Haleon H1 2022 results presentation

20th September 2022

Brian McNamara, CEO

Hello everyone. Welcome to our Half one update. Haleon is off to a strong start.

But, before I talk about the results we published today, I'd like to take a moment to express how deeply saddened we all are at Haleon both in the UK and beyond by the death of her Majesty Queen Elizabeth II. Her extraordinary dedication and service over the last 70 years is an example to all of us, in every walk of life.

Turning to Haleon.

As you saw in our half year release this morning, we delivered strong results: Both double digit revenue growth **and** margin expansion.

In terms of market share, the business is also in good shape with 2/3 of the business gaining or holding share.

Our cash flow is also strong and reinforces our confidence in our ability to quickly reduce Haleon's debt and deliver on our de-leverage expectation by the end of 2024.

We remain confident in our guidance for FY 2022 and beyond. That means organic sales growth expected to be 6 to 8% for this year and 4-6% over the medium term.

Medium term, we expect to deliver moderate margin expansion at constant currency. Net debt / EBITDA leverage will be below 3x by the end of 2024, and we'll have a dividend payout ratio at the lower end of 30-50%.

Our HY results also demonstrate that we are delivering right in line with our strategy.

Despite the macro-economic climate, we continue to see good trading in the second half. Our categories and brands tend to perform well in difficult economic times. We've been successful in taking pricing across the portfolio without impacting consumer behaviour. While in one or two areas we have seen a bit of down trading and some consumers moving to private label, it has very little impact on our business. Our performance has really held up through difficult times, and that gives me confidence in the outlook for the business, and that we are well placed for growth.

Now, before taking you through some of the numbers, I'd like to take a step back and remind you of what we said at the Capital Markets Day back in February. You will recall we laid out our approach to delivering on our growth ambitions.

Haleon is clearly a global leader. We are 100% focused on consumer health. We have a world class portfolio of category-leading brands in a sector that's estimated to be growing at 3 to 4% a year and we've got an attractive geographic footprint. We have strong capabilities combining our trusted science, with strong consumer skills. I'm talking about brand building, and innovation as well as leading route to market and digital.

To generate growth, we will focus on: Increased household penetration and capitalising on new and emerging growth opportunities in channels, geographies and through portfolio expansion. Underpinning these sources of growth, will be a strong focus on both execution and financial discipline to improve profitability and sustain our reinvestment in growth opportunities. And finally, running a responsible business, which is integral to everything we do. Acting responsibly allows us to reduce risk and support performance across the company.

Taken together, all of this will drive the expected 4-6% organic annual sales growth we've been talking about. That growth, along with our strong gross margins allows us to deliver moderate margin expansion, strong cash flow, and to invest in the business. Tobias will give you a bit more detail on margins shortly.

The strong first half numbers we're reporting today are the direct result of executing our strategy.

So, our overall organic revenue growth in the first half was up 11.6%. Our 9 power brands did even better with their growth up 13.4%. And, during the first half, 2/3 of our business gained or maintained share, something I feel really good about.

So how does performance look across individual categories and brands?

I'd like to start with Oral Health. Here, revenue was +5.1% organically, but it was game of two quarters. In Q1 revenue was up 8% and only up 2% in Q2. The reason that happened is that Oral Health was disproportionately impacted by the inventory build-up by retailers ahead of our systems cutover which moved sales from Q2 to Q1. We also had an adverse impact due to Covid lockdowns in China. In the first half, three-quarters of our business gained or maintained share. Overall performance included share gains in both the US and China. Globally, our 3 category power brands, Sensodyne, parodontax and Polident all gained share.

Sensodyne delivered strong growth in its key markets with e-commerce particularly strong in the US. Parodontax, benefitted from strong double digit growth in the Middle East and Africa, and we launched it very successfully in South Africa. Finally, Polident rolled out the Poligrip Power Max Hold + in 16 markets and it's performing well.

In Vitamins Minerals and Supplements, we gained share overall and delivered double digit organic revenue growth. I'm especially pleased that we also grew our share in individual key markets like the US and China. VMS is particularly strong in the US where we grew at an impressive three times the market. That growth was the result of deliberate actions we took.

First, we kicked-off new campaigns including ones for Centrum Silver and Emergen-C Kidz in the US. Second, we optimised our media plan and increased A&P across the category. Finally, we had an exciting series of new innovations that helped us to drive performance. A few examples are: Apple Cider Vinegar Emergen-C, Centrum men multi-gummies and Caltrate chewable tablets in China.

In OTC, Pain Relief, Panadol was a standout performer, with growth in the mid 20s in the first half. That's double the category. Panadol's performance reflects increased A&P, improved distribution, and successful brand activation. Advil was also up in the low 20s with Voltaren up low single digit.

In Digestive Health we increased revenue by 3.5%. ENO and Tums were strong performers.

I'd like to spend a bit more time on Respiratory.

A very strong and prolonged cold and flu season helped Respiratory deliver 47% organic growth. In the first half, cold and flu added 4% to Haleon's organic revenue growth.

The cold and flu season this year was well ahead of 2021, which was at a historically low level in the first half last year. Cold and flu levels in the US and in Europe were around 20% ahead of an average season. The Covid-19 Omicron wave accounted for part of that increase.

We more than doubled Theraflu revenue, with a particularly strong performance in the US. And, Otrivin was up just under 50%. We also benefitted by introducing a number of innovations across the portfolio, such as Theraflu Max Strength, Robitussin Elderberry and Theraflu Pro Natural.

For the first half, we increased e-commerce by the high teens to 9% of total sales. We had particularly strong growth in the US, up 20% and China, up 30%. We are continuing to invest in that growth channel for the future.

Excellent brand marketing also supported growth across the portfolio. I talked about the success of Panadol that was heavily influenced by the Take Care Campaign. That campaign aimed to educate consumers who bought Panadol on the benefits of using the product after Covid vaccination. Elsewhere, we won a number of awards for Haleon 'marketing campaigns' across the portfolio. And, our A&P spend was up 6% in constant currency. That's a great example of our continued investment to drive sustainable growth.

Finally, geographically, we continue to have opportunities to roll brands and innovations out into markets. As an example, in the first half we launched parodontax in South Africa and we most recently launched Centrum in India.

To maintain our momentum in top line growth, strong execution and financial discipline remain absolutely key. So, they are both a real focus for all of us at Haleon.

In the first half of the year, we successfully completed the separation from GSK to become a standalone entity. And, we completed all technology and systems cutovers smoothly and efficiently.

We delivered 70% of this year's expected Pfizer synergies by the end of June and we remain firmly on track to deliver an incremental £120m this year. The final Pfizer synergies in total are £600m per year.

We are mitigating inflationary cost pressures with initiatives such as: forward buying value engineering and supply chain improvements. Elsewhere, across the business we have rationalised SKUs, improved logistics productivity, and enhanced ROI on A&P spend.

I'd like to spend a bit of time talking about health inclusivity where I personally believe Haleon has a compelling opportunity to make a meaningful difference and do it in a unique way.

By 2025, we intend to help 50 million people per year to gain access to better everyday health. During the first half, we continued to leverage our brands to do just that.

Initiatives such as Theraflu Rest and Recover in the US where we partnered with the Good+ Foundation to create a fund to help provide financial support to those in financial need. That program allows people to take a day off from work to rest and recover when they are sick.

And in China, we launched several mobility enhancement programs, to engage with adults to understand bone health. And, even more importantly taking actions to improve bone health through online mobility tests and on-ground interactive tests.

I'm also excited about the launch of the world's first Health Inclusivity Index that we created in partnership with the Economist Impact and UCL here in London.

We remain committed to setting ambitious Inclusion, Equity and Diversity targets. So, I was really pleased that we recently launched an exciting and leading parental leave policy globally across the company.

Of course, we continue to focus on delivering environmental targets. We are on track to achieve a 100% reduction in Scope 1 and 2 carbon emissions and a 42% reduction in our Scope 3 Carbon footprint from source to sale by 2030. We plan to have all packaging to be recyclable or reusable by 2030.

So, I hope that this brief review gives you the impression that the whole Haleon Team and I are confident that we've got the right strategy, and that we are excited about continuing to build this great business in the coming years.

Before concluding, and handing over to Tobias, I'd like to give you an update and a few remarks on Zantac. While the focus of today's call is our half year results, we have provided some further information on Zantac in the release .

As we have said before, Haleon is not a party to any Zantac claims.

Today, we have informed you that Haleon has notified Pfizer and GSK that we reject their requests for indemnification. As a reminder, the JV agreement was signed when the JV for was formed towards the end of 2018. We believe that the indemnities set out in the JV agreement only cover GSK and Pfizer's Consumer Healthcare business as conducted then. At that time, neither GSK nor Pfizer marketed OTC Zantac in the US or Canada.

With that, I'd like to hand over to Tobias to take you through our detailed results and show you how our strategy is delivering results in practice underpinning our strong performance in the first half across the whole of Haleon.

Tobias Hestler, CFO

Thank you Brian, and good morning everyone.

Today I will focus on our adjusted results as this is the most meaningful way to understand our performance. A full reconciliation of our adjusted results to IFRS results can be found in our results press release published today. As you know given Haleon was still part of GSK for the period, we are reporting an unusual year with some KPIs that do not yet reflect the separation.

Let's look at the headline numbers for the first half of 2022.

We delivered strong results demonstrating that our strategy across the business is working and delivering growth.

Revenue of £5.2bn reflected 11.6% organic revenue growth. Adjusted operating profit of £1.2bn, up 15.5% constant currency resulted in 23.0% margin, up 90 basis points percent constant currency.

Finally, the business continued to be highly cash generative with £553m of free cash flow in the first half, including a £224m outflow related to separation, and restructuring costs. Our free cash flow conversion was 102%.

Turning to the drivers of revenue growth in more detail

Revenue increased 13.4% to £5.2bn on a reported basis. There was a 240 basis points benefit from favourable foreign exchange …. largely in the second quarter.. and mostly due to the movements in the US dollar and Chinese Renminbi. Acquisitions and disposals carried out in the prior year as well as decline in manufacturing services agreements resulted in a net 60 basis points drag on growth.

We delivered 11.6% organic sales growth, importantly with 3.7% price and 7.9% volume mix.

Looking at the growth across our categories, growth was broad based. Importantly, the impact of advance purchasing in Q1 due to the systems cutover fully reversed in Q2. So half-one results are more indicative of trends.

Oral Health revenues were up 5.1% with Sensodyne up mid-single digit and as Brian said earlier with continued share gains, benefiting from strength for example in ecommerce in the US and a good performance from parodontax and Polident. In VMS, organic revenues increased 12% with Centrum up mid-teens helped by double digit growth in North America and Asia Pacific.

Pain Relief revenue was up 11.7% with Panadol and Advil up in the twenties due to Covid related demand as well as strong campaigns and activation whilst Voltaren grew low single digit.

Respiratory revenue was strong, thanks to strong and prolonged cold and flu season which added 4 points to group organic growth.

Finally, Digestive Health and Other revenue was up 3.5% with good growth in Tums and Eno partially offset by a modest decline in smokers health.

Importantly we saw a healthy balance of both price and positive volume mix through both quarters with notably improved pricing in the second quarter to 4%.

Turning now to our geographic segment performance, we delivered double digit organic revenue growth across all of our regions, and as you will have seen from the release all with a healthy balance of price and volume mix.

Starting with North America.

Organic revenue increased 10.4% with 2.1% price and 8.3% volume/mix. We saw double digit revenue growth in VMS, Pain and Respiratory. In Oral Health, Sensodyne was up low single digit due to changes in retailer inventory levels… and Parodontax saw good growth. Across VMS, growth in the mid-teens was helped by increased capacity which came on stream last year. As a reminder we will lap this from Q3 onwards.

Pain Relief was up double digit driven by increased Covid related demand for Advil and Respiratory health was up over 50% benefitting from a prolonged cold and flu season in the first half underpinned by strong marketing campaigns and innovation during the period.

Adjusted operating margin increased 440 basis points to 24.2% and increased 350 basis points on a constant currency basis. Margin expansion was driven by strong operating leverage, combined with productivity improvements including sku rationalisation and improved logistics productivity which taken together more than offset commodity and freight cost pressure. It is worth bearing in mind, the increase did also reflect favourable comparatives, as the prior year included site investments and some one-time manufacturing write-offs.

Turning to Europe, Middle East, Africa and Latin America.

Organic revenue increased 12.1%, with 5.5% price and 6.6% volume/mix. There was strong growth in Latin America and Middle East Africa helped by Sensodyne. In Europe revenue was up high single digit with broad based growth, with the exception of Germany which was down slightly.

Across the categories, Oral Health saw good growth helped by strong parodontax sales, with a successful rollout in South Africa. Denture care continued to recover following the removal of lockdown restrictions, and Sensodyne saw continued growth. In VMS, there was high single digit growth in Centrum and double-digit growth in local strategic brands. Pain Relief revenue was up mid-single digit reflecting double digit growth in Panadol. Respiratory was strong, up over 50% following the strong cold and flu season, and Digestive Health and Other saw sales up double digit.

Adjusted operating margin declined by 150 basis points or 90 basis points at constant exchange rates due to reduced sales from Russia/Ukraine as well as the one-time adverse impact of stock and receivable write downs, and cost for humanitarian efforts. Higher commodity and freight costs, along with increased investment in A&P were offset by strong operating leverage and efficiencies across the business.

Finally, turning to Asia Pacific,

Organic revenue increased 12.3% with 3.1% from price and 9.2% from volume/mix. This included a 2% one off benefit from distribution changes in Vietnam. The region delivered good growth, with double digit growth in VMS, Pain Relief and Respiratory and high single digit growth in Oral health. China, our second largest market, was up mid-single digit in the first half with slower growth in Q2 due to Covid related lockdowns.

Oral health was up high single digit, with strong growth in India, particularly from Sensodyne helped by new innovations in the market. In VMS, we saw low double-digit growth underpinned by immunity campaigns in China by Centrum and Caltrate and in Pain Relief, our successful “take care” campaign allowed us to capture Covid related demand in a number of markets including Australia, New Zealand, Malaysia and Taiwan.

Adjusted operating margin increased 140 basis points or 110 basis points at constant currency to 24.1%. Margin expansion was driven by strong operating leverage as well as efficiencies, which more than offset higher A&P investment, and higher commodity and freight related costs. A further one-time benefit to margin in the first half related to the distribution change in Vietnam.

Looking now at our operating performance. As mentioned, revenue increased 13.4%. Gross profit increased slightly ahead of this at 13.9% resulting in 30 basis point margin expansion. Strong increases in commodity and freight costs were more than offset by strong pricing, synergies, efficiencies and mix benefits.

Adjusted operating profit increased 21.2% or 15.5% at constant exchange rates which included 6% growth in A&P. This investment underpinned revenue growth and was also impacted by phasing.

The chart on the next slide shows the drivers of our Adjusted operating profit growth.

We delivered 1.2 bn of adjusted operating profit. Operating leverage combined with supply chain efficiencies and Pfizer synergies more than offset cost inflation, investment in A&P and R&D and also standalone costs.

There was also a £56 million benefit from movements in foreign exchange rate.

Taken together, this resulted in a 21% increase in Adjusted Operating profit to a 23% operating margin.

We are structurally advantaged on COGs which were 37% of sales in the first half, and I have given you a breakdown of this on the slide. Materials accounted for around 1.1 billion which are roughly equally split across contract manufacturing, packaging and materials. Materials includes items ranging from active ingredients such as paracetamol and ibuprofen. As well as raw materials including glycerine, sorbitol and sugar. As we've mentioned before, we have lower commodity costs relative to peers, with less than 10% of sales in commodity or commodity related costs.

For the full year, we expect inflation to be up mid-teens for commodities and materials, and up high double digit for freight.

Additionally, at the end of the first half we had around 90% fixed price contracts or hedges for materials for the remainder of the year.

We continue to expect to mitigate cost inflation through pricing and efficiencies.

Finally, for Haleon, energy costs are limited, at around 1% of our cost of goods sold.

Taking you through the other items in the P&L, our interest charge of £36m is abnormally low. This included £79 million of expense related to the bonds we issued in March partly offset by interest income of £43 million mainly related to the on-lend of funds to GSK and Pfizer before the demerger.

I continue to expect our interest charge to be approximately 0.2 billion for the year.

Our Adjusted tax charge was £245m representing an effective tax rate of 21%. For the full year, I now expect the adjusted effective tax rate to be at the lower end of the 22-23% range.

This resulted in adjusted earnings per share of 9.6p, up 21.5%.

Turning to the adjusting items, the first half was heavily impacted by the separation spend.

Taking these in turn; there was a £19m impairment charge relating to a brand in the Ukraine included in Amortisation and impairment of intangible assets. Restructuring costs were significantly lower at £20m as we are completing the Pfizer integration. You will see significantly higher separation and admission costs at £229m compared with £105m last year – this reflects the peak of costs in the current year given the listing in July. This was always going to fall mainly in FY 2022 and will be significantly lower going forward.

For the first half, free cash flow was £553m which included £224m of cash outflow from separation, restructuring and disposals. This demonstrates the strong cash generative nature of our business model and our focus on this area.

During the first half, there are several key items to note which impacted the cash flow.

We paid £138m in cash tax, a lower level than expected following repayments from prior years.

The net interest income of £8 million reflects largely interest income from on-lent funds to GSK and Pfizer prior to the demerger. Notably the cash interest cost will catch up with the charge in the P&L from 2023.

We had an outflow of £47 million related to non controlling interests mainly related to our joint ventures in China and Taiwan. This largely reflects timing as the distribution was paid in the second half last year.

Net capex was £88m, nearly double the level of last year which simply reflects the prior year having £75m of higher disposal proceeds.

As I mentioned, we incurred £224 million of cash outflow from separation, restructuring and disposals.

Turning to Haleon's debt and liquidity profile. On the date of the demerger from GSK we started as an independent company with net debt of £10.7 bn.

As you may recall, in March, we secured our long-term capital structure with the issuance of just over £9bn of notes which at the end of June had a duration of 8.4 years with a weighted average cost of 2.8%. This was up 10 bps since our last update in June on account of recent FX moves. Of our gross debt circa 80% is fixed and circa 20% is floating. As a reminder, we have issued our debt with swaps to largely match where we earn our profits so creating a natural hedge in the P & L.

We had £2.9bn of liquidity at separation, made up of £2.2bn of undrawn bank facilities and £0.7 bn in cash or cash equivalents.

Consistent with our commitment to de-lever to less than 3x net debt/Adjusted EBITDA by end of 2024, we repaid £750m of our term loan through a combination of operating cash flow and proceeds from commercial paper issuance.

Finally, we have re-iterated our revenue and margin guidance for 2022.

We continue to expect organic revenue growth of 6-8% for the year.

Adjusted operating margin is expected to be slightly down at constant currency…and assuming spot rates as at 12 September we would expect FX to be slightly positive on operating margin.

We expect our adjusted effective tax rate to be at the lower end of the 22-23% range and our net interest expense is unchanged at 0.2 billion for the year.

Looking at the cash flow, we still anticipate spending approximately 3% of sales on capex.

Our medium-term guidance remains unchanged as we also shared in our press release.

In summary, Haleon is delivering strong performance and attractive returns evidence that the model we shared with you at the Capital Markets Day is delivering. Our scale and strong brand performance is supporting attractive gross margins. Alongside operational leverage and efficiency programmes we continue to invest in our brands, underpinning our confidence to deliver on our guidance.

Strong cash flow and high cash conversion is creating capacity to support our capital allocation priorities, prioritising reinvestment in the business, dividends, bolt on M&A and deleveraging in the near-term all underpinned by a commitment to maintaining a strong investment grade balance sheet.

With that I will hand back to Brian.

Brian McNamara, CEO

Thanks Tobias.

In the first half, we delivered strong financial performance with double digit revenue growth and margin expansion.

Importantly, our performance was competitive with two-thirds of the business having gained or maintained share.

We delivered strong free cash flow and that underpins our confidence in our ability to de-lever quickly.

We are also confident in our FY 2022 and medium-term guidance. This is reinforced by our results both half year and our recent trading momentum.

All those metrics confirm that Haleon is delivering sustainable growth that's right in line with our strategy.

Thank you.