the first half and then an inflow in the second half for most consumer companies. Would you be any different or how should we think about that? Then secondly in terms of your efficiency programme, you are talking about some quite large numbers in terms of gross savings for that efficiency programme. You also just said that you think A&P is in the right place as a percentage of sales so I was intrigued as to how we should think about where those efficiency savings will be going. Will they be reinvested back into the business? If so, where, given you comments on A&P or what proportion of them might fall through to the bottom line medium term? Thank you so much.

Tobias Hestler: Thanks Iain. Let me start with working capital. Yes, I think we probably see a similar picture to what you mentioned. For us particularly in half one we have always seen working capital outflows and that is largely driven by us building cold and flu inventories ahead of the big season sell-in that is in Q3. Of course, this year it was a bit more pronounced given the strong sales growth. Just to give you a colour, I think our day sales outstanding actually has improved from 55 to 50 days in half one. I think this year is a bit more pronounced given the strong sellout but you would always expect working capital outflow half one and then it reversing out in the second half of the year. As a result our cash flow, free cash, which you saw last year what we did between separation and year end, to have a much stronger performance in the second half of the year. While I am at cash flow, just for you to note as I had guided, this year is the first time we have the interest cost cash out because the payment of the interest is arrears so that has normalised. Also the cash tax has normalised because we had a benefit in before so both as I had guided you for half one.

Brian McNamara: Iain, on your question on the efficiency programme, as we previously communicated £300 million, the majority of which will happen in 2024 and 2025. Tobias's comments on A&P were certainly for this year we feel like it is in the right place. The reason I say that is we will provide guidance at the year end on what that looks like but this £300 million certainly gives us the flexibility to understand what is the best way to move forward. If there are more opportunities to go after we have the opportunity to look at that if we feel like we get the right returns. If not, then there is an opportunity to use those funds in other ways. It is really about the flexibility of that but certainly as we get into the end of this year we will give more clear guidance next year on where we think that will come out.

Iain Simpson: Thank you so much.

Olivier Nicolaï (Goldman Sachs): Hi, good morning Brian, Tobias and Sonya. Just two questions on my side please. First a follow-up on China and Sensodyne. Growth last year Oral Health in general was effected by the lockdowns. How are we compared to pre-Covid levels? Is there still much of a catchup to be done in China for Oral Health? Secondly, the question is more for Tobias on this one. You are obviously expecting a strong growth for this year from the beginning of the year. Your cash flow tends to be much stronger in H2. You have done one disposal at a really good price and the bulk of your debt is in USD, which is weakening. Could we expect your net debt to EBITDA to be below 3.0x maybe at the very beginning of 2024, which will still be within the guidance? Or even at year-end? Thank you.

Brian McNamara: Good. Let me start on China. Yes, like I said earlier, we are seeing a little bit of softness in that category. Our negative categories were slightly less negative than that so we actually see share growth in the most recent periods. We do expect it to stabilise.

It is certainly a dynamic that began towards the second half of last year so in the back half we are expecting to see that category more stabilise and us being in a position where we can get back to growth on the business. Tobias?

Tobias Hestler: Yes, on the leverage, we have guided to less than 3.0x during 2024. I think doing the divestment increases that confidence that we get to that place. As you mentioned, yes, there is currency benefit coming through on the US dollar debt. However, also remember on the leverage side it goes against the adjusted EBITDA number and on the adjusted EBITDA number you take the translational currency hit as well. I think there is a bit of an offset. Over time these even each other out but it really depends on exactly where it lands because you never get 12 months to 12 months. In the long term I think we have broadly aligned our currencies of debt with the currencies where we have our earnings, as we spread the debt across the dollar, the euro, to a small extent the pound and the Chinese renminbi as well.

Olivier Nicolaï: Thank you.

Bruno Monteyne (Bernstein): Hi, good morning Tobias, I just want to come back to something you said earlier that investors would not want to see A&P go above the 10% organic sales growth. I do not really recognise that sentiment. I think if you are able to grow A&P ahead of sales growth, reinvest some of the operating leverage in more A&P and actually further strengthen future growth, I am pretty much sure that most investors would actually be happy about it. Was that just a short term observation? How do you think about it in the medium and long term?

Tobias Hestler: Thanks for checking that. It was meant as a short term comment. When we get strong short term benefit coming through from cold and flu or the benefits from China, that is not where you pump in more money to deliver that. Long term is exactly what Brian said before. Of course, we are keen to invest in A&P and looking for the growth opportunities that we have in the business.

Bruno Monteyne: Thank you.

Tom Sykes (Deutsche Bank): Morning, thank you. I just wanted to clarify some of the things you were saying on APAC and the APAC margin because I think the minority is up by quite a lot. I think your minority is up by 60% or so which I thought the majority of that is always the JV you had in China and yet that is obviously a long way above what the organic operating profit increase was for the APAC region. I know you gave some other points in the slide on APAC so thank you for that but could you just explain what is happening to profitability outside what is included in that JV? Maybe could you just remind us of that pie chart you gave, what goes through that JV which comes out in the minority please?

Tobias Hestler: Yes, sure Tom. The joint venture in China has the Over-The-Counter Medicines business in it. It is about a third of the sales in China so it is really the OTC sales that go through that. Of course, that is where we had in half one the major pickup in revenue because in both Fenbid and Contac, which were the ones that were blocked before, then had the massive demand coming through, that we were able to meet given our local production footprint there. The production footprint is also in that joint venture so I think really strong support locally to run the production 24/7. That means that of course part of that upside we have to share with our JV partners and that is why you see that increase in the minority.

That of course is predominantly in half one where that stepped up. Then I think the JV does not share, for example, cost allocations on the standalone costs so the ones that are applied to the overall region which is why you get a difference in the overall region margin picture compared to what sits in the JV as part of the JV agreement. It is a bit unusual in half one given that strong Fenbid and Contac growth coming through there.

Tom Sykes: Okay, thank you.

Brian McNamara: Great, thanks everyone, appreciate your time and questions. As we have said, we feel great about how the first half has gone and we are confident in the outlook that we laid out today. I hope you all have a great summer and if you have any further questions feel free to reach out to Sonya and the Investor Relations team. Thanks again for your interest.

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