Britvic plc Preliminary Results 2012

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Paul Moody

Chief Executive, Britvic plc

Opening remarks

Thank you, everyone, for joining us for the preliminary results presentation webcast. Before we start, you should be aware that we are still constrained by the Takeover Panel regulations and we cannot provide any forward-looking statements or guidance. The purpose of today is to talk about Britvic's last financial year, so we will not be discussing the proposed merger or taking questions on that subject. John Gibney and Roger White are in the process of an investor road show regarding the merger and they will be happy to discuss any of your questions at that point.

With me today is John Gibney, Group Finance Director, who will take you through the financial results, after which I will take you through the commercial overview with a focus on the five near-term priorities that we communicated earlier in the year. At the end, there will be an opportunity to ask questions of both John and myself. I shall now hand over to John.

Financial Performance

John Gibney

Group Finance Director, Britvic plc

Overview

Thank you, Paul, and good morning everybody. Today we report results for the 52 weeks ending Friday, 30th September 2012. All the numbers and comparisons are on a pre-exceptional, constant currency basis and have been adjusted for the impact of double concentrate changes to both Robinsons and MiWadi. Comparisons which show volume and ARP unadjusted for the impact of double concentrate are available on Britvic.com. There is no doubt that 2012 was a difficult year for the soft drinks market, with a challenging consumer environment and extremely poor weather. Britvic was further affected by the Fruit Shoot recall which had a material impact on our financial performance.

Revenue for the Group was 0.8% down on last year, but we estimate that the Fruit Shoot recall impacted revenue performance by approximately two percentage points, bearing in mind that Fruit Shoot is a premium product within our portfolio with an ARP and margin profile higher than the group average. Additionally, we also have costs associated with the recall, reflected in fixed costs. In total, the Fruit Shoot recall impacted profit by £16.9 million this year, with a balance of up to a further £8 million to come in FY13. As a consequence, EBITA is down by 15.5% and EBITA margin is down 160 bps, with adjusted earnings per share (EPS) down 17.8% to 27.2p. Whilst it is clearly disappointing that profits have declined, results prior to the Fruit Shoot recall would have proven relatively resilient despite the challenging market conditions. Absent the recall, we estimate EBITA margin decline would have been restricted to less than 50 bps with EBIT of £129.6 million being down by about 4% on the prior year.

We have maintained a real focus on cash generation with full-year free cash flow of £62.1 million, an improvement of £2.8 million on 2011 despite the material impact of the Fruit

Shoot recall. As a result, the adjusted net debt position has fallen by over £5 million to £446.7 million, equating to a net debt to EBITDA ratio of 2.8 times. We view the free cash flow generation and net debt reduction as a highly creditable performance given the cash impact of the Fruit Shoot recall in the last quarter of the financial year.

As announced on Wednesday, 14th November 2012, the board has therefore announced a second interim dividend of 12.4p which gives a four-year dividend of 17.7p in line with last year.

Segmental reporting

GB stills

The performance of GB stills has, of course, been materially impacted by the limited availability of Fruit Shoot. Four-year volumes are down 9% with revenue down by 8.4%. The trend of consumers down-trading in the entree from premium packaged to draught carbonates has continued, as have the consumer shifts from imports to grocery. Both of these trends have diluted the ARP growth that we achieved from the price increase we implemented earlier in the year. The mixed impact from the lack of availability of Fruit Shoot was also negative for ARP. As a result, ARP growth has been restricted to 0.6%. Brand contribution margin benefited by almost 50 bps due to a reduction in A&P spend in this segment with overall margin improving by 120 bps.

Encouragingly, we saw a much improved performance from Robinsons in the second half of the financial year and Paul will touch on that later.

GB carbonates

One again, the carbonates portfolio has delivered a robust volume and ARP performance, up 2.1% and 0.9% respectively. This has led to a revenue growth of 3.1%. We have seen consumer behaviour focus on value, leading to volume growth coming from larger value-orientated packs in the grocery channel, which tends to be more promotionally led than the imports channel. Consequently, brand contribution is down slightly on last year, whilst margin is down 120 bps. If you recall, however, the brand contribution margin was down 320 bps at interims due to the channel mix and the lag effect of price increases to offset raw material inflation. As such, we have seen a significant recovery in margin in the second half of the year.

Encouragingly also, all of our core carbonate brands – Pepsi, 7UP and Tango – have all taken share this year.

International division

This includes sales of Fruit Shoot in the US and Australia, as well as the Netherlands and Belgium. There is also a sizeable travel and traditional export market for the other Britvic-owned brands.

The Fruit Shoot recall has materially affected the performance of the international division, with volume growth limited to 1.6% and revenue growth to 0.7%. The recall impacted the Netherlands and Belgium markets but did not affect the franchise business. As expected, we had commenced the shipment of concentrate to the US for in-market manufacture earlier in the second half and we now no longer ship any finished product to the US.

The brand contribution margin is materially down for two reasons: firstly, the lack of availability of Fruit Shoot in Holland and Belgium, which is a high ARP and margin product, and, secondly, we do continue to invest to support the franchise activity in the US, both in marketing investment and now also to fully recruit a sales development team based in the US. The emergent franchise opportunity continues to make good progress and Paul will describe that in more detail.

Ireland

Britvic Ireland continued to face very challenging macro-economic conditions, with the Irish consumer focused on seeking out value. The licensed wholesale division which supplies third-party brands, in addition to our own, to pubs and clubs has suffered as a result of continued market contraction, and the sales of third-party brands account for half of the revenue decline this year. Bear in mind that these third-party volumes are excluded from the volume and ARP numbers that we report here.

We have also seen the trend of consumers shifting from the imports to grocery channel and switching more of their purchase to price promotions as they look to manage their basket spend. This channel shift has had an adverse effect on the ARP performance. Overall, brand contribution is down 18.2% on last year, although the margin decline at 330 bps is an improvement on the first half of this year, when margin was down 430 bps. In what continues to be a difficult market, our brands grew both our volume and value market share in the take-home channel. The business, as you know, continues to focus on cost reduction in this market to mitigate the decline in top-line, and in 2012 the vast majority of cost savings that we will have spoken about would be delivered below brand contribution line in fixed costs.

France

Volumes are down 2.7%. This reflects the lack of availability of Fruit Shoot, the withdrawal from commercially unattractive juice contracts, and also the pack changes we introduced to parts of the Teisseire range. With raw material inflation higher than the group average, due to its exposure to juice and sugar in this market, it was a priority for the business to offset this, which it has done very successfully. The impact of our actions can be seen in the ARP growth of 10.9%, which has delivered revenue growth of 8% and brand contribution growth of 1.4%. Brand contribution margin was down 150 bps, as much of the benefit of the increase in ARP was absorbed by raw material inflation. The timing lag of the price increase plus the increased A&P investment behind the Fruit Shoot brand and the subsequent recall had a further negative effect on the brand contribution margin. Both Teisseire and Moulin de Valdonne performed well, growing our market share of syrups in the take-home channel.

A&P investment and fixed costs

A&P spend in absolute terms was broadly flat on last year at £62.5 million. Total fixed costs decreased by 1.7%, although the 2012 number also includes costs associated with the Fruit Shoot recall. The underlying reduction in fixed costs base, therefore, was around 4% as a result of strong and effective focus on cost.

Earnings

Our interest costs, as you can see, are down by £1.6 million, reflecting the full-year benefit of the refinanced bank facility we secured in March 2011 and the improving cash flow. The effective tax rate this year is 25.5%, which is down 40 bps on last year due to a lower rate in the UK, partly offset by a temporary increase in the French tax rate. Profit after tax has decreased by 18% to £62.9 million, reflecting the impact of Fruit Shoot on earnings this year.

Exceptional and other items

These are a net charge of £6.9 million. The key movement since the half year has been a non-cash £3.2 million negative movement on the fair value of financial instruments, resulting in a £0.8 million charge under 'Other and fair value movements'. In addition, costs here include £1 million incurred by the year-end which relates to the merger discussions with A.G. Barr.

Cash flow

The underlying group free cash flow pre-exceptional is 4.7% better than last year at £62.1 million, which, given the impact of the recall of Fruit Shoot on both earnings and working capital, is a pleasing result and reflects the focus on cash in the second half of the financial year. Consequently, adjusted group net debt is down slightly on last year, taking our adjusted debt to EBITDA ratio to 2.8 times. Capital expenditure reduction has come from the refocus of the organisation's near-term priorities, but we still continue to invest substantially in the business, with this level of capex still above our D&A charge. The year on year reduction of capex is primarily in intangibles such as IT projects, rather than our investment in the infrastructure of the business.

Improved working capital is largely due to improved year-end inventory levels, and other costs have benefited from a lower tax rate but also lower interest in share-based payment charges.

Summary

In summary, whilst this has clearly been a difficult year, our focus on cash and costs has driven tangible benefits. The Fruit Shoot recall has weighed heavily on the results but this has obscured the strong progress we have made in rebuilding our margins in the second half. I will now hand over to Paul who will take you through the near-term priorities for the business.

Britvic and the Market Review

Paul Moody

Chief Executive, Britvic plc

Overview

Thank you, John, and good morning again everyone. As you will be aware, 2012 has been a challenging year for Britvic, and following the Fruit Shoot recall we reset our expectations for the year and consequently we communicated a five-point near-term strategy for the organisation. The focus of the business since then has been, and continues to be, the following:

- firstly, to re-establish Fruit Shoot in all impacted markets;
- secondly, to build and realise the value of the emerging US Fruit Shoot business;
- thirdly, the rigorous management of our cost base;

- fourthly, a focus on cash generation;
- and, finally and importantly, driving an improved performance for the core brand portfolio.

I will now take a few minutes to update you on progress on each of these five priorities.

Re-establish Fruit Shoot in all impacted markets

Bringing Fruit Shoot back to market and re-establishing the brand to its leading position has been a priority since the recall in early July. At that time, we anticipated product being unavailable for a six-week period whilst we rebuilt stock levels to be able to supply our customers effectively. During this period of non-availability, we actively communicated the ‘back soon’ message with a print media campaign. Fruit Shoot was successfully back on shelf within the six-week timeframe in Great Britain, France, the Netherlands and other export markets. I should remind you that Ireland, Australia and the US Fruit Shoot businesses were unaffected by the recall. McDonald’s in the UK was also unaffected and continued to perform well across the summer.

To coincide with the return into store, we invested in a campaign to communicate to parents and children that Fruit Shoot was back on shelf. This has been a heavyweight campaign employing all media types, including an extensive television campaign. It is too early to be definitive on the success of the re-launch plan as we continue to rebuild supply to historical levels, in preparation of supporting a full promotional plan to retailers and consumers. We are on track for full supply by January 2013 and the brand measures we use to assess brand health are returning to pre-recall levels.

Fruit Shoot in the US

Let me now move to our emerging Fruit Shoot business in the US. As you will recall, we confirmed at the interim results that we now had distribution agreements for eight states with four Pepsi bottlers, including PAB, the beverage business unit wholly owned by PepsiCo. I can confirm that we have now secured an agreement with a fifth partner for Fruit Shoot. Pepsi-Cola Bottling of Central Virginia, based in Charlottesville, Virginia, are the holders of the longest established Pepsi franchise in the US. They bottle and distribute a wide range of products across Virginia. This agreement provides further evidence of the potential to take Fruit Shoot successfully into other markets, and to develop the premium children’s category. We remain confident of achieving our target of 20,000 distribution points by the end of this calendar year.

Management of our cost base

We prioritised an even stronger emphasis on cash generation and rigorous management of the cost base. Fixed costs are down 1.7%, but this includes the cost of the Fruit Shoot recall. Excluding Fruit Shoot recall, the actions of our leadership teams have meant that we have reduced the cost base by just under 4%. It is important to recognise that, at the same time, we have continued to invest behind the future growth drivers of the business, such as franchise. Despite the impact on cash of the Fruit Shoot recall in the final quarter of the financial year, we were able to mitigate the impact and generate a creditable £62.1 million of free cash flow. This was up £2.8 million on 2011. In addition, we were able to reduce net debt by over £5 million, leading to a net debt to EBITDAR ratio of 2.8.

Market conditions in 2012

Before turning to discuss driving improvement in our core portfolio, I want to share with you an overview of the market conditions that we have endured during 2012.

Great Britain

I think that we would all recognise that 2012 has been a year of celebration across the country: from the Diamond Jubilee celebrations in June, through to the Olympics and Paralympics in late summer. Likewise, the weather across the country lived up to expectations, with some of the coldest, wettest weather on record. The GB soft drinks market saw another subdued performance, with only 0.3% of volume growth. Value growth was a more robust 4.5%. Once again, carbonates has been the driver of growth, with volumes up, whilst stills volumes continue to decline. The pub and club sector has also continued to decline in absolute-volume terms, alongside a consumer trend to downtrade from packaged stills to draught carbonates.

Over the last two years, the market volume growth has been below the historical average of 2% to 3%. It is really apparent that the GB consumer continues to manage their basket-spend carefully in the current economic environment. Clearly, for Britvic, our historical strength in stills and in the pubs and clubs channel has presented us with additional challenges beyond those met by everybody else in the market.

France

The soft drinks market in France has slowed down this year, with full-year volume growth limited to 1.8%. As in the GB market, it continues to see a better value performance, with growth of 5.1%, reflecting the impact of price increases and the sugar tax that was implemented in January. In the syrups category, we have seen double-digit market-value growth and over 6% value growth in juice. Our syrups portfolio has continued to take share this year, whilst their Pressade juice brand, which focuses on its organic and local credentials, has grown ahead of the category.

Ireland

The difficult economic conditions in Ireland are well documented and need no further explanation. The recent trend continues to see the pubs and clubs channel contract, whilst the grocery channel has performed better than impulse. Overall market volumes are down 2.2% this year, in stark contrast to the performance we have seen in GB and France. The last quarter of the year saw a further decline year-on-year. The pub and club channel continues to contract further as overcapacity continues to lead to pub closures. However, Britvic Ireland, with its portfolio of leading premium brands such as Ballygowan, 7UP and MiWadi, has held share this year.

Improved performance

I now want to share with you two success stories where the core portfolio has driven an improved performance this year.

Pepsi

Carbonates have driven the growth in the GB soft drinks market this year, and Pepsi has been at the heart of that growth. Against the backdrop of major sporting activity this year, it may have been anticipated that the share growth of the last few years would have come under real pressure. Pepsi responded by delivering a year-round marketing campaign to engage consumers. In quarter one, the programme started with Pepsi linking with Doritos, both brands offering a limited-edition flavour to complement each other under the Fire and Ice strapline. This proved hugely successful for both brands, and was repeated later in the year. The football credentials of Pepsi were utilised once more with an on-pack promotion offering the chance to win prizes such as 3D TVs ahead of the football championships, and a TV advert featuring famous players such as Messi and Drogba. This consumer engagement has continued with a sponsorship deal with ITV's X Factor.

Alongside this, we have seen the introduction of 250 ml cans that have grown the category, increasing consumption and bringing more users into the Cola category with Pepsi Cola. This innovation has also benefited our 7UP and Tango brands. As well as taking substantial value and volume share of the cola and carbonates market, Pepsi is now valued as a top-ten grocery brand.

Robinsons

Robinsons is clearly a core brand in the GB portfolio. As you all know, we experienced some challenges with the move to double concentrate last year. In-store execution in some accounts was not optimal, and we had some work to do really to get across the value message of double concentrate to our consumers. Since then, we have been working hard to fix the issues, and in 2012 we launched a media programme to sell the virtues of double concentrate. Alongside that, we saw the Boogie campaign back on television, a Jubilee-themed limited edition, and an extraordinarily successful Wimbledon tennis on-pack programme in the summer.

Consequently, this has led to material value share gains for Robinsons this year, with both our Q3 and Q4 share performance up significantly on the previous year. Robinsons has now returned to its historical share high of two years ago.

Concluding remarks

In summary, our focus was re-establishing Fruit Shoot, and that programme is on track. As I have explained, our core brands are winning in the market, despite the challenges of that market. Our emerging US business continues to grow, and in the context of the challenge presented by Fruit Shoot, we have effectively generated cash and controlled our costs.

Q&A

Andrew Holland (Société Générale): In the context of the Fruit Shoot recall, you talk about the possible remaining £8 million that may come in the current financial year, which I think is dependent on litigation. Obviously, it is difficult for you to discuss that, but I am just interested in the timing of that. Is that something that will work its way through in the current financial, given that if it is a legal proceeding, then it could take longer than that?

The second question relates to the stills division, where you managed to get your margin up despite the Fruit Shoot recall. You talked about cutting A&P, yet you also talked about the spend you made to re-launch Fruit Shoot. I am just wondering whether you could quantify what has actually happened to A&P and the timing of that in the year, please?

John Gibney: I will take the first question on the Fruit Shoot recall: the reason that there is a range that we put in there of £15 million to £25 million over two years is the potential for what I call claims rather than litigation. We clearly cannot comment too much more on that, but. as you know, we have incurred costs of nearly £17 million at the most. As we have highlighted, there is the potential for up to a further £8 million of costs to come through and lost profit in relation to Fruit Shoot; if it is towards the lower end of that range, that may well be associated with any claims. As I say, I cannot say any more than that.

In terms of the improving stills margin, I think first, as you have highlighted, there was some reduction in the A&P that was behind our stills brands this year. Overall though, as you will be aware, the total A&P that we spent for the business was in line with last year. It is not unusual to see us refocus and reprioritise our A&P spend across the various segments, depending on one particular time. Bear in mind also that last year the A&P spend within stills reflected the launch of Robinsons DC (double concentrate) into the marketplace, so we were lacking that comparison as well. I think the important thing to note is that, despite the challenging trading conditions, we continued the level of investment that we have previously had in our brands.

Jonathan Fell (Deutsche Bank): First of all, just on working capital: you managed to get an inflow this year, but I think you had said previously that there was going to be a one-off outflow associated with the Fruit Shoot recall. Could you quantify that, or did it not in the end happen in a material way?

The second question was just in relation to the segment that Fruit Shoot is playing in. Could you just give us a bit of background on what has happened in terms of competitor products? Have there been more that have moved into that space? In the stores where you are back in more like full supply, what has your success been so far in taking that shelf space and share back?

John Gibney: On working capital, we flagged at the time of the Fruit Shoot recall that we thought that we would have an adverse working capital impact of around £10 million, which was associated with getting the product back into store, building our stocks, etcetera. We certainly did see that sort of impact coming through, but I think that, again, is testament to the focus that we have had on cash flow, particularly in the second half, where we have actually managed to turn working capital into an inflow. A lot of stock management is reflected in that number, that you will have seen across all of our SKUs. Whilst the impact of Fruit Shoot would have been negative, we managed our stocks pretty effectively elsewhere. Then just what I have described as good, solid underlying core discipline in terms of how we collected cash and how we implemented our payment terms to actual terms was really what drove the balance of that benefit.

Paul Moody: I will touch on the second question. The segment that Fruit Shoot operates in is clearly kids' juice drinks. The segment would clearly feature own-label, and that has been the case for the last three years, as own-labels have mimicked the Fruit Shoot proposition. The other material player in that segment would be Capri-Sun, which you are no doubt familiar with. I guess that during the period that Fruit Shoot was off-shelf, what we saw was retailers facing up primarily with own-label, but some secondary brands as well. As we have rebuilt our distribution, we clearly had a phased programme. There is a fairly broad range of skews under the Fruit Shoot, but we prioritised the multipacks of the two leading flavours, and as the distribution phase is rolled out, then we will have more and more distribution of the second and third flavours within the brand. To an extent, we always expected that there would be a degree of distribution rebuild; some of that is linked to availability of stock, to enable us to run the normal underlying promotional programmes, which clearly we have not done in the first instance because our priority was to get distribution of goods into all retailers. I think what we can comment on is that where we have re-established the brand within a retailer, we have pretty quickly returned to the rate of sale that we would have seen prior to the Fruit Shoot recall. That, combined with the brand health tracking that we have done, gives us confidence that whilst regrettable, the Fruit Shoot recall has not had any long-lasting damage to the brand equity. We are pretty pleased by that.

Andrew Holland: One thing that has just occurred to me is, is there any implication in the timing and nature of your negotiations with the supermarkets around your merger? I am just conscious that the timing of negotiations a year or 18 months or so ago was quite a big issue. I am just wondering whether there is anything that we ought to be aware of, whether you are going to sit down with Tesco and Sainsbury's and so on at the same time, this time round, for price negotiations, as you did last time round, or whether that is going to be delayed by the merger process?

John Gibney: We cannot specifically comment on that. I think the only thing that I will say is that clearly this is still a merger that is conditional and, in the context on that, both Britvic and Barr continue to run themselves as they would do under any other circumstances. We still at this point in time remain two separate businesses, and indeed, we remain competitors.

Olivier Nicolai (UBS): I have one question on your capex into cash flow statements. You indicated at the beginning of the year that the capex would obviously be much higher, then you reduced this to £50 million for the guidance after the product recall. How much should we expect? How much did you postpone, and how much would we expect into next year?

John Gibney: Unfortunately, I cannot give you any guidance at all on what the capex would be for next year. Clearly, this year we reprioritised our investment in line with what we felt were the business needs. I am not sure that I would characterise any of that other than the business transformation investment in France that we spoke about as being the main deferral into future years.

Olivier Nicolai: Initially, you were expecting, or at least you guided for around £62 million capex at the beginning of the year. Should we expect it to be around £50 million in the next coming year, or should we just forget about it?

John Gibney: Unfortunately, I am not able to give you any guidance, frustrating as I am sure that is. The brokers are very clear that we cannot talk about anything relating to future years.

Simon Hales (Barclays Capital): I wonder if you can talk at all about recent trading trends since the end of the full year, whether there has been any notable change in trading conditions in any of your sub-segments. I am just looking out of the window and still seeing the rain coming down. Is there anything that you can say there at all?

John Gibney: Clearly, again, we cannot say anything specifically about Britvic. I think we could give you a couple of observations about the general market, more in the context, I guess, of promotional activity. We would not describe what we are seeing in the market now as anything particularly unusual, so very much in line with the level and the volume of promotions that we would have expected to see around this point in time leading up to the key Christmas trading period; there is nothing unusual, we would say, in the marketplace at the moment. Clearly, weather has much less of an impact this time of year, other than, of course, if we get hit with severe snow.

Paul Moody: Thank you everybody for joining the webcast. We appreciate your attendance and your questions, and we will be speaking with you soon, no doubt. Thanks very much.

[END OF TRANSCRIPT]