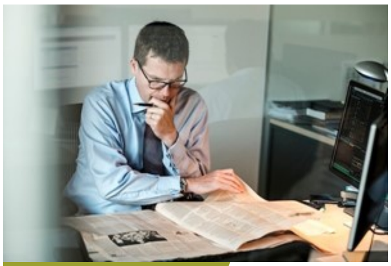

Friday Morning Coffee

Nr. 90 — A sweet business turned into a sweet investment

In the second half of 2018 a small Swedish company pops up in our screening. The company appears offering both high quality and compelling valuation. Furthermore, it operates in a non-cyclical industry. Without further delay we start to investigate the company behind the numbers in our screening.

The company is **Cloetta**. The name of the company is unknown to most as it is a rather small and regionally focused company selling candy, chocolate and other confectionary products to consumers. However, their products are very well known by kids and adults. Depending on which country you are from you may recognize one or more of their brands like **Malaco, Cloetta, Läkerol, Venco, Jenkki, Jelly Bean, Candyking** etc. If you only recognize one of the brands, that's fine. Most of the brands are very strong in local markets. If you live outside the Nordics, the Netherlands, Germany and UK chances are that you don't even know any of their brands, because Cloetta's business is concentrated in those countries.

Speaking of size, a little perspective always helps. The size of Cloetta's business is only a fraction of global peer companies like Mondelez, Nestlé, Hershey, and Mars. However, in the before mentioned local markets **Cloetta has a strong position and give all their competitors a run for their money. That's the true power of local strong brands. The candy we eat as children, we continue to eat in our adult lives and we even pass on our own childhood-candy-eating-habits to our own kids. We have an emotional attachment to the product.** That is how solid brands can survive across generations.

In 2018, our research into Cloetta revealed that the company had fallen deeply out of favor amongst investors on a combination of weak organic growth, a string of disappointments from their Italian operations, and an acquisition of Candyking. In short, investors had put Cloetta into the "wait-and-see" corner.

Conclusion: the share price fell from 38 SEK to below 24 SEK in 18 months' time. It was by the end of that 18-month period we started to become interested.

Our research revealed another interesting factor. Through all the negative headlines created by their Italian operations and negative investor sentiment, we found some compelling pieces of information:

- The management had finally realized that the Italian operations could not be restructured and had therefore been sold

Friday Morning Coffee

Nr. 90 — A sweet business turned into a sweet investment

- The 2017 acquisition of Candyking made logical sense because it would bring access to growth potential and lead to cost savings through insourcing of production
- The company had paid off significant amounts of debt and thereby made the business profile less risky
- A shareholder dividend was initiated in 2015
- Company management could finally get the focus back on growing their branded consumer goods which carry high margins

In short, **the management had shown decisive actions and laid out a roadmap ultimately leading to an improved organic growth profile and a higher profitability.** The journey is designed to take a few years and we decided to join the journey at a point in time where Mr. Market had priced in very low probability for any kind of improvement in Cloetta's business. Our judgement at the time: A good part of the planned improvements was in the hands of management and self-help measures alone would bring some improvements.

Here we are five quarters after we bought Cloetta around 26 SEK. Shares are now changing hands at 33 SEK, and we have received a dividend on top. All parameters of the company have enhanced: Sales are growing, margins and cash flows increasing, and the balance sheet has improved further. **We still see room for self-help margin improvement and a higher dividend over the next couple of years and none of that is priced into the current share price.**

Part 1 of our Cloetta investment has played. We believe part 2 is due to come too.

Have a nice weekend,

Allan S. Jensen, CFA, CAIA
Portfolio Manager
February 7th, 2020