Chr. Hansen Holding A/S
Q1 2020/21 Results
Conference Call Transcript

14 January 2021
10 am CET

Operator

Thank you for standing by and welcome to the presentation of a Christian Hansen Holding Interim Report Q1 2020/2021. 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 do wish to ask a question, you will need to press 01 on your telephone keypad. I must advise you that this conference call is being recorded.

I would now like to hand over to your speaker today: Christian Hansen's CEO, Mauricio Graber. Please go ahead with the meeting.

Mauricio Graber

Morning everyone and welcome to today's conference call on Christian Hansen's Q1 2021 results. Together with our CFO, Lise Mortensen, and the IR team, we would like to wish everybody a Happy New Year and hope that you and your families continue to be healthy and safe during these challenging times of the COVID-19 pandemic.

Before we start, I would like to pass the word to Lise to briefly introduce herself, given that many of you have not had yet the opportunity to meet her since she started last year. Lise.

Lise Mortensen

Thank you, Mauricio, and a warm welcome also from my side. My name is Lise Mortensen and I joined Christian Hanson in October of last year. Before that, I worked for ten years at Microsoft, heading first finance in Denmark and then in India and then the last five years as CFO for Microsoft Germany.

In addition to my finance background, I have a lot of experience with chains and transformation that I believe I can put into good use with the ongoing portfolio changes at Christian Hansen. In my role as CFO, I will also be in charge of IT, and coming from the software and digital services industry, I'm looking forward to bringing in an external perspective to further develop Christian Hansen's digital agenda, not least in the finance area.

What I really like about Christian Hansen and what attracted me to take up this job in the first place is the company's strong purpose and its ability to contribute to some of the world's largest challenges by using its microbial solutions. I've always been convinced that doing well by doing good is not a dichotomy for corporates and thus Christian Hansen is a perfect match for me.

And with these introductory words, back to Mauricio.

Mauricio Graber

Thank you, Lise. Before we continue, please take notice of the safe harbour statement on the next slide, slide three.

Thank you. And let's then turn to slide four. Christian Hansen delivered a strong start to the financial year 2021 with 10% organic growth, which was supported by all businesses, so on a relatively easy comparable from last year Q1.

Volume growth in Food Cultures and Enzymes picked up compared to Q4 supported by upselling and wins in our cheese and enzymes business. But the quarter was not without challenges as dairy markets, particularly in some emerging markets, remained weak and our ability to drive sales continued to be impacted by travel restrictions. In light of these developments, I am quite pleased with our performance.

In Health and Nutrition, our supplement business continued to profit from increased interest from consumers, and customers in immunity enhancing solutions. And Animal Health benefited from new customer wins in poultry and swine, while plant health delivered a strong quarter in line with our expectations.

Underlying EBIT margin before special items, meaning our EBIT margin before special items excluding the recent acquisitions, was 28.5%, down 50 basis points compared to last year due to FX. Including the acquisitions, the reported EBIT margin before special items was 25.2%, in line with our own expectations. Free cash flow before acquisitions, divestments, and special items came in at minus €6.9 million, below last year due to the acquisition of the Kalundborg site for our HMO business that was partly offset by a higher operating cash flow.

With that, let us now look at the strategic progress on the next slide, slide five please. Last August we unveiled our new 2025 strategy and purpose to grow a better world naturally. We're investing in our core platforms of dairy, human, and animal health remains one of our strategic priorities and bringing new innovations to market faster is a key enabler for that.

During the first quarter we launched great new solutions that helped cheese and yogurt manufacturers bring tasty products to end consumers while driving their own efficiency agenda. For example, we launched a premium version of our YoFlex culture range that allowed dairies to produce yogurts with great texture while saving costs.

In Human Health, we presented our first concept for oral care to customers, which is one of our novel indication areas that we are exploring as part of our new strategy. And we have seen also very good traction with our new combined Human Health offering.

Lastly, in Animal Health we are further rolling out our products globally and have seen great success with Gallipro feed in Southeast Asia, as well with our swine probiotics in China. Innovation is also a key driver when it comes to leveraging our lighthouses and I am very excited about the strong pipeline we have across the different businesses.

In November, we already launched a new bioprotective solution for fermented plant bases and we are on track to introduce the third generation of our FreshQ range during this financial year. Following the success

CHR HANSEN

Improving food & health

of our bionematicides in Plant Health, we are currently awaiting regulatory approval for our first biofungicide [ph 00:11:01] which will start selling to our partner FMC in the US. In the meantime, we have opened a new application centre in Milwaukee to support FMC sales activities on the ground with technical expertise.

If we look at Bacthera, I am thrilled to see that momentum in the live biotherapeutics industry has accelerated noticeably over the past few months with important positive clinical trial results and more funds flowing into the space. All of this confirms our positive view on this exciting emerging market and Bacthera is uniquely positioned to establish itself as a leader in the field supported by the competencies of both Lonza and Christian Hansen.

Looking at the extent strategy pillar, the focus of our current financial year is very much on the successful integration of the three acquisitions we announced over the past months. Our Human Health organisation is working full steam on the integration of HSO Health Care and UAS Labs. The new combined organisation has already been established. The new route-to-market strategy has been aligned and the first cross-selling revenues realised. The process is expected to be completed by the end of our financial year and first synergies are expected to materialise from fiscal year 2022 onwards.

With regards to our HMO business, in Q1 we have further validated the long-term potential in market attractiveness of this emerging field. We have received very positive feedback from customers that look forward to working with us and we have started the project phase of our new state-of-the-art production in Kalundborg, Denmark.

We estimate that building the new production in Kalundborg will take at least two years from start of construction, and our spend in the financial year will be less than initially indicated, which is why we have adjusted our total CapEx guidance of the year. The market will develop as more cost countries approve the inclusions of HMOs and as customers launch products containing HMOs.

And unfortunately, COVID-19 has caused some delays in both. In addition, we are currently facing some short-term capacity constraints in the existing factory in Germany, which we expect to resolve before the summer with a minor investment. But it means that parts of the expected financial year 2021 revenues will be pushed into the financial year 2022.

Accordingly, we have corrected the initial revenue contribution from our acquisitions from €130 million to €140 million to around a €100 million and the EBITDA contribution from around €30 million to around €10 million. However, let me be very clear that these temporary delays from the financial year 2021 do not in any way change our conviction in the long-term prospects of this very exciting business.

Lastly, the carveout of Natural Colours is well underway and closing is expected for spring 2021. Please remember that until then the division is reported as 'discontinued operations' and is no longer affecting the Group organic growth and profitability. But let me also say that I am very pleased with the performance of the division in Q1.

The results of Natural Colours demonstrate the good execution of the strategy and a team that has remained focused in customers and winning new business as we complete the transactions. I am proud to see FruitMax now being the largest segment of the division.

After this strategic update, let's look at the regional performance on the next slide. In Q1, we saw improving momentum in EMEA and North America compared to Q4, while APAC saw a decelerating trend. Our largest region – Europe, Middle East and Africa – delivered 7% growth for the quarter versus a minus 3% last year. Food Cultures and Enzymes grew solidly with better momentum in the Middle East and Turkey supported by customer wins and order timing.

Health and Nutrition grew slightly in Q1 because Human Health faced a more challenging business environment in Europe where the business is more dependent on traditional pharmacy channel sales. North America, which following the acquisitions now represents more than 30% of our revenue, reported 9% organic growth after 8% in last year's quarter, with Food Cultures and Enzymes growing solidly supported by very strong growth in cheese.

In Human Health, growth in Animal Health was flat given the very strong growth in Q1 comparables from last year, while Human Health continued its very strong performance in supplements. Organic growth in Latin America was 40% versus 9% last year, of which approximately two thirds was euro pricing and one third volume. But both Food Cultures and Enzymes and Health and Nutrition contributed to the strong performance in the region.

Lastly, looking at Asia-Pacific, the region reported a negative organic growth of 4% versus a negative 2% last year in Q1 and we continue to see a negative impact from China.

With regards to China, the local dairy market, we have seen a more severe decline in yogurt production over the past months than what we had expected, while liquid milk sales continued to increase, and this impacted our business negatively. We are currently investigating potential business opportunities for Christian Hansen in the liquid milk space, but I will not expect a meaningful contribution from this effort in the short term.

While we expect to see some improvement in the second half of the year and continue to believe strongly in the mid and long-term prospects for the Chinese market, short-term China remains a challenge and we do not expect the market to come back to positive growth in the financial year 2021.

Overall, we see that in developed markets the increasing retail or at-home consumption seems to compensate or more than offsetting the decline in food service and on-the-go consumption, while in certain emerging markets where dairy is still a discretionary premium item, we see lower volumes, and this is more pronounced for yogurt than for cheese.

Furthermore, while so far we have not seen a meaningful negative revenue impact from delays in our commercial pipeline, we remain somewhat concerned about how increasing cost focus from customers, launch delays and less appetite for new innovation will impact our commercial pipeline over the coming months. Our team has made great progress in expanding our virtual sales toolkit, but in-person meetings remain an important element of our sales process.

With this, I would like now to turn over to Lise.

[connection issue 00:19:25 to 00:20:03]

Lise Mortensen

Okay, let's maybe start again with slide seven and I apologise for this technical glitch. Food Cultures and Enzymes grew 8% organically in Q1, with a 2% contribution from volume mix and 6% contribution from euro pricing. Dairy market volumes reflect a slight decline in Q1 due to weak fermented milk markets in some of the emerging geographies as just alluded to by Mauricio, which means that even though 2% volume growth is below our midterm ambition, it is still outgrowing the underlying market.

If we look at the product segments, we've seen very strong growth in our Cheese and Dairy Enzymes business, while Fermented Milk sales were muted, and Probiotics and Wine declined. Regarding our lighthouses, we are pleased to see continued good traction in Fermented Plant Bases, mainly in the Dairy Alternative space. And Bioprotection on the other hand, had a soft [ph 00:23:09] start to the year with mid-single digit growth, but we expect this to accelerate throughout the year as we see our commercial pipeline ramping up with the new product launches, which should get us to double-digit growth for the year.

Looking at profitability, the EBIT margin for FC&E decreased to 30.7% compared to 32.1% last year, as efficiencies that we continued to realise in our production plants and COVID-19 related lower travel expenses were offset by favourable product mix, higher freight costs, increased depreciations and FX.

Please move to the next slide, slide eight. In Health and Nutrition, we've seen another strong quarter with 15% organic growth supported by all three businesses, though compared to an easy baseline of minus 4% organic growth last year.

In Human Health, our supplements business continued to grow very strongly, with variations across regions, partly offset by Probiotics for infants and young children that declined because of inventory adjustments and order timing, however leading to solid growth for Human Health overall. Animal Health surprised us positively with very strong growth driven by customer wins in Poultry and Swine, while momentum in Cattle business in North America, which accounts for about 40% of total revenues, was stable.

Plant Health delivered strong growth as we continued to see a good uptake of our bionematicides Quartzo in Latin America. HSO Health Care, UAS Labs and Jennewein, our three acquisitions, contributed €21 million of revenue in Q1. Looking at profitability, the decrease of the reported EBIT margin is clearly attributable to the acquisitions. If we look at the underlying business, then the margin was 22.1%, up 2.5 points supported by strong volume growth and lower travel activities, and partly offset by higher freight costs and FX. The acquisitions then contributed a €2 million loss to EBIT which led to an overall EBIT margin for the segment of 13.6%.

On slide nine, if we look at the top line performance of the Microbial business in total, we realised 10% organic growth with equal contributions from price and volume. Price was, as usual, driven by our euro prices mechanism and given the current FX rates, we expect to also see a meaningful contribution for the rest of the year.

Acquisitions contributed 9% and adjusting for negative currency effects, mainly because of the strengthening of euros versus the US dollars. This led to euro growth of 11% for the quarter. It is also worth flagging that in Q1, we had a relatively easier baseline which, as you can see on the right side here, will change as we go through the year.

Let’s now look at profitability on the next page, page ten. If we look at the margin bridge on the left side, you can see that the underlying business developed favourably in the first quarter driven by Health and Nutrition. However, this is expected to turn negative over the course of the year as we ramp up investments in our 2025 strategy and return to more normal travel activity in the second half of the year. FX headwinds and the consolidation of the three acquisitions diluted the EBIT margin by one percentage point and 3.3 percentage points respectively.

The impact of the acquisitions and currency is also visible in the gross margin that decreased 4.4 points to 55.9%. For the underlying business, the net effect was slightly negative, as product mix and higher freight costs outweighed production efficiencies and scale effects. Operating expenses as a percentage of sales decreased to 30.6% from 31.2% last year, due to lower spending in various cost categories due to COVID-19. For a full view of EBITDA and EBIT growth reconciliation, I recommend you look at page 20 in the Q1 company announcement, which has a breakdown of the impacts from the portfolio changes.

Please move to the next slide, slide 11, for cash flow and leverage. Free cash flow before acquisitions and special items decreased compared to last year, mainly due to higher investments driven by the acquisition at the Kalundborg side for the HMO business. The CapEx-to-sales ratio excluding HMO was 12.1%. Operating cash flow increased as a negative development from working capital was more than offset by lower taxes paid and higher non-cash adjustments related to the acquisitions.

Leverage was 3.8 times EBITDA in line with the expectations and fully related to the acquisitions. As stated during the last conference call, it's our ambition to bring down leverage again by the end of the financial year 2021 to a level which is in line with an investment grade credit rating and the proceeds from the Natural Colours divestment will primarily be used for this.

With this, I would now like to move on to the guidance on the next slide, slide 12. We are very pleased with a strong start to the year but also remain cautious considering the developments of the global pandemic and tougher comparables for the rest of the year. Therefore, we keep our guidance for 2021 on the key parameters. We expect organic growth to be 5% to 8% with the highest contribution from Health and Nutrition. Both Health and Nutrition and Food Cultures and Enzymes are expected to outgrow their respective underlying markets.

Given recent currency movements, we also expect a positive contribution from euro pricing of more than 2% at a Group level. EBIT margin before special items is expected to be in the range of 27% to 28% and I'll do a short recap on the drivers on the next slide. Free cash flow before acquisitions, divestment, and special items, is expected to be €120 million to €160 million, with CapEx of around €150 million to €175 million. CapEx is lower than the previously mentioned €200 million due to the phasing of the investment for our new HMO production as already mentioned.

At the same time, operating cash flow is now expected to be lower than last fiscal, primarily because we expect the contributions from acquisitions will be lower. Further, we will see a realisation of certain working capital items and higher interest costs, while cash tax is estimated to be lower than the last fiscal year due to the acquisitions made.

Please turn to the next page, page 13, for a couple of additional comments on the EBIT margin guidance. Unlike last quarter, we are only showing the development of the continuing operations here on the left side, i.e., excluding Natural Colours, which is why the starting point is 33.7%, but the drivers are unchanged.

The EBIT margin of the underlying business will be below last year as the 19/20 number contains some positive one-offs, which we discussed at the annual report. And as I already mentioned, we intend to ramp up investments in 2025 strategy key initiatives and expect to return to more normal cost levels during the second half of 2021.

Currencies are expected to dilute the EBIT margin negatively by up to one percentage point and the acquisitions around 4.5 percentage points. Please note that our EBIT margin guidance does not adjust for PPA amortisation from the three acquisitions, but for those that look at EBIT and EBITDA, let me provide some additional data points.

As Mauricio already mentioned in the beginning, the EBITDA contribution from all three acquisitions is now expected to be around €10 million. D&A from the acquisitions is estimated to be around €30 million, of which €15 to €20 million are PPA amortisations.

As you can see in the amortization schedule on the right, which is preliminary and indicative as the PPAs from all three acquisitions are not final yet, the majority of intangibles will be amortised over the next 10 years. In terms of EBIT margin improvement over the coming years, we are aiming for EBIT margins for HSO Health Care and UAS Labs to gradually increase over the strategy period and reach around 30% by FY 2025, as we realise costs and revenue synergies from FY 22 onwards.

For Jennewein, we first need to establish the manufacturing facility in Denmark and gain critical mass. So, it will take more time for margins to reach around 30%. And thus, we see this to be realised beyond 2025, however with solid progress by FY 25.

Lastly, please note that in relation to the carve-out of Natural Colours and the acquisitions we estimate that there will be a total of €15 million to €20 million of special items for the continuing operations for the full year. So, you can model around €5 million of special items for Q2 and Q3, but please also understand that those are estimates that may change slightly.

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

Mauricio Graber

Thank you, Lise. Let me keep the wrap up on slide 14 short. Christian Hansen had a strong start to the year by all businesses and we see ourselves well on track to deliver our guidance for the financial year 2021. While short term, our EBIT is negatively impacted by the acquisitions as guided, and we have said that the financial year 2021 is a transition year, let me re-emphasise that we continue to see plenty of opportunities to drive efficiencies in our operations and expand margins over the strategy period.

We are fully committed to delivering on our 2025 strategy of forming a differentiated bioscience company, with focus on our microbial and fermentation technology platforms, and the successful integration of the three acquisitions, as well as the carve-out of Natural Colours; our top priority for the coming months.

Despite higher than normal uncertainty because of the global pandemic, I've remained very excited about the many opportunities that lie ahead of us by applying microbial solutions to grow a better world naturally. And I am very proud of the entire Christian Hansen team and how they have been handling the challenges of the pandemic up to now.

Thank you for listening, and with this, let's open up for the question and answer session.

Q&A

Operator

Thank you. Ladies and gentlemen, if you do wish to ask a question, please press 01 on your telephone keypad now. If you wish to withdraw your question, you may do so by pressing 02 to cancel. So, that is 01 to register a question. Our first question comes from the line of Anette Lykke from Handelsbanken. Please go ahead. Your line is open.

Anette Lykke

Thank you so much. My first question is within the Human Health and how you see second half of this year in respect to Europe, in particular Southern Europe, as you highlighted. Are there any risks that it will take some times for some consumers to get back to normal levels or is there a risk that they simply figure out they go well without the probiotics? So, how do you see the dynamics there? Also, on this HMO capacity, what is the surprise or what was new to you, and why do you have to delay the sales thing in that respect?

And then finally, I appreciate all the comments you made on China, but when do you see a normal production in China, as such, and is there a chance still that the ambience you could in favour compared to fresh dairy? Thank you so much. Oh, and sorry, welcome to Lise as well.

Lise Mortensen

Thank you.

Mauricio Graber

Thanks. Thank you for your questions. I think I'll take a stab at them one-by-one. So, first with Western Europe and probiotics, what we have seen overall, is that dietary supplements in the market that have a stronger online channels, and in this case, being North America and China, dietary supplements have performed very, very well and you see that in the strength of our results.

Now, particularly Western Europe, and as you said, some of the southern parts of Western Europe, you have a very traditional channel through the pharmacy, where in lockdowns consumers go less to the pharmacy. I do not think the outcome of that will be that people will do away with probiotics.

I think you will see several aspects. I think it puts a great opportunity for some of the customers to strengthen the online channels in Europe and I think also as the lockdowns, hopefully by spring, start relaxing, I think you will see a return to more normalisation in the pharmacy channel, which is very well established in the process of Western Europe.

So, overall, we continue to be very optimistic on probiotics. We see a lot of engagement. The number of clicks in our probiotic institute continued to grow a lot. So, the science behind some of our probiotics, and the breadth and depth of the portfolio that we have, I think is something that provides a great opportunity for growth, innovation, and margin expansion in the future.

On HMO, as I tried to mention in HMO, you have both a market demand challenge, which is some of the country registrations, and some of the customer launches are being slightly delayed, but I can tell you very clearly that in all the conversations with the global and regional infant formula customers, HMO is among the top priority of the future product compositions. So, you will see very strong launches of these products and the timing of that will vary by some of the markets.

Now, the capacity constraint that we have, remember that we had always mentioned that we acquired in Jennewein an organisation that has very strong IP, probably the leading IP in the field, a team that I'm extremely proud on their science, their conviction, the experience that they have in the HMO market, but it was a very, let's say, early start-up from an infrastructure point of view. Part of the process is outsourced, and then the downstream is in-sourced in Germany but with a very small capacity.

So, in order for us to address the short-term capacity constraints, we will have to work with productivity on our partner – on the outsourced side. We will need to invest slightly in our downstream capacity, and we expect that we will do most of that within the next few months. But by the time that capacity is de-bottlenecked, some of that revenue will shift to the fiscal year 2022.

I don't want to minimise the impact of that in any way, but the way I view it is a short term negative for a longer term positive, because obviously that will result in a larger acceleration of our revenue growth and organic growth in 2022. Now, in order to drive the full profitability of the HMO segment, we need to in-source and build our facility in Kalundborg, and that will be sort of a state-of-the-art scalability factory with the right growth. I just wanted to give a comprehensive HMO answer given all the questions that have been received on this [ph 00:41:20].

Lastly, moving to – and I cannot really contain my excitement and enthusiasm about the HMO field. I think we have a very strong IP. I think it will be a high growth, high margin innovation business.

China, you all have the same information about China that I have, so not sure how much more depth I can provide you. In China there was – during the COVID – when COVID hit, a year ago now, it was not a lockdown, it was a close down, meaning the largest dairy companies closed.

As they reopen, what we have seen is they have enough supply of milk and enough demand of liquid milk to basically run their facilities. And that has resulted in them putting out less volume of fermented product. And that has lasted for longer and you read the same reports that we read, which is the performance of the large dairies in China is good and it is good because of the performance of liquid milk.

The fundamentals that fermented products, basically yogurt, is an excellent way to store milk and to add premium value-added products to consumers still remain. So, I do not believe that anything has changed in the Chinese consumers' interest in both chilled and ambient fermented products. But I think it will take time for that volume, promotion and offering to the consumers to normalise. And that's why we are saying that while we expect a better second half of the year, I think 2021 will be overall a very challenging year for the fermented business in China.

And just to provide, and to close on that, if you look at our overall business in China, our Animal Health is doing fantastically well with the new growing swine category in China. Our dietary supplement is performing strongly, and we expect also a strong second half of the year with our Infant Formula business in China.

Anette Lykke

Okay, thank you very much.

Operator

Our next question comes from the line of Soeren Samsoe from SEB. Please go ahead. Your line is open.

Soeren Samsoe

Yes, hi, it's Soeren Samsoe from SEB. First, a warm welcome to Lise from my side and then a few questions. First on Food Cultures and Enzymes, the 8% organic growth seems a bit stronger than what you have indicated for this division for the full year. Do we agree on that? And also, what has sort of surprised you positively? What is driving stronger growth from the start of the year and will that continue?

Secondly, on Jennewein, when you made the acquisition, you guided €50 million revenues in 2021 and now you talk about implicitly €15 million, so that's 70% down on your original expectations for revenue this year. That's a big number. You simply have to explain this a bit better; how you can go wrong in this way, what has really gone wrong?

And also, what likelihood do we put that you actually get €50 million or more in revenues in 2022 then? I think that that's really important. And also, if you could tell us when exactly did you become aware of this issue with Jennewein? Yes, that's my questions.

Mauricio Graber

Excellent, Soeren. Happy to take those. Basically, Food Cultures and Enzymes, I think the growth was indeed stronger than we expected. I view the 2% volume growth as a positive signal. Meaning, I know achieving 10% – reading the comments this morning may seem as something that was expected. I believe that being able to achieve 10% growth in Q1, given the current market conditions of lockdowns, et cetera, is very, very strong.

Obviously, 15% in Health and Nutrition, but the 8% in Food Cultures and Enzymes, here are the strengths. I think North America performed very strongly. And I think it talks a little bit about the resilience and the growth opportunities in the cheese, the probiotics, and the fresh dairy we market in North America. China was definitely – continues to be a very challenging market. But Europe also was strong, probably partly driven by in-home consumption versus food service.

And I think the team's ability to execute on launching new products, working digitally with customers, was what enables us to deliver this growth, so I'm extremely proud of the team. And I hope that gives you a little bit of perspective, meaning we have to help customers innovate virtually, and there's no way you can achieve an 8% growth without new products, new launches and new wins with customers that continue to take place even with less physical visits.

Now, moving on to the HMO, I know it's a large change on the estimate for this year, but take into consideration the timing of the financial year that really ends in August. So, it puts a lot of pressure on our business that we are just starting to own and understand. That was handed over to us from, let's say, a family owned business. And once we took over the business and we looked at the true yields and productivity that you can get from the side versus projections on how they are going to scale up – so it's not something, Soeren, that one day you go into the plant and you learn, 'Oh, it is going to be 20 instead of 50.'

It's a sequential analysis of questions and tests and trials, until we really – very late December, early January – get the confirmation of what we believe, based on our knowledge and understanding, is the true output that we can get from that facility. And I will tell you, I'm proud of our Christian Hansen team that worked all through the break between Christmas and New Year to continue to drive the debottlenecking of this facility and the solutions that we can have to continue to build volume for the HMO business. As far as the competence – yes?

Soeren Samsoe

No, go ahead.

Mauricio Graber

Go ahead. You asked the question about fiscal year 2022. So, the volume of HMO will be driven by the dosage and the volume launches in the future. One of the strengths of Jennewein is that they have developed the five HMOs and are able to sell those five HMOs. What you'll find today in the market is mainly one or two HMOs. So, the scale of the five HMOs will be an important contribution into our future revenue.

Soeren Samsoe

But I was just wondering, how you can come up with an estimate of €50 million to start with that then becomes €15 million or €20 million. Shouldn't it have been the other way around. So, if you didn't really have an overview when you're bought it, then you started out low and then you found out later what's the real output from this facility. That's just really puzzling, I think.

Mauricio Graber

I think any acquisition, Soeren, we base our assessment also on the acquisition perspectives and prospectus and documentations that we based our initial analysis from.

Lise Mortensen

Maybe I want to mention here that the decline in the revenue from the acquired businesses is also impacted by FX. It's not all attributable to the capacity constraints of Jennewein.

Soeren Samsoe

Okay, then it would be nice if you supply those numbers to us. You don't have to now, but at least afterwards.

Then finally a question on dietary supplements, it looks like Spain has decided to actually start using [? 00:51:09] on probiotics, sort of bypassing the EFSA rules that came out many years ago and Italy has done the same. What do you think this could mean for the European markets as such? Do you think more countries will follow and what would that mean to your European dietary supplements business?

Mauricio Graber

Yes, I think it talks about some of the markets exactly having the frustration on the overall EFSA European ruling. I think Soeren, it’s too early to say, but obviously being able to use the word probiotics, being able to talk about the benefits of probiotics, we view that as a positive. I think overall, the healthier solution would be to have an aligned European policy regarding that, and we continue to work hard on science and advocacy to –

[connection issue 00:52:00]

Mauricio Graber

Thank you. Apologies for that, again. It looks like the line dropped. So, I think it's positive, Soeren, that some countries will have a more open legislation towards dietary supplements. And we continue to believe that probiotics have an important role to play in immunity and preventive health in the whole gut health going forward. So, it's a net positive for the business.

Soeren Samsoe

Okay, thank you.

Operator

Our next question comes from the line of Lars Topholm from Carnegie. Please go ahead. Your line is open.

Lars Topholm

Yes, just a couple of questions on my side. You answered a lot of it when you answered Soeren before, but on Jennewein and currencies representing the deviation in your outlook for acquired companies, does that imply that the expectations to HSO Health Care and UAS Labs is completely unchanged?

And maybe in terms of harvesting synergies in these two if you can elaborate a little bit of the plan. I understand the scope for in-sourcing production in HSO Health Care, also for ramping up capacity utilisation in the new UAS Labs. So, I just wonder how you see the pace of harvesting the various synergies here?

And then I have a question on Food Cultures and Enzymes because you point out mix is hurt by the fact you grow strongest in Cheese and Enzymes and you contract in China. How much do these two parameters need to change before we will see positive margin momentum in Food Cultures and Enzymes? Maybe it's difficult to answer because there are more moving parts, but some thoughts on the margin erosion you're seeing there and what is required in order to bring that to an end.

And welcome, Lise, but we have met already. Thanks.

Lise Mortensen

Yes, thank you, Lars.

Mauricio Graber

Thank you, Lars. So, let me take HMO and Jennewein first. Basically, I think your point is right. In order to drive the margin entitlement that we see for these business – and by the way our analysis sort of validates that this will have a margin entitlement similar to our business of around 30% – we will need to in-source the manufacturing and have the Kalundborg site running.

In the meantime, obviously, by the time we are able to debottleneck and ramp up volumes, the business will have continued improving profitability versus what it is today with low volumes and the short-term challenges that we have faced. On the probiotic acquisition, Lars, if you carefully read through the text, basically what I'm saying is, we're saying our probiotic acquisitions are on plan.

Remember that UAS Labs is a large acquisition. It is the largest acquisition we have made. It is running on plan or ahead of plan both from a revenue and integration point of view, but it has a large FX negative component because all the revenue is mostly US dollar based.

HSO from a go-to-market and organisation is fully integrated. The only thing that's pending with HSO is the in-sourcing of the strains [ph 00:56:53] that we bought. But you can see in our report that the combined portfolio in women's [ph 00:57:00] health is proving to be a high growth platform, as we've reported. So, let me unbundle the problem on the acquisitions as it has been discussed, which is probiotic acquisitions, UAS Labs, HSO, on plan, running well, fully integrated into the Human Health organisation with good tracking, just the FX impact. HMO is a strong validation on our business case for the acquisition with short-term challenges on the fiscal year ‘21, due to the production capacity constraints.

On FC&E and the question about mix. Lars, if I make the complex simple, I would say the largest mix difference is really between enzymes and cultures. I think when you look at cultures for cheese, cultures for dairy, it is relatively within the same range. And I would not overplay significantly the Chinese premium. You have to take into consideration that China has now become the largest dairy market in the world with very large Chinese customers that have global parameters – negotiating parameters similar to the large global international dairy companies.

So, my concern with China is about the underlying Fermented market, our volume and innovation with customers, and that's the largest opportunity that we see in China, and where we need to focus our efforts together with the customers to bring that back.

If there's any part of the answer that you want me to elaborate a little bit more, please let me know.

Lars Topholm

Yes, maybe a little bit, Mauricio, because last time you and I met we briefly discussed China and I had my concerns, and you mentioned that based on the insight you had into which projects you were working with customers on, you were, I think, at least less pessimistic than I were and now we seem more aligned. So, I wonder what factual observations you have made in the past one and a half months that have made you change? Is it underlying sales data or is it the pipeline you have that has become thinner or have projects been delayed, or what has made you change your mind?

Mauricio Graber

But Lars, want to bring forth that my confidence in the long term growth and relevance of the Chinese dairy market is there. I think we will see continued opportunities for fermented product innovation. As I mentioned in the call, we're exploring some new opportunities in milk and you still have the cheese market to emerge. And you have the SMEs. Those are the growth avenues for China.

Short term, my disappointment and the only thing that has changed since we last met is that we continue to see the strength of liquid milk and the customers not yet committing more capacity to put out fermented products. That's probably the only thing that has really changed since we last met and it's very much aligned with the reports that you have as well.

When will that change? I will tell you even with the very senior contacts and connections that we have with the Chinese customers, I cannot give you an answer. What I can tell you is that the pipeline remains very strong. The progress on the projects and the frequency of digital contacts that we have with the customers remains very strong. So, I have not seen anything on the appetite for cheese or ambient projects that has decelerated in our workings with the Chinese customers.

Lars Topholm

That’s very clear Mauricio. Thank you very much for answering my questions.

Mauricio Graber

Thank you, Lars.

Operator

Our next question comes from the line of Heidi Vesterinen from Exane BNP Paribas. Please go ahead. Your line is open.

Heidi Vesterinen

Good morning. So, a few on China then. So, as alluded to in the earlier question, you do sound increasingly cautious on China dairy. How do you know that you aren't seeing competitive pressures? And what is the opportunity that you talked about in liquid milk?

And then also on Infant Nutrition, so you said in the statement that it declined given lower demand from physical stores. Do you think the overall market was down or are your customers biased towards physical stores rather than e-commerce? I'm a bit confused because I thought the local players were doing okay and that you would be selling to all players in all channels. So, some clarification there would be nice, thank you.

Mauricio Graber

Sure, Heidi. On China, I want to reinforce the only concern that I've outlined on China is how the financial year 2021 will shape up and when the market will sort of come back. But I am in no way sounding less optimistic about the long-term journey and trajectory of the dairy market in China. But the fact that we are now in January, and we are still seeing a larger output of liquid milk versus fermented is longer than we would have expected.

Now, as far as our competition, Heidi, and even though we have discussed that several times, I think the competitive landscape in China remains unchanged. We continue to compete with the same large global customers that we compete and that is the competitive framework that we have seen. And actually, we have done a deep dive following all the comments around that on the Chinese market to make sure that we have no blind spots around how the Chinese competitive landscape is developing. I don't know, Martin or Lise, if you want to take the question around physical stores versus imported or online.

Martin Riise

Yes, so in the Infant Formula business in China, there is still quite a bit of volume going through physical stores. And that has been a problem for some of the local players actually to have flowthrough there, because the stores have been closed due to COVID for a period of time during the first quarter.

Mauricio Graber

But there, Heidi, just to highlight I think the outlook for Infant Formula for the balance of the year, we view that with very positive perspectives.

Heidi Vesterinen

Thanks, and I –

Martin Riise

I think in the – sorry, Heidi, we need to take one more question and then, please for the rest of you guys that are unable to get through today, you can follow up with me after the call.

Operator

Our final question comes from the line of Charles Eaden from UBS. Please go ahead. Your line is open.

Charles Eaden

Hi, thank you, and good morning, Mauricio and Lise. I just wanted to come back to your fiscal 2021 organic sales rep guidance, where you mentioned that your pricing is likely to be greater than a 2% contribution for the full year. So, that's implying volume guidance of 3% to 6% rounded. Could you help us frame this versus what you expect the overall market is growing this year? Just trying to get a sense of your expected outperformance for the fiscal year. Thank you.

Mauricio Graber

Yes, we definitely are an ambitious company. We expect or wish to outperform the market. I think our current performance in Q1 we expect to be outperforming the market. We will see that particularly as I mentioned in the underlying dairy market; we believe it has been faster in Q1. We do see some signs as we cross reference many data that that is improving; the underlying dairy market.

And obviously with the strong Q1, I was expecting on the call – 'Okay with a strong Q1 in a little bit of tailwind from euro pricing, will you guys sort of increase your guidance?' But the reality is that we live in very uncertain times. And I think the guidance that we set up at the beginning of the year serves us well for now. The way I view it this one quarter in the pocket, let's see how Q2 develops.

We go into Q2 with a strong pipeline, with a very engaged organisation. And that's why we are confident that despite the COVID challenges, we're able to deliver on our guidance for organic growth, EBIT and free cash flow. But we take a cautious approach, given the uncertainty that exists about COVID, the economy, in the months ahead.

Charles Eaden

Thank you very much.

Mauricio Graber

With that, I would like to thank you for your calls. Obviously, our IR team is available for any follow-up calls, but this concludes today's session. Thank you for joining and we would look forward to conducting some of the virtual road shows and I wish everybody to take care and stay safe. Thank you.

Operator

This now concludes our conference call. Thank you all very much for attending. You may now disconnect your lines.