Selecta Q2 & H1 2022 Results Noteholder Presentation

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Welcome

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Welcome

Good afternoon and good morning to those joining us from the United States. Welcome to Selecta´s second quarter and first half year 2022 results presentation. Please note that the call will be recorded. On the call today we have with us, Christians Schmitz who is Chief Executive Officer of Selecta Group and Philippe Gautier, who is Chief Financial Officer.

Before we initiate, I would like you to refer to the disclaimer, which can be found on page two of this presentation. As a reminder, after the presentation a Q&A session will follow. Moving on to the agenda page, today's presentation will cover business updates, H1 financial highlights and Q2 financial results. I kindly remind the speakers to refer to slides change as they progress to the presentation. Finally, I would like to hand over it to Christian.

Introduction

Christian Schmitz

CEO, Selecta Group

Welcome

All right. Thank you very much, Angela. Hello everyone. Good morning to the United States. Good afternoon here in Europe. Great to have everyone on the call today. Welcome back to the ones that are following us regularly and welcome to anyone who has not joined one of our previous calls.

With me here as Angela said, Philippe. We are going to guide you through together. The way we're going to do that is I'm going to give you all a brief update on the business and take you through some of our priorities, so you understand we're focused on as a company and then give you brief highlights for the full first half and then I'll hand it over to Philippe and he's going to walk you through more of the details and then of course, we'll keep time for questions.

So, with that I'll jump right in page eight. I thought it might be helpful starting point to just give you a little bit overview in terms of what the key priorities are that we're executing against here. Obviously, time has changed, last two years, a big part of that was battling with all the impacts from COVID. That one is now on the retreat then obviously a lot of additional headwinds came up. We are dealing with an inflationary environment. There is a lot of dynamic there. Got a major conflict in Europe. We got to navigate all of that, at the same time, of course, we got to grow our business, drive our new solutions. So, there is a lot going on for us, I guess, as for most companies out there.

Growing Foodtech

So, what you got here as an overview is the key priorities that we are focusing on as a team. I want to start with growing foodtech. We talked to you about it last couple of quarters. We see Selecta´s foodtech business as foodtech leader in Europe. As you will see we continue to broaden our portfolio and at the same time we are growing the segment very fast. This has to do with our food markets, our smart fridges, the unmanned fully autonomous store solutions that we have. So that continues to be a key and critical priority for us.

The second piece, I think very clear in the current environment is protecting our margins. What we have here is this massive pressure that comes from our suppliers and on various cost line items, not only your product, but of course also labor, supply chain, energy, but we got a large vehicle fleet that we operate. So, there's a lot happening there, at the same time we got a portfolio of longer-term contracts, right? So, it is very important for us to navigate that and make sure that we deal with this, that we pass on the cost increases. We will talk about that in more detail.

What we are doing on the margin side, important to say, it's not only about increasing prices, right? It's also managing our cost, looking on alternative suppliers. It's optimizing our assortment. There is a lot of different pieces that play into this.

Production

From a productivity perspective, it's very important for us coming out of COVID and now being what we call new normal that we make sure that our assets are productive. We've done that through doing a rigorous review rather on portfolio speaking with a lot of our clients and making sure that the footprint is right. Actually, we're very happy when we look at – Philippe is going to talk about that a little more in detail as being able to record SMD sales per machine per day in Selecta, right? That is what we had in 2019. So, our entire approach of streamlining our portfolio, making sure that the solutions that we serve are really valuable and drive business and bring joy to people. All that is connected. This is a very important piece that we're working throughout the year.

Tech-enabled service platform

From a tech perspective, we call the tech-enabled service platform, we talked about telemetry multiple times before as a game changer for this company and for the business that we do. The moment you are able to get an entire sale of machines in a country on a fully connected solution, you can run this in a much smarter way. I talk about that a little more in detail. There's the substantial productivity that you drive, but also service improvements given that you show up in the right moment in time. We've invested a lot in that and we are also very happy to report that in the vast majority of the countries by the end of this year, we'll have everything that is relevant for a fully operated machine portfolio, converted telemetry to be integrated, centralized planning in pretty much all markets with one or two exceptions that will continue to be done in into 2023.

So that's sort on how we are growing the business, how we are managing performance, kind of the key levers, how we drive productivity.

Cash conversion

Then build a left-hand side page. Obviously, you got very close with cash conversion. It's very important that that the cash conversion is right. Again, there's not one trick that allows you to ensure that. Very important in that it certainly the pivot of our business model from one in the past where we would take all the capital into one where client plays a much more important role. So, the assets do not sit on a balance sheet. We do not have to pay the cash up front, and we still get the revenue, the profit streams from the installations that we service. So, I talked a little more about that, and then of course, rigorous management of inventory, receivables, payables, etc. I think team has done a nice job of really getting into that and building the structure in the processes to make sure that our cash conversion further improves. Important to say here that we still got a number of one-time effects, right? So, we still doing and having some restructuring hangover. I call that from last year, we are still at cash pays related to the right sizing of the organization. There is still some more adaptations and adjustments that we do in the organization, given that we bring more technology. We think there is still more opportunity to run this business in a leaner and more efficient way.

ESG Implementation

Then now from these the entire ESG implementation. We have made a big effort to really build a very robust program around sustainability. We have not talked about much before because we had to talk about so many things. So, with past two years, it comes to transformation and rightsizing all the things that we had to do, but we think it is really the time to put that one in focus. I am very excited to talk about that in a minute, what some of the key initiatives are.

So that is sort a short overview. I might have already covered some of the details on the following pages. So, I will take you through that fairly quick. We can go to the next page, page nine. Look, I think what you see here is three examples, three very different examples use cases, of how driving foodtech, right? The first one is a campus, and we have got a fully autonomous store. You can have 25 more people just checking to that store with a simple phone barcode, or tap with the credit card and go in, grab whatever you want and leave, right? No scanning, no checkout, no RFID chip, no basket. The technology works really nice.

We have ran this as our first part of test case at one of the largest technology innovation campuses in Europe, in Belgium. I mean, huge positive feedback, 95% of the consumers told us this is great, fantastic. It is exactly we're looking for, which again, directly is in sync with our purpose, bringing joy to people, making people happy. A beautiful solution like that for people where there is not many alternatives within a five-kilometer radius, I think is beautiful.

The second one is I wanted to point out to you is we have got a massive push at the moment into steam parks and holiday parks. What you see is obviously there is a mega trend around shortage of labor, especially when it comes to service. I think everyone is dealing with the theme of somehow wondering, where are the labors out there in the past. It is not back. I think we all see it when we travel airports and waiting for the baggage handling. There is restaurant and hotel outlets who got limit service hours because they do not have enough people. You got theme parks that cannot open because they don't have enough staffing. There is a major, major trend here, which we think is not going to go away anytime soon. It is probably even getting worse.

There is an incredible amount of inflow from clients talking to us and saying, look, how can you help me out? Obviously, it's got to go beyond the classic distribution of a chocolate bar and coke, but without new technology, we can obviously bring much more. You see the example of Parques Reunidos, one of the leading park operator, a huge footprint, where we went in with our full range, digital vending, foodie, food markets, coffee, multiple countries. I mean, that's the sweet spot where we're going to operate over the next years. You got the full range of portfolio, and you get complexity in there. You get multiple countries at the same time. Then there is only one player that can really execute against. Which is Selecta, with a range of solutions, perfect client for us. That's one example. Just yesterday, another deal came in on theme park with a different operator, very hot segment.

Then we go to the airport segment as an example where obviously travels bouncing back fast. There is like crowded terminals. There's these more peak demand than in the past. You see an example at a regional airport that we recently implemented. In east Midlands you see a sort of convenience smart fridge plus coffee solution, perfect for an airport of this size. If anyone comes through it the moment through Copenhagen, you will see our new smart solutions. You come to Zurich anytime soon; you will see the first of our smart solutions. You happen to stop by at the Zurich train station, today you will see one of our smart fridge solutions where we are piloting and bringing this into our client relationships. I really see what performs and take it from there.

So real dynamic here. You see in the total growth of units, and those are very high revenue units. I mean, all of magnitude different from the classic vending machine. So, with that let me get into some more of the challenging topics.

Go the next page, Page 10. Obviously, the current inflation environment is not easy to navigate. Just see it later on our gross margin, which is slightly down that there's some real dynamic here. We had anticipated in December, maybe put our price increase around inflation around 5%. We started executing first round with around 6%, but obviously as we all know the dynamic when it comes to inflation it accelerated quite a bit over the past six months.

Right now, our situation is as I think most of you know. There are some businesses that we have that are priceless driven, and that adjustment is fairly straightforward. Also, the public business, usually it's fairly straightforward to adjust prices, but then we also have a large portfolio of long-lasting contracts, which have certain points in time when you can adjust the prices that is not necessarily immediately. So, it means you got to go into that and there might be a mid-year or end of year or whatever clause in there where you can take the increases, but not at any given point in time.

So obviously there is a lot of beauty to having this portfolio of contracts is an average duration of almost five years. But if you are in like an extraordinary situation like this, they can also be a little sticky and takes little bit of time to really adjust all of that.

Obviously, we now anchored on the high inflation. We also gave you some data on some of the specific categories that we are dealing with, which are much higher than the average inflation, something like coffee, which went up massively and continues to stay at very high levels. Obviously, some of the same, like energy, fuel, obviously even harder, impact us on the coffee roaster, impacts us on the fleet, driving all the different things.

So long story short, we have done a first round in the first half of the year, and we've started to execute on second round of substantial size to make sure that we start closing the gap in quarter three and move out in the right direction here.

Then as I mentioned earlier, it is not all about price increases. There is also some obviously price elasticity that you got to factor in. So, it is not around category management. It is our productivity. It is making sure you can have different dialogues with your clients in terms of how you can find sustainable solution and that it is hard work on fleet. That has been done with optimizing our real estate footprint. It is driving more energy saving. There is a lot more around it that goes into their bucket.

Productivity

Page 11, on the topic of productivity. So next page, we see that we continue to increase the productivity on an ongoing basis. That is very important for us also going forward to further drive profitability of the business. What you see is a rebound in sales, 17%, which we have been able to deliver with fewer resources as we've had in the comparable half year, last year. You see the combined productivity increase. So, the sales that we do per FTE and that one is gone up got up substantially. Obviously, the total sales included price increase component, but I mentioned before on the previous page, how much that was. So you see, there's still a very substantial uplift in productivity, which is not just driven through selling goods at higher price. You see that. I guess in a lot of earnings reports right now where pricing can store a little bit when you look at but here, this is really strong productivity, again, through an optimized footprint, but also through much smarter and better way to search.

You see that – I just gave you the headline for that on the right end side, because telemetry continues to be a great driver for both service quality and efficiency, right? It is like it pays into both. If you know exactly what you saw at what point in time, then obviously you can tailor your visits to that, you can already prearrange and pre-kit the merchandise. So, you can do that in one go, you just go to the machine to just slot it in. You don't have to figure out how much you store when you did it and you don't come late, you don't come early, all that stuff you can take out of the system, which is really nice to see substantial increase of our telemetry estate in Spain, the substantially increase in France, got a plan to get everything that's relevant in France and is done by the end of the year. The day that we have agreed with our local leadership there is December 23rd, and then we will take stock and see where we are. We are doing a full rollout in Belgium to completing our next month. So, there is a lot of dynamic time and substantial investments that we continue to put behind that technology.

Free cash flow conversion

So, on page 12, I want to briefly touch on the entire subject around free cash flow conversion and how we drive that. As mentioned before, CapEx is an important part here, which has been historically high in this business. So, there's a couple of things that we are really focusing on. One is we are much stronger discipline around payback. So, the threshold that we set in order to drive new business and be willing to fund it with straight cash has been increased. In the past would be much longer payment terms, lower returns that were accepted in order to grow the business cash. We have got a lot of discipline around it. Obviously whenever we have the opportunity to do an alternative model where it's not direct straight cash from us, we can think about some of the deals a little differently. But we got to keep a very top line on when it is our own money goes to work right away.

We have intensified the effort of reusing our existing machines. That is something that I think is a win-win win in many different ways. First of all, a lot of our clients are looking for circular solutions where we actually have more sustainable alternatives than just bringing in everything new. We have got fantastic refurbishment centers where we train people further that allow us to deliver an incredible quality. It is a new machine, basically, that's coming to you. There are all new components in there. It is all new. It is like you won't be able to differentiate that it's an older new machine that comes out. Sometimes people think, oh, like a circular machine, it is some old machine that we're giving a second live, actually, it's not. It is all like redone in a way that it's fantastic equipment.

Then of course the pivot of the business model is towards client is important. Especially when it comes to our new foodtech solutions. So smart fridges, food markets, the entire range unmanned stores. Those models as default growing client lease. It is a superior value that we bring to our clients. They really appreciate what we do there for them, bringing joy to people, helping them with employee retention, other things we do. So, it's obviously much easier to get those in a client lease model than a standard sort of a plain, a European tender vending machine, kind of somewhere in a public entity. There are still pockets where CapEx were required. So, CapEx won't go to zero, but we are driving CapEx more down through that conversion in the model, more circular machines and all the things that I mentioned about.

Then I think there has been a couple of questions in the past on how this entire client lease construct works. So, we just thought we spend a minute on that. It is as easy as that. So basically, as Selecta, we sign a contract with our client. There is service and product charges in there that go with those innovative solutions and then there's the lease arrangement with the client and the client pays the leasing fee to the leasing company. Hence it does not touch our balance sheet and it's a solution of all that makes a lot of sense to us.

So that's sort of the direction we are taking the business. It is a gradual change. It does not happen all overnight. But I think we are very pleased with how this is progressing.

ESG Targets

Now as the last point in this overall section, before we get into financial, I want to briefly talk about our ESG targets. It is very important for us that we don't just have I'd say some strategy but that we make it very tangible, and we make some real commitments here that we're going to put out here and then everyone outside, the world, our partners, the investors community, everyone can measure us against.

First of all, we want to drive down the CO2 emissions by at least 5% every year from our 2019 baseline. We want to be scope one and two net zero by 2030. So that's important part. The electrification of the fleet is probably the biggest drive in that but there's also additional initiatives that we are driving.

From a healthy and sustainable product perspective we are driving the percentage of fully 100% recyclable product, the recyclable packaging to drive it forward. We also want to shift the range. So, we get a larger percentage of products with the Nutri score of A and B, and it increases over time. Obviously, the fresh food solutions that we bring in our smart fridge is food markets give us a lot of opportunity to really offer a range of healthy foods to people in all different levels. This is not just for the high-end office segments. Most of our installations are actually in the blue-collar manufacturing, logistics segment, where we drive our new solutions. Also there, it is important that we bring food and meals to people that obviously give them the energy for the day when they work hard but also have the right nutrients in there and a lot of people in that segment to have a balanced diet.

Supply chain

Then from a supply chain perspective we will have a 100% of our Pelican Rouge coffee CO2 neutral compensated reduced by 2025. We are revamping the anti-program that we have in place with our partners and the farmers through our Selelcta coffee fund. We will do full relaunch of Pelican Rouge, the brand, from a sustainability angle towards the end of the year, which I talked about earlier.

Last point around diversity, especially when it comes to the percentage of women overall in the company and in leadership positions, we gave ourselves, again, very clear target, 40% of all Selecta and 40% of all first level leadership roles held by women by the end of 2024. So, we think we have got a very robust and aspirational program here. We got a lot of focus on it. We got a C level responsibility that's behind it, as we think this is an important part of the transformation of the company in this next phase.

Summary

Just to wrap that up. On Page 14, we have got a little deep dive on our scope on our net zero plan for scope one and two. I mentioned the targets before. Then you see the key levers here, fleet electrification, and we got first projects where entire cities go fully electric and we have got an electric vehicle first policy, more telemetry means smarter driving, better routing. We put a lot of money into putting telematics in every single vehicle. So, we get a driving score on a regular basis. There's competition around it. People want to drive better and there is a positive benefit for the environment. Then of course we will continue to optimize our real estate footprint, which also means that we drive the energy consumption in our building staff.

Financial Highlights

So, with that thought that was a sort of an overview I will go straight to the financial highlights and then Philippe is going to take you through more of the details. So, page 16 you got our brief overview on our business. So first of all, you got broad base, continued sales growth. You see the recovery. Finally, we also see the recovery in the office space, which has been lagging and I think now we are at what we call the new normal. So that is an uplift of 16%.

You see, our adjusted EBITDA is up by 19.7% versus last year. On the margin side, for the first half, we are slightly up when it comes to post IFRS 16. If you look at it pre IFRS 16 given that we've got fewer cars and other things, we get less of an IFRS 16 pickup. Philippe will explain that to you in more detail. There you would see a full 2.1% points EBITDA margin improvement. So, I think that's important to keep in mind when you look at the first half of the year.

LTM EBITDA are now at 215 million. Reported EBITDA also continues to grow. Despite the fact, as I mentioned that we still have a substantial number of restructuring charges related to right sizing and some catch up on COVID related stuff. That is all from our perspective heading right direction. Then free cash to 28.7 million first half, despite the right sizing efforts that I just mentioned. So, we got strong liquidity. So, we are comfortable with where we're at. Obviously, we got clear plans, as I mentioned for the second half of the year, we have got a drive here.

So, with that Philippe hand it over to you for somewhat detail in quarter two.

Highlights

Philippe Gautier

CFO, Selecta Group

Highlight of the quarter

Okay. Thank You. Thank you, Christian. Good afternoon, everyone. So, I am now going to zoom on the highlights of the quarter. This is on Page 18. So, what did we achieve in Q2?

Well, Q2 is another quarter of profitable growth. So, we've got the main figures here. So, this starts with the top line. We have seen continued double-digit sales growth towards 15.6% in the quarter. So, this is driven by sales gain, as well as the recovering mobility and office. presence. We reached 91% of 2019 levels level in June.

Just to have in mind, in the 15.6% growth, you have a little bit of forex. You have 1.6 points of favorable forex gains. That is mostly in the Swiss zone. So, the currency constant number is 14%. That is very similar to what we saw in H1.

The adjusted EBITDA margin is at 17.5%. The adjusted EBITDA is 7.8% versus prior year. So here as Christian mentioned, it has been impacted by inflation and the timing of the selling price increase. Nevertheless, there has been a very strong outset in terms of cost management, and we achieve strong productivity gains, as Christian highlighted.

So that is where when you look at our adjusted EBITDA margin pre IFRS it is 14.5% is up 0.3 points compared to post which is a margin of 17.5 and down 1.2 points. The difference comes from the leases. We have been reduced costs, including leases and therefore less pick up on margin. So, which means the adjusted EBITDA is at 52.1 million, up 7.8%. The reported EBITDA grows by 18%. So that is coming from the higher adjusted EBITDA and then we less one of what we had last year.

Then free cash flow for the quarter at 27.4. A nice improvement compared to Q1, where we were at 1.3 million. That is we had the first impact of our cash generation action plan, which is paying off. So that is where we ended with the liquidity of one and realized 138 million despite the rightsizing cash outs which have continued.

Performance by Segment

Now moving to the next page. I am going to walk you through the performance by segment. This is starting with the snapshot of the overall sales. So basically, what we have seen is that that is a very strong recovery of the SMD sales machine per day, which is an important indicator that we have in all the segments. We have reached an SMD of Euro 10.8. So that is higher that we had in 2019. This goes along with machine park reduction of 11.8%. So, we have now a bit more than 300,000 machines.

What we have done during the first have of the year is that we have continued to remove underperforming machines. We have removed about 12,000 of them. So that is pretty substantial, in six months. We are doing that in a very systematic way. It has touched mostly the UK, France, Spain, and Italy. So, when we do that, it enables us to improve our client contribution and improve as well our productivity and our service level.

So, when you look a bit by segment, you see a private segment continuously showing a positive trend, plus 15.7% and that is held by increased office presence. The strongest increase was seen in semi-public which is up 32.1%, which was the hardest hit segment in the prior year. Then we have sustainable growth in Public at 12.4% which is held by the continuous recovery of mobility.

Moving on to the next page. Here you have the key number for the private segment, which is showing a very continued positive trend, that's our biggest segment, about two third of our business. You have like two main sub segment there, which is services and administration on one side and then manufacturing and logistics on the other. So, the sales are improving by 15.7%. The biggest driver here is services and administration, which has been very, very strong. You can see that as well in the SMD. So very impressive growth of SMD plus 37.4%. That is mostly due to increase office presence.

Manufacturing and logistics field trading positively, despite some of the tension there could be in the supply chain in a lot of different industries. So besides that, we continue to see growth there.

The private segment is where we got the bulk of the machine park reduction, consistent with this approach to reduce the nonperforming machines.

Now moving to the semi-public segment, as you know continuous to improve, very impressive plus 32% in sales. And here, it's mostly driven by the recovery of Horeca and retail, on the one side. So Horeca is relatively small segment but almost doubled compared to last year. Retail is the largest segment that shows healthy growth. Then we have also double-digit growth both in education and healthcare. So, you have a very strong SMD recovery, with 35%, that comes from the fact that this segment was very hard hit. Not fully recovered yet compared to 2019 in terms of SMD, there still some potential, but very big improvement in this quarter. Machine park here stabilized versus last year where we had already optimized the base.

Moving to the next page. You can see how public is trading, we have reach very impressive record SMD €27, the highest we have seen ever in this segment. That is where you've got the railways, you've got the energy segment, you've got the airports. Here, the sales were up 12%, a segment which has been growing beyond the 2019 level. Driven by all of the sub-segments with particular very high growth in airports, as you have might have seen all airports with elevated traffic and we can benefit from that. The machine park has been stable, leading to SMD up 15.6%. So that's the view per segment.

The key takeaway is a broad-based growth, and all the segments are growing. Similarly, you look at countries, first things to note is that all our countries are growing. So, you see that in the following page which just come that here are actual rates. So, you have pickup mostly in Switzerland and a little bit in the UK, regarding forex evolution. So here, I would say where you look at the evolution, considering is versus last year you see on the left hand side very strong performing countries with growth over 20%s. I would highlight the Nordics, which were hard hit last year and have recovered a lot. You have also the Benelux which is a very strong contributor. And then on the lower side you have the UK where you had like already relatively good recovery last year. So that is the view per country.

On the next page you have the growth across all of our regions. Then again, same story. We have sales growth both in terms of sales and EBITDA in all the regions. Now, different magnitude, the region which has been performing the best is the north region and that relates to the two areas I was highlighting: Benelux and the Nordics, which have been growing pretty fast and explains the strong growth in the north region.

EBITDA performance

Now, let me go to the cost management and our EBITDA performance. The key highlights is that we have made a lot of progress in terms of cost and productivity gains and this lead to a strong EBITDA performance. So, Christian highlighted the gap we see in timing between purchasing price and selling price. So obviously there will be a big catch up when we do our next wave of price increase in H2. Right now, there is a gap. So that is on the flip side, if you look on the very positive, we have seen a strong improvement on our cost ratio. Overall, our cost ratio has been reduced by 2.7 points of sales versus last year, that is pretty meaningful. That means that our costs are growing much less than our sales. So, they are growing 9% when our sales are growing 15.6%, so that's pretty big difference. This is true both for personal expenses as well as other overheads.

So, in the personal expenses, interesting to mention that we did very little furlough in this quarter. This is like we have a little bit of options in France and Italy, but it's fairly marginal compared to doing 10 million of furlough last year in the same quarter. So that is a big change. Basically, we have been able to operate this quarter with 6,800 FTEs. So that is 300 less than at the end of 2021. That is 700 less than last year, same quarter. So that is very meaningful. Basically, we are doing more business with less resources. This is also true for the other overheads, so we continue to be very tight there, drive zero based budgeting initiatives, look at how we can mitigate the inflation through all kind of initiatives. So that is where we go to 1.1 point pick up there.

So, if you look before IFRS 16 you have the net favorable impact of 0.3% points. When you look at the total adjusted EBITDA you had less of this impact because the lease that we are considering IFRS 16 have been reducing significantly as all our other costs. We had one-offs of 6.1 million. This is due to the fact that we continue to look at certain right sizing activity, but not much less than last year. This explains why our reported EBITDA is growing more than the net sales.

Working Capital and CapEX

Now moving on to working capital and CapEx. We have a pretty good quarter in two respects. One is the working capital, we have a pretty moderate growth of the working capital. On one side you see trade receivables, which continue to go with the higher activity level. Now increasingly we have been able to optimize quite a lot inventory. So, inventory are down 5% versus the month of March. This has been due working a lot on food and beverage inventory. So, to give you an idea, we had a peak of 3.5 months of stock in February 22. We are now at 2.9 months end of June, so that is like a nearly 20% optimization in just four months. So, this is helping the working capital.

We continue to see cash out on one-offs which are significant, of 11.8 million. So that's compares to about 10 million in Q1 to still sustain cash out there.

The CapEx, we are at 4.1% of sales. So, a little bit higher than what we had in Q2 of last year. Now it is pretty good level in percent of sales, 4.1%, more than two points less than what we had in Q1. So as Christian was mentioning client lease solutions is our way to avoid CapEx, and we did that in the level of 10.5 million in the quarter.

Liquidity

Now moving to the liquidity on the next page. We have strong liquidity. We have maintained that 138 million. So that is as you know combination of what we have a cash bank plus the non-used part of our RCF. Importantly we have continued to deleverage. We deleveraged quite a bit. You look versus reported EBITDA retails that we’re leveraged from 9.2 to 7.7. So that's in six months we have reduced by a turn of 1.5 times. Then versus adjusted EBITDA as well we have reduced from 6.8 to 6.2, so we are deleveraging faster than what was foreseen in the noteholder plan.

Which brings me to the point around the free cash flow. That's on the next page, how our free cash flow impacted our liquidity. So here free cash flow for the quarter was 27.4 million. That's despite the nearly 12 million related to the one offs either incurred this year or prior year. So, the 27 million is an improvement of 26 million compared to what we have in Q1. So that is a combination of better management of working capital. So, you see that excluding one-offs, working capital is almost in the period. You have like better level of CapEx, more optimized and you have also higher EBITDA coming with higher activity in the quarter. So, all that combined enabled us to get 27 million of free cash flow. It is just one step in the right direction and we want to go further clearly. Then if you take out then the different interest and financial lease liabilities, you get to 138 million and this is before paying on July 1st for our interest payment. So, we have like a good liquidity, which can enable us to face any headwind and continue to invest in our business. So that's conclusion on this part. Then I will end over to Christian for the final conclusion.

Conclusion

Christian Schmitz

CEO, Selecta Group

Conclusion

All right. Thank you, Philippe. I thought there was very, very granular information, thank you. Good. Look, conclusion is pretty straightforward on what we just said. Focus on profit and growth and free cash flow conversion for 2022. Keep resilient liquidity position. We are laser focus on that. That is all the routines, the rituals and everything set up. To do that we have got to take a little more of rightsizing actions in a couple of markets where we think we have got the opportunity to do that. Given our continued investment in technology from fully optimization we think it is the right thing to do. That will go beyond what we originally planned. So, I just want to give everyone a heads up that that is coming and working through that.

We're prepared to address the needs of the new market landscape. I think from a solution perspective, shortage of labor in service areas and then also war for talent when it comes to industries like logistics, I think really got great portfolio here. That entire macro environment will be very helpful for us. I think there is a lot we can do here.

On flip side, obviously the highly inflation environment continues. So, we got to be aggressive when it comes to comes to the required price increase, contract adjustments and make sure that we execute on that. Then as every quarter, I think it's important that it sits on every presentation, confident achieving our strategic plan that we agreed with all of you back in the days when we did the recent both through 2022 and beyond.

All right. Thank you for listening so far. I think we can open the line for questions.

Q&A

Operator: Thank you. If you would like to ask a question, please press star followed by one on your telephone keypad now. When preparing to ask your question, please ensure that you are unmuted locally. Our first question today comes from Stefan Binder of Palmerston Capital. Stefan your line is now open.

Stefan Binder (Palmerson Capital/*Analyst*): Yeah. Hi, thanks for taking the question. Just obviously on a gross margin and inflation. So, the two and a half points of gross margin that you kind of lost in Q1. You said you implemented another round of price increase in July, so just a bit of helpful. Should we think about that you recover most of that in Q3 or to what degree do you think you were going to recover your gross margin. Maybe, I don't know if you can talk about the lagged effect of the price increases, and also do you see any customers dropping off from the July price increase? If you can give a little bit of clarity on, like, how do you see gross margin evolving over the next time? That will be helpful. I have more questions.

Christian Schmitz: Well, thank you. Appreciate the question. Well maybe I will start with it and then maybe Philippe you want to add to that. I think first of all, obviously it's a big topic and something that we spend a lot of time on. I think it is important to see that the gross margin erosion that we've seen in the second quarter, there’s really two elements to that. One is obviously the cost increases that we get hit with and then the mitigating price actions that we got to take and the time lag that's there and some of the stickiness of the contract and kind of like certain points in time when you can adjust the contract.

There is another piece here as well, which is I would call it probably a COVID normalization effect and a mixed effect. We have not talked that much about it in our presentation, however, maybe just to illustrate that a little bit more. At the time, typically we get different sources of income. There are product sales and then there is service fees, fixed service fees, monthly fees and stuff that plays an important role. At the time when we added some markets, very low consumptions, the service fees last year were disproportionately larger part of the total revenues and of course they flow through is 100% margin, right. So, there is a little bit of a onetime COVID normalization effect that we see here as well. Obviously, we try to mitigate part of that as well. Then there's also mixed effect, especially see the stronger semi-public kind of place into that as well.

There's also a gearing into summer kind of impact of that with typically those segments and the public segments stronger. So, you got a mix of different things. The price increase rounds that we are now doing, we obviously looked at the size so that we can start reducing that gap despite everything that is happening. However, it is something that, again, takes time to execute. We started executing it in July. Some of this stuff again is effective immediately, which is a priceless adjustment on clients that are in a partial service model. So, you just sell them ingredients and then it hits them right away. Then now of course, we got to churn through, again, a number of these larger contracts. So, we are optimistic that for the second half of the year we'll be able to narrow that gap, but I don't think that we'll make a statement here. We are going to fully close it in that timeframe.

Philippe, I do not know if you have anything else you want to add to that.

Philippe Gautier: Yeah. Just to add to your document, Christian. Stefan, when you look at it, we have been able to deliver pricing increase of 6%. That is about like 33 million in the bottom line in H1. So that is pretty impressive. It has been done through very discipline action. Like we need to do it machine by machine, client by client. So it's a pretty big endeavor and that was exactly executed. Then we knew that there was going to be a little bit of timeline because then the second round just comes now. So, there is no real surprise here. Now there will be another very meaningful step like in the start of the second half year. So, I think there has been a lot of work here, a lot of result and that should pay off.

Stefan Binder: Yeah. So, I take it like partial, gradual recovery, not fully closing gap, but partial, gradual recovery over H2. Different question. So, you said you exited June with 91% of '19. I think if I have it correctly, March was – no – sorry. Yeah. March was exited with 81% and June is 91%. So, kind of like 10% improvement. If you look at Q3, is there any reason to assume that it should not follow the same path, I guess, less steep to improvement, but is there any reason I should assume no further improvement?

Christian Schmitz: Well, by and large, I think we are now in what I think is a steady state post COVID. So, we don't plan with substantial recovery in office anymore. We've still got a number of clients where office attendance is 30%, 35% kind of the range, 40% large clients, especially large corporates, which still pretty strong recovery. From how we think about our business, we pretty much call it a day. All right? Now what we do is in some of those client relationships, what we still have that that we adjust the footprint and have those conversations. So, we say, look, I mean, the COVID time's over. This is the new normal, and how can we now find something that works here permanently.

I think it's important to keep in mind when you also think through the dynamic versus 2019 and where we stand, that we actively terminated quite a bit of business, which is the unprofitable clients that Philippe and I inherited from the past and just business that from our perspective, didn't make a lot of sense. So, we have said that in previous calls we are not here to just like generate empty revenue. For us, it has got to be accretive. It got to have a solution that brings joy to people. It has got to be something that is differentiated. It has got to be catered to the needs of the client and it's got to make money for us. Right? That is how we think about business. That is why despite the price increase you won't see a full snap back, however then of course you going to add business, I think for the – now we are in the lucky situation that finally get net organic growth in the business, which is something we're excited about. This company hasn't had that in a while. They grew through acquisitions. So now we got that we got to accelerate that and that is how we see the path going forward.

Stefan Binder: Okay. I understand. Yeah. That helpful. I understand. Last question from my side before I turn back. So previously, historically you mentioned sort of 8% CapEx is like your normalized. So now you stressed again, like the leasing model and how you focus on free cash flow. Is that 8% number still good or do you think you can do better, like sort of obviously 5% in H1 is probably too low, but in terms of your more steady state CapEx, what is your latest thinking on that?

Philippe Gautier: You're right, Stefan. So, we feel the 8% was really high, that was one of the issues of the company. We have been working a lot on fixing that and there is still some room to go. So, I would say what we have now is much more normal. So yeah, we would expect to be much less than the 8%. That is part of the different initiatives that we are carrying out to improve our free cash flow conversion.

Stefan Binder: Okay. So, the 5% I can think of that ballpark is kind of okay.

Christian Schmitz: You pick the number that you would like to pick. I think Philippe’s answer was then it is going to be below 8%. All right. So, I think thank you. We appreciate the questions. I think we should go and see if we have got another question waiting, given that we are about to be at time. Thank you.

Operator: Thank you. Our next question is from the line of Toby Hanson of Boundary Creek. Toby, your line is now open.

Toby Hanson: Thanks. I'm afraid the first question is actually just continuation on the pricing. So, looks like from the chart, at least that you have in the slide deck, the July increases around 12%. I understand that there is a lag in implementation, but if hypothetically on 1st of July you were able to adjust the pricing across the whole business, would that 12% price increase reflect the inflation that you are seeing in the cost base? Or are you still kind of under recovering versus what you are seeing? That is the first question.

Philippe Gautier: Hi Toby. Well, we do not have any 12% number anywhere in the deck. I just checked but I did not see it anywhere. I'm not sure where you are finding this number.

Toby Hanson: I just had my ruler out, comparing the size of the first and second round to the first round.

Philippe Gautier: That's why we say the drawing is done for illustrative purposes. You should not take that like as an exact step. What I would say that like, yeah, there will be an over material step in the start of H2. So yeah, I think we delivered a lot and then there is another big step there, that should help to mitigate the gap and hopefully create a bit of buffer.

Toby Hanson: Okay. Thanks. Then the second question is just in the free cash flow chart that you showed, the one off of I think it's about 12 million. Yeah, 11.8 million. Now, if I use your adjusted EBITDA figure pre IFRS and run the cash flow through that, the one-off cash figure is much lower. So, is an amount of that 11.8 million figure running through the change in other assets line on the cash flow statement?

Philippe Gautier: What do you have is that the 12 million correspond to two parts. There is a part which gone through the P&L in 2022 and then another part which comes from 2021. So that's about like 50-50. So, we have continued to pay for the one of which were put through the P&L in 2021.

Toby Hanson: Okay. But just confirm, it wouldn't be running through the change in other assets line in the cash flow statement?

Philippe Gautier: No. No. It's like you have a part which goes through the one-off in the P&L, then the other part would be in other payables in working capital.

Toby Hanson: Okay. Great. Thank you.

Christian Schmitz: Okay. Thank you. Appreciate the question.

Operator: Thank you. We have no further questions for today, so it is my pleasure to hand back to the Selecta team.

Christian Schmitz: All right. Look, I just want to thank everyone for joining today and taking the time. We appreciate it the questions. We're obviously laser focused on our priorities, and we look forward to an exciting second half of the year. However, we think with what's happening in the market, with our new solutions are spot on and we look forward to a bright future of this company. Thank you, everyone. Have a great day and see you next time.

Philippe Gautier: Thank you.

Angela Cinelli: Thank you all. Have a good day.

[END OF TRANSCRIPT]