Chr. Hansen

Q1 results 2017/18
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10:00 CET

Operator: Thank you for standing by, and welcome to the presentation of Chr. Hansen's results for the first quarter of 2017/2018. At this time, all participants are in a listen-only mode.

There will be a presentation followed by a question and answer, at which time if you wish to ask a question, you'll need to press star one on your telephone. You are also welcome to submit questions via the web by clicking on the Q&A tab in the webcast at any time during the call.

The questions submitted via the web will be answered after the call. I must advise you that this conference is being recorded today. I would now like to hand the conference over to your speaker today, CEO, Cees de Jong.

Cees de Jong: Thank you, Operator. Good morning and welcome, everybody. I'm Cees de Jong, CEO of Chr. Hansen; and with me is our CFO, Soren Lonning.

The start of the financial year 2017/18 for Chr. Hansen has been solid. We've realized organic revenue growth of 10 percent, with strong growth in Food Cultures & Enzymes, while Health & Nutrition grew in line with expectations.

And as expected, Natural Colors was below our long-term guidance, impacted negatively by order phasing and the ongoing profitability initiatives, and that included pruning of the portfolio. As you will remember, we had indicated this already at the full year announcement.

Our EBIT margin was 25.4 percent, and that is lower than Q1 of last year. But again, we indicated that margins would come down in the first half of the year, and especially in Q1, as we had some one-offs last year that are not repeated and because we are taking our new capacity in Food Cultures & Enzymes into use. We expect that margins will improve during the second part of the year.

We're encouraged by the solid start to the year. And whilst we maintain our overall guidance for the full year, we now expect the organic growth for Food Cultures & Enzymes to be even stronger and to be above the long-term 7 percent to 8 percent growth target that we have for this business.

At the same time, we now expect organic growth in Health & Nutrition for the full year to be below our long-term guidance for this business. As we announced on November 28 of last year, I'll be leaving Chr. Hansen.

And as announced earlier this week, Mauricio Graber will take over from June 1. And as you know, my decision to leave is entirely for personal reasons, and it's absolutely nothing to do with Chr. Hansen, the strategy of the Company or the people in the leadership team.

And I'll stay in the Company until summer to ensure a smooth and thorough handover to Mauricio. And in the meantime, I'll continue in my role, and I'm currently also leading the strategy review process, and I will ensure that I leave Chr. Hansen in the best possible shape.

But before we move on, please have a look at slide two and read through the disclaimer or do so afterwards, please.

And with that, let's move on to the next slide, slide number three. Like I said in the introduction, our organic growth rate was 10 percent in the first quarter, and that translates into a revenue of EUR 255 million, 5 percent up compared to last year.

Growth in Q1 was overall on par with expectations, with a slightly better performance in Food Cultures & Enzymes, driven by bioprotection, but of course, offset by slightly lower performance in Health & Nutrition and Natural Colors.

Volume and mix accounted for 8 percent of the growth, with euro-based price increases of 2 percent accounting for the remainder.

Adverse developments in currencies have a negative 5 percent impact between the organic growth and the reported euro growth. And there, the decline in the U.S. dollar of about 10 percent relative to the U.S. -- to the euro, excuse me, is clearly the main impact here.

Food Cultures & Enzymes organic growth was 12 percent, with strong growth in cheese, fermented milk, enzymes and meat. And bioprotection continued the very strong growth trends and grew by around 45 percent. Our organic growth in Health & Nutrition was 10 percent, mainly driven by animal and plant health, and offset by moderate growth in human health.

And as we've been talking about lately, the situation in the United States for human health is challenging. The overall market growth is actually quite good with overall volumes growing, but the faster growth is taking place in the low-cost, low-quality segment where we do not operate. And the growth is in the online channels where other players, other customers of ours, are currently better positioned to win here.

Natural Colors grew by 4 percent organically, with 1 percent from volume, 3 percent from prices. And the trimming of our portfolio to increase profitability has impacted the growth rate negatively and again as expected.

And this is combined with negative timing of orders in North America and a tough comparable from a big conversion win that we had in the Middle East last year.

And then we also saw a soft market for fruit preparations to the dairy market in North America where colored yogurts, and they are the ones that often the most sweet, are losing share to yogurts with less sugar.

The EBIT margin before special items was 25.4 percent compared to 27.1 percent last year. The decrease was expected and is driven by the sale of a property in Argentina last year, which boosted our margins, and also driven by cost related to the start-up of the new production capacity in Copenhagen this year. The new capacity is producing ahead of schedule, and we expect to see improving margins from this towards the end of the year.

R&D expenditures amounted to EUR 20 million or 7.8 percent of sales, and that compares with 7.4 percent last year. The increase in R&D expenditures was driven by strategic initiatives, including bioprotection and LGG.

And in the first quarter, we typically have a higher R&D spend compared to the full year as this is our smallest quarter revenue-wise. Investing in research and development is a key priority for us and a good way to ensure a healthy pipeline to support future sales growth.

And finally, profit for the period ended at EUR 47 million, on par with last year. The free cash flow before acquisitions and special items was negative by EUR 19 million, which is on par with last year as well.

Now please move to the next slide for the strategic highlights in the first quarter. As you know, we've identified three key strategic initiatives, and we call them lighthouses, to support the long-term growth of Chr. Hansen. And again, I'm pleased to see the continued good progress across all three of these.

Bioprotection continued the strong growth momentum with around 45 percent growth, and that is still driven by the first generation of the technology only.

The growth rates in bioprotection are expected to come down somewhat as we go through the year, especially in the second half of the year where growth was also very strong last year and the base is getting higher. We still expect strong double-digit growth for the full year, though.

We also launched the second-generation bioprotective cultures in the beginning of this financial year. And hence, the actual sales contribution from these new cultures is still limited in this quarter.

But that obviously will change over time as these newer bioprotective cultures are more powerful and enable us to enter markets where we haven't been before. And hence, we remain optimistic about the overall development of this category.

As you know, in plant health, we launched two new products, Quartzo and Presence, and we launched them at the end of the last financial year.

And these new products, which are both biological nematode control products, are already supporting the strong growth of plant health in Latin America, together with the existing product Nemix C. And our portfolio is now quite strong for sugarcane applications, and we're more optimistic now about our position here than a year ago.

The Brazilian authorities have recently banned some of the chemicals, which our products may replace. And these banned chemicals obviously were very toxic, and you know that our products offer a natural solution with a similar performance to these chemicals.

Moving to LGG, then I can say that our probiotic strain LGG, which we acquired in November of 2016, is now contributing to growth both in Food Cultures & Enzymes as well as in human health.

We have just launched a new concept for a children's drinking yogurt, and we call it ProKids, and is the LGG probiotic strain in combination with a newly developed compatible acidifying culture.

We will, thus, be able to offer a strong solution for a functional dairy product targeted towards children, and that is in a product category with very limited innovation in the last several years, and we think it does offer us a strong untapped potential.

And as you will remember, clinical studies have shown that LGG supports the immune system and especially upper respiratory tract health, such as reducing the length and severity of colds, which is common reason for absence from daycare and school, impacting the entire family.

LGG also contributes to reduce the use of antibiotics, which is important for many consumers and especially families with young children. And while we are touching upon human health, the market situation in North America is challenging for us and for some of our customers especially.

The overall market is growing, not least because of an increase in online sales, but the market is at the same time being saturated with lower-quality products, and consumers have a hard time navigating this. This is partly due to the unregulated nature of the market where it is still possible to make irrelevant claims with few repercussions.

Moving back to Food Cultures & Enzymes. We've now taken the new capacity in Copenhagen into use, and we are producing commercial batches a little faster than we had expected. Of course, we still have the extra cost associated with bringing the capacity online, and we have now started depreciating the new capacity.

But we do expect a positive contribution to margins towards the end of the year. And finally, in Natural Colors, growth was impacted by order phasing in North America as well as by our profitability initiatives.

And with that, I'd like to move to the next slide, please. If we turn to the developments in the different regions, then we grew 6 percent organically in the largest region of Europe, Middle East and Africa, and that region represents 44 percent of group revenue.

The growth was driven by strong growth in cheese, enzymes and meat and solid growth in probiotics for fermented milk. The growth in bioprotection in EMEA continues to be very strong and is almost exclusively driven by the first-generation technology.

In North America, we saw 26 percent organic growth with strong growth in cheese, probiotics for fermented milk, enzymes, meat and animal health. In North America, we also see strong growth from bioprotection, and like EMEA, the growth is in first generation.

And like I mentioned previously, human health in North America is challenged by market conditions, so here, revenues declined. In Natural Colors, revenues also declined due to timing of the orders and a soft market in dairy and food prep.

Asia Pacific grew 20 percent organically, driven by strong growth in fermented milk in China, human health, animal health and natural colors. Enzymes and probiotics for fermented milk showed good growth, while revenues from cheese declined.

And finally, Latin America grew 15 percent organically, driven by strong growth in cheese, fermented milk, enzymes and plant health. Natural Colors showed good growth, while probiotics for fermented milk and animal health was below last year.

In Latin America, we've seen the first significant wins for the second-generation bioprotection technology. The second-generation technology is designed to work better under, for instance, hot conditions in emerging markets, and this is exactly as expected. And with that, I'll hand over to Soren to go through the financials of the business.

Soren Lonning: Thank you, Cees. In Food Cultures & Enzymes, the 12 percent organic growth was driven by 10 percent growth from volume and mix and 2 percent from prices. The volume growth was primarily supported by strong development in cheese, fermented milk, enzymes and meat as well as good growth in probiotics.

Bioprotection cultures delivered organic growth of approximately 45 percent, and this was driven by the existing segments within fermented milk, cheese and meat, with EMEA and North America being the main regions.

Due to the strong start in Food Cultures & Enzymes, we now expect organic growth for this area to be even stronger and, thus, (had past) the long-term growth ambition of 7 percent to 8 percent.

The EBIT margin for the first three months ended at 31.7 percent, which was a decline of 3.3 percentage points and in line with our expectations.

The main reason for the decline was the extraordinary contribution last year from a property sale in Argentina, but the decline in the U.S. dollar ramp-up cost related to the start-up of our new fermentation capacity in Copenhagen and an unfavorable product mix also contributed.

Let us turn to the next slide. Health & Nutrition delivered 10 percent organic growth, all from volume and mix. This was driven by strong growth in animal health and very strong growth in plant health, albeit from a low base. Like Cees has mentioned, human health in North America declined due to difficult market conditions.

Based on the start of the year, we are lowering our expectation to organic growth in Health & Nutrition for the full year to be below our long-term ambition, which is double-digit growth for this business area.

The EBIT margin in the first quarter improved by more than 2 percentage points to 23.2 percent, especially driven by an acquisition synergy that's related to the absence of royalty payments on LGG and the in-sourcing of NPC products.

However, reduced scrap and a positive product mix in human health also contributed. On the negative side, the declining U.S. dollar had a negative impact on margins. Let us turn to the next slide. Natural Colors grew by 4 percent organically, with 1 percent from volume and mix and 3 percent from prices.

The price increases reflected both the increased raw material prices and general price increases. Carmine volume continued to decline due to profitability initiatives, but this was offset by strong growth in the annatto and carotene category as well as in coloring foodstuff.

The EBIT margin was 8.4 percent, a decline of roughly 2 percentage points, driven by negative impact from timing of raw material, inventory and lower sales. The optimization initiatives partly offset the negative impacts.

Please turn to the next slide. This page shows the group results for the first three months. Sales grew by 10 percent organically, which is in the upper end of our long-term target of 8 percent to 10 percent for the group.

Volume and mix accounted for 8 percentage points, and price is the remaining 2 percentage points. Gross margin declined by 0.9 percentage points, but this was as expected due to the ramp of our new capacity in Food Cultures & Enzymes.

This effect carried through to the EBIT margin, which was further down due to the reason explained previously, most notable the sale of a property in Argentina last year. We do expect the positive margin contribution for the new capacity to kick in towards the end of the year.

Please turn to the next slide for the cash flow development. The cash flow from operations improved by EUR 2 million, while the cash flow used for operational investment activities increased by EUR 1 million.

The investment level for this financial year will be roughly on par with last year in actual terms. We are investing across the business in various upgrades in order to remove bottlenecks and to safeguard the very high level of quality that our customer expects from us. Free cash flow before special items and acquisitions was on par with last year.

When turning to the outlook page on Page 11, with the solid start to the year, we are maintaining the overall guidance. So we still expect to see 8 percent to 10 percent organic growth for the group with similar margin and free cash flow levels compared to last year.

However, we are, like mentioned, tweaking the guidance for two of the business areas. We now expect Food Cultures & Enzymes to grow above the long-term target of 8 percent to 10 percent, up from slightly above. And we now expect Health & Nutrition to grow below the long-term target of more than 10 percent.

We continue to expect that reported revenue growth will be around 4 percentage points lower than organic growth, especially driven by the weaker

U.S. dollar. Based on current exchange rates, the impact will likely be slightly larger in our Q2 and Q3, and this is where we see the largest difference between current exchange rates and last year's exchange rates, and then a lower impact in our Q4.

Please move to the next slide. Finally, I just want to remind you all that we have our upcoming Capital Market Day in London on April 18 this year. If you're interested in attending, please reach out to our Investor Relations team after the call. Thank you. And with that, please turn to the next slide, and I will hand back to the operator to start the Q&A session.

Operator: Thank you. As a reminder, if you do wish to ask a question, please press star one on your telephone keypad and wait for your name to be announced. And, if you wish to cancel your request, please press the hash key. Your first question comes from the line of Soren Samsoe.

Soren Samsoe: It's Soren from SEB. Firstly, a question regarding your margins on bioprotective cultures. If you can't give us a number, could you just indicate whether they are above, in line or below the margins in Food Cultures & Enzymes division?

Second question is in Health & Nutrition, where North America has been very important for your growth in the human probiotics in the recent years.

I'm just wondering, how come you're not taking down your mid- to long-term growth guidance for this division if you see such a problem, which could continue for several years to come? Yes, let's stop at those two questions.

Soren Lonning: OK, Soren, let me address your questions. On the bioprotection margin, relative to margins of other products in Food Cultures & Enzymes, bioprotection is above the average in the business area.

However, the reason why we still see a slight unfavorable effect from product mix is that we've had very strong growth in enzymes and, in particular, some enzyme categories where we have a lower margin. So this has, in the quarter, overthrown the positive effect from the higher bioprotection growth.

Secondly, why we are not taking down the longer-term financial targets for Health & Nutrition. First of all, we do see strong growth opportunities in this business area across all segments. And in particular, when we look to North America in human health dietary supplements, then we do believe that we will see improvements when we look forward.

One very concrete thing is that part of the decline we are seeing now is related to our -- some of our customers reducing their inventories, so there is a nature of one-off effect in the numbers. And then secondly, we do believe that when we look long term, probiotics is here to stay. We believe that the consumers, they will become more and more educated in this field.

And they will -- there will be a move and reinforcement of products with a high-quality level and strong documentation behind. And that is also why we expect that we will continue to grow in this area also going forward.

Bear in mind that the category dietary supplements with probiotics continues to grow in North America, so we are not seeing the market moving into confection. It's just coming down from a, historically, a double-digit growth level.

Soren Samsoe: OK, that's fair. The next couple of questions is -- or the last two questions is, first of all, the margin you delivered in Q1, can you just confirm, this is where you roughly expect it to be already in the beginning of the year after Q1?

And then secondly, you have a Capital Markets Day in April. Just remind us, is this typically a time where you normally would reevaluate your mid- to long-term targets? Or is this completely different topics you are going to talk about there?

Soren Lonning: Let me address your margin question, but could you -- maybe I didn't fully understand. Could you repeat it again, Soren?

Soren Samsoe: No, yes, just whether this is where you expect it to be after Q1 in terms of the margin?

Soren Lonning: Yes, but I can confirm that. That is exactly where we expect it to be. And when we look to the drivers that was impacting us, unfavorable in this quarter, first of all, the property sale last year; currency rates, which really changed during Q4 and not during Q1, they've been quite stable during Q1; and then finally, the fact that we would be ramping up our facility.

And last year, we had a positive effect from the building up inventories ahead of shutdowns. All of these factors were known, so that's why it was fully expected, the development that we saw here.

Cees de Jong: Let me -- Soren, let me take your second question on the Capital Markets Day. We run a two-year strategy cycle, and so we are currently in the process of updating. So the intention is indeed, at the Capital Markets Day, to give our midterm guidance, which is like a five-year guidance.

We've also taken note of comments by various analysts with the request to better articulate our long-term future, and then we talk about the lighthouses. And to the extent possible, it's also our objective to better give insight in how we look upon plant health, bioprotection and maybe even microbiome.

That's the one where we've always been saying to you guys, if this is going to happen, Chr. Hansen is going to be a key player. But please, don't put anything in your models. Let's see what we can tell on microbiome. The other two, we'll definitely articulate better, also the longer-term strategies.

Operator: Your next question comes from the line of Heidi Vesterinen.

Heidi Vesterinen: So first question, on human supplement. So you were talking about there being a near-term issue around channel exposure being unfavorable and also the fact that, yes, there are lower-quality products out there. Do you see this being resolved without changes in regulation?

And also, what stops this from happening in other regions? Is it possible we see similar impacts in Europe and Asia? As here, we also see a lot of different types of probiotics, and it's very difficult for consumers to tell the difference.

And then the second question, on Cultures & Enzymes. Soren, maybe if you could please break out the various components of the margin change year-on-year?

Cees de Jong: Heidi, let me take your first question then. On human health dietary supplement probiotics, what is important is that the resulting health benefits are strain-specific.

So all of you know that, for instance, on LGG, by far the most studies have been done. And that's also why that is a product that, for instance, is being used by doctors in hospitals because they rely on that information.

In addition there, too, what is important is that the probiotic bacteria that are being sold are stable and not just stable in the bottle or in the pill in which they're sold, but also stable to end up at that part in the gastrointestinal tract where they need to do their work.

And for those of you who have visited our R&D labs, you will have seen that, for instance, we have -- we used to have one. We now actually have more artificial guts so that we can also certify the stability of our products and that they do the work where it needs and not just stay in the stomach, but go lower down, so to speak.

What we now see in the U.S., and I'm coming to your question, Heidi, is that consumers are confused because simply, the products will say there's more bacteria in this product and, by the way, the price is low.

But the irrelevancy is that it's not about bacteria. You need bacteria where the clinical studies have been done. When you're an optimist, you would say that regulators already take a closer look.

And some of you will remember that one of the dietary supplement providers not so long ago got summoned by a regulatory body to take their product back because they couldn't substantiate the claims. That was not good for the category. It was good for Chr. Hansen because obviously, thereafter, we could provide that company with material.

I believe that some of our customers have relied a little bit too much on their brands and a little bit too less on educating the consumer what the strains really do. And I fundamentally believe we live in a world of total transparency, so assuming our consumers will find out.

I think regulators are moving in, and the (grand finalist) in the U.S. is an example that the FDA is pursuing. And I'm with Soren on this one. I think the category will restore. What we see is some might have a one-off, not repeated. We see some destocking at our customers that has aggravated the picture in the first quarter. My guess is we'll also see some of that in the second quarter as well.

Over the long run, there's no doubt that probiotics for human health will continue to show healthy growth. And one of the key drivers there is that all the studies that are being done in the microbiome help us to get better understanding what bacteria do in and on the body.

And then when it comes to positioning, I think Chr. Hansen has some of the best probiotic documented strains. So for the long run, we think this category will stay healthy. I find it difficult to predict, Heidi, what exactly will happen in other regions on the short term. Obviously, our exposure to the U.S. was, with certain customers, a bit larger than to other regions.

Soren Lonning: And then let me address your margin question, Heidi. In Food Cultures & Enzymes in Q1, if you look at the Page 6 in the presentation, then the drivers that we mentioned roughly contribute along the following lines.

The property sale in Argentina is impacting negatively by around 1 percentage point. The currency is a little more than 0.5 percentage point. And then we have the ramp-up cost for the new production, but also the effect from the inventory buildup last year.

If you check the combined effect here, we are talking around 1.5 percentage points. And then finally, the product mix that is less than 0.5 point. So those are, in rough terms, the margin drivers of Food Cultures & Enzymes in Q1.

Operator: And your next question comes from the line of Lars Topholm.

Lars Topholm: Lars, with a couple of questions. Just to follow up on Soren's question, and you've been discussing it, about the long-term guidance in Health & Nutrition. So I understand why you keep that, but there's always a question what long term is. So if I ask more specifically, I mean, in Q1, you grow 10 percent organically, but have a 5 percent currency headwind.

If I look at Q2, 3 and 4, your average comp will be roughly 8 percent tougher. So my question for the year, I know you now say you will grow less than 10 percent, but could you envisage a situation where the revenue in DKK is actually flat? And when you comment that in Q1, you're also hurt by destocking, can you put some quantification on that, how much is destocking and how much is something else?

Then the second question, are you able to begin to quantify how much of revenue in Health & Nutrition comes from plant health? And if not yet, when will you begin to quantify?

Do you have a hurdle rate they have to reach before you begin quantifying it? And then in Natural Colors, I understand your margins are down, among other things, due to commodity price inflation, but you have gone through with some price increases. Do you have a delay in price increases that we will see you catch up on in the coming quarters? Or how should we look at that?

Soren Lonning: Let me try to address that. I may have to go back and address some of it. If I take the plant health first. We are not specifically quantifying it because it is only – only constituting a few percents of the business, so that is roughly what you should expect at this point in time. It is still human health and animal health that are by far the largest areas in this.

In terms of the long-term guidance for Health & Nutrition, I think you are trying to get me to specify how large the deviation will be for the year. I would put it this way that we do still believe that we will see growth in Europe for the year.

And I think then you can do a little bit of math if the currency effect is to the tune of four, 5 percent in this business year. But we do still expect to grow...

Lars Topholm: That would mean you have to grow a little bit more than 4, 5 percent organically?

Soren Lonning: Yes.

Lars Topholm: I just did the math.

Soren Lonning: Yes, yes. So I hope you get a feel for what it means when we say below double digit.

Lars Topholm: But you're not able to quantify the specific destocking effect?

Soren Lonning: To be honest, we don't have full transparency on this. But given that the market is still growing in North America in this one, it is a sizable effect for the North American market.

Lars Topholm: Well, what is “sizable?” I'm a bit lost here.

Soren Lonning: But I cannot give you a precise answer to this, Lars. But when we have a decline in North America in dietary supplements and the market is still growing, then it is an important driver of what happens for our specific business in North America in Q1.

Lars Topholm: OK. So it means the products you are supplying through are still growing?

Soren Lonning: Our...

Lars Topholm: In sellout from your customers?

Soren Lonning: And some of our customers are still growing in the market. There are also some that are more challenged. But overall, the market is growing. And overall, our customer base is growing in the end market. But we are negative in this quarter, so inventory has an important impact for us. And lastly...

Lars Topholm: Sorry, just if I can follow up on Health & Nutrition? Because you also mentioned that your customers are more brick-and-mortar exposed maybe than the average market or more exposed than those winning some traction in the U.S. right now. But what can you strategically do to get the stronger online presence given that you have an indirect sales model?

Cees de Jong: No, it's not us that's doing that, Lars. The point I wanted to make, and it's a nice lead-in, is that some of our customers are very dependent upon maintaining their probiotic dietary supplement brands.

One of our customer's wins is more than 50 percent of its sales of that particular unit or group is in dietary supplement probiotics. So they're very committed to making this happen. This particular company has just been bringing onboard additional competence to also become better in the online segment. They are by far the number one in the brick-and-mortar.

They have noticed that they missed a bit what was going online, acted very swiftly and basically brought on people that they brought in from Amazon. And I don't think there's any better company to help win when they've worked with Amazon.

So that's an example. And again, what we have to remember here is that in the end, in a world where people today have access to much better information, the better science is going to prevail.

This is not consumers that want to be tricked and want to spend money on a product that's not working. And there, Chr. Hansen is backed by all the good science on all our products. There was one last question that we didn't answer, Lars.

Lars Topholm: Yes, that was in Natural Colors, if you still have some catching up to do in terms of price increases. So we -- from a price increase perspective, you'd expect some margin momentum in the coming quarters?

Soren Lonning: I would say that we have some product categories where we are adjusting downwards and some where we are adjusting upwards. The key driver of the margin swing here in Natural Colors was actually raw materials prices impact on inventory, not so much at our end customers.

And as you may remember, we discussed this also in the Q4 call, we did have from that the inventory effect, we did have a positive effect in Q4. I think we flagged it around 2 percentage points positive in Q4 Natural Colors, but also clearly stated that we will see a swing -- a negative swing into the first half of '18. And this is exactly what we've seen.

So we have in Q1 seen a negative impact of these changes, raw material changes, price changes on our inventory of between 1.5 and 2 percentage points. So that is the key driver of this and, to a lesser extent, the prices to the end market.

Operator: And your next question comes from the line of Fulvio Cazzol.

Fulvio Cazzol: I have two. The first one is on the Food Cultures & Enzymes. I noted that the pricing that you're getting of around 2 percent in the quarter is less than the currency headwinds. And if I go back to 2016, I know that actually, through the euro pricing strategies that you use, it should be a little bit more balanced.

So I was just wondering, is there a lag effect on some of the euro pricing, which would mean that, that pricing line should accelerate as the quarters persist? So that was my first question.

And then my second question, I apologize, but it's on the Health & Nutrition North America issue. I'm just trying to understand the parallels between the situation in North America today and the European probiotics for yogurt situation a few years back, i.e., some competitors making claims that are not credible, the regulator coming in and basically then impacting the entire market. How should we think about the two case studies?

Let's say, could there be a risk that in Health & Nutrition North America, regulatory changes could actually impact the growth of the entire category and consumer confidence could reduce on some of the health claims across the board?

Soren Lonning: If I address your first question, then, of course, we have some markets where we are not pricing in euro price list. This includes North America as the most prominent example. And it means that you cannot necessarily deduct what it has been in the past, the delta between the organic and euro growth.

So in this case, given that the U.S. dollar has declined quite a lot compared to last year, then you see the difference. There's no changes in our euro price list mechanism (base). It is more or less a live thing that we do. It's adjusted very fast, so no changes to that.

Cees de Jong: Let me take your second question, and I think it's a great question. I understand where you're coming from. But what happened in Europe and EMEA at the time when the European agency stepped in was that we had yogurts on the market that made claims that could not be substantiated.

And one of the major suppliers of yogurt was basically saying, if you take this probiotic today, you're healthy. Tomorrow, you will be even healthier. And that claim could not be substantiated by good science.

And then what happens is that the regulator came in and banned the use of the word probiotic on dairy product. I think the situation in the U.S. is slightly different. There's a quite litigious environment.

And the people who are putting their dietary supplements out there, they don't dare to make these claims. So the only claims that they make is that in the bottle or in the sachet are a significant number of bacteria or a significant number of different bacteria.

I would urge all of you to go online or into a Whole Foods and look at the shelf. What you see is people advertising, there's these different strains in and they're in at these volumes. And probably they are. They don't make any further claims.

They don't say that those strains have any health benefits because they can't and they don't dare to because then they will be taken off market by the FDC. Nor do they make claims that these bacteria do the work where they need to do it, nor do they make claims that the bacteria are stable over a prolonged period.

And that is exactly what our customers will begin addressing. And that's exactly the sort of science where we have the documentation and the studies done to back it up. So I think this -- I understand where you're coming from, Fulvio. I think it's a very relevant question. But I do believe the situation is different.

And just to build on that, you should probably Google buyer probiotic dietary supplements withdrawn from the market. I think this happened back in 2015 or thereabouts. I'm not exactly sure. And then there were claims made by a U.S. seller of dietary supplements that could not be substantiated. They were forced off the market.

Operator: And the next question comes from the line of Annette Lykke.

Annette Lykke: So Soren, I was just wondering what it would mean to your overall margin for the group that you are enjoying your expectations for HND and (earned it for FC&E). I was -- thought it would have a positive effect, if you could elaborate a little bit on that?

And then also, if you could just share with us a little bit more what the first sales has been and what situation has been for your bioprotection's second-generation products? And should we expect any sort of acceleration of the growth? Or has it just been a very strong Q1?

Soren Lonning: OK, Annette, let me address your first question in terms of the margin. You are right that we -- the higher sales in Food Cultures & Enzymes have a slight positive effect on our mix. So from that point, you are right, but it's not of such a magnitude that, that influence our overall assessment of where we'll end the year.

Bear in mind that when you look to our gross margin, then it's relatively on par between -- in our microbial platform between Food Cultures & Enzymes and Health & Nutrition. And that's what really matters when we look to changes in our revenue projections. So there is a small positive effect, but it's not material enough to impact our outlook.

Cees de Jong: Let me take your second question on bioprotection, Annette. What we've been doing, and I'll get to what the application areas are in a second, what we've been doing is we've taken our entire collection of 30,000 strains to look for those strains that have the strongest possible bioprotective mode of action. And that enables us now to target markets that were a little bit more difficult before.

And you need to think of Latin America, you need to think of Asia Pacific, where in Latin America, we now can replace chemicals that were used to keep the yogurts fresh and safe; and in Asia Pacific, we can help our customers to extend shelf life. And initially, I was thinking that it had to do with hygienic conditions in some of those facilities.

But it's more important to recognize that even when the facilities in those geographies are of top quality, the moment the yogurt leaves the facility, they're being challenged. It's either high temperatures, it's either cold change that are not intact. And there, we have now seen that we have solutions that will help the customers in those markets.

Actually, this morning, we had an internal presentation where we have compared our products to those of competition. And what we then see is that our products are significantly stronger than those of competition. So it's clear that we were not the first in the market with bioprotection.

But by now -- by far, we have the Number One position. And also, when we compare ourselves to new entrants, their solutions are less strong. And the sole reason for us being in that position is that we have a broader base, a significantly broader base to work from, and that's the 30,000 strains.

And then finally, obviously, (displays) to a consumer trend where consumers look at the label, and they don't want artificial preservatives in that label. So when you use bioprotection, you'll have a complete (thin) label.

And then back to your question, what does it do for the numbers? In Q1, it's hardly moved the needle. I mean, in Latin America, we had some wins. For this year, that will be also quite modest. Normally, in dairy, it takes time before people start adopting the new solutions. However, the outlook, of course, is quite positive.

And to see an acceleration in the growth rate that is already around 45 percent, i.e., that will probably be a tough ask. But we foresee very good growth in this category. So when we look at Food Cultures & Enzymes, the fundamental business does well, but also bioprotection is a fantastic lighthouse to have next to that.

Annette Lykke: Can I ask if you have made any second-generation sales to China? Or maybe would you find it likely to make it this year? Or will that also be something in '18/'19?

Cees de Jong: No, in China, we could probably make it this year. The first quarter, there were no sales in China, to the best of my knowledge. But I don't know all the individual sales. But this year, I will be disappointed if we haven't.

Operator: Your next question comes from the line of Arthur Reeves.

Arthur Reeves: Two questions from me. On the long term, we haven't talked much about animal health yet. What's happening on the antibiotic shift? And then could you just update us on any changes that have happened to your microbiome project, please, over the quarter?

Cees de Jong: Let me take those questions, Arthur. The outlook for animal health as, by the way, was the Q1 growth, is I think unchanged positive. When -- the awareness of antibiotic usage in the feed chain is unchanged. A large number of investors are playing in the field. And well, maybe let me give you just one number.

In 2015, only 10 percent of the poultry produced in the United States was antibiotic-free. That's now gone up last year to above 40 percent. And I think that the trend is unchanged. It also means that some of the traditional providers of antibiotic into feed are struggling. But the awareness is so high, and we expect this to continue to be a driver.

In addition there, too, what we've been explaining in previous occasions is that we're launching better products. “Better products” meaning that there is a higher yield gain when it comes to feed conversion ratios -- so from the same amount of feed, the animals grow better. And we have products that reduce mortalities to some extent better than previous products.

And in all fairness, we're trying to get our arms around as to what the productivity gain of the widespread use of antibiotics has really been for the farmers. The farmer has just been brought up by, “OK, if we use antibiotics, it works quite well.”

But it would appear that the productivity gains are actually not as high as previously expected. And then when you see that you can reach 3 percent to sometimes 5 percent productivity gain with probiotics, it makes it a quite powerful solution.

Now the sale of animal health probiotics is a highly technical sale, so it's not something that we can do with distributors. It's different from essential amino acids. And that means that we need to set up our infrastructure, our route to market in all the relevant markets. And that's what we've been doing in the United States.

It's worked quite well for us. It's also the business that was (protected) best when there was volatility in the agri end markets. And we're now copying that in relevant other markets, in EMEA and some markets in Asia. So outlook, unchanged, positive, and I'm sure we'll come back to that on the Capital Markets Day.

Microbiome, unfortunately, a lot of the things that happened there do not -- and we're not able to talk about it rightly. We need partner permission to talk about the things we're doing. I think it's fair to say that the progress that we've made technically is, yes, is impressive.

We've recently opened a whole new lab here in the science park where we avail of the really latest equipment where we can deal both with very difficult anaerobes and also milder anaerobes.

And then when you look at the segment itself, apart from all the numbers you guys can find on the investments that go into this at the end market, that I consider less relevant. I consider more relevant that the science community is now finding out that some of the bacteria, which we've been knowing at Chr. Hansen for a long time, which we would consider the more easy bacteria, are equally relevant in the microbiome space.

And that opens up certain opportunities for us. I hope you would allow us to come back at this at the April Capital Markets Day.

Operator: And the next question comes from the line of Ben Gorman.

Ben Gorman: Just one left from me, I think. In terms of Health & Nutrition, thinking about the margin progression there and obviously, flat pricing again.

So to clarify, within human and animal, I'm guessing, still, you're not giving anything away on pricing, despite the difficulty in the U.S., so still remaining quite firm there. Is that something which is a very clear strategy for you guys and not planning to move on that?

And then, in terms of the margin progression, as animal progresses into other categories, specifically more into poultry and swine, my understanding is that, that is inherently a lower-margin business. And is that something that you think is going to slow down margin progression in your long-term forecast?

Soren Lonning: Yes, Ben, let me address those two questions. Yes, we, of course, try to stand firm on pricing in these segments. And then, as you will see, the numbers are flat, of course, reflects that there are some where we see a small decline; and then in some areas, we have been able to increase our prices.

So from a margin point of view, looking forward in the near term, that's also what we expect. And this is also why we guide around 30 percent in the long term for Health & Nutrition.

When you refer to the animal health segment and which product categories that have highest to lowest margin, you're right that we see a somewhat lower margin on the poultry side. It's not hugely different, but we see a slightly lower margin here.

And that is, of course, a result of a -- especially in North America -- very consolidated customer base. And also, this is where we see most competition and most companies entering the space.

That's the easy place to start, you can say. When it comes to swine, these products are very interesting from a profitability point of view. And they are on par with the high end of the range, so that's not a low-margin category for us.

Ben Gorman: To clarify very quickly, if I can, on that. I know that you've obviously talked about the new competition coming in, in poultry categories. But are you still quite insulated from new competition in beef, in cattle probiotic?

Soren Lonning: The competitors exists, so we -- it's not -- we don't have the market for ourselves. But it's clear that the competitive situation is completely different from what we see in poultry right now.

It is much more difficult to develop products for the cow's stomach. It's a much more complicated process, and that makes it more challenging for companies to enter this field.

Ben Gorman: All right. So there's no change in that message.

Soren Lonning: No. No change, no change.

Operator: And the next question comes from the line of James Targett.

James Targett: Just a quick one from me, on Natural Colors, actually on the organic growth line, I just wanted to talk about the phasing a little bit of growth throughout the year, particularly the SKU reduction.

I think, in carmine, I think you're cutting about 1,500 SKUs. So where we are there and if that's going to continue to be a headwind from Q2. And then the customer order timings in North America as well, which you said impacted Q1, should we expect that to -- or fully recovered by Q2?

Soren Lonning: Let me address this one, James. If you look to the timing in North America, it's predominantly a Q1 thing. And it also means that although we declined slightly, we do believe that we will end up with quite attractive growth in North America for the full year. That is our expectations at this point in time. And then your first question, could you repeat that again, James?

James Targett: I think you're talking about SKU reduction last year in Natural Colors, I think about 1,500 SKUs, and I think carmine was probably the main one. To what extent will that continue to be a headwind on growth from Q2?

Soren Lonning: Yes. We're basically doing two sorts of profitability initiatives on the SKU side. We are doing, first, where we saw business with selected customers, primarily with the carmine, that we thought was uninteresting from a profitability point of view, that was what we addressed first. And then we've been on a journey also to overall reduce our number of SKUs by up to 40 percent as a complexity reduction measure.

So both of these levers will be smaller as we progress during the year, but we will not be completely done here in Q1, and we'll not be completely done in Q2 either. So we'll see a smaller effect for the remainder of the year.

Operator: And the next question comes from the line of Faham Baig.

Faham Baig: Faham Baig from Credit Suisse. Can I come back to Natural Colors and understand the conversion taking place in North America and how that's developing this year and how you expect it to develop over the next 12 to 18 months?

And sticking on Natural Colors, the mid-teens margin guidance, when should we expect that to (result)? Should it be in the next year or two? Or should we expect it further out?

The other question is on the U.S. Could I understand the impact of the U.S. tax reform on your tax rate as well as any other impact? I know your tax rate is already quite low, but what impact that may have?

And finally, on depreciation in Food Cultures & Enzymes. I believe you will start depreciating the new capacity from the next quarter. What impact should we expect on a quarterly basis?

Cees de Jong: Why don't we start at the end, and then we'll work our way back to the first questions? We'll see who picks up what, but I think depreciation, Soren, that will be you.

Soren Lonning: Yes. So if you look to the depreciation, then it was an investment of -- to the tune of EUR 45 million. We'll depreciate it over roughly 15 years. It means it's an annual impact of around EUR 3 million, so it means that's a little bit less than EUR 1 million per quarter.

Bear in mind that we didn't start at the beginning of Q1. We started during Q1, so we'll have -- that effect will be slightly larger in the coming quarters, but then some other things will change and makes up back to (play). So that's the answer on that one.

Then on the U.S. tax reform, what I can say here is that it will fall for the short- and mid-term. It will have quite limited effect on Chr. Hansen. We'll have in the very short term, over the next three, four years, we will have some -- a smaller positive effect from the lower tax rate and also rules that now allows a faster depreciation of certain assets for tax purposes.

If you look beyond the four, five-year horizon, there's a little bit more uncertainty of what the base erosion will actually mean. Right now, we are below the threshold where these rules apply to. But once we get over that, and we will probably be there in five years' time and maybe a little before if things go well.

Then we could have a negative effect from that, not very large, but there will be -- could be a smaller negative effect. But it's still highly uncertain, and we will, of course, try to look at what we can do in that time horizon, so it gives us some time to adjust for that. So that would be the assessment of the tax reform, quite limited.

Cees de Jong: Let me take your NCD questions. In terms of conversion, we continuously see that go on. I think as recent as last week that Dunkin' Donuts announced that they now have taken out all the artificial colors out of their, how do you call that, toppings or casings -- what they put on the donuts.

And particularly, in the foodservice area, we've recently seen a lot of progress. I think we've talked about McDonald's before. We also see Pizza Hut out there. So it's a trend that continues with some of the major companies.

Some of the projects go as planned, some of them go slow. And then we even had one company, towards the end of last year, reintroducing a very colorful product, and they didn't particularly get a lot of compliments on that. We think it's a continuous process.

And you have to remember that what is happening there is that it's not just about taking out the artificial color. Particularly when it comes to the confectionary area, the beverage area, people are trying to take out all the artificial ingredients, and that takes work.

Now in terms of the margins, remember that we had said that in the current plan period, we would want to take NCD to mid-teen margins.

And when I was asked to specify that a little bit more detail, I said I would want to have it somewhere in the middle of the plan period, that will be this year. I'm not saying we are. But with 13 percent or 12.9 percent, I think, we had last year, I think we're very well under way of improving the EBIT for Natural Colors.

Operator: We have time for one further question, which comes from the line of Hans Gregersen.

Hans Gregersen: Two quick questions. I'm not really sure whether I have the right name in English, but there is a bacteria called Akkermansia, which have some quite beneficial health impact. Is that one of the projects you're looking in, within Health & Nutrition? That's the first question.

Secondly, going back to the bioprotection, do you have any -- or can you give a little bit further insight into how penetrated you are in the dairy market and if there's any major wins, as such, being up for decision in the short term?

And then finally, in terms of the cheese market where you still have a lower conversion rate than in yogurt, are you currently in dialogue for any major conversions with major cheese producers anywhere, not names, but just confirming whether you're in dialogue?

Cees de Jong: I'll take the first and third question, Hans. Obviously, I cannot comment to the individual projects that we do in microbiome. But the name is Akkermansia, and maybe that's a little bit too Dutch pronounced.

But let me tell you that it's a bacteria that's very well-known to the people in Chr. Hansen working in microbiome. With that, I have not confirmed that we do a project on it.

And then your third question, on cheese conversion, cheese conversion is an important driver for our growth. You will remember that not so long ago, we've converted one of the largest cheese manufacturers in the world. And we are in continuous dialogue with relevant cheese manufacturers to convert them. That is also a process that takes time.

This large cheese manufacturer or one of the largest, maybe the largest that we converted recently and that still contributes to the growth in Food Cultures & Enzymes, it took us three years before they gave us the green light to start introducing our solutions in their plants.

And so it's not that any given time, we start and stop projects. It's a continuous dialogue that we have with these players. And one of the activities that we have is to make our portfolio of solutions stronger so that for these ultra-large manufacturers, we can provide the right solutions. Soren, you want to take the (mid) question?

Soren Lonning: Yes. In terms of penetration in the bioprotection segment, then when we look to fermented milk or the yogurt part and the meat -- and with meat, here, I am thinking certain niches where it applies today of the market. Here, we see a penetration rate in the market of below 10 percent still, where we see probably most movement in the fermented milk market. So this is where that has been moving fastest.

And then if you look to -- turn to the cheese segment, we guide below 5 percent penetration. And here, it's really below 5 percent penetration. So that gives all the penetration rates for bioprotection solutions in the market.

Hans Gregersen: Soren, how much does bioprotection account for of divisional revenues today in Food Cultures & Enzyme?

Soren Lonning: I think one year ago, we said around 5 percent. It has obviously outgrown, so now we are a bit above the 5 percent, but we are not closing in on 10 percent yet. That's...

Hans Gregersen: 6 percent, 7 percent is a good guess?

Soren Lonning: That will be a reasonable assumption, Hans.

Cees de Jong: Thanks for your questions, Hans. I would like to thank everybody for participating on this call this morning. We're a little bit over time, apologies for that. But operator, we need to close it here and now. Once again, thanks, everybody, for listening in.

Operator: Thank you. That does conclude our conference for today. Thank you for participating. You may all disconnect.

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