

# CCH – 2019 Third quarter trading update

## Conference call Q&A transcript – 13 November 2019

### **CORPORATE PARTICIPANTS**

**Zoran Bogdanovic, Chief Executive Officer**

**Michalis Imellos, Chief Financial Officer**

**Joanna Kennedy, Director of Investor Relations**

### **QUESTIONS FROM**

**Sanjeet Aujla, Credit Suisse**

**Andrea Pistacchi, Deutsche Bank**

**Stamatis Draziotis, Eurobank Equites**

**Nico von Stackelberg, Liberum**

**Ewan Mitchell, Barclays**

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### **QUESTIONS AND ANSWERS**

#### **Telephone Operator**

Thank you.

If you would like to ask a question, please press '\*1' on your telephone keypad. If you change your mind and wish to withdrawal your question, please press '\*2'. You will then be advised when to ask your question.

We have the first question in the queue from the line of Sanjeet Aujla from Credit Suisse. Please go ahead.

#### **Sanjeet Aujla, Credit Suisse**

Yeah. Hi, Zoran. Hi, Michalis.

A couple of questions, please. My first one is really on Nigeria. Can you just articulate a little bit more how the strategy's evolved, what you've done with the price pack architecture, and why you now have the confidence that the business has been reset for growth? Maybe if you take one first and then I'll follow up with a couple more.

#### **Zoran Bogdanovic, Chief Executive Officer**

Yeah. Thank you, Sanjeet. Good morning.

So, in Nigeria, as I mentioned in my remarks, in Q4 of last year we started with our investments in pricing initiatives on our returnable glass packaging, and we have seen that that has really started giving good results, and we've seen that throughout the year, especially our focus was in Lagos, where we had been recording very strong double-digit growth rates.

Then, a significant part of the market is in PET, which has high competitive intensity, as I highlighted, and this is where, in September, we have done further investment in our pricing initiatives based on which we've seen a very strong acceleration at the start of Q4 that we also observe to date.

So, these are like the core of that, and I would highlight, at our imperative is, that we are competitive for our consumers. This is also enabled by our continuous, very strong work on increasing the overall competitiveness and efficiency of our business which is fuelling and funding our initiatives to drive the top line growth.

Therefore, I feel confident that Nigeria is going to have a quite strong Q4 based on these initiatives. And, let me just add, that also I expect some very exciting and strong marketing initiatives that we'll also start kicking in from Q4, which are done together with the Coca-Cola company.

### **Sanjeet Aujla, Credit Suisse**

Got it.

And my follow-up question is just on media discussions around the potential sugar and plastic tax in Italy. Can you just give us your take on the sort of likelihood of implementation of either of those and potential impact on the business, as you said?

### **Zoran Bogdanovic, Chief Executive Officer**

Yeah. Thanks.

So, indeed, there is this proposal that, in Italy, related to one plastic tax and the other part is related to sugar tax. You asked me my take, so I have to say that, at this point, it's really hard to speculate.

We know that, because the magnitude of the proposed plastic tax is sizable and, in fact, it affects a quite wide industry because it defines euro per kilo of plastic from wherever, the whole industry is in very intense discussions. It's all happening as we speak from various stakeholders who are discussing with government bodies, etc.

So, I think, from the proposal, I have to say, it's evident that this is a pure budget gap intention to fund. However, I think that sector arguments from, not only the beverage industry but broader industries, that are in plastic, which is pointing out what would be the consequences of such taxation, are clearly pointing out that, net-net, the economy would be in a low situation.

So, my take is that what is, at the moment, on the table, I would be very surprised that this ends up in such form, but I can't comment any further because it's really an estimate.

However, let me just say that, on the sugar tax which we see, based on what is, at the moment, on the table, it is half of the level of sugar tax that we've seen in Ireland. And you probably will recall, from my remarks in previous calls, that we have prepared, very diligently, and we have been fully ready in Ireland when a similar situation has happened. Our teams in Italy have already fully gained all the learnings from the approach from Ireland, and we are ready for any such situation.

And, if you allow me, I will just highlight that, if something like that happens on sugar, there are many steps that we do, from downsizing that we have done in Ireland, on the existing package - this can be a different price between Regular Coke and Zero and Light, even upsizing Zero and Light for in-and-out promos, and introducing, you know, a wider variety of multipacks.

Last year, when the sugar tax was introduced in Ireland, we grew Sparkling almost 4%, and this year this has continued even stronger. We are talking about mid single digits plus.

So, we closely monitor, we are fully ready for whatever will come, and we are actively part of the wider industry in finding solutions and protecting the industry and wider economy in Italy. Thank you.

### **Sanjeet Aujla, Credit Suisse**

Got it.

And, my final question, one for Michalis perhaps, are just some margins. You talk about another year of good margin expansion, you know, with where currencies have evolved - can you just update us on your margin expectations for the year, please? Thank you.

### **Michalis Imellos, Chief Financial Officer**

Yes. Hi, Sanjeet.

So, we are guiding today to a small further improvement in FX. So, in our previous call in August we had guided to €20m negative impact, now this has gone down to €15m. It's primarily transactional FX. So that will flow effectively as a benefit to the margin.

So, we had also spoken since the beginning of the year for a minimum of 40 basis points, margin expansion, organic, plus the 10 basis points benefit from the consolidation of Bambi, and we absolutely stick to it. We feel very comfortable that, as a minimum, we can keep this 50 basis points improvement this year.

### **Sanjeet Aujla, Credit Suisse**

Thank you.

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### **Telephone Operator**

Thank you for your question, Sanjeet.

The next question comes from the line of Andrea Pistacchi from Deutsche Bank. Please go ahead.

### **Andrea Pistacchi, Deutsche Bank**

Hi. Good morning.

My first question is this, please. So, you've had two quarters now below your 5% to 6% targets, clearly held back by the weather, but, besides the weather, has there been any other factor, would you say, that has held you back? Any other cause for you to be below this target? Anything different from what you would have expected when you set out this medium-term guidance back in June?

### **Zoran Bogdanovic, Chief Executive Officer**

Hi, Andrea.

In short, no. We clearly see that the weather has been the key driver because the other elements of competition or macro environment across our territories has been fairly stable. In some places, maybe that has been just a little bit slower. In some cases, we've seen a little bit higher. That's why, through our thorough analysis and review, we really see that this, primarily, is driven by the weather conditions as we have explained. And that's why, where we are now coming in a normalised period, this is where everything that we do on the ground gives me, personally, confidence that we'll see that also in our growth.

### **Andrea Pistacchi, Deutsche Bank**

Okay. Thanks.

My second, and follow-up question is one on Russia, please. If you could talk a bit about the dynamics in the Russian market - I think you said you gained share in Sparkling, you didn't mention Juices. You haven't delivered a lot of growth this year. I appreciate the weather comps. Would you be confident that, next year, Russia should accelerate?

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### **Zoran Bogdanovic, Chief Executive Officer**

So, let me first start with the end of your question where I would really express my strong confidence in the plan and expectation of Russia for next year.

This year, we have to acknowledge that Russia was cycling last year two strong effects - an excellent summer and we had really strong FIFA activation which brought more than expected tourists, and all of that was happening in a perfect blend with the great weather. So, our impact of last year was great. This year, indeed, we really had a bad summer, and probably, among other countries, Russia was one of the most affected.

So, given that, and acceleration that we see versus Q3, that will happen in Q4, I would even say that we are targeting to, if possible, make Russia be marginally in decline or even flat.

Now, I did mention that we have gained share in Sparkling, which is led by very strong growth of Coca-Cola Trademark, that gives excellent confidence, and this is a market where we expect, for many, many, many years, strong growth in Sparkling, but led by Trademark Coke.

Also, another thing that is working very well, and will work even stronger, is the whole Adult proposition where, even in such quarter as the third quarter, we've been growing Adults double-digit.

Juices, we are gaining share in a declining category. The team has been doing an excellent job, not only this year, but also as a continuation from last year. So, in a category that, unfortunately, is in a declining trend, the focus on premiumisation, our strategic focus on immediate consumption and single serve packages, as well as with a smarter and the effectiveness of the promos, how we do them, has resulted that we have been gaining sizable share.

Similar happens in the Energy where, in a highly growing category, we are gaining share.

So, I know that our Russia team has a very strong Q4, and that gives me confidence that we will spice up the momentum, for which I do expect it's going to continue in Q1 of next year and then throughout the next year.

### **Andrea Pistacchi, Deutsche Bank**

Thank you.

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### **Telephone Operator**

Thank you, Andrea.

The next question comes from the line of Stam Draziotis from Eurobank Equities. Please go ahead.

### **Stamatis Draziotis, Eurobank Equities**

Yes. Hello, there. Yeah, just one question from my side.

I understand it's a bit early, but could you maybe provide us with some indication as to what you expect for next year in terms of raw material inflation, please? Thank you.

### **Michalis Imellos, Chief Financial Officer**

Hi Stam.

Yes, as you say, it's early days. We are just finalising the plans now, so we'll give a full update in February.

However, early signs are, excluding the impact of coffee because, obviously, this year, we have had coffee, the biggest part of the year whereas, at this point in time for next year, it's not going to be so pronounced. So, excluding the impact of coffee and recycling, things don't look much different to what we have seen this year, so, potentially, towards a low single-digit increase. However, we'll come back, as I said, in February, with a more detailed guidance.

### **Stamatis Draziotis, Eurobank Equities**

That's clear. Thank you so much.

### **Telephone Operator**

Thank you, Stam. The next question comes from the line of Nico von Stackelberg from Liberum. Please go ahead.

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### **Nico von Stackelberg, Liberum**

Hi there. Thanks for the questions, guys, and good morning.

Just regarding the acceleration that you've seen in Q4, could you tell me a bit more about where you see those bright spots by country, please?

### **Zoran Bogdanovic, Chief Executive Officer**

Good morning, Nico. Yes.

So, I already mentioned Nigeria where I think I already explained that part. Also, we see that Russia is going to do, in Q4, fairly well. We also see acceleration in Poland. We also see it in Romania, Ukraine. So, these are some of the largest markets, but, based on also the start of Q4, I'm pleased that I can say that, overall, our performance has been, on a wider territory, has been quite good.

### **Nico von Stackelberg, Liberum**

Excellent. Thank you.

And, could I get you to comment on the consensus expectations for EPS and free cash flow? So, it's at €1.34 per share for 2019, and free cash flow of €527m. I was just wondering if you think that's achievable and just where, roughly, you stand on consensus.

### **Michalis Imellos, Chief Financial Officer**

Okay.

We don't give guidance on free cash flow itself, but, on the EPS, comparable EPS, we expect to see another year of good growth in 2019. So, yes, we are comfortable with consensus on a comparable EPS basis.

### **Nico von Stackelberg, Liberum**

Okay, excellent.

And one last question, just thinking a little bit about the affordability initiatives that you're doing in Nigeria, I was wondering, have you ever sold sachets or, you know, very small



pack sizes in, perhaps, more affordable price points within PET or maybe even a juice box format, like Ribena? I know there's a lot of sachets of water going around in Nigeria in some of the more, you know, economically difficult parts of the country. I was just wondering if you could give more colour around that and just want to understand a little bit more about how you're approaching the affordability issue. Thanks.

**Zoran Bogdanovic, Chief Executive Officer**

Yeah, thank you Nico, that's a good question. We haven't gone there yet. It's, you know, it's one possibility to explore. However what we've been in light exactly of what you asked is that we've been downsizing a number of our packages across categories. We've done that in Water. We've done that also for a while in Sparkling. We've done that also in Juices. So we've been doing that and that remains let's say a critical topic that we are constantly reviewing and finding new ways and solutions whatever will help us. But the overall downsizing to keep and play at critical price point is one of our focus areas.

**Nico von Stackelberg, Liberum**

Okay, excellent. Thank you.

**Telephone Operator**

Thank you, Nico. The next question comes from the line of Ewan Mitchell from Barclays. Please go ahead.

**Ewan Mitchell, Barclays**

Hi, thank you very much for the questions. Could you just give a little bit more colour as to where you might have been in Emerging and Developing markets had you not had the very poor weather. It feels like the guidance has been it's sort of hit by the weather and I'm just trying to work out where you might have come out if it had been a more normal year?

### **Zoran Bogdanovic, Chief Executive Officer**

Thank you, Ewan. So I mentioned in the remarks some of the countries that for example especially in the Developing segment we've seen Czech and Slovakia, Poland, and Hungary really having the impact of the weather, which worked quite well last year.

Also, in Emerging, Russia was the biggest market with that impact. And we've seen in the category, overall in the NARTD category, when we see what happened in Q3 what kind of slowdown happened versus H1, we see really a sizeable deceleration. And I'm happy that again such situations in the majority of markets we've been able to maintain or gain share.

### **Ewan Mitchell, Barclays**

Okay, thank you very much. And the second one on Romania and some of the Eastern European markets where you're working on your pack prices, can you just give a bit more colour as to sort of how Schweppes is going there and in some of the more premium package sizes, 1783 Innovation, etc, the pricing line that you've now got in Energy, it seems to be underlying growing very well. But any colour on that helpful. Thank you.

### **Zoran Bogdanovic, Chief Executive Officer**

Yes, absolutely. So Schweppes is one of our key engines of growth in the countries where we have it and particularly in these countries that you mentioned where we see that this Adult segment, the beauty of that is there is such a huge value pool in the market. It also proves to be more resistant to weather conditions and especially with the markets like Romania, Bulgaria, Serbia, Croatia, Greece, Ukraine, these are all markets where we are having a strong performance of Schweppes both in volume but even more in the revenues, because what has happened over the last few years is that we have been able to push the premiumness of Schweppes versus the average of Sparkling or even Coke.

So that it ranges now between 15% to even 60% price premiumness. And that comes as a result of package changes, flavour combinations that we have introduced, very strong marketing, experiential, also activation and engagement with the channels in the market mixability efforts that we are doing across the market.

And we are also looking into 1783 in some more markets. We have started with that in Ireland and it's performing very well. And I'm really pleased that's in the Premium and even in the Super Premium segment we are continuously gaining share.

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### **Ewan Mitchell, Barclays**

Thank you. And just to clarify, that 15% to 60% price premium, that's to sort of Trademark Coke where Schweppes is trading?

### **Zoran Bogdanovic, Chief Executive Officer**

Yes, that's pretty similar to the average of Sparkling.

### **Ewan Mitchell, Barclays**

Okay, brilliant. Thank you.

### **Zoran Bogdanovic, Chief Executive Officer**

But I would say that in average the price premium would range between 20%/30%.

### **Ewan Mitchell, Barclays**

Thank you very much.

### **Telephone Operator**

Thank you, Ewan. We have another question from the line of Sanjeet Aujla from Credit Suisse. Please go ahead.

### **Sanjeet Aujla, Credit Suisse**

Yeah hi, Zoran. It's just a quick follow up on Innovation really, you know, the last couple of years it feels like the pace of Innovation across the Group has really stepped up. And I just wanted to get your assessment of how things have gone, particularly on the New Product Development side, you know, launching brands like Fuze, AdeZ. It may be early to comment on Coke Energy. But yeah, just I'd love to get your take. You know, some things it feels have worked, others haven't. I would love to hear your thoughts. Thanks.

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### **Zoran Bogdanovic, Chief Executive Officer**

Thanks, Sanjeet. Innovation is one of our prioritised and also organisational capabilities for growth. And together with the Coca-Cola Company we are paying huge attention, focus and investment and time behind this. And before I go into the concrete details, I just want to say that I'm really pleased that the pipeline of the Innovation is very strong. It's a prioritised and disciplined approach to it that we are applying because it's not that everything goes everywhere at the same time, so we are pacing ourselves as we are expanding also our capacity and capability.

So in Fuze for example that you mentioned, that's very important because this year we started with our Zero variant. We have also our Premium line that is also coming along the way. In AdeZ we've also been playing with some new flavours and there is more to come next year which makes me personally very excited about this new category to us.

And just to highlight that Italy is one of the markets that really shows us the way and shows how with patience but with a quality approach how we are consistently making our strides in the market in this category.

Coke Energy, even though it's new I think that that's one excellent example of what this innovation does for our consumers and customers because it's bringing in new consumers into the Energy category. It's leveraging very well the flagship trademark of Coca-Cola. And it's a great proposition for customers because it helps to grow the pie and it's also increasing the value of the category because Coke Energy trades and has a price on an average of two times versus the average of the category.

And I'm really pleased that by now we are already with Coke Energy in 13 markets and based on those who started first like Hungary, Romania, we already see some very, very good awareness both among let's say Energy drinkers as well as SSD drinkers.

So that's where we stand with some of these things that you asked me, but I would really highlight that the pipeline and innovation is the way we do business. And every year this is a critical part of our growth algorithm.

And to summarise, while we ramp up, imbed and scale what we have introduced last year, this year we are also very selectively and with great lenses also choosing what are the next innovations to expand the categories, the brands, new packages, reformulations, and that's what's been driving the growth both over last year, this year and it will continue to do that in the next years.

### **Sanjeet Aujla, Credit Suisse**

Got it, thanks.

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### **Telephone Operator**

Thank you, Sanjeet. The next question comes from the line of Andrea Pistacchi from Deutsche Bank. Please go ahead.

### **Andrea Pistacchi, Deutsche Bank**

Yes, I've got a quick follow-up please. It's on bolt-on deals. You've done two bolt-ons this year. Do you have any more in the pipeline, i.e., over the medium term should we expect you to use your excess cash with bolt-ons?

### **Zoran Bogdanovic, Chief Executive Officer**

Yes, Andrea. With these two bolt-on acquisitions we did not reduce the intensity of the work that we are doing so we are quite busy, and we are exploring a number of things. So that's all I can say. And as always it has to be the strategic fit as well as the fair price for our shareholders and that's what makes, you know, the marriage happen.

But in short, yes, we are quite busy on that and exploring a number of things.

### **Andrea Pistacchi, Deutsche Bank**

Thanks.

### **Telephone Operator**

Thank you, Andrea. The next question comes from the line of Nico von Stackelberg from Liberum. Please go ahead.

### **Nico von Stackelberg, Liberum**

Hi guys. Thanks again for the follow-up. I think we have a pretty clear understanding of how you mitigate sugar tax increases and how you, you know, reshape the portfolio. But I was just wondering could you give me a bit more colour on if the Italian's plastic tax were to go through how you plan to mitigate that? And obviously it probably has to do a lot with the pack format. And I'm just wondering how you assess that and how much capacity you have in your plants to produce a lot more glass and so forth?

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And just for a technical, I was just wondering if you'd give a comment on how many tonnes of plastic produce per year? Thanks.

### **Zoran Bogdanovic, Chief Executive Officer**

Thank you. So like every - clearly it's too early to say but you already mentioned in Italy for the last few years glass has been one of the areas that we've been pushing and focusing behind a lot. And this type of possible taxation, and I say possible because really, it's hard to believe that something like that could happen. However, this will only reinforce even further how we would focus on glass both in single-serve as well as also multi-serve, because we do have that as well in Italy.

And a good thing is thing is that we do have capacity and capability to do these types of things. So whatever might come our way I'm confident that we will find solutions to adjust and continue our growth journey in Italy.

### **Nico von Stackelberg, Liberum**

And I guess on the tonnes of plastic per year, is it maybe around 35,000 tonnes of plastic per year you produce over there or it's quite a big number?

### **Zoran Bogdanovic, Chief Executive Officer**

Yeah, yeah, it is somewhere there like 33,000 or somewhere there, yes.

### **Nico von Stackelberg, Liberum**

Okay, okay. And so again, mitigation just comes back to you assessing the pack formats and I guess in the event that you switched over, as much as you could, over to glass do you have a rough view on how that could impact profitability in light of reduced PET sales?

### **Zoran Bogdanovic, Chief Executive Officer**

No. Look, it's glass but also the cans. So we play with various types. However, glass is a profitable pack as well as cans so the beauty of that is that you know, we can play a balanced portfolio. And with that I'm confident you know, that we'll find a solution that is not only volume sustainable but also economically and profitability wise that will make sense.

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### **Nico von Stackelberg, Liberum**

And finally, just so I understand the potential timeline of this, this is still a draft bill, right? And do you have any understanding of a potential timeframes of when this could develop?

### **Zoran Bogdanovic, Chief Executive Officer**

Yes, they said that by the end of the year the budget needs to be finalised and done, which is good that I think by the end of the year we will know. In case anything in that area happens, we estimate that such a law would start with implementation sometime Q2 or by the end of June.

### **Nico von Stackelberg, Liberum**

Okay. Thanks so much for all the colour, guys. I appreciate it.

### **Zoran Bogdanovic, Chief Executive Officer**

You are welcome.

### **Telephone Operator**

Thank you, Nico. We have no further questions in the queue at the moment. So as a reminder, if you would like ask a question it's \*1 on your telephone keypad.

We have no further questions in the queue, so I'll hand the call over to Ms Joanna Kennedy.

### **Joanna Kennedy, Director of Investor Relations**

Thank you for joining the call today and your questions. And as always, the rest of the IR Team and I are at your disposal for any other queries that you may have.

I wish you a very good day.

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