Chr. Hansen Holding A/S
Jennewein acquisition
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PRESENTATION

Operator
Thank you for standing by and welcome to the presentation of Christian Hansen Holding A/S conference call. At this time, all participants will be in listen mode only and there will be a presentation followed by a question and answer session which at time, if you wish to ask your question you will need to press 01 on your telephone keypad. I must advise you that this conference call is being recorded. I would like to hand over to the conference speaker today, Christian Hansen’s, CEO, Mauricio Graber. Please go ahead with your meeting.

Mauricio Graber
Good morning everyone and thank you for joining this call on the acquisition of Jennewein that we announced earlier today. I will do this call together with Christian Barker, who leads our health and nutrition business, and our CFO, Søren Westh Lonning. And we will start with a short presentation before opening for questions and answers. Please note that we will only discuss the acquisition today as we have entered into the quiet period ahead of our full year results, which will be released on October 8.

Before we start, please take notice of the safe harbour statement on the next slide, slide two, please. Thank you, let’s move on to slide three. I am very excited that we have entered into an agreement to acquire Jennewein with the ambition to lead the fast growing market for human medical legal saccharides, or, in short, HMOs. At Christian Hansen, we have followed the emergence of this relatively new market with strong interest for some time now because it's very complementary to our probiotics and infant formula business and builds on the same fermentation technology platform.

As one of the first movers into this space, Jennewein has truly been pioneering the HMO space with its highly innovative and cost competitive production process and build a unique market position. I believe not only because of that, Jennewein is a great addition for health and nutrition business portfolio, but
also because they share the same passion for delivering and developing innovative microbial solutions for a better world, as we do at Christian Hansen.

The acquisition has a transaction value of 310 million euros on a debt free basis and we will invest more than 200 million euros over the coming five years, mainly in a new brownfield production facility to meet the fast growing demand for HMOs from customers that has in a meaningful part already being secured through long-term contracts. We expect the business to contribute around 50 million euros in revenue in the calendar year ‘21 and be accretive in group organic growth the following year.

The EBIT margin potential is expected to be in line with the Group beyond our strategy period as we build scale and the market is maturing. Our long-term financial ambition and our outlook for the financial year 19/20 remains unchanged and we expect closing of the transaction during this month. With this overview, I would now like to hand it over to Christian to elaborate a bit more on the HMO business opportunity, Jennewein, and our plans for the future. Christian.

Christian Barker

Thank you, Mauricio and welcome also from my side on this very exciting day. To start with, allow me to briefly explain on the next page, page four, what HMOs are for those on the call that are not familiar with the concept, and why they fit very well into our health and nutrition portfolio.

Human milk oligosaccharides are the third largest component in breast milk, and it is the key differentiator between mothers’ milk and animal milk. We know to date that there are more than 150 different types of HMOs and scientists have shown that HMOs, just like probiotics, play an important role in modulating the microbiome of infants and adults.

Simply put, you can say that HMOs are the food our good bacteria need to grow, meaning that they stimulate the growth of beneficial microorganisms and as such are, amongst other things, very important for the development of a strong immune and digestive system. Given the fact that HMOs have only been available for commercial use for a very short period, penetration levels are still very low, but we expect the market to expand rapidly.

Please turn to the next slide, slide five. We believe there are four main drivers that will make the addressable market grow to more than 400 million euros by 2025 and more than 1 billion euros long term. First, premiumisation. Consumers have a strong desire for infant formula products to be as close to human breast milk as possible and the commercial availability of HMOs will further fuel the premiumisation trends that we have seen in the infant formula space.

Secondly, regulation. HMOs are already approved for usage in infant formula applications in many markets, but important countries like Australia, New Zealand, China are still pending, and we expect this to be a large growth driver for the category given that China is the world's largest infant formula market.

Thirdly, clinical evidence. Both Jennewein and Christian Hanson have a strong commitment to science and together we will continue to build clinical evidence around the health benefits for HMOs, which will support the adoption of this new functional ingredient.

And last but not least, product innovation and expansion into new application areas. There is significant opportunity to launch new types of HMOs in the future and further tailor products to different consumer segments and needs. And as I explained, HMOs and probiotics are very synergetic, and we believe there is big potential to also develop combination products for the premium segment.
Also, mid to long term, we see opportunities to sell HMOs into other application areas such as adult nutrition or supplements. Given the strong growth prospects and the expected future market size, HMOs clearly qualify as a lighthouse opportunity for Christian Hansen. Now, remember that we define a lighthouse as a new business opportunity of strategic importance that has a revenue potential of at least 100 million euros per year. And it’s expected to grow significantly faster than the Group. So, this clearly qualifies as a lighthouse, and the opportunity is very exciting. And with Jennewein we are acquiring one of the leading HMO players.

Let's move to the next page, page six, please, to give you a short business overview. Jennewein is a German company with headquarters, R&D and production facilities near Bonn that was founded 15 years ago and has been one of the leading players that has been pioneering commercial scale production of HMOs.

What really sets Jennewein apart from competition is its highly cost competitive downstream production processes as well as the breadth of its product portfolio. Thanks to being one of the first movers, Jennewein has built a unique and strongly protected portfolio with more than 200 patents to date. They were the first company to have an HMO registered in Europe and North America and are currently in the process of registering the first blends of HMOs for commercial use.

Together, we will build on this strong position by bringing Jennewein’s HMOs to a broader customer base, bundling our R&D efforts, and taking our combined production expertise to build a global state-of-the-art manufacturing hub, which can serve the fast growing customer demand over the coming years.

Please turn to the next slide, slide seven. As Mauricio said in the beginning, we will invest more than 200 million euros to build a global state-of-the-art HMO manufacturing hub, which will complement Jennewein’s existing footprints in Germany. To do so, we have acquired a high-quality manufacturing facility in Kalundborg [ph 00:08:41], Denmark where we will build both downstream and upstream capabilities over a period of five years with significant opportunities for quick and cost efficient future expansions beyond the strategy period.

Jennewein will operate as a separate business unit as part of health and nutrition to ensure full focus on executing on its existing commercial pipeline and expanding the manufacturing footprint. But of course, we’ll make sure that there will be support from all the relevant functions across Christian Hansen as well as a close collaboration with human health probiotics team.

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

Mauricio Graber

Thank you, Christian. To keep it short, just a brief wrap up. We are really excited about entering the high growth HMO market with the acquisition of Jennewein. We think our new HMO lighthouse has tremendous potential and we will invest in large-scale production facilities to enable the rapid expansion and adoption of HMOs globally.

The acquisition is fully in line with our 2025 strategy of pursuing bolt-on acquisitions to strengthen or microbial and fermentation technology platforms. We look forward to welcoming Jennewein’s more than 100 employees to the Christian Hansen family to grow a better world naturally together.

Thank you for your attention and with this, I would like now to open it up for the Q&A that Søren, Christian and myself will be pleased to answer. Thank you.
Q&A

Operator

Thank you. If you wish to ask an audio question you may do so by pressing 01 on your telephone keypad. If you wish to withdraw your question you may do so by pressing 02 to cancel. Participants are kindly asked to limit their questions to three questions only. Again, if you wish to ask a question, it’s 01 on your telephone keypad.

Our first question comes from Jonas Guldborg from Danske Bank. Please go ahead with your question.

Jonas Guldborg

Yes, thank you and good afternoon all. First of all, so you clearly stepped up the speed of acquisitions in Christian Hansen. So, first HSO and then UAS and now this Jennewein. Are you at all worried if you have the resources to handle this number of acquisitions and how do you actually in practise handle it? That’s the first question.

Then will the higher balance sheet leverage short term here, will it have any implications for your capital allocation policy? And my last question would be how should we - how will you face the 200 million euro investments that you're going to make over the next four to five years? Thank you.

Mauricio Graber

Excellent. I’ll give you a quick overview and Søren pass it to you. So basically M&As, we have had a framework for M&A for quite some time. I always like to remind people that Christian Hansen has done M&A with MPC [ph 00:11:54] and LGG [ph 00:11:54] that also happened in the same year. I think our strategy calls for a very defined space on the microbial and fermentation technology platforms and I think we were lucky that these assets were available that had such a good strategic fit and able to compete and acquire HSO, UAS Labs and Jennewein.

On how we will execute the integrations, I think we have a pretty successful record doing that at Christian Hansen, making sure that we set up highly capable integration themes with a steering committee that follows up on the plans. And I think we feel confident on how we have structured the acquisitions to make them a success and fully integrate them into Christian Hansen as the integration process gets complete.

From a leverage point of view, obviously long term we want to come back to our investment and create leverage and that would be the objective. Obviously, we continue to be a company with a strong cash flow as well. And Søren, I will pass it to you to comment a little more specific.

Søren Westh Lonning

Yeah, so to confirm our current capital allocation priorities remain intact, so organic growth remains number one with bolt-on acquisitions as number two and then distribution to shareholders following thereafter. And as Mauricio pointed out, we are currently at a leverage level which is more to the tune of 3.5 to 4x EBITDA after having completed this transition. It's something which Christian Hansen's cash
flow is strong enough to address, but obviously we will be looking at how to come down to the solid investment grade level within the coming period. So that is the projects [ph 00:14:01] as they are set.

In terms of the 200 million plus investments that we will be facing over the coming four/five years, if we think about it as a little less than 100 million is what we expect in the coming financial year. So, it is somewhat frontloaded, not least because we are making the purchase of this Kalundborg [ph 00:14:29] facility that is also mentioned in the presentation, where we are simply acquiring a state-of-the-art facility in an area with high competence level within fermentation technologies. And that means that on the capex side we will be somewhat more frontloaded with a little less than 100 million expected in our financial year ‘21.

Jonas Guldborg
Thank you, guys.

Operator
Thank you. Our next question comes from Theodera Joesph from Goldman Sachs. Please go ahead with your question.

Theodera Joesph
Hi. Good afternoon. Thanks for taking my questions. My first one is more on returns. Just wondering what kind of returns [? 00:15:16] do you expect to make on this acquisition? The second question is more about wondering if you can give some colour around the EBITDA margins this business will have and how much you expect margins to improve once you fully integrate production and how long it’s going to take?

And my last question is basically what is your current market share of the HMO market and what’s your target over the next five years? Thank you.

Mauricio Graber
Christian, do you want to comment on the overall market and HMO market share and then we will pass it to Søren to comment on the [? 00:15:53] EBIT and margin development?

Christian Barker
Sure, Mauricio, and thanks. So, regarding the market as we said it is a very fast growing market that we expect to grow from around 100 million last year to more than 400 million by 2025, which implies a CAGR of more than 30% over the next five years. Now this is a very young industry and there are a lot of dynamics in play, so we don’t want to discuss market shares at this stage. But we do believe that this acquisition puts us in a very strong position relative to competition and certainly long term, we are ambitious to be a leader in this industry.
Søren Westh Lonning

And let me address the return EBITDA consideration. So if we start by the EBITDA margin, you will say this is a business that is still in its very early stages of its development potential and hence when you look to the EBITDA around this time, it's close to zero. So that's where we are starting right now. But if you look to then when we do the acquisitions, of course there will be some depreciation on the purchase price that comes also from this.

But if you look to the potential of this and that's what we're saying in the company announcement, when we get to the other side of our strategy period of 25, we do believe that this business holds the potential to have a similar margin profile compared to our existing business. And here we are talking an EBIT level of around 30% and also a very attractive EBITDA level. So, we do see - even though it's a younger business, we do see a quite significant margin expansion and scalability journey in the years to come as we build scales and as the businesses are growing and as we can strengthen and build our own platform to service the needs of the customers.

When it comes to the return on invested capital, I would say that we are only making investments where we see a clear return that exceeds our back [ph 00:18:01] level and when you look at this particular investment, we do see an MPV potential that is significantly above the value that we have paid.

That being said, obviously this is a little bit longer term investment that when you compare to the UAS Labs, so we will take some time to fully unfold the potential, but the long-term potentials are very attractive and very sizable in this business in our view, and hence we are very convinced that we can create significant value for Christian Hansen through this acquisition.

Mauricio Graber

Yeah, [? 00:18:36] just to return on the margin development really the [ph 00:18:40] two key factors is sort of the scalability insourcing that will drive our productivity and cost efficiency to drive the margin expansion.

Theodora Joesph

Okay, thank you very much.

Operator

Thank you. Our next question comes from Annette Lykke from Handelsbanken. Please go ahead with your question.

Annette Lykke

Thank you so much, Anette Lykke from Handelsbanken here. Just questions on the integration or are you seeing any additional one-off or integration costs coming and as well also this investment of 310 million, does that include additional production facilities that you will need for this?
Mauricio Graber

So, the facility that we have just acquired is not part of the acquisition price, but is part of the indicated capex level, so that is included in the 200 plus million euros capex indication over the coming five years, and it's also the reason why the capex level is somewhat frontloaded because that will be money that we pay in our Q1 of our financial year '21.

When it comes to the integration, there will always be some one-off costs related to completing a transaction. That's quite customary, and then there will be some smaller one-off costs potentially to bringing the Jennewein into the Christian Hansen family. But giving that this is really a growth case and it's all about building the future base on the platform and pulling on the key elements of Christian Hansen that can really drive value, as an example, our exposure to the infant market that we already have up front, the amount of integration costs will be relatively modest.

Annette Lykke

Okay, then a follow-up on the technology itself. You expect an increase in penetration of this HMO. What do you base that on and the clinical evidence that you highlight on slide five, is that something you already have or is that something you have to establish? And then of course in respect to the penetration and infant formula producers, what is it the cost for them to include this?

Mauricio Graber

So, there's a lot of science that already Jennewein has built as part of them pioneering the market. As Christian mentioned, HMO is one of the key ingredients that is going into the premiumisation of infant formula, because the way that I would describe HMOs would be, let's say, the missing ingredient that would make infant formula closest to a mother’s human milk. So that's the value addition that this brings. Christian, do you want to build on that?

Christian Barker

Absolutely. So it's been proven that HMOs have a so-called bifidogenic [ph 00:22:14] effect in that they stimulate the growth of beneficial bifidobacterial [ph 00:22:17] in the infant microbiome, so that's kind of the science of it. But frankly, even from a marketing standpoint, I think most consumers around the world now recognise that breast milk is actually the gold standard that infant formula aspires to approximate.

And given that you now have the opportunity with the addition of HMOs to make infant formula a lot more like breast milk, I think it's clear whether you look at it from a customer, a consumer or a science standpoint that this will be a very high growth ingredient and will see a lot further penetration in the coming years.

Bear in mind that we are only in the early stages of seeing this commercialised and you still have regulatory barriers that will fall away in a number of markets around the world as we look to the future, so there's no question in our minds that we will see very high growth in this market for the next five or 10 years.
Mauricio Graber

And while we will not comment specifically on the cost for the manufacturers, I think as you have seen in the commentary during the call, we have secured long-term agreements with some of the key manufacturers of infant formula. So, there’s a strong commitment to the space and the utilisation of HMOs by leading customers.

Annette Lykke

Just then a final question to Christian. Is this a technology or HMO, could that be used in other areas of [? 00:23:48] than in infant formula?

Christian Barker

Yes, it certainly could. So, we think the big near term opportunity for sure is in infant formula and the market size estimates that we communicate are primarily based on infant formula and the infant market. But in long term we see a lot of further application opportunity and that would include, for example, supplements for infants just like we have oil drops in probiotics today. We could use that as a big opportunity.

But longer term, you could also certainly see adults application in the form of supplements, in the form of medical foods. And if you look about it really long term, I think you may also see pharmaceutical applications like we’ve seen it already now with the probiotics and with the bacteria.

So, we think the infant formula opportunity is big and high-growth enough to be an attractive in and of itself but we certainly could view add-on opportunities to that as we look to the mid and long term that could also over time become very sizeable.

Annette Lykke

Okay, thank you so much.

Operator

Thank you. Our next question comes from Soren Samsoe from SEP. Please go ahead with your question.

Soren Samsoe

Yes hi, it’s Soren here. So, basically first of all, I want to hear a little bit about your thoughts on the strategy here, because it seems like before you were quite firm and your primary strategy was to sell bacteria, more or less. Now you’re buying something where you sell something that’s not bacteria, but of course produced via bacteria. So, it's just wondering if you're [? 00:25:36] strategy and we could also go into other stuff that is made by fermentation, but that is actually not bacteria. That's the first question.

And then secondly, this seems to be sort of a more long [? 00:25:51] with a more long term view. So, it seems like you're increasing the risk in your acquisition strategy. Is that also how you view it? And is that
a sort of a road you want take where you take bigger risks and more long-term view when you make the acquisition. Thank you.

**Mauricio Graber**

Thanks, Soren. Thanks for the question. If you go back actually to our capital markets day presentation, our consistent theme across it and very clearly stated in my opening capital markets day presentation is that the core of Christian Hansen is our microbial and fermentation technology platforms. So, we have really emphasised that, that our expertise is in microbes and our expertise is in fermentation processes.

You are right that this fits into our strategy more through the fermentation process. But we will not, I think, if you remember the framework that we use of reinvesting in the core, strengthening the lighthouses and extending the business to strengthening the microbial and fermentation technology platforms, this is precisely where it fits before we go to the review of the natural colours that's ongoing.

So, basically it fits. As far as the risk it’s important to highlight that we view this as a growth accretive business. We believe we have unique capabilities to grow this business and it's not that we have an appetite to make Christian Hansen a riskier company or step out of our well-defined core of microbial and fermentation. So, Søren, any additional from you?

**Søren Westh Lonning**

Yeah, just a few other perspectives in addition to what you have outlined here, Mauricio, in terms of the connectedness to the Christian Hansen strategy. I think first and foremost we're selling into a customer segment, infant formula, which is one that we are catering to today and have intimate knowledge of. Secondly, if you look to the production technology, it's actually quite similar to our enzymes. There is enzymes production that we do in-house today and hence the fermentation is really something in an area where we have a deep knowledge also.

And then finally back to the point about the synergistic between the prebiotics and probiotics. This is actually a product that sort of works very well together with bacteria and [? 00:28:34] also the potential of good bacteria. So, in many aspects it's really closely connected with our strategy.

**Soren Samsoe**

So, not unlikely that you go further on that route in the future.

**Mauricio Graber**

Well, I don't see, Soren, when you say that you go further on that route, I think what we have said is microbial and fermentation opportunities that have a strong fit to our purpose, those are the things that we would pursue. I don't want to mislead you to think there are many other spaces out there that are such a clear fit as we have found with probiotics in the case of UAS Labs to expand our probiotic offering and end use application or with HMOs as prebiotics that have this very close synergistic effect.
Soren Samsoe
Okay, thank you.

Operator
Thank you. Just as a reminder, if you do wish to ask an audio question, you may do so by pressing 01 on your telephone keypad. Our next question comes from Heidi Vesterinen from Exane BNP. Please go ahead.

Heidi Vesterinen
Hi, I wondered if you could talk about the competitive landscape, please. I think your usual big competitors already have this, from what I understand. So, are there many other small players out there? And more specifically could you talk about how this compares with Glycom please? I think Glycom, it was disclosed is only slightly larger in sales but had a very attractive margin. So, I’m just wondering why this one is lossmaking. Thank you.

Mauricio Graber
Hi Heidi. I think, as we mentioned during the call, it is definitely an emerging market with only a few players. I think what makes it very attractive and where we think Jennewein is sort of a jewel of an asset in this space is because the IP and the patents pretty much are covered. It would be, I think, very complex to see more new entrants into the space.

The main competitors, as you mentioned correctly, are Glycom, that was acquired by DSM, and other players that include FrieslandCampina, DuPont and BASF, but I think the largest players, as far as ourselves and established IP and patents are Jennewein and Glycom. Christian, anything that you would add?

Christian Barker
No, I think clearly there are several competitors out there. We actually consider that a good thing. This is still a space that has very low penetration, so the biggest competitors here is actually not other HMO players but it’s non-use and therefore I think having some competitors that help drive the signs and the innovation in this category as we see it construction.

And as Mauricio said, we do believe that Jennewein is quite distinctive. They’ve been a pioneer in the space. They have distinctive IP and capabilities on critical elements of the production process. They have a customer footprint in terms of the breadth of the global customer agreements, which I think is second to none in the industry and we actually like the fact that we can get in in time to shape the industrialisation of how this now gets scaled up with the acquisition of the Kalundborg facility.

So, we are very pleased with the asset we have acquired and with the competitive position we think will be able to build with that asset in the industry.
Mauricio Graber

And I think, [? 00:32:18] Heidi the second part of your question, which is what will make this profitable is once we have built the productivity and yields and critical mass in the Kalundborg [ph 00:32:30] facility and be able to produce this at the cost in use that will drive the profitability.

Operator

There appears to be no further questions so I will hand back to the speakers for any other remarks.

Mauricio Graber

Thank you for joining today's conference call and we look forward to continuing the dialogue after the full year results in October. Thank you..