# Chr. Hansen Holding A/S
# Q4 2018/19 Results
# Conference Call Transcript

**October 10, 2019**
**10:00 a.m. CET**

Operator: Thank you for standing by. Welcome to the presentation of Chr. Hansen's Results for Q4 2018/2019. At this time, all participants are in a listen-only mode. There'll be a presentation, followed by a question-and-answer session. At which time, if you wish to ask a question, you will need to press "star," "1" on your telephone. I must advise you that this conference is being recorded.

I would now like to hand the conference over to your speaker today, Chr. Hansen's CEO. Mauricio Graber. Please go ahead.

Mauricio Graber: Thank you. Good morning, ladies and gentlemen, and welcome to Chr. Hansen Investors and Analysts Call on the publication of our 2018/'19 Annual Report. As usual, together with our CFO, Søren Westh Lonning, we will first give you an overview of the business developments of the last months before we open the line for questions and answers.

Before we move on, please take notice of the safe harbor statement on slide two.

Thank you. Let's continue.

2018/'19 was a solid year for Chr. Hansen, although clearly not without challenges. Market conditions made it more difficult for Chr. Hansen to grow at the level of our ambition this year. And whilst we ended 2018/'19 with a solid growth of 7 percent, in line with our revised guidance range, we have aimed for a better finishing, particularly in Natural Colors and Food Cultures & Enzymes.

There is no doubt that for a growth company like Chr. Hansen, a quarterly organic growth number of 2 percent is clearly not what we aspire for, nor what our investors expect from us. Macroeconomic headwinds in emerging markets, raw materials price declines in natural color pigments and customer dynamics negatively impacted our performance in the second half of the year.

However, we must also be self-critical and acknowledge that in certain parts of the business, we simply did not live up to our own expectations and could have done a better job at delivering good results, for example, in Natural Colors, in Animal Health and in Food Cultures & Enzymes specifically in Asia Pacific.

Considering the softer top line performance then, we are satisfied that we deliver on our quarter two financial guidance metrics. EBIT before special items came in at 29.6 percent, 40 basis points above last year. The increase was mainly driven by scalability benefits from our Copenhagen site expansion that was largely offset by investments in our lighthouses and other strategic priorities.

Free cash flow before acquisition and special items grew by 17 percent to EUR 229 million with a sizable contribution from the sales and leaseback of our headquarters here in Horsholm.

To dive a bit more into the Q4 dynamics, please turn to the next slide. As expected, the fourth quarter, we saw a meaningful slowdown across all three businesses with different moving parts.

Let me start with Food Cultures & Enzymes. We delivered 3 percent organic growth in Q4, leading to 8 percent for the full year, slightly below our guidance. In line with our expectations, the tailwind from euro pricing faded in the fourth quarter, but we saw a further deceleration in volume growth slightly beyond what we anticipated.

Whilst our core categories of cheese, fermented milk and enzymes delivered solid growth in line with our long-term ambition, our probiotic business, which has a sizable exposure to the Chinese market, continued to be challenged, and bioprotection did not deliver the growth that we have hoped for. We have always said that it's not a straight line to reach the lighthouse target, but it does also become clearer over the last 12 months that we need to step up our effort in bioprotection. So, excluding probiotics and bioprotections, FC&E performed very well and in line with the growth model.

But it is also true that we saw headwind from emerging market intensify. Particularly in Latin America, Middle East and China, some of our customers are increasingly under pressure to realize cost savings as end consumers are looking for more affordable products. This creates a headwind for us. But let me note that it also creates an opportunity to help them drive efficiencies with our products.

Turning to Health & Nutrition. With 9 percent organic growth for the year, we delivered on our guidance for 2018/'19, but we also saw a noticeable decline to 4 percent organic growth in Q4. Most of this step-down is related to timing in Plant Health business, which has had a great year. So, while this decline in Q4 for Health & Nutrition may have come as a surprise to you, it's purely related to order patterns.

Dynamics in Human Health are unchanged with infant formula driving growth globally both in Q4 and for the full year. For dietary supplements, we continue to see market growth in large sales markets like the U.S. below historic levels, which is why it will be increasingly important for us to expand our product offering and customer base.

In Animal Health, I am pleased to report that in the U.S., we have seen further signs of improvement in the underlying market in Q4. However, what is more important than farmer economics is our ability to drive sales and strengthen our market position. And with a fresh view from our new leader in Animal Health, we concluded that we need to put more emphasis on self-execution and distributor management.

Moving on to Natural Colors. We ended the year below guidance at 3 percent organic growth because we saw a further erosion in business with negative minus 2 percent organic growth in Q4. Our large exposure to annatto and carmine, where prices are down 30 percent year-on-year, almost at historical low level, hurts us particularly in Latin America but also in EMEA. To put it into perspective, excluding annatto and carmine, our Natural Color business would have grown 7 percent for the full year.

But the weakness in Natural Colors was not only related to raw material price declines. The Middle East, which was supposed to be a growth driver for this year, contracted. And whilst our business in coloring foods grew strongly, we did not secure as much new business in Europe as we have planned for. The difficult macroeconomic environment in emerging markets is clearly visible when you look at our regional numbers.

Please turn to the next page. Our largest region, Europe, Middle East and Africa, declined minus 2 percent in Q4 and thus delivered a 4 percent growth for the full year.

Momentum across all three segments slowed compared to Q3. In Food Cultures & Enzymes, growth in the core dairy business was offset by weaker demand in Turkey and Middle East as well as lower probiotic sales and a decline in wine cultures due to a late season.

In Health & Nutrition, we saw a decline in the business, but that was mostly because of timing of orders in Animal and Human Health business.

Lastly, Natural Colors declined because of the already mentioned weakness in the Middle East and its carmine and annatto exposure.

In contrast to EMEA though, North America developed quite positively in Q4. Organic growth was 9 percent in the fourth quarter, leading to 7 percent for the year. Whilst growth in Food Cultures & Enzymes came slightly – came down slightly because of less momentum in cheese and a decline in probiotics, Health & Nutrition grew strongly driven by both Animal and Human Health. And in Natural Colors, we see double-digit growth in North America driven by the large conversions – wins that we have already talked about earlier this year.

Finally, in Latin America, growth came down to 2 percent in Q4, leading to 21 percent for the year. Excluding Europe pricing, organic growth in the quarter was minus 2 percent. While growth in Food Cultures & Enzymes was strong except for Argentina, Health & Nutrition declined largely because of order patterns in Plant Health and Natural Colors was impacted by raw material price declines and general lower demand for Natural Colors in the challenging economies of Latin America.

Lastly, coming to Asia Pacific. Organic growth was in line with last quarter, leading to 3 percent organic growth for Q4 and 4 percent for the full year. While Natural Colors faced another soft quarter and momentum in Health & Nutrition was impacted by the African swine fever and less momentum in dietary supplements. We saw improved growth in Food Cultures & Enzymes and no further deterioration as some may have feared. Food Cultures & Enzymes in China grew slightly, though solid growth in fermented milk was largely offset by the continued weakness in dairy probiotics.

It should also be noted, the comparable for Q4 was slightly easier as we saw the slowdown in China start at the end of the last financial year, meaning that the overall market dynamics that we discussed in depth last quarter are unchanged. So all in all, a more challenging market environment for Chr. Hansen and a fourth quarter that clearly fell short of our ambition. However, we strongly believe that Chr. Hansen should not only be judged by the performance of a single quarter but equally on the merits of our long-term opportunities.

And if you turn to the next page for our Nature's number one strategy update, you can see that over the last 12 months, we've made good progress in further developing the business and building a solid foundation for Chr. Hansen industry-leading growth trajectory.

The technology that we master, our microbial platform, is incredibly powerful. And having been in business for more than 145 years, Chr. Hansen has a huge competitive advantage. We are only now starting to understand which role bacteria play in our daily life beyond fermenting food and which business opportunities can arise from our collection of around 40,000 strains, whether it is in improving health or making agriculture more sustainable. Not least, the recognition that we received from Corporate Knights as the World's Most Sustainable Company in the World is a testimony to the area of good bacteria that lies ahead of us.

If we look at the progress in our segments one by one. For Food Cultures & Enzymes, it's all about leveraging the full potential, and I see ample room for us to further grow our business, both in the existing categories via upselling and innovation but also and increasingly so in the new adjacencies like bioprotection, fermented beverage and plant-based alternatives. And we are making good progress here. The Sweety culture for low sugar yogurts or the CHY-MAX Supreme enzyme which allows cheese makers to achieve a meaningful yield increase in their production, are two really good examples of launches that came out of the R&D pipeline recently.

Digital services are another promising field that we're developing and even though it's still very early days.

Lastly, 2018/'19 was also a good year for our plant-based alternative business. We are receiving more request (and briefs) also from large brand owners that want to enter this fast-growing segment.

Turning to Health & Nutrition. I'm really excited to talk about our human microbiome lighthouse, where we reached a huge milestone by signing the joint venture with Lonza, our newly formed company now called BacThera, which we'll operate as a contract manufacturer for live biotherapeutics, received antitrust approval at the end of August. With that, we have started to upgrade our existing facilities here in Horsholm and equip our labs in Basel and expect to complete the first wave of investments by December 2020. However, already now we can start doing preclinical work and have good discussions with first potential customers.

Our second lighthouse in Health & Nutrition, namely Plant Health, as already mentioned, had a fantastic year. We continue to roll out products in Latin America, and I am very proud to report that we also generated first sales outside of sugarcane this year.

With regard to the U.S. market entry, we now have all registrations in place to start selling, and first trials with distributors are ongoing. To further advance our R&D pipeline, we also opened a new lab here close to Copenhagen where we will work on screening and strain improvement for the next generation of plant probiotics.

In Natural Colors, we continue to strengthen our portfolio with the launch of the HANSEN SWEET POTATO and coloring food alternatives to carmine and synthetic red. And we also launched a new pet food range that was very well received by the market.

And with this, I would like to hand it over to Soren for a further deep dive into the segment numbers and group financials.

Søren Westh Lonning: Thank you, Mauricio, and good morning also from my side.

Food Cultures & Enzymes ended the year on a soft note with only 3 percent organic growth in Q4 leading to solid 8 percent organic growth for the full year. Whilst pricing remained intact in Q4 with 1 percent, despite increasing cost pressure from some customers, volume growth came down to 2 percent and that was because of the already-mentioned weakness in probiotics and bioprotection that largely offset solid growth in our core categories: fermented milk, cheese, enzymes and meat, which grew in line with our long-term financial ambition.

In probiotics, our sales in North America and EMEA were negatively impacted by large-volume brands losing market share. And whilst we've had good wins with new brands, also in plant-based alternatives, the volumes are still very small with the net impacting negative for us.

In addition, China, our largest dairy probiotic market, declined but not because of the entrance of new players but mainly because of the preference shift of consumers, which we believe is partly driven by the increase in food inflation in China. As we have talked about last quarter, we have equally strong positions in both ambient and chilled yogurt, but upselling opportunities in the ambient space, which is gaining share, are more limited, which is why the shift in consumer preferences has a negative revenue mix impact for us.

In bioprotection, we delivered double-digit growth for the full year, but Q4 was soft as we had a high comparable from the ramp-up of the second generation last year but also because we saw a decline within the cheese segment, which offset most of the growth in fermented milk and meat.

So overall, we saw solid growth in our core business in line with the long-term growth model but a negative impact from our added functionalities categories.

Looking at profitability for the business area. The relatively low revenue growth affected our EBIT margin for Food Cultures & Enzymes, which decreased by 1.4 percentage point in Q4 to 38 percent. Furthermore, there was an impact from strategic investments and inventory reductions at our sites which were only partly offset by underlying scalability in production.

For the full year, the EBIT margin was on par with last year as investments in bioprotection, digital and other strategic initiatives offset the scalability benefits of about 1 percentage point from our Copenhagen site expansion.

Coming to Health & Nutrition on the next page. Human Health delivered solid organic growth, both for the quarter and the full year. Whilst in Animal Health, we saw a further improvement in Q4 leading to overall good growth for the year.

Plant Health reported very strong growth for the year, but order patterns led to a decline for Q4. And I can already now flag that we will also see an impact next quarter.

Within Human Health, infant formula continued to be the main growth driver globally with strong growth both in Q4 and for the full year. Dietary supplements declined in Q4 and was flat for the full year, with the main drivers for Q4 being slower market growth in the U.S., order patterns in EMEA and lower promotion activities by customers in Asia Pacific. Please note that the strong growth in dietary supplements that we saw in North America in Q4 was mostly because of timing of orders and will reverse next quarter.

In Animal Health, all species contributed to solid growth in Q4 with a very positive development in cattle in the U.S. market, whilst our APAC business was challenged by African swine fever, and EMEA was impacted by timing of orders in our silage business.

If we look at the margin development for Health & Nutrition, the EBIT margin in Q4 and for the full year improved driven by favorable product mix and a small contribution from currencies, which were partly offset by strategic investments.

Let's continue with Natural Colors on the next slide, and we can keep this short as we have already talked about the main drivers. As already said, organic growth in Natural Colors decelerated further to minus 2 percent in Q4 and 3 percent for the full year. And whilst we continue to see strong growth in our premium segment, coloring foods, this was not enough to offset the impact from declining raw material prices and softer demand in emerging markets.

Whilst the top line performance is clearly not satisfactory, we managed to achieve a solid improvement in the EBIT that grew by 8 percent in FY '19, also by deliberately passing on some low-margin business and maintaining an attractive return on invested capital. And as I keep emphasizing, these are the most important metrics for this business.

To get organic growth in Natural Colors back on track next year, we have restructured the sales organization in Europe and APAC to better serve the specific demands of our customers, and this is what you see reflected in the Q4 margin together with an unfavorable impact from currencies. The EBIT margin came in at 13.4 percent compared to 15.3 percent last year. For the full year though, we saw an increase to 12.7 percent driven by operational efficiencies and lower raw material cost that was partly offset by the organizational changes and currencies.

Moving on to the group financials on the next page. Group organic growth came in at 7 percent for the year with the volume component of 5 percent and a 2 percent contribution from price. The impact from currencies on the top line was minus 1 percent, whilst the effect from the Hundsbichler acquisition was immaterial.

If we look at profitability drivers, gross margin improved by 1.3 percentage point year-on-year driven by all three business segments, whilst operating expenses increased by 1 percentage point to 26.6 percent of revenue due to the continued investments into Nature's number one initiatives. Overall, this led to an EBIT margin before special items of 29.6 percent for the year, up 40 basis point. The impact from currencies was overall immaterial. In Q4, the EBIT margin before special items was 33.3 percent compared to 33.8 percent last year mainly because of lower volume growth combined with the strategic investments.

Turning to the right side of the slide. Free cash flow before acquisitions and special items came in at EUR 229 million, EUR 33 million above last year driven by the completion of the sale and leaseback of our main site in Horsholm.

Operating cash flow was on par with last year as higher taxes paid due to the absence of acquisition-related benefits offset the increase in operating profit.

Operational investing cash flow came in at EUR 72 million net of the inflow from the sales and leaseback agreement, which was closed at the end of August and, as such, in line with our revised guidance of significantly less than EUR 110 million to EUR 130 million.

Capex as a percent of revenue was 12 percent compared to 10 percent last year, which is a step-up from historic level but in line with the expanded capex program outlined at the Capital Markets Day. It was below what we initially planned for the year as some of our projects were delayed into next year, and this phasing means that the capex for 2019/'20 will still be at an elevated level.

With this, I would like to come to the guidance for next year. Please turn to the next page.

As we don't expect a material improvement in trading conditions, at least not in the first half of the year, and Natural Colors raw material prices are expected to remain low, we take a cautious stance and expect organic growth for the group to come in below our long-term ambition in the range of 4 percent to 8 percent with a neutral impact from euro pricing.

We expect a weak Q1 with flat to low single-digit organic growth for the group. This is in part because of the specific challenges that we've seen in the business in 2018/'19 but also because there will be an impact from normalization of inventory levels in the distribution chain for Food Cultures & Enzymes. As we have seen demand come down in some markets during the second half of the year, we have identified higher-than-normal inventory position in parts of our distribution channel, and we expect these to normalize during Q1.

Also, order patterns in Health & Nutrition will not be favorable in Q1, and here, I would like to flag Plant Health again and also dietary supplements. For the remainder of the year, we expect our microbial platform combined to grow 7 percent to 10 percent, in line with the long-term ambition, and Natural Colors to grow low to mid-single digit. Our confidence in this guidance come from our view of the commercial pipeline in Food Cultures & Enzymes as well as the actions that we have been implementing to improve execution, and Mauricio will expand on this in a second.

The EBIT margin before special items is expected to be around 29.5 percent. And we will invest the scalability benefits from our Copenhagen site expansion and other operating efficiencies back into the business to further drive our lighthouses and other strategic priorities.

Maybe it's worth reiterating that we continue to see possibilities to further drive profitability as volume grow but that we have taken a deliberate decision to prioritize growth at this point in time.

Free cash flow before acquisitions and special items is expected to be around EUR 190 million. As we execute on our expansion program, capex is expected to be above the EUR 139 million realized in 2018/'19, and this is primarily related to investment phasing from 2018/'19 to 2019/'20.

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In terms of capital allocation, next page please, our priorities remain unchanged. We will continue to invest in capacity, R&D and our people to support our organic growth.

Secondly, we will also continue to consider inorganic growth opportunities to strengthen our technology platform or market presence. And over the last 12 months, we have done some work here to set up a more structured way to identify potentially interesting targets, mainly in our Food Cultures & Enzymes and Health & Nutrition businesses.

Thirdly, we'll remain committed to paying an ordinary dividend and distributing additional cash to shareholders in the absence of acquisitions or other corporate actions like the BacThera joint venture that we signed this year. For the financial year 2018/'19, together with the Board of Directors, we will propose an ordinary dividend of EUR 0.95 to the annual – per share to the Annual General Meeting, which will take place at the end of November.

And with this, I would like to hand back to Mauricio.

Mauricio Graber: Thank you, Soren.

Chr. Hansen is a growth company and in 2019/'20, our number one priority will be to improve and accelerate our execution of the Nature's number one strategy. I want to highlight six areas of growth execution focus.

As Soren said, we expect emerging markets to remain a headwind for our core dairy business, which is why upselling, innovation and further developing our adjacencies will become even more important.

For bioprotection, we have a good commercial pipeline and more than 500 customers currently using our products. And we feel very confident about the long-term growth potential and the value proposition we bring to customers. Also, we have stepped up our R&D efforts to accelerate the development of the third generation of our fresh new range to open up with the Asian market. And we invest more in our cheese range to facilitate the next bigger wave of growth and further increase penetration of this new technology. In China, the priority for next year is to sustain our existing business while investing into new innovation for the Chinese market and strengthening our market share with SME players and in the low-tier chilled segments.

Coming to Human Health, growth next year will be supported by launching new products and expanding our customer base.

In Animal Health, we have identified areas to strengthen our execution and will further expand our route to market with distributors and via direct selling outside of North America. Also, we will further roll out our most recent innovations such as GalliPro Fit and advance our new product pipeline.

In Plant Health, we expect another strong year in Latin America driven by sales in sugarcane and other crops as well as more contributions from our U.S. market entry.

Lastly, in Natural Colors, we will work harder to increase our coloring food sales in EMEA, win new conversion projects in the U.S. and strengthen our position in food services.

At the same time, we have initiated our usual biannual strategy review process. The result of this will be presented at the Capital Markets Day, which will take place on April 22 in Copenhagen. So please book your calendars already today. On the next slide, you will see the date.

Though I do not expect any fundamental changes to come out of this strategy process, we have many exciting growth opportunities in microbial and natural solutions produced via fermentation as our framework, but we will use this strategy review process to assess the progress of our growth opportunities and to stress test all the assumptions that we have for our business.

We are active in a very dynamic industry where the pace is accelerating and agility is crucial. And I want us to make sure that we have all it takes to stay ahead of the game.

To wrap up, 2018/'19 was a solid year for Chr. Hansen but not without challenges. While we made good progress in our Nature's number one agenda and, in particular, on our lighthouses of Plant Health and Human Microbiome, we didn't achieve our initial growth targets, and it has become very clear that in the current market environment, we need to roll up our sleeves and work even harder to raise the bar in term of growth performance. But I am 100 percent convinced that with the team that we have in place and our strong technology platform which caters to many megatrends, we will succeed.

Thank you very much for listening, and we're happy to take your questions now.

Operator: Thank you. For the Q&A session, participants are kindly asked to limit themselves to three questions only. As a reminder, if you wish to ask a question, please press “star,” “1” on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the “hash” key.

Your first question comes from the line of Jonas Guldborg from Danske Bank.

Jonas Guldborg: First of all, you're very detailed in your guidance, your outlook for the year, yes, even down to quarters also. Could you kind of elaborate on what is the biggest risks as you see it in this guidance? That's the first question.

The next question is on bioprotection. First of all, of course, I'd like to hear the dynamics behind the decline in sales in the cheese in this quarter. But also the comments you made about that you are increasingly convinced about the success of bioprotection and that you need to step up the effort. But especially how will you step up your efforts within bioprotection?

And then the last question is regarding the declining prices for annatto and carmine. What is driving this decline – price declines?

Mauricio Graber: Thank you. This is Mauricio. I will take on a high level the answer to your questions and passing on to Soren for more details.

So, on the guidance, we are providing a wider range 4 percent to 8 percent given what we view as a little bit more uncertain and volatile environment. And we're also providing the Q1 guidance because we think it's a little bit of a special quarter given the order phasings in Human Health as well as the inventory described by Soren.

I think the key aspect for us to deliver on our guidance would be to drive the growth in the areas that I just covered in one of our last pages. I think that's the fundamental and that we don't see any further deterioration of our trading conditions.

On bioprotection just quickly, so bioprotection, we are very confident on the value that it brings to customers. Most customers want what are clean labels. And our bioprotective cultures just represent a formidable way of keeping products fresh and using the power of good bacteria. But we need the technology to work across areas where it has not worked so well, and one of them is in cheese. That's a very conservative industry and where we need to drive better technical performance of our bioprotective cultures.

Soren, with that, I will pass it to you to comment a little bit more on those topics and the prices on annatto and carmine.

Søren Westh Lonning: Yes. So, both carmine and annatto are two raw materials where we historically have seen volatility. And it's often linked to harvest conditions which has been favorable. It's been linked to more farmers moving into this category, combined creating a higher supply than there is a demand for. And that is what is also maybe driving down prices in these categories. And over time, it will find some sort of equilibrium, and then other events can then drive it up or down again.

But we believe that the price level that we have now is sort of the – is at a – we see in the raw material side is at the lower level of what we can foresee because it's become – it's starting to become less attractive for farmers to move into the category, and hence, it will limit the supply.

So – but it takes some time. I think that's an important point. From you have the low point in the raw material, it takes some time before that is translated fully into our sales prices. There are some delays going up, but there's also some delay going down, and that creates a little bit of extra timing when we consider our sales and organic growth in Natural Colors.

Jonas Guldborg: So, could you just remind me of the lag time here? Is it around a quarter or what?

Mauricio Graber: It would typically be a little bit be more of a quarter, it will be more to the tune of around – more of a half year at least.

Operator: Our next question is from the line of Lars Topholm.

Lars Topholm: A couple of questions from me also. First, on Food Cultures & Enzymes and probiotics, which seems to be a big reason for the lower growth, can you give us some insight into how much of revenue in the division is probiotics and how much of your Chinese revenue in Food Cultures & Enzymes is probiotics, just to understand the growth dynamics?

Second question, also to Food Cultures & Enzymes, you flag, what you call it, muted Q1. Could Food Cultures & Enzymes contract in Q1? And can you quantify what effect you have factored in for Q1 from this destocking you were mentioning?

And then question number three – I have more, but then I'll just jump back into the line. In bioprotection, your lighthouse ambition is EUR 200 million in revenue by 2025. On my numbers, and that assumes it is 7 percent of current Food Cultures & Enzyme revenue, you need to grow 27 percent CAGR to reach that. Are we not at a stage where it would be advisable to reduce that long-term targets? And if not, then why not?

Søren Westh Lonning: Let me address your questions. If we start by the Q1 contracting in the distribution channel, we – on a full year basis, we assess this impact to be less than 1 percentage point. So, it will be – we expect some percentage point negative impact in Food Cultures & Enzymes in Q1 but less than 4, you can say implicitly. It also means that we do not expect a contraction in Food Cultures & Enzymes in Q1. So that's not what we expect.

On bioprotection, I would say that you're absolutely right that hitting the number in '25 is becoming more challenging. We are taking actions to accelerate part of that. But I think the key message that I want to leave you with, Lars, is that we remain very committed to the EUR 200 million ambition. We see the potential out there. We see our technology relevant to address that. And what we will consider as part of our strategic review is, of course, the exact year where we'll be able to realize that in. You are right that '25 and 27 percent CAGR is making it more challenging, but we'll make an in-depth review of that as part of our strategy review this fall and spring.

And then to your questions regarding probiotics, probiotics is somewhere between 10 percent and 15 percent of our Food Cultures & Enzymes business overall. And it's significantly larger in our Chinese market, so significantly larger in our Chinese market. And I will not go in – more into details on that. I would say one more comment that I want to add to this is that when you look to probiotic and the – as a key disappointing element in Q4, it was a combination of China being worse than we expected. Actually, we saw very solid growth outside probiotic in the Chinese market in Q4. But probiotic was worse than we expected.

The other element is that in other regions, we also saw a negative development in probiotics in Q4 that we hadn't fully expected. And it's primarily the large brand owners – a few large brand owners who are – who seems to be suffering in this element whereas we continue to see a lot of interest in the probiotic category among the smaller players within new, innovative concepts, plant-based yogurts, et cetera. So, in that segment, we are still growing very well, but it's not enough to compensate for the dynamics in the – among the larger players.

Lars Topholm: Just one follow-up question on the bioprotection, Soren. So, you mentioned second generation is growing very fast. Does that imply that when you launch a new generation, the older generations will actually contract? Or is that a misunderstanding on my side?

Mauricio Graber: Lars, this is Mauricio. I don't think I will make this assumption. So, the second generation has grown very well because they continue to provide a very strong bioprotective efficiency while reducing any other implications for the formulator, meaning any taste or acidification or aftertaste in the product. So I think what we need to have with the third generation is to be a third generation that help us address the challenge in cheese. Cheese is the smallest of the three categories where we are playing now. And when you look at the success of bioprotection in fermented milk and in meat, it's performing very well.

So I think to your question – and Soren's answer is not a question, if we will succeed in bioprotection a little bit more to the speed, but it's not going to be a straight line. I think when you kick in a new generation, you are able to address more of the market potential, and we also have adjacent spaces where we are closer to breaking in with our bioprotection technology. So we'll address the answer as part of our strategic review in April but committed to the EUR 200 million.

Lars Topholm: And what is the time horizon for the launch of third generation? What does that bring to the table compared to version one and two, both in terms of which bad bacteria you address? But maybe also, does it allow you to enter new verticals?

Søren Westh Lonning: Yes. I think the third generation is something that realistically is one to two years out, so it will take a little bit of time. It's not something we will launch in the coming quarters. So that's to address that point. And it's definitely got to address new segments. I mean the second generation have been quite successful in Latin America and other markets we couldn't address before. It has not been able to really unlock the potential we see in Asia Pacific. And that is one of the key missions of the third generation. And also the third generation will also be targeting to come with better solutions for the cheese segment.

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Operator: Our next question is from the line of Heidi Vesterinen from Exane BNP Paribas.

Heidi Vesterinen: More in addressing the challenges in FC&E in China, you had talked about finding new smaller customers. Could you update us on how that is going? And to me, this sounds a little bit like in North American dietary supplements, where about a year ago – 1.5 years ago, you talked about how some of your key customers lost share and then you were going to expand your customer base. But we haven't really seen a recovery a year-plus on. So how can we be sure that you will turn around – FC&E around so quickly? That's the first question.

And then the second one, so we saw the weaker top line and then margin was down as well for FY 2020 or lower than expected. In any parts of the business, are you sacrificing margins to deliver top line? You talked about some customers being challenged and saving costs. So I wonder if you need to reduce prices or launch products that are at lower price points to help your customers.

Mauricio Graber: So Heidi, I think on China, it's been – we have made progress in our organization, in our go-to-market and in establishing the relationships and the pipeline with SMEs. And all of this is happening, for sure, at the same time that there's been a lot more challenging trading conditions in China as you know and as reported by many companies.

So the - while we are happy with the pace of our execution of our plan, the monetization of that into revenue has clearly not yet materialized to, let's say, effect that, it reflects on the results. You have had consumer in China that has to pay a lot more for food, given the food inflation driven by swine and many other categories as well as all the underlying economics that we discussed. Yet we remain confident on the, let's say, expansion

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and granularity of our customer base in China that will derive – deliver future growth.

Just addressing quickly dietary supplements. So I think dietary supplements is not only about expanding the product base but also expanding the product offering. And there, we have very tangible effect on the value propositions we are bringing to customers and the innovation that I've seen from our Human Health organization. We have four to five very exciting launches coming that are being very well-received by the market.

And finally, on your question about margin and execution, I don't think it's the way our business works, which is I don't think we would sell more if we lower our prices. We price for the benefit that our cultures and the activity that our cultures deliver to the market. And I think a pricing discipline on our business model is a fundamental way of our structure of doing business.

Soren, you might want to complement if there's anything on that.

Søren Westh Lonning: No. And I can also, to the specific subpoint of your question, Heidi, related to whether we are launching products at a lower price point. That is not the core of what we do. We continue to bring innovation and deliver value. Of course, there are – we will continue to review, well, there are segments of the markets where we can come with some new solutions that are also addressing sort of the lower end of the market where we are not as strong as in the high end of the market. But we don't expect that to be an impact on our margin part here.

When it comes to Food Cultures & Enzymes, I think it's very important to really focus on the full year picture and not so much the quarterly dynamics. Full year, we are flat in Food Cultures & Enzymes. But it represents a gross margin improvement of around roughly 1 percentage point, which is quite sizable. And then we have then taken the decision to invest that into initiatives in Food Cultures & Enzymes to drive the future growth of the company. And the specifics of Q4 doesn't change that overall story or momentum, you can say.

Operator: Our next question for today comes from the line of Anton Brink from Kepler Cheuvreux.

Anton Brink: In the call, you mentioned the impact of the African swine fever. Could you maybe give some elaboration on how you include that in your guidance for 2020?

Then a short question on your best pricing mechanism. Is it still estimated to be 0?

And then I guess some comments on DuPont. You've previously said that an (acquired active) causing some price pressure. How is that developing?

Søren Westh Lonning: Yes. To address your question regarding the African swine fever, the way we see it right now is that it's impacting our Animal Health business in China negatively. It's not a very large business for us. But on the other hand, it's favorable in some other markets that is then supplying the swines to the Chinese market. So we have actually seen quite good development over the year in EMEA as an example. So that component is factored in when you look to our Animal Health projections for '20. We don't believe that picture will change.

Then the other aspect is that the African swine fever is putting – is creating – is supporting to create a food inflation in China that is overall affecting the consumer buying patterns. And we believe that, that is also going to continue to be a drag. And that's also included in our assessment. So I'll say, overall, the African swine fever is considered in our guidance. When it comes to euro price effect, I can confirm that we are still expecting an immaterial effect in '20 based on the current currency rates.

And in terms of DuPont, without mentioning specific competitors, I would say that generally some of our large competitors have been more active recently. But I think it's also important to stress that it's what we consider more of a normalization after some years, where some of those competitors have been more distracted.

So definitely, we feel the competition situation normalizing. But I would say that's also that. It's not – we are not out in something that are radically changing the markets that we're operating in.

Operator: As a reminder, ladies and gentlemen, it's "star," "1" for any questions. Our next question is from Ben Gorman from UBS.

Ben Gorman: Apologies if I'm repeating any questions. I think you have dropped off for part of the call, so back on the line now. Two quick ones from me. First of all, in terms of the probiotics' weakness that you mentioned in Cultures & Enzymes, is this still the whole trading-down aspect? Or can you give a bit more of an idea in terms of your delivery versus the market growth? It sounded like you were losing some market share to DSM before. That's the first one.

And then secondly, in terms of bioprotection. I think this has sort of been asked already but can you give an idea of actually how big cheese was? It was my understanding that it's almost all really yogurt which has been growing, so it's sort of surprising that a decline in cheese has driven what is presumably a sort of close to 0 percent delivery in Q4.

Søren Westh Lonning: Maybe I can address your last question and then Mauricio can address the second. I would say that for bioprotection, we operate – today, you can say that the three core segments that we have are cheese, fermented milk and meat. And we are doing quite well in meat, very strong growth in meat. We are also, when you look at the full year, doing quite well in the yogurt segment outside North America, where we had some clear headwinds in the beginning of the year, in particular. But outside that, particularly weak. And in fermented milk, we are doing quite well. And those two are the two largest segments, that's right.

And then you have cheese, which is smaller than the others but still able to impact also the overall growth numbers. And here, one of the key challenges that we have is simply in some cheese types that are most relevant for bioprotection, we don't have a solution that is good enough in addressing the post-acidification in some of these cheeses. And that is currently limiting our ability to grow in that segment. But you are right, yogurt and fermented milk are the two larger segments, but cheese is not unimportant.

Mauricio Graber: And just to clarify on your third question – first question, you were talking about probiotics within Food Cultures & Enzymes, correct?

Ben Gorman: Yes. Just from what you mentioned in the press release.

Mauricio Graber: Yes. So basically, what you see with probiotics is, on the positive side, we see a renewed interest in probiotics in innovative food products. So whether it's fermented beverages or plant-based products, if you see, many of them are being launched with a probiotic offering. However, the contrast to that is some of the large brand owners in the dairy category have seen a poor performance of their brands with probiotics. So I do not believe that we're losing share. I think our probiotic growth is declining in connection with the performance of some of the large brands of dairy products, fermented milk that have probiotics.

Søren Westh Lonning: And then maybe just one additional comment regarding China specifically. Bear in mind that here, we have this dynamic with the ambient temperature yogurt and the chilled yogurt, where ambient right now is gaining share on the account of chilled, which further impacts the growth in China, plus some trading down in products within the dairy space in China as well, which is also impacting probiotics.

Ben Gorman: Okay. Maybe just a final one on a different note. You mentioned on capital allocation, I mean is it sort of a message that actually acquisitions will be a more important part of your growth formula going forwards? It sort of seemed to be what you were mentioning in terms of restructuring your approach.

Mauricio Graber: Well, I wouldn't necessarily say in that way. I think what we have taken is a more structured approach to look at the – and assess the environment where we operate and the adjacencies. Because as we also said during the call, we operate in an environment that's moving very fast. And I think the core capabilities that we have in microbial solutions and fermentation processes, we want to keep a leadership position on that. We have always, I think historically Chr. Hansen, done bolt-on acquisitions and we will continue to look at things that either continues to give us technology synergy opportunity or a route-to-market synergy. But it's within that context.

Operator: Our next question for today is from the line of Arthur Reeves from Barclays.

Arthur Reeves: Arthur Reeves, Barclays here. A couple of general questions, please, and then one specific. At the start of the presentation, you said that some of the disappointment in 2019 numbers were down to execution. How much additional growth could that – if you'd executed well, could that have made in the year, please?

Second question is you've said a couple of times that Chr. Hansen is a growth company. What percentage growth do you have to have to be a growth company?

And then I've got one specific question that maybe I'll leave until later, if that's okay.

Mauricio Graber: So I'll take a stab at the questions and then pass them to Soren to complement. It's always very difficult to split execution from external factors. I think what we try to do is take ownership of our destiny and make sure that we're not just blaming microeconomic factors. For sure, it was a year of some headwinds that we have. But if – I think the simple answer to your question would be I think execution should have allowed us to come at the upper end of our revised guidance. So that would be my assessment. I think we were disappointed that we guided – lowered our guidance 7 percent to 8 percent and came in at 7 percent rather than 8 percent.

Where do you have to be at a growth company? Many people put that in different ranges. I think in many markets, they would say above 5 percent is a growth company. For us, Chr. Hansen, a growth company is aligned with our long-term ambition of being a growth company of 8 percent to 10 percent. And we believe the microbial and power of good bacteria over the long time should enable us to deliver a CAGR of 8 percent to 10 percent. And that will be part of our strategic review as we look into the future 5 years for Chr. Hansen.

Arthur Reeves: My specific question is about Plant Health and the timing of orders that is going to affect quarter 1. Can you give us a bit more detail on that, please?

Søren Westh Lonning: Yes. You have to bear in mind that Plant Health is still a relatively small business for Chr. Hansen. We sell very limited products and it's all sold through one partner. So the buying behavior and order pattern that we get from that partner can influence the quarterly timing quite significantly in Plant Health.

So I think it's worth reiterating when you look to '19 overall, we saw a significant increase, a very, very high double-digit growth rate in Plant Health. And we also project strong growth in '20 overall. But when our partner will buy, put on inventory for the season, et cetera, is – will, as long as it has this size exposure to one customer and primarily one region, it will be a topic in a business like that. But we absolutely confirm that we're convinced that we, in '20, will see another strong year in Plant Health with very, very attractive growth rates.

Mauricio Graber: And I think, Soren, probably one comment to add to that is we have already mentioned in previous guidance and calls that Health & Nutrition overall is a division that we are banking a lot of growth. We are happy that it delivered 9 percent. But you can see that on a quarter-to-quarter basis, it has more variability. So I would encourage you to look at Health & Nutrition on an annualized basis and a consistent track record of growth.

Operator: Our next question for today is from the line of Annette Lykke from Handelsbanken.

Annette Lykke: Quite – some of my questions have been asked. But in bioprotection, we saw in Q4, you had a – or for the full year, you had a 10 percent growth. And for the first nine months, you had 15 percent. So basically, I guess you must have had a negative growth in Q4. My question is, is this slow uptake of new clients? Or is this a loss of existing clients? I'm aware of the cheese situation. But could you maybe say a little bit more about that?

And then I just wonder on your – how certain you are on these new initiatives that should return growth from Q2 and onwards? I mean the lower Q1 relates to macroeconomic challenges. And do these macro challenges have to improve before you see high growth from Q2? Or what are – as it also was as before, the most essential assumptions to return to grow from Q2 and onwards?

Søren Westh Lonning: Yes. Let me – Annette, let me address your first questions regarding bio-p. First and foremost, it's not – we grew slightly in bio-p in Q1, so it's not negative, just to be clear about that. Now the key reason, in addition to cheese, is not related to big losses of clients in bioprotection. We continue to have a very solid customer base. We continue to have a very solid pipeline of projects that we execute on and we are winning good projects. That being said, when you look to it, I mean, Q4 was the quarter last year where we launched second-generation bio-p and there was some immediate uptick from that, that makes the comparable a bit tougher.

The other part is that as this is still a relatively new concept for several customers, there are still some optimization done in terms of how much the customers are using it across the product portfolio, finding – experimenting to find the exact right doses that works for them, et cetera. So there will be some of these factors also influencing the momentum.

So in addition to cheese, it's a tough baseline and then there are these customers that are still learning how to really use it. But we've not had losses as such in bio-p. And it's not a question of competition becoming much fiercer in this space. I mean we have competitors, but it's not – the picture hasn't changed much over the last couple of quarters.

Mauricio Graber: And I think, Annette, to your question on the Q1 versus the Q4, I think it's less about the macroeconomic effects and more about the one-off effects or the timings of our execution that I have mentioned. So in Q1, we had a lower momentum, given because of the timing of orders that we have discussed overall in Health & Nutrition, particularly in Plant Health and in Human Health highlighted by Soren, and also the normalization of inventory stocks in our distributors in Food Cultures & Enzymes.

So those, and some of the lingering of the macroeconomic factors. But when we look at our predictive information in our pipeline and our level of activity to customers, we have a strong conviction on our Q2 to Q4 microbial platform coming back to the range of growth that the business has to deliver.

Søren Westh Lonning: I think we would traditionally close the Q&A session here. But I think given the questions that's been and so on, we can open up for a few more questions and extend the Q&A to make sure we address the questions that you have.

Operator: Our next question is on the line of Faham Baig from Credit Suisse.

Faham Baig: Can I start with the topic of adjacencies because you've mentioned it for a couple of years now, that we haven't actually seen anything put into practice? So when you think about adjacencies, sorry, I should say, what do you mean by that? What sort of categories or technologies could we think about when Chr. Hansen is looking at its adjacent categories? That's my first question.

The second question is that the majority of your gross margin expansion this year was reinvested in sales and marketing. Could you identify specific areas where that investment is going?

And secondly, related to that, gross margin expansion has been slowing sequentially. So I think – or think it's probably lower next year than it was this year. And at the same time, you're anticipating your margins are maintained. So should we not expect more investment in order to maintain your top line growth rate? That's my second question.

And the final question is just on your market growth rate. Historically at Chr. Hansen, we've become accustomed to a end market growth rate of 3 percent to 4 percent. What do you think that market growth rate is today? And how do you see it developing?

Mauricio Graber: Answer a little bit the first ones and pass it on to Soren for your last questions. So on adjacencies, some of the exciting adjacencies that I can mention in Food Cultures & Enzymes, for example, would be the whole area of fermented beverages.

And the growth of fermented beverages within the beverage category has been tremendous. You see all the type of kombucha beverages, near beer beverages. And in many of those fermented beverages, we're deploying our technology for either fermentation or also probiotics. And we have some really exciting technologies for – that are microbial-based for zero-alcohol beer, et cetera. So a large (flow) from a highly energized team dedicated to that.

Plant-based is another part of that. You see plant-based solutions being developed as alternative to other type of protein, dairy, meat proteins. Most of those require a fermentation process as well. And we have a lot of new wins in helping those leaders in those categories to convert to those categories. Those are actually monetized already on sales, so we are active in those adjacencies and not only talking about that.

On the areas of investments, I will highlight 3. So one of them is research and development. And precisely, for example, for these adjacencies, we are growing our capabilities in R&D to develop microbial solutions for plant-based solutions for fermented beverages for our new generation of bioprotection and expanding our scientific base on that. We also continue to invest in our bioprotection team. And we mentioned in our call our digital services, which is another area we're investing to create a basis of digital services for our Food Cultures & Enzymes.

Soren, you may want to complement that and answer the question on (beyond the range).

Søren Westh Lonning: Yes. In terms of the gross margin that you allude to, I think it's important to split it a little bit business-by-business area. So when it comes to Health & Nutrition, the key driver is really product mix. And that can be a little bit volatile from quarter-to-quarter. In Natural Colors, we saw the largest effect of our raw material impact in the first half of the year and sort of operational efficiencies kicking in during the year but coming down during the year because of the raw material impact.

And if you look to Food Cultures & Enzymes, we guided already from the beginning of the year that we would expect a much tougher baseline in the second half of the year, particularly Q4. Still, we were able to deliver a very strong underlying scalability from our production setup during the year. But there was some inventory movements and all of that, that sort of skewed the picture a little bit in Q4.

So I would say overall, we are quite pleased with the development in gross margin. Don't overinterpret it, the Q4 part here. When I move into FY '20, I would say that probably the area where we expect most positive impact in gross margin will be from Food Cultures & Enzymes, given that we will continue to gain some scalability benefits in that part of the business, so just to give a little bit of guidance to where we believe that will come from.

You had – I hope that answered the questions on gross margin. You had some questions regarding also the end market. And the 3 percent to 4 percent, I believe, is a reference to especially the dairy segment in Food Cultures & Enzymes. And what I can say is that over the last 12 months, we've probably more seen a market growing to the tune of around 2 percent, 2.5 percent. So fermented milk has been growing at a lower level. It's more been these 2 percent, 2.5 percent during the year, not least because emerging market not growing to the extent that we have seen historically.

And the other component is cheese, which has been around 2 percent for the full year, but where we've seen a gradual, you can say, slowdown in growth during the year. So the cheese market in the U.S. are producing at a high level, but growth is not to the level that we saw early on in our financial year '19.

So there are some dynamics there on the end market growth that is also playing in. But as we said many times before, I mean, our ambition in Food Cultures & Enzymes is not to grow in line with the market. Of course, we are affected by the end market growth. But our growth model really builds on a lot of levers in addition to market growth. And those are the ones that we can really work on to grow the business.

Faham Baig: Can I just have one follow-up maybe and focusing on the first part of the question, which is on adjacencies? How does Chr. Hansen, being a dairy company for the last 100 years-or-so, pivot itself into different categories without really acquiring expertise?

Mauricio Graber: Well, I think the – that's why we call it adjacencies because there are adjacencies that are very close to our capabilities. So if you look at plant-based, plant-based, you need to understand fermentation and that is what we do in dairy. Plus from a go-to-market, many – it's many of the dairy customers that have been also the leaders in developing plant-based alternatives. So I think we have the go-to-market and we have the technology.

You're right that in fermented beverages, we have the expertise. But in some cases, we are building relationships with new customers. And that is important for us to expand our coverage, which is also one of the areas where we have invested.

Operator: And our last question for today is from the line of Lars Topholm from Carnegie.

Lars Topholm: Yes. A couple of additional questions, it's around M&A. So the first one, which I'm sure you're sick and tired of getting, but why are you the correct owner of Natural Colors?

The second one, hopefully more intelligent. So there are a couple of assets being shopped around right now: Glycom, here in Denmark, for example; CSK down in Holland, which among other things, contains a culture business. I know you can probably not be very specific but what is your view on larger M&A, Mauricio? And is it completely unrealistic to assume you could buy one of these or another larger asset within the next 12, 18 months?

Mauricio Graber: Thank you, Lars. So on Natural Colors first, I mean it is a recurring question. I think I would expect the question, particularly given the challenging performance of Natural Colors because you could say, if you take out Natural Colors, our performance of last year as far as growth would have been a lot stronger.

However, it still had a return on invested capital north of 24 percent. And we understand the business quite well. So it – there's nothing new for you. It does not have a great amount of synergy with our microbial platform. But its natural solution is on trend, and we believe that the conversions in Natural Colors in the North American market represent a large opportunity. So that's Natural Colors. On the ...

Lars Topholm: Mauricio, sorry, if I can just interrupt. Because I mean those dynamics, we know. But that doesn't answer the question whether you are the right owner or the best owner, because if return on invested capital is attractive, presumably selling it would give you a price that reflects that attractiveness, wouldn't it?

Mauricio Graber: We've always said that we run and execute that business to our best of our ability. If somebody thought they were better owners and were prepared to sort of pay the price for better ownership of that business, we would consider that. But we don't have a formal process to sell Natural Colors, just to be clear on any rumors around that.

On the others that you mentioned, without commenting on any special M&A, I would say you are right. I mentioned that we are in a very dynamic moment in the industry. Our major competitor, DowDuPont, is up for sale. We know that we cannot participate in that. But there's very exciting opportunities within the bioscience microbial space, where we play. And I think we have to recognize which one of those could enhance Chr. Hansen's value and long-term industry leadership. And I think we will give them fair considerations on what they represent and why would be the potentially good owners of those businesses.

Lars Topholm: Sorry, is infant nutrition sort of more attractive than your average segment?

Mauricio Graber: So let's tackle – let's not talk about Glycom, but let's talk about HMO, just to be clear. So, you saw from our report that infant formula has been a growth engine for our Human Health business. And we believe that infant formula and nutrition is something that has a lot of positives. So we will study the HMO market. It's a prebiotic. What are the potential synergies, go-to-market? Is it interesting? Will HMO remain as a differentiated technology? Will it commoditize? I think you want to have a firm conviction about those areas when you talk about HMOs.

We really appreciate your questions. Thank you very much. And we will be available in the times ahead if there any additional questions. Thank you very much.

Operator: Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect.

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