

## **Chr. Hansen Holding A/S Q3 2019/20 Results Conference Call Transcript**

**2 July 2020  
10 am CEST**

Operator: Thank you for standing by, and welcome to the presentation of Chr. Hansen's results for Q3 2019/'20.

At this time, all participants are in a listen-only mode. There will 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, everybody, and welcome to today's conference call on Chr. Hansen's Q3 2019/'20 results. I'm here with our CFO Søren Westh Lonning and the IR team, and we hope that everyone listening in today is healthy and well during this special times. As always, we will start the call with a short presentation and then open up for questions and answers.

Before we continue, please take notice of the safe harbor statement on the next slide, Slide 2.

Thank you. Let's turn to Slide 3. Across regions and industries, trading conditions in Q3 were dominated by the global spreading of the COVID-19 pandemic. As a supplier to the food and health industries, Chr. Hansen is in

the very fortunate position that we are part of what's considered an essential industry, and the demand for our products did not collapse during the lockdowns.

In Q3 – the Q3 results are a testimony to the resilience of our business. With the measures that we have been taking to keep our employees safe and operations running, we were able to maintain business continuity throughout the lockdowns. And we also did not see any major production disruption on customer side.

With a net positive impact in Q3 from consumer pantry loading and customers securing additional safety stocks, group organic growth came in at 7 percent in Q3 and 5 percent year-to-date. Our group EBIT margin before special items was 30.8 percent in Q3, up 40 basis points, as scalability benefits from production and lower travel expenses due to COVID-19 restrictions were partly offset by higher freight costs and continued investments into our strategic priorities. Year-to-date, the group EBIT margin before special items stood at 28.4 percent, up 20 basis points compared to last year. Free cash flow before acquisitions and special items was EUR 106 million in Q3 and EUR 147 million year-to-date, which is a meaningful improvement compared to last year and the result of an improved operating cash flow but also lower CapEx spending due to phasing of projects and delays related to COVID-19.

On segment level, please turn to Slide 4. All 3 businesses showed improved momentum in Q3. Our microbial platform, Food Cultures & Enzymes and Health & Nutrition combined, delivered solid organic growth of 9 percent in Q3 and 6 percent for the year-to-date. Food Cultures & Enzymes grew 8 percent in Q3, which are a weak contribution from both volume and price, leading to 5 percent organic growth year-to-date. Health & Nutrition reported 12 percent organic growth in Q3 with a very strong performance in both Animal and Human Health, resulting in 6 percent year-to-date. Lastly, our Natural Colors division delivered 1 percent organic growth in Q3, and this number continues to reflect a negative impact from low raw material prices. Year-to-date sales were on par with last year. All 3 businesses, of course, saw

an impact from COVID-19, but channel shift and changed consumer and customer behaviors affected the business differently, also across regions.

We tried to illustrate the different dynamics on the next page, Page 5. During the third quarter, we focused all of our efforts on keeping our employees safe and ensuring business continuity. And when I look back at the past 3 months, I have to say I am really proud of the entire Chr. Hansen organization, how they embraced the global lockdowns and this sudden change of working from home, finding new creative ways to engage with our customers digitally, advancing our R&D project in the labs at reduced capacity and with strict social distance and hygiene rules, handling the sudden variations in order volumes in production and delivering our products to customers around the world despite the travel restrictions.

If we look at the impact from consumer pantry loading and customers responding to the pandemic outbreak by placing additional holders to secure their inventories and derisk their supply chains, then the net impact for Chr. Hansen on group level in Q3 was a net positive. And as I said, we tried to illustrate the different moving parts here in this slide, but please only take the arrows as directional indications of the COVID-19 impacts.

Let me start with Food Cultures & Enzymes who generally benefited from the shift to a more at-home consumption and increased retail sales in cheese and yogurt, but we also saw demand dropping in some parts of the business. The collapse of the food service channel, for example, negatively impacted our key sales in the U.S. and the shutdowns in the meat processing industry were negative for our meat culture business. Whilst our fermented milk business saw a decline in some emerging markets as well.

Coming to Health & Nutrition. Human Health also benefited from customer increasing orders, short term, to build up additional safety stocks and cater to the extraordinary demand from end consumers.

Our Animal and Plant Health business on the other side did not see a material impact from COVID-19 yet. But – though our ability to advance

projects with customers was limited because of travel restrictions and a decline in commodity prices, putting farmers under more pressure.

Lastly, for Natural Colors, COVID-19 was a net negative in Q3, but with regional variations. In markets where we have a large exposure to products that benefited from increased at-home consumptions, like packaged foods or confectionery, we saw a step-up in sales. Warehousing markets where we have large exposure to products that are mainly sold during summer travel season for out-of-home consumption or into food service, demand dropped. Overall, it's clear that our Q3 results do reflect a positive contribution from customers, building additional safety inventories to ensure business continuity. However, after a spike in March and at the beginning of April, we have already seen order patterns normalized during the second half of our Q3.

If we look at our commercial pipeline, and we have mentioned this already in our last call, this is where we are most cautious about the potential negative impact over the next 12 to 18 months and in the medium term. As you know, an important step of our Food Cultures & Enzyme sales process is running trials together with customers at their premises to demonstrate the efficacy of our products. Because of the travel restrictions, though we were not able to do that to the same extent that normally, and we may see slower progress of our commercialization pipeline. We are also likely to see longer registration times for new products for the late clinical studies within Health & Nutrition.

And lastly, as we are facing a global recession, there is a likelihood of consumers down-trading and customers focusing more on cost, especially in emerging markets, and this could impact all 3 businesses. That said, there are also opportunities coming out of COVID-19 for Chr. Hansen. The increased demand for immunity enhancing products, for example, resulted in a lot of good dialogue with customers for new probiotic solutions that we are still to see in the numbers and in the market. But overall, I would say that we are facing a more challenging period ahead.

If we look a bit more into the regional numbers, please turn to Slide 6. Then group organic growth in the third quarter was mostly driven by EMEA, APAC and Latin America. In Europe, Middle East and Africa, organic growth was 6 percent in Q3, leading to 1 percent year-to-date. Food Cultures & Enzymes delivered solid growth, especially driven by Europe, whilst Middle East and Africa were more challenged. Health & Nutrition reported a strong quarter on the back of COVID-19, whilst Natural Colors declined because of lower demand in food services and the tourism sector. Furthermore, the adverse economic climate in the Middle East and low raw material prices impacted the division negatively.

Whilst in EMEA, we saw positive trend compared to the first half of the year, North America delivered a softer quarter with 1 percent organic growth in Q3 and 5 percent year-to-date. Food Cultures & Enzymes and Natural Colors were adversely impacted by the disruptions in food service. And Health & Nutrition delivered good growth, but grew at a slower pace than during the first half of the year. This is explained by the fact that the improved momentum in the U.S. supplements market was partly offset by higher comparables in Human Health, and Animal Health posted less growth explained by a normal seasonality in silage and more normal sales momentum in cattle after 2 record quarters.

Latin America, the region which was last hit by the pandemic, reported 20 percent organic growth in Q3 and 15 percent year-to-date. The contribution from euro pricing in the quarter was approximately half. Food Cultures & Enzymes and Natural Colors grew strongly, driven by recent launches and new customer wins, while Health & Nutrition posted good growth, driven by Animal and Human Health that was partly offset by decline sales in Plant Health.

As you remember from our last call, Plant Health is facing a more challenging time at the moment with lower-than-expected momentum in soy. But together with our partner, we have taken steps to address this, and we hope to be back in growth territory next year.

Lastly, looking at Asia Pacific, we posted strong growth in Q3 of 13 percent, which led to 5 percent organic growth year-to-date. Here, the COVID-19 drivers were actually positive for both Health & Nutrition and Natural Colors. Human Health experienced strong demand for both supplements and infant formula, while Natural Colors business benefited from increased at-home consumption, for example, in Southeast Asia.

Food Cultures & Enzymes revenues were at par with last year as growing fermented milk continued to be offset by decline in probiotics in China. In China, where we saw negative impact from COVID-19 already last quarters, yogurt production levels continued to be below normal levels, but we saw decent demand in Q3 also from inventory buildup. In probiotics, despite another quarter of declined sales, we have actually seen the first launches with immunity claims in South Korea and expect more to come out of our pipeline over the next quarters.

After all these comments related to COVID-19, I am excited to also talk about the strategic progress we have made during the quarter with regards to further expanding our microbial platform. So let's turn to next slide, Slide 7, please. With HSO Health Care and UAS Labs, we have announced 2 acquisitions within Human Health in Q3 and early Q4 that will strengthen our probiotics offering and expand our microbial platform. With HSO Health Care, we are building on our position in the fast-growing women health market, which is estimated to be the third largest probiotic category after gout and immunity health. HSO Health Care is an Austrian biotechnology company that was founded in 2007 and has strong offering for women health with its unique Astarte brand with 4 strains of probiotic blend.

The company has grown double digit over the past few years and expected to generate about EUR 50 million in revenue in the calendar year 2000 (sic) (2020.) The acquisition rationale is very much based on leveraging Chr. Hansen's global commercial capabilities to expand HSO reach beyond U.S. and Europe, particularly into Asia. Furthermore, we will continue to advance our innovation pipeline in this attractive category by bringing Chr. Hansen's and HSO's strengths together and developing new concept for all life stages

from fertility to menopause. The acquisition closed with the announcement, and we are well on track with the integration, which is expected to take about 24 months.

Our second acquisition, UAS Labs, which is still subject to regulatory approval, will further strengthen our position in dietary supplements. UAS Labs is a U.S.-based probiotic player with expected revenue of around EUR 75 million in calendar year 2000 (sic) 2020. Over the past years, UAS has very successfully built a business in the fast-growing multi-strain, high-potency space, where Chr. Hansen has historically not invested. With the acquisition, we will not only get access to UAS Labs' documented strains but also acquire 2 GMP production sites with downstream capabilities, which will give us more flexibility in production and allow us to serve even a broader customer base in the future. Similar to HSO Health Care, we see significant potential for production, innovation and commercial synergies, and we are very excited to have the team of more than 230 employees join the Chr. Hansen family.

I think it is useful in this context to also reflect that our capital allocation framework and put those 2 acquisitions into context. Please turn to next slide, Slide 8. Both acquisitions are fully in line with our framework and our strategy of pursuing bolt-on acquisitions that strengthen our microbial platform, particularly within the fast-growing Health & Nutrition space. If we look at our priorities for capital allocation, then organic growth will continue to be our number 1 priority, followed by bolt-on acquisitions, then ordinary dividends and finally, distribution of excess cash to shareholders. We will continue to assess opportunities for inorganic growth in the future with the intent of pursuing similar acquisitions that extend our technology platform or strengthen our market presence. But let me reassure you that we will also continue to operate with the same level of financial discipline and focus on value creation as we have done in the past.

And with this, I would like to hand over to Søren to give you a bit more color into the Q3 numbers.

Søren Westh Lonning: Thank you, Mauricio. And please move to Slide 9 for the segment review. Food Cultures & Enzymes grew 8 percent organically in Q3 with equal contributions from volume and price, leading to 5 percent organic growth year-to-date, which is well in line with our guidance. Despite the positive tailwind from increased yogurt and cheese retail sales, dairy end markets continue to track at a low level with fermented milk on par with last year and cheese estimated to grow 1 percent year-to-date. In fermented milk, we saw the disruption in the Chinese yogurt production from March to May and more difficult trading condition in some emergents markets like Middle East and India. On the cheese side, the disruptions came mainly from the U.S., but food service is a key channel and dairy farmers despite government support had to throw away milk because of oversupply and lower prices.

If we look at the performance by product segment. Enzymes grew strongly in the third quarter with good uptake of our NOLA Fit and CHY-MAX Supreme enzymes. Fermented milk also grew strongly, whilst cheese and meat cultures delivered solid growth and probiotics declined slightly, although with an improving trend. Bioprotection grew around 10 percent.

Looking at profitability. The EBIT margin for Food Cultures & Enzymes decreased 70 basis points to 34.4 percent in Q3, as increased freight cost because of COVID-19 and a small negative impact from currencies offset the benefits from lower travel activity and production efficiencies.

Please move to the next slide, Slide 10. In Health & Nutrition, Human Health and Animal Health both delivered strong growth, whilst Plant Health declined, leading to 12 percent for the quarter and 6 percent year-to-date. Please remember that year-to-date organic growth remained impacted by adverse order timing in Q1. The strong performance in Human Health was driven by both dietary supplements and infant formula that benefited from increased interest in health and immunity enhancing products, such as probiotics. In Animal Health, we also saw a strong momentum in both cattle and poultry and swine. Lastly, Plant Health did decline because of the weakness in soy mentioned earlier, but we expect this business area to be able – to be back in growth territory as of next quarter. That said, it is also



true that we are looking ahead into next year, and there is risk that the global recession and lower oil prices may impact our ability to drive penetration in sugarcane as farmers may decide to postpone replanting.

Looking at profitability for the segment. The EBIT margin was 34.7 percent in Q3, up 3.9 percentage point, driven by cost-management initiatives and savings from COVID-19-related travel restrictions as well as scalability from the strong top line.

Moving on to Natural Colors on the next slide, Slide 11. The division reported 1 percent organic growth in Q3 and flat sales year-to-date, as our Natural Colors business continued to be challenged by low raw material prices for carmine and annatto and also saw a net negative impact from COVID-19, as described by Mauricio earlier.

Regionally, the economic climate in Middle East remained very challenging. That said, excluding the weakness in Middle East and the raw material headwinds, Natural Colors would have grown by 5 percent year-to-date. Across geographies, the key growth driver for our Natural Colors business remain our premium range of coloring foods, which reported very strong growth. Looking at profitability, the division's EBIT margin stood at 14.3 percent in Q3. Benefits from low raw material prices and less travel activities were offset by increased freight cost and adverse currencies.

Let's now look at the group financials on the next slide, Slide 12. Year-to-date, group organic growth of 5 percent was mostly driven by volume. Currencies had a negative impact leading to 3 percent euro growth year-to-date. If we look at profitability drivers, the gross margin decreased to 55.0 percent, as scalability benefits in Food Cultures & Enzymes and low raw material prices in Natural Colors were more than offset by increased freight cost as a result of COVID-19.

Operating expenses decreased by 50 basis points year-to-date despite continued investment into strategic priorities, driven by cost-management initiatives and lower travel expenses due to COVID-19. Overall, this led to an EBIT margin before special items of 28.4 percent for the year, up 20 basis

points. Special items of EUR 5 million in total were related to our recent acquisitions and the BacThera JV.

Turning to the cash flow. Free cash flow before acquisitions and special items increased substantially to EUR 147 million year-to-date. The improvement was driven by the positive cash flow from operating activities, which was due to a favorable change in the net working capital, IFRS 16 adjustments, lower taxes and higher operating profit. The change in net working capital is mainly related to timing and does not reflect any changes with regards to how we run our business. Cash flow used for operational investment activities was 9.1 percent of revenue compared to 11.3 percent last year because of phasing of projects and delays related to COVID-19. For the full year, we now expect CapEx to end around the prior year level of EUR 139 million.

With regards to our balance sheet, Chr. Hansen remains in a strong position with a leverage ratio of around 2.1x EBITDA despite the recent acquisition.

With this, I would now like to move on to the guidance on the next slide, Slide 13. Based on the business performance of the first 9 months of our financial year 2019/'20, we maintain our guidance for organic growth and EBIT margin before special items and upgrade our free cash flow guidance, although I have to say, subject to high uncertainty than normal with regards to end market demand because of the COVID-19 pandemic and the global recession that we are entering.

For 2019/'20, expectation to organic growth is maintained at 4 percent to 6 percent. The microbial platform, which is the combination of Food Cultures & Enzymes and Health & Nutrition, is expected to grow mid-single digit. Food Culture & Enzymes is expected to grow significantly above the relatively low end market growth and with a positive impact from euro pricing. Organic growth in Health & Nutrition will primarily be driven by Animal Health as well as Human Health. Natural Colors is still expected to deliver flat-to-slight organic growth due to the continued low raw material prices and COVID-19. The EBIT margin before special items is still expected to be around 29.5 percent, increased utilization of production capacity and lower travel activities will have a positive impact on the margin, which is expected to be

offset by investments in the lighthouse projects as well as higher freight cost due to COVID-19. Acquisitions will have a smaller negative impact on group EBIT margins before special items. Free cash flow before acquisitions and special items is now expected to be around EUR 200 million and to be above EUR 200 million as COVID-19 has delayed CapEx projects, and as a result, cash flow used for operational investment activities is now expected to be lower.

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

Mauricio Graber: Thank you, Søren. I am sure you have seen in the company announcement that we have also announced a new date for our Capital Markets Day, where we will present the results of our strategy review process. As we have said in the past, we continue to believe strongly in the opportunities that our microbial platform and fermentation technology offer, and you should not expect any major changes. However, as part of our portfolio review, the Board of Directors, together with the Executive Board, have decided to explore options for the future of our Natural Colors division including a potential sale of the business as it does not share the same microbial platform with the rest of the business. At this point in time, we can unfortunately not provide any further information on this, which I am sure you will understand. That said, we hope to be able to provide an update at the Capital Markets Day in August.

To wrap up, Chr. Hansen maneuvered very well through the first phase of this global pandemic crisis. And whilst at the moment, countries around the world are slowly opening up again, trying to return to some kind of new normality, it is also clear that the pandemic is not over yet and that we will have to deal with it and its consequences for some time ahead. We delivered a solid Q3 result with a net positive effect from customer safety inventory buildup that we expect to see come down further over the course of the next quarters as global supply chains normalize.

We maintain our guidance for organic growth and EBIT margin for the year, and we upgrade our cash flow guidance, assuming no major disruptions in our supply chain from COVID-19, but it's also clear that we are heading into a

global recession, we will face more challenging trading conditions if consumers are changing spending patterns and customers increasingly come under pressure to save costs. At the same time, we will focus our efforts on capitalizing on the increased awareness and interest in health and well-being and probiotics and our 2 acquisitions with Human Health – within Human Health will help us on this journey.

Lastly, we look very much forward to welcoming you at our Virtual Capital Markets Day on August 24 and 25, and I recommend that you check our Investor Relations website to sign up in advance.

With this, I would like now to open up the call for questions and answers. Thank you.

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 Annette Lykke from Handelsbanken.

Annette Lykke: First of all, interesting new strategic initiative to potentially taking your color division up for sale. I know this has been discussed many times, and you have previously said that it could be hard to find a buyer for a company with a ROIC of 19 percent and getting a decent price at the same time. I would like to have some comments on that, please.

Then on FC&E, with an 8 percent organic growth, I can see that with bioprotection up 10 percent, the rest of the business is only by 2 percent. Maybe you could, in this respect, elaborate a little bit more on how you see the future growth for the non-bio-p activities. Of course, here, I would very much like to have an update on the Chinese yogurt market. How you see this coming? Is production now fully back on track? And how do we see consumer behavior over the next 12, 18 months?

Mauricio Graber: Thank you, Annette, Mauricio here, I'll take it first and pass it on to Søren to complement. So first of all, I just want to say generally, on Natural Colors, what we have announced is that we're putting out the business for strategic review that may lead up to a sell. So it's a broader consideration than selling the business.

Second on FC&E, to your question. So 8 percent for FC&E, I think, proved the resiliency of the business during COVID. I wasn't sure how you made the calculation of the 10 percent, 2 percent. Remember that bioprotection represents about 7 percent of our business, and it grew at 10 percent. I think 10 percent was good growth given that, as we said, there were limited new trials with customers. So it tells you that there's a sustained momentum in Food Cultures & Enzymes bioprotection initiative.

Lastly, on China, I mean, there's a lot of moving pieces with COVID-19 in China, whether you look at (ambient yogurt, specifically.) But overall, while China is back – is not fully back, (inaudible) come back to a (30) percentage but not fully. Søren, anything you may want to complement on that?

Søren Westh Lonning: Yes. I think just to clarify, I mean, when you look to the growth outside bioprotection, I think it's very important to clarify that when 7 percent of the business is growing by around 10 percent and the 93 percent, what that is growing, it's pretty close to the overall growth level of 8 percent, maybe in the range of 7 percent to 8 percent, but it's definitely not there too, that I can guarantee.

Annette Lykke: And any comments on the pricing on the Natural Colors division? You have previously said it can be hard to find a good buyer for a company or a good price for a company with a ROIC of 19 percent?

Søren Westh Lonning: I honestly don't remember saying that. I think we should not comment on – likely we are just initiating the strategic review. So we don't know what the interest will be, but I actually think that the – when you look to the Natural Colors business, surely, we are happy with it. It's a growth business. It's grown by more than 10 percent organically over the last 10 years. It has a

solid margin profile, and it has a ROIC that has been tracking between 20 percent and 25 percent over the last 5 years also. So I think from a profile point of view, I think it will be a quite attractive asset. In addition, it is the global leading Natural Colors business. So if everyone wants a leading play in this field, this is the option. So – but I will not speculate in terms of the interest because, as we said, we are only now starting the strategic review, and it's broader than only selling it.

Mauricio Graber: Yes. And maybe, Annette, just to complement that, I would just close on saying the following. You heard from my words during the presentation the importance for Chr. Hansen on our unique value proposition of the microbial and fermentation technology platform. So while Natural Colors does not sharing that, Natural Colors has a brilliant future. Natural Colors provide the color that ends up being the color identity of many brands, and I think it's a very strategic asset that if we would move to a sell with, for sure, fetch, very good interest from many players.

Operator: Your next question comes from the line of Jonas Guldborg from Danske Bank.

Jonas Guldborg: First, a question on the end market growth. So it's down in yogurt and flat as far as I can see in cheese. Is – the decline in growth rate, is that mostly due to the Chinese yogurt market? Or is it more due to the collapse in the food service industry? If you could put some words of that, that would be my first question.

Then diving into the organic growth in Food Cultures & Enzymes of 8 percent, whereof 4 percent is pricing. So could you tell us what currencies are driving the euro pricing here? And then also what level to expect for Q4 and for the full financial year?

And then if you could put some comments on the EBIT improvement in Health & Nutrition. You're improving the margin by around almost 4 percentage points. It's cost management initiatives and then there's travel restrictions, how is the split on these 4 percentage points? And is the cost management initiative part of it? Is that a structural thing? That was my third question.

Mauricio Graber: So Jonas, I would say on the end market growth, and I'll ask Søren to complement a little bit. What we have talked to is a low-cyclicality moment on the end market growth. And I think you're right to point out that the 2 negative contributing factor to that remaining at a low-cyclical point has been the dairy dynamics that Søren referred to as well as the U.S. food service and the impact on China. When you look at the EBIT in Health & Nutrition, but in general, I think we mentioned 3 main dynamics. So first, we'll continue to see productivity from our manufacturing capacity and the continuous improvement that we have in managing our yields in production.

The savings on travel are mainly driven honestly by the COVID restrictions where we had to be a lot more creative about working digitally with customers and there were less number of internal meetings and external meetings that implied travel displacement versus digital connections. And obviously, that was partly offset by freight cost because, as you know, some of the routes, particularly by air freight, were reduced. There was less capacity and slightly higher cost. Having said that, I think our supply chain team did a fantastic job in being able to find mitigating alternatives to reach products on time to our customers. Søren, I'll pass it on to you to comment as well on the currencies and the question around that.

Søren Westh Lonning: Yes. So the key drivers – back to your question regarding the euro price, the key drivers behind the effect relates to the Brazilian real, the Turkish lira, the – there was also an impact from the Russian ruble and a smaller impact from the Argentinian peso. So those were the main contributors of the currencies driving the euro price list effect. And it's likely that we will also see an impact from that when we look in the coming quarters. So that's the comment on that.

And then I would say on the EBIT margin, maybe just supplementing on the EBIT margin in Health & Nutrition. Obviously, when you are in a situation where you grow by 12 percent on the top line and your – despite investments into the business, your cost is close to – on par with last year when it comes to SG&A and R&D, et cetera because of lower travel and some

postponements in further investments. Then, of course, it gives a solid scalability, so very much driven by these factors.

And then you can just note that when it comes to the freight cost, Health & Nutrition is the area that have the lowest freight cost per top line relative to the other businesses, where Natural Colors weighed more per unit sold and Food Culture & Enzymes are more that are transported at very low temperatures, which is a more costly transport also. So just (inaudible) also here that when we talk about the freight impact, it's less in Health & Nutrition and more on the 2 other businesses.

Jonas Guldborg: OK. That was very helpful. Just on the – getting back on the pricing and the impact going forward. Should we understand that as we should also expect a 4 percent-ish kind of impact in the coming quarters?

Mauricio Graber: I would be a little bit mindful of giving a specific guidance on this because, as you know, the currency rates are developing every day. And in particular, during this COVID-19, there has been some volatility. But it's fair to assume that there would be a material positive impact also in our Q4.

Operator: Your next question comes from the line of Lars Topholm from Carnegie.

Lars Topholm: Congrats with another good quarter. I have 3 questions. The first one goes to infant formula and the growth you're seeing there. I wonder if you can comment a bit on how much is underlying volume growth in that market and how much of your growth comes from increased penetration. And of course, if you can comment how big a proportion of your sales it is, that would be nice?

Second question goes to BacThera, where you're now ramping up cost. I wonder if you can give some guidance as to how long that cost ramp-up will continue and to what level and when we can expect to see the first China revenue.



And then finally, on CHY-MAX Supreme, if you can put some comments on what the penetration is within your own cheese customer base? And what do you think that penetration can potentially go up to?

Mauricio Graber: Thank you, Lars. On infant formula, a lot of our growth really comes from the penetration of probiotics into infant formula. And what you have to take into consideration of that is the continuous movement towards premiumization in infant formula that benefits the growth of the category in probiotics.

Moving on to BacThera. I would say, remember that what we said in BacThera is that the focus was to have our GMP capabilities completed by the end of this calendar year. We are focusing on that. We have announced that we have signed some of the first customer agreements, which is encouraging and COVID-19 is also having an impact on BacThera in their ability to do some trials, et cetera. So I think we will see next year as we have our GMP capabilities ready. The dual impact on BacThera, on the positive side, there's never been more interest around live biotherapeutics and the interest of BacThera as the unique value proposition of having the end-to-end supply chain. On the other side, it's a more difficult time for start-ups and tests and trials, so a positive and a negative there.

And finally, on CHY-MAX Supreme. CHY-MAX Supreme continues to do very well in the market. It's one of the examples of projects where we continue to win with customers based on the strong proposition that it has on driving productivity yields for cheesemakers and replacing other technologies that penetrate on that. Søren, I pass it on to give more specific on some of the questions.

Søren Westh Lonning: Yes. So if we take maybe – a few additional comments on the infant formula, we see the underlying market growing with – from the statistics that we can see around 2 percent to 3 percent globally on the infant formula markets. And now I'm not talking Q3 specifically, but more structurally, that's the level we have seen. And we have indicated that with – in our business, where we're selling probiotics and tapping into the premiumization effect, that we're expecting that to grow faster than the overall growth in Human Health. So it's indicating something that is close to a – getting close to a

double-digit level. So it's a pretty significant effect from higher penetration and premiumization that this category is experiencing.

In terms of the BacThera, I want to emphasize also that we have previously communicated that we expect to be breakeven within a 3- to 4-year horizon and that's still the plan. Obviously, the COVID-19 and the full effect of that, we are still evaluating. But as such, we are still committed to that. So there will be some cost ramp-up. There will be some – also some CapEx spend to be ready, but we also expect revenue to follow and bring us into a neutral territory within a 3- to 4-year horizon from the start of the JV. And then maybe just on the penetration, I would add that it's a relatively low penetration that we are still seeing on this. So there's still ample of room to further penetrate with our CHY-MAX Supreme, and we are most advanced actually in Latin America in terms of the penetration, and there's ample room to grow still in LATAM, but especially also in other regions.

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

Heidi Vesterinen: So a couple of questions, please. First, on the inventory reduction that you talked about, which you saw in the end of Q3. Can you clarify if you said that is now done? Or has that continued into Q4? And what sort of products in regions are you seeing the (inaudible)?

Second question, you talked about some slow progress with your commercial pipeline. Did you already see a financial impact of that in your Q3 numbers? Or was it too early? So is this more to come?

And then lastly, we saw that pricing was down in Health & Nutrition. Could you talk about what drove that, please?

Mauricio Graber: So, Heidi, to your question on inventory. I think what we said during the call is that we saw a spike in March and the beginning of April from both consumer pantry loading and customer safety stocks that, to a large extent, normalized in the second part of the quarter. My overall view, and I want sort of people on the call to listen to this carefully is, I think, for decades, the

focus on the supply chain of food ingredients and food had all been about productivity and cost, productivity and cost. Then came COVID-19 and the mentality shift to reliability and business continuity. I don't think that focus is going to go away. We are not out of the challenging conditions of COVID. So I don't expect that the industry will operate with lower safety stocks anytime soon during Q4 or so. I think it will take many quarters for this situation to, let's say, destock, if you're talking about destocking. What we have mentioned is that it has normalized to the normal patterns after the inventory buildup.

Søren Westh Lonning: When it comes to the – to address your other questions in terms of your commercial pipeline, I would say that we've had a solid performance in Q3 on the commercial pipeline. But bear in mind that, that is also the project that was most advanced in the states or more in a negotiation, finalization. And we have been able to progress also virtually on that part. So you can say we are still assessing how the projects that are less advanced and requires more trials and more physical attendance with customers, how that is going. And we are working on how we can cope with that in the best manner possible.

So I wouldn't – we have not seen that effect yet. That's to answer that question directly. I expect there could be a smaller effect in Q4, but it's more something we will monitor in the coming months, how we progress also maturing these. But clearly, there has been, in some – in addition to what we're able to do, there are some customers who said, now it's not the time to do – to roll in new innovative solutions. We will wait a bit and focus right now just on business continuity and supplying. So that's a little early. We haven't seen effect in Q3. We expect to see some sort of effect in Q4 and next year, but it's very difficult to assess the size. And I would say, I take some comfort in the way that we've been able to handle and progress in the Q3 also.

On the pricing in Health & Nutrition, I would say this is an adjustment related to, you can say, the strategic key account segments, where we have some customers that have just grown very in size and are committing to taking

more volumes. And hence, we are making some smaller adjustments to price in that context. There's no structural changes in the industry dynamic in terms of pricing behavior from competitors or that thing. So it's more of a, you can say, a normal adjustment. Traditionally, Health & Nutrition has been quite steady on price around 0 net-net. And right now, it's – I think it's minus 1 in the quarter. And so it's still relatively close to what we would normally report in this.

Operator: Your next question comes from the line of Søren Samsøe from SEB.

Søren Samsøe: Just a couple of questions from my side. First of all, just if you can help me sort of explain how you think about your guidance, you're maintaining your 4 percent to 6 percent organic growth guidance for the full year. However, if you take the midpoint of that, that would imply around – organic growth around 7 percent in Q4, i.e., the same level as in Q3. However, your comp is around 6 percentage points easier. Why this sort of cautiousness on Q4 given that a lot of markets are coming back in June, July from – August from COVID-19, Asia, Europe, et cetera? That's the first question.

The second question is on the gross margin, which is down 170 bps in Q3. And if you can quantify or sort of give a bridge of what causes this? I mean, how much is coming from higher freight costs? How much is currency, et cetera?

Mauricio Graber: Thank you, Søren. So I'll comment on the guidance and pass it on to Søren for the margin question. I think it's quite sort of simple from my perspective, we maintain the guidance. If you look at Q3, we delivered 7 percent growth. When you look year-to-date, we're at 5 percent sort of in the middle of the guidance. I think you are right to point out that there may be upsides, there may also be downsides. And I think what COVID has proven is that there's a lot of volatility. It has really created a dichotomy on creating some opportunities, but also creating some risk. So I think our best assessment as management is that the 4 percent to 6 percent remain at the right range for us to deliver during the full year, so it's our best assessment as management to maintain the guidance.

Søren Westh Lonning: Yes. And in terms of your question regarding the gross margin, the freight cost is, by far, the largest driver of the decline. Bear in mind that we do transport products by air, and that's where the challenge has been to – due to our rather consolidated production facility setup. And we have seen air rates in certain lanes go up to 5x higher than normal rates. On average, it's clearly lower than that, but it has been a quite significant spike in air freight rates, and that has had a material impact on our gross margin in this quarter.

We do expect that we have seen a start to moving in a more normalized way. But it's still – we're still operating at higher price levels, and we expect that to continue for a while. But that goes a bit hand-in-hand with the travel upside that we have in our operating expenses because the reason for why the freight rates are high is that there are very few commercial airlines flying relative to what you normally saw. And that's because we are traveling less also in many other ways. So there's – you can say there is sort of a hedge somehow, you can say, almost, say, between the 2 lines. So it's more moving cost between lines than it's overall, having a very material impact in our Q3 on a net basis.

Mauricio Graber: And I think, Søren, it's also fair to say that once COVID hit and securing business continuity was the top priority with very limited availability on some freight routes, things have to somehow normalize, and now there's better time to plan to explore options to ensure that this can be mitigated. So I don't – I would expect this incremental cost in freight to be mitigated over time.

Søren Samsøe: OK. But do you still feel that you have the same kind of operational scalability now that you actually have pretty good growth? You still see the underlying scalability benefits of this in your production? Or has that sort of tailed off now that you have become bigger, you can say?

Mauricio Graber: We continue to see very good scalability in our production. And I think that journey is far from over. I think we continue to see productivity from scale and productivity from the way that we can run fermentation.

Søren Westh Lonning: Yes. And I would be – I would caution not to over interpret. One – the performance in 1 quarter on this dimension to conclude on that journey because there are many things that can influence with cost in freight. There can be other things influencing at a given quarter. But we are definitely on a journey where production costs in our microbial platform is growing at a lower level than our overall sales level is.

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

James Targett: Two questions. Just mostly clarifications or sort of follow-ups from previous ones. Firstly, on the kind of the question on destocks or safety stocks. Am I right in thinking that you're saying you're not expecting a headwind from destocking over the coming quarters or the quarter, but rather, there's no further tailwind? I just wanted to check that's what you were trying to say. And then secondly, on the commercial pipeline, you mentioned 3 things, which were making you cautious, so inability to run trials, delays to new product registrations and also cost reduction from your customers. Of those 3, which are do you think are the most material and kind of the main reason for your caution?

Mauricio Graber: Yes. Sort of on the safety stocks, I think what I tried to mention is that I think it will be a cautious and slow movement to reduce safety stocks as the situation normalizes. But once we look at the situation that's taking place, North America, Latin America, the COVID-19 impacts are far from over. And overall, on the commercial pipeline, James, I think it's difficult to quantify each one of them. Because as I said, there's a lot of dichotomies in this COVID-19 impact. On one side, there is more challenges to drive some of the trial with customers. On the other side, there are some customers that are really eager to get to the next generation of immunity probiotic use, et cetera. But our cautious, I think, it's an overall cautiousness about the ability to execute an end-to-end commercial pipeline in close collaboration with our customers. That's our model.

Søren Westh Lonning: Yes. And maybe I add that it will also vary from business segment to business segment. So in Food Cultures & Enzymes, the trial component may be more important than in – when we look to Natural Colors, whereas here,

there might be more decisions by our customers to postpone some projects, et cetera. So it will vary also by business area, James.

Operator: Your next question comes from the line of Casper Blom from ABG.

Casper Blom: First of all, I'm sorry to keep more questions in these areas. But rather than sort of speculating whether or not there will be a destocking, could you maybe say how much the pantry loading and safety stock has helped here in the quarter? And secondly, when it comes to these challenges in coming out and meeting with clients going into the lab with them, could you give some comments on how much those activities would in a normal year have added to growth in the following year?

And then some other subjects. Thinking a bit ahead with the recent acquisitions you've done and assuming that Natural Colors would not be part of Chr. Hansen in the future, how should we think about your investment needs, CapEx to sales in such a scenario?

And finally, I think, Mauricio, you mentioned that a global recession might be looming a couple of times. Do you have any tools that you can offer to clients in terms of mitigating that? Any interesting new products that could sort of be helpful for the customer in such a situation?

Søren Westh Lonning: OK. I will try to address some of your questions, and then maybe Mauricio will join in. I would say regarding the CapEx to sales ratio, let me start there. We don't – we're not speculating at this point Natural Colors part of our business, and we are not speculating in potential changes. If that should materialize, then we will update the market on what to expect. So I can't really comment on that part. If you look to the commercial pipeline impact in a year, it will also vary from business area to business area.

I mean, if you look to Food Cultures & Enzymes, this is where you can say the largest relative component of the – probably the commercial pipeline is playing in, in the sense that market growth right now to the tune of flat to small growth, and we are still growing by 8 percent and 4 percent volume. And the – you can say, the difference between the end market growth and

the volume growth, that's an indication of how much the commercial pipeline is contributing, bringing innovation to our customers, et cetera. But that will vary business area by business area. But it's a very important driver overall. It's not something that is standing still. I think that's important to say we are making progress, but there can be some delays.

When it comes to the stock build in Q3, your first point, I think the comment I would make here is that it's – there is a sum of positives and negatives. I would say the – when we – from the COVID-19, if we add it up, we are more – we are closer to 1 than we are 2 or 3 in terms of positive effects, but it's very difficult to put an exact number on it because we don't have full transparency into our customers' inventory positions and also consumer pantry loading, et cetera. So – but that will give you some sort of indication.

And then I'm sorry, the fourth question, maybe I could ask you to repeat that.

Mauricio Graber: I will take this, great in connection to the recession. So just completing a little bit what Søren said, indeed, we – there's so many in and outs on COVID-19, and I tried to mention that during the call, how it affects each business and each business within the region differently. So if you ask to quantify, it's difficult, but we would say probably a net positive around the 1 percent that Søren mentioned. To your question on the recession, I think I want to set the right tone for the call. We reported what we think is a strong quarter, and we want to be humble and cautious that we're reporting this in the middle of a very, very challenging global environment.

You have a lot of people that are out of jobs. You have a concern by consumers on what lies ahead in the future and that recessionary environment, we just need to be conscious about that. Having said that, our business has proved to be quite recession-proof. I think, for sure, in a recession environment, consumers will spend less on durable goods, less probably on travel and dining out, but groceries will maintain a strong resiliency. And our product portfolio has a lot of technologies that help customers do more with less, drive productivity, CHY-MAX Supreme, convert more of the milk into cheese and fresh dairy, use probiotic as a way to drive



immunity. So I think we have strong tools to continue to drive our own growth destiny even within flagging a more challenging recessionary environment.

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

Arthur Reeves: My question is really around midterm guidance. I think in January, you said you've got mid-term guidance of 5 percent to 9 percent. And that was based on market growth in Food Cultures & Enzymes of 2 percent. Given everything you've said on the call today, do you think that 5 percent to 9 percent is still realistic given that market growth in Food Cultures & Enzymes is certainly not 2 percent and difficult to see how it's going to increase? And all the points you've made about bioprotection not growing as strongly as it would, Plant Health being potentially affected by the recession, Animal Health being potentially affected by lower commodity income for farmers and the issues around the pipeline, the commercial pipeline that you've been very clear about. Is that 5 percent to 9 percent realistic still?

Søren Westh Lonning: Well, it's a good question. I think we have in our communication here said that we are not making any changes to our long-term financial ambitions, the preliminary ones we issued in January. So it means that we are committed to what we have said. When it comes to this, bear in mind also that it is an ambition over a 5-year horizon. And when I look to the level of uncertainty that at least I'm seeing right now, I see more uncertainty in the, you can say, the short, medium term, the next 12 to 18 months, than I see, you can say, 3, 4, 5 years out. So obviously, how we exactly are going to go through the COVID-19 in the coming year, that's probably where I see the largest uncertainty. But that's also the reason why we have postponed our strategic update. That is that we want a complete thorough review of how we see the world in a COVID-19 environment, and we'll come back and address that at the Capital Market Day, Arthur.

Mauricio Graber: Thank you, Søren. I think that's well captured. And I'll just say, we have a strong conviction about the growth and profitability of our microbial and fermentation technology platform for the future despite that the next 12 to 18 months due to COVID will be challenging across industries and segments.

Operator: Your next question comes from the line of Patrick Rafaisz from UBS.

Patrick Rafaisz: Three quick ones, please. The first would be around Plant Health and you confirmed what you've already said at the last call, which was that the growth will all come in the fourth quarter. But can you update us on the rollout in North America? Any changes there in your planning?

The second question, just a quick 1 on CapEx. And that's also something you already addressed partially. But can you remind us the delays in the CapEx projects into next year? Will they all materialize? Or should we assume a full transition into 2021? Or are some of these projects may be cut for good?

And then the last question, Mauricio, you talked about the immune-enhancing products, where you're having very good discussions with customers. Can you frame or quantify a bit your portfolio in this area and the potential you're seeing in the near and in the midterm?

Mauricio Graber: So Patrick, I'll answer a couple of questions. Søren, I'll let you address the one on CapEx. Around Plant Health, our strategic initiatives in Plant Health, where we have said, we need to move outside of Latin America and outside of sugarcane continue to advance as planned. Obviously, COVID-19, we have to be conscious places more challenges to be able to do trials in farms because they imply travel, they imply collaboration, face-to-face meetings.

But the progress in North America has been as planned. I think where we see the biggest challenges in Plant Health were really in the soy planting season. And we have a slight concern on the sugarcane level of replanting given that the low level of oil prices and ethanol and how much of sugarcane will be planted in the future, and that's why we're a little bit cautious on Plant Health. But the journey where we are with Plant Health of using bacterial solutions for plants is a very promising one, and we will see growth in Q4 and in '21.

As it relates to immunity, I would just comment that it applies to both a high level of immunity solutions for dietary supplement as well as in food

solutions. And that's where our portfolio of documented strains of probiotics is the largest, let's say, ammunition or tools that we bring to co-develop those products with customers in Human Health and in Food Cultures & Enzymes.

Søren Westh Lonning: Yes. And to address your questions regarding CapEx, the majority of these are postponements. There, we are also taking the opportunity to review the portfolio and make a bit of pruning of projects, but the majority is postponement, but you should not – I would not say you should think of it as everything being postponed into '21, there will be also sort of a gradual postponement throughout the years.

So the best guidance I can give you is probably that we moving into FY '20, we saw '20 – '19 and '20 as the 2 peak years and then a clear reduction in 2021, and that sort of dynamics will probably – the steepness of curve, et cetera, will be changed somewhat from this level here. But overall, generally, postponements that we are working on throughout the period to address this.

Mauricio Graber: Thank you all for joining the conference call today. We look forward to continue our discussions over the next week with a series of virtual roadshows with many of you and that we can meet in person where circumstances allow it. My IR team reminds me not to let you forget to sign up for our Capital Markets Day, and we look forward to seeing you in August. Thank you.

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

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