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Half-year Report 2022
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Slide 1 – Welcome

Joséphine Edwall: Hello and welcome to Essity’s Conference about our Half-year Report 2022. I'm Joséphine Edwall, Head of Communications for Essity and I will be your moderator today. Today's presenters will be, of course, our CEO and President Magnus Groth, and our CFO and Executive Vice President Fredrik Rystedt. And then we are happy to have Joanna Griffiths here, the founder and CEO of Knix. After the presentations, we will have a Q&A session.

So with this, I am over to you Magnus.

Slide 2 – Half-year Report 2022

Slide 3

Slide 4 – Summary Q2 2022

Magnus Groth: Thanks, Joséphine. Welcome, everyone. And I'm pleased to report the strongest sales growth quarter that we have ever seen. And a large part of this is price increases also, the highest price increases that we've ever seen in a quarter by far. And this has resulted in a sequential EBITA improvement, even though it's small, but still an improvement. We see that the price increases that we have achieved are significantly higher than we had expected, but also the cost inflation that has continued to accelerate throughout the quarter. Looking forward, we continue to invest in our brands, in our market positions. This is what makes it possible for us now to work on improving our profits and our margins. Important also for the future is that online sales increased with 25% in the second quarter to 15% of sales. And of course, I also want to welcome Joanna to this presentation. It's a very, very significant and strategically important acquisition of Knix as well as Modibodi. And it's not only strategic; it's also very profitable and high growing business that puts us in the lead in intimate hygiene. And I'll talk more about this in a second.

Slide 5 – Financials Q2 2022 vs Q2 2021

Some financial highlights, the growth over 20% in total and acquisition growth over 2%, which is above our target, I think worth mentioning. And we'll get into the details. But when it comes to the organic 17.8%, 12.5 was purely attributed to price. Looking at cash flow was strong, I would say, and adjusted EBITA was slightly lower than the same quarter last year, but sequentially an improvement.

Slide 6 – Adjusted EBITA Margin, Q2 2022 vs Q2 2021

The EBITA Bridge, as you can see, again, severe cost inflation, 1280 basis points, as you can see there down below, the red box. And this is not all of it because this is the cost inflation that we measure to global indices. And that's obvious kind of in comparison to market prices same quarter a year ago. But in addition to this, we also have inflation on a number of areas. It could be pallets, it could be sea freight, it could be other areas, salary inflation of course also. That actually adds to the cost pressure even further.

But as mentioned, with significant price increases, better mix and better volumes in more or less all our categories and all our geographies. I am very, very proud about the achievements of the organization in this quarter. And we have a very strong momentum going forward when it comes to continuing to achieve growth through a combination of price, mix and volume. A&P is slightly lower in the quarter compared to a year ago and also contributes to margin, while SG&A is higher but lower in relation to sales. And the reason why it's higher is that we're seeing a normalization compared to previous years dominated by COVID, which means that we are seeing some salary inflation but also accruals for bonuses that we haven't had in quite some time. And also, for instance, travel increases, but still in relation to sales and in relation then to the EBITA margin contributing positively here.

Slide 7 – Innovating for Increased Well-being

As always, innovation is what drives this company. And it's another quarter with a number of very, very strong product launches. All of these examples here are in personal care and maybe worthwhile noting, it's not obvious from the picture, is down in the right-hand corner, our completely new feminine care product platform that will replace our very, very successful, secure fit platform that we've been using for the last 15 years. And as you know, we've been growing market shares and improving our market positions here for years and years and years. And this is an important not only upgrade, but actually a completely new product platform that we're launching with very positive customer and consumer response.

Slide 8 – Higher productivity

Productivity, as you can see from the numbers, the COGS savings that we normally see as being between SEK 0.5 to 1bn per year were negative in the quarter. This is not because we're saving less. Actually we're saving more than last year and at a very high frequency. But this is offset by inflationary pressure in a number of areas.

So, we are seeing substantial savings in everything from operational efficiency improvements, digitalizations, very much in the supply chain overall, material rationalization, sourcing savings, and the negative impacts by inflation are inflations in areas as I mentioned before. I think this is a beautiful picture of the investments that we're doing that's not only good for the company and for our long-term return and profitability, but also for the planet. So these are solar panels on our tissue plant in Kostheim in Germany.

Slide 9 – Health & Medical, Q2 2022 vs Q2 2021

With that, I would like to hand over to Fredrik. Over to you.

Fredrik Rystedt: Thanks, Magnus. And let me just give you a few comments relating to the business areas and starting with Health & Medical. As can be seen from this slide, we continue to do well in terms of organic growth, and that's both for Incontinence and for Medical. And within the Medical part, especially wound care and orthopedics continue to grow at very, very healthy rates. You can see that the emerging market growth was really strong. And this is particularly in Latin America, both for Incontinence and Medical, and of course also Eastern Europe. Now, generally, price and mix was strong in most markets actually. And if you look at the price/mix component here of 4%, as it stated here, the absolute majority is related to price increases. Now, if you look at Health and Medical, it's typically the business area within Essity least affected by raw material. But in essence, if we look at the last couple of quarters, this is actually where cost inflation has been the greatest. So quite unusual from that perspective. And it's related to materials such as fluff pulp. It's SAP and generally plastic products. And of course, this is mainly within Incontinence, so much less in Medical, so mainly Incontinence.

Now we have compensated quite some with price, as I mentioned, but the contract structure within Health & Medical is such that pricing changes are much, much slower, so longer contracts lengths, listings, et cetera. So therefore, compensation or price increases is a much longer process. So we have ventured into that. We have raised prices quite significantly, also sequentially in this quarter and we will continue to do so going forward. We expect raw material to significantly increase also for Q3, sequentially and versus last year.

Slide 10 – Consumer Goods, Q2 2022 vs Q2 2021

So turning to Consumer Goods, this was a quarter with very, very significant increases in all categories and in all geographies. So in average, price increased with nearly 15% compared to one year ago and also within this quarter very significant increases. And together with a good mix, the organic sales growth, as you can see on the slide, was close to 18%.

Now volume is in the context of the other business area, slightly lower, and particularly so for Baby. So there are basically two reasons for this. One is that we have taken the decision to exit our diaper production in Colombia or a diaper business in Colombia. And this has had a negative volume impact. We will see that negative volume impact also going forward as we exit gradually. If one takes away that impact, Baby would have had roughly about twice the growth of what you see here, so roughly about 4%. And the other reason why volume is slightly lower is due to Russia with much, much lower sales volume in the quarter. So here you can see that the impact from raw material is the highest of our business areas, so 14.5% margin impact if you compare to one year ago. And we will see also here in this area significant cost increases sequentially and compared to last year, ss we go forward.

We have executed with on a lot of price increases and we'll see additional benefits from the already agreed price increases as we go forward now into Q3. And we will continue, of course, the journey on increasing prices as we go forward. And as Magnus also said, of course, obviously cost control, pricing is a very, very -- or both very key focuses of the group at this point of time. But we continue to execute on our more long-term agenda, so performance management with the exit of diapers in

Colombia as an example. And of course, the acquisitions which you will hear more about of Knix and Modibodi.

Slide 11 – Professional Hygiene, Q2 2022 vs Q2 2021

Turning to Professional Hygiene, really strong growth. And of course here we're still benefiting, you can say, from the recovery, from the COVID restrictions that were present during last year and to a much less extent this year. So we are having a strong volume development and together with a really good mix and very significant pricing to the extent of a bit over 13% in Professional Hygiene. Then of course, organic growth was a bit over 26%, as you can see.

Now, here is the area where mature markets is actually growing more than emerging markets. And there basically two areas which is impacting this. The first one is China. You all know that the COVID restrictions in China have not been lifted, so the volume development there is quite weak. And the other area contributing to this to the relatively weaker growth in emerging market is Russia. So we have practically no business left there when it comes to Professional Hygiene.

So no different, of course, to the other business areas. The raw material impact is very significant, 10.6% as a negative margin impact compared to last year. And also here, we have compensated with price, and we will continue to do so as we go forward with further price increases in Q3. Thank you.

Slide 12 – Taking Global Lead in Leakproof Apparel

Magnus Groth: Okay. So let's have a closer look at how we are taking the lead in leakproof apparel. And we're using the term leakproof apparel and washable absorbent underwear somewhat side by side. And of course, the acquisitions of Knix and Modibodi are key to taking the lead here.

Slide 13 – Intimate Hygiene

But just to give a background, we define Feminine Care and Incontinence Care together as Intimate Care. And what we have experienced over the last number of years is that these two categories are becoming more and more interlinked, and that from a consumer perspective, it's all the same. And it's perceived from a consumer perspective as an overall intimate hygiene category, and period care, daily intimate care is how we define Feminine Care while we split Incontinence Care into women and men. And relative size of these two altogether, Intimate Hygiene is approximately 11% of our sales, and Incontinence Care is slightly higher portion of that than Feminine Care.

Slide 14 – Leakproof Apparel, The fastest growing segment within Intimate Hygiene

Leakproof apparel. Why is it so exciting? It's so exciting because it's by far the fastest growing category in Intimate Hygiene. We expect it to grow by 20% per year at least for the next five years. It's also a category, and Joanna will talk more about this, that's really attractive for younger people. It's today 7% of the intimate hygiene market. We expect it will be 15% in five years.

Slide 15 – Consumer Shifting To Reusable, Leakproof Apparel

And this is the overall reasons why consumers are shifting. It's a more sustainable option. It's comfortable, it's discreet, it's reliable. And not least through direct to consumer sales, its availability is higher and also awareness.

Slide 16 – Knix

So with that introduction, I would like to introduce the founder and CEO of Knix Wear, Joanna Griffiths. Over to you.

Joanna Griffiths: Thanks so much. It's wonderful to be here today with all of you. I'd like to tell you a little bit about Knix, and we really are an interesting organization. We sit at the intersection of intimate hygiene, which we've just heard about, intimate apparel, and active. And our mission is to inspire our customers to be unapologetically free and truly to improve their lives through product and authentic storytelling. When you think about Knix, there really are a couple of things that I wanted to point out to you.

Slide 17 – Knix, What Began As An Idea Has Become A Category Defining Brand

So the first is that we are category creators. We helped invent the leakproof apparel category. This is a very exciting category. It's one that the better part of ten years ago really didn't exist. When you look at this category today, at least from an American perspective, over 54% of people are aware of leakproof underwear, and the interest in trial is growing rapidly.

Secondly, we're product innovators. So within this category, we strive to make the best possible product. A couple of accolades that we received last year were the number one rated leakproof underwear brand by both Consumer Reports as well as Good Housekeeping. And this applied to both Knix and our teen brand KT by Knix, which I'll touch on later. Finally, we are a movement brand. We have been pioneers within a lot of the trends that you're seeing more broadly within marketing today, including body positivity, inclusivity, and diversity, and really using our brand and platform to break down taboos and stereotypes, which is something that we share with Essity.

Slide 18 – Knix, "We're Redefining Intimates"

Next, I will talk a little bit about Knix as a whole. So as I mentioned, we're a leading player in the leakproof period and incontinence work category. We have a wide variety and assortment of functional intimate apparel and activewear, which I'll speak to momentarily. We're a bold innovator. We love to use our platform to innovate and to build trust within our consumer base.

And perhaps most interestingly for this call is we as best in class digital capabilities. So, we are a direct to consumer brand. 98% of our sales come online through our own websites. We do not currently sell through any third-party sites. So all of the success that you've seen to date has been exclusively through our own channels, and this has led us to have about a 30% market share in North America. These sales are split almost equally between Canada and the United States. And then finally, we have high gross margins in our capital light business, which has allowed us to scale to date very effectively.

Slide 19 – Knix, Enjoy worry-free protection

When you think about this category, there's sort of three key buckets that are really important to consider where customers are looking for worry free protection. So the first is for period protection and period underwear. About 80% of people experience leaks during their period, so this is a great option for backup protection.

About two years ago, we brought products to market that completely replace the need for disposable products. So, consumers are using it for both of those reasons. The second is incontinence underwear, which again is a high need case within women specifically, especially during the postpartum period, or for very active people, where we see about one in three women experience what we call stress incontinence. And then the third, and this might be surprising to folks, is everyday use. So people are actually coming to leakproof underwear for worry-free protection against sweat, discharge, odor, all of those different things. And over 50% of Knix customers are wearing leakproof underwear every single day, which is very exciting and trend that we're seeing within intimate hygiene, more broadly speaking as well.

Slide 20 – Knix, By combining performance, our leakproof technology and design, Knix is reinventing products across the intimates category

When we speak to intimate apparel and leakproof apparel more broadly, what we've done at Knix over the past several years is we've taken our leakproof intellectual property and we've rolled it out.

We started in underwear. We then took our leakproof IP and rolled it into maternity wear, launching products such as leakproof nursing bras as an example. More recently, we've launched leakproof swim, which has been met with terrific response. It's a wonderful alternative for people who wear exclusively pads and who are looking for protection while they swim. And then we really see the next frontier for leakproof existing in active. It's when people are sweating, it's when they are having the most challenges with traditional products. And it's also where there is high incidences of stress incontinence. And so we're very, very excited about our foray into activewear that we began last year. And then finally, we offer traditional reusable pads.

Slide 21 – Knix, Multi-generational, Knix is there for Her Through Every Stage of Life

One thing that Essity and Knix share are that we're really there for consumers through every single stage of life. In 2017, we launched our teen brand, KT by Knix, and this really had the insight to be there from first period onwards to help normalize periods and to help give peace of mind and confidence for young girls as they are first approaching their periods.

From there, we take that consumer and they can live with us through being a young adult into the maturity and postpartum phase where we have specific products for them and then through menopause as well as later in life. Knix, we pride ourselves on having customers that are shopping for their mother. They're shopping for their teen daughter, their sisters. And we really are a multigenerational brand.

Slide 22 – Knix, How Knix Approaches Her: Storytelling First, Selling Second

Part of the way that we've been able to achieve this successfully where others haven't is that we really approach our customer by storytelling first and selling second. We put our customers at the epicenter of everything that we do as a brand. They are our models. As an example, we've worked with over 1,000 of our customers. We do casting calls through our social media channels. Our most recent one, I think we had over 16,000 people apply to be a model for Knix. That gives you any indication of sort of the interest level in the brand. They are inspiration for new products.

We have a very close, direct relationship with our customers thanks to being a direct-to-consumer brand. And so we get lots of great ideas from them and actually credit the customers on our packaging. And then finally, they are ambassadors. So they really are speaking on behalf of the brand, sharing their experiences. And we use our platform of over 800,000 social media followers to share their incredible life changing stories and to inspire others around them. I'll now pass it to Fredrik who will give some more details about the transaction.

Slide 23 – Knix Transaction

Fredrik Rystedt: Yeah. Thanks, Joanna. The purchase price for Knix, the agreed price was USD 320m, or roughly about SEK 3.3bn, and this is for 80% on a debt and cash free basis. So, of course, Joanna will remain as a 20% owner. Now, as Joanna, you already mentioned this, but Knix is a very high growth, high gross margin company, but also with very, very significant investment into growth. And of course, despite that, the EBITA margin is quite attractive. So we expect to finalize the acquisition in the second half of this year after customary regulatory approvals that we expect to have sometime in the next few months.

Slide 24 – Modibodi

So turning to another acquisition of Modibodi, as Magnus mentioned, and this agreement was signed actually the day before we signed the agreement relating to Knix. And Modibodi is also a leading leakproof apparel company with strong market positions in Australia and New Zealand and in the UK. And just looking at Australia alone, the market share is approximately about 40%.

And exactly as Knix, Modibodi is a high growth company, has very, very attractive gross margins and of course also EBITA margins, but of course impacted by significant growth investments. And growth is a major theme also for Modibodi. So the purchase price amounts to slightly less than SEK 1bn or AUD 140m on a cash and debt free basis. And we expect also this acquisition to be completed sometime during the second half of this year.

Slide 25 – Building the Fastest Growing Company in Intimate Hygiene, Global Lead in Leakproof Apparel

Magnus Groth: Thank you Fredrik. To summarize, we are building the fastest growing company in Intimate Hygiene and taking the global lead in leakproof apparel. And just to say that with Knix, Modibodi, and the leakproof products that we have launched over the last couple of years under our own brands like TENA, TOM Organic and our Feminine Care brands, we are really in pole position in the fastest growing part of intimate hygiene. Very exciting. And also very exciting, Joanna will continue to lead Knix. And both Knix and Modibodi will be operated completely independently from the rest of Essity. And then, of course, we hope to learn by the success that these two companies are enjoying at this point in time.

Slide 26 – Summary Q2 2022

To summarize then, this is the same slide that I started with, we've seen strong sales growth, significant price increases, high volumes, sequential EBITA improvement. And as I mentioned now several times, significantly higher costs actually from all areas. So materials, energy, distribution, but also inflationary cost impacts. We continue to invest for the long term. To finalize looking to the extent that we can into the third quarter, I would say that uncertainty is higher than ever and it will be a very challenging quarter again. And this is due to the accelerating costs that we have already mentioned now a number of times that will continue also into the third quarter.

We continue relentlessly to raise prices. We see that we will have significant price increases, especially in the fourth quarter. And this is then something that we will be working very, very hard to achieve, if possible, similar margins in the third quarter as in the second quarter. And this will depend, again, huge uncertainties, it will depend on the development of the costs. We know that our price increase momentum is very, very strong and it's now also increasing, especially in personal care. And to the extent we will balance that in the third or the fourth quarter, I think we will have to see. So with that, let's open up for questions.

Slide 27 – Q&A

Operator: Ladies and gentlemen, please press star one to ask questions. Will now take the first question from our Charles Eden from UBS. Please go ahead. Your line is open.

Charles Eden: Hi. Good morning. Thanks for taking my questions. I've got a couple. Firstly, on the 10.8% price/mix at the group level in Q2, could you split out how much of this is less price increases versus mix? And also, if you did get the energy surcharge pricing in Consumer Tissue and Professional Hygiene you were talking about at Q1, could you also quantify how much this contributed to the pricing in the quarter, please? Equally, if you could also help with the breakdown of the 21.6% consumer tissue organic sales growth between price and volume, that would be helpful. And then if I can just squeeze in a second question, it's just on German manufacturing and specifically focus on your Consumer Tissue and Professional Hygiene businesses, given the energy intensity there. But I believe you have four sites in Germany, which is about 12.5% of your global capacity in tissue and professional hygiene. Can you just talk about the excess capacity in some of your other sites in Europe or globally and whether any potential limitations to production in the German sites could be offset elsewhere? Thank you.

Magnus Groth: Do you want to start Fredrik and I will talk about how we are preparing for any eventual gas shortages in Germany, which I guess you're referring to. So, starting out --

Fredrik Rystedt: I think the first question, if I remember, Charles, you said how much of the total price mix was related to price. Was that the question?

Charles Eden: Yes, please. And then if there was an energy surcharge contribution, if you could strip that out separately as well.

Fredrik Rystedt: I cannot actually strip that out because you can say energy surcharges is just another price increase you can say. So it's more of a tactical and faster way of increasing prices. So, we don't specifically split exactly how much that was. But if you take the total price increase for the Group, it was roughly about 12.5%. And the rest of the price/mix, obviously, then 1.5 was relating to mix. And I think I mentioned before the different areas. So the majority of the 4% in Health and Medical was related to price. When you come to Consumer Goods, it's roughly about 15% or just short of 15%. And when you come to Professional Hygiene, a bit north of 13%. So this is basically the different price increases that we have had. Let's see the second question.

Magnus Groth: The growth in Consumer Tissue at 21.6%.

Fredrik Rystedt: Yeah. So if you take the total growth of volume was 1.6%. If you look at the mix, approximately a couple of percent. And then finally, the price increase, roughly about 18%.

Magnus Groth: And coming into this is, again, Russia, which has a negative impact on volumes.

Fredrik Rystedt: Exactly. So the volume is bit lower than for the other areas. And of course, Russia is a very, very big part of that. So, yeah, those are the numbers.

Magnus Groth: Okay. So over to Germany and our sites in Germany where we are preparing to manage any situation from an energy perspective, and especially as relates to natural gas. So, what we're doing very practically is that we are preparing our German plants to be fueled by LNG. So, to be able to supply them with fuel by trucks replacing then pipeline gas. So that's one thing that we're doing. We're also, in some cases, able to run production with electrical drying. So, we have some examples of that. We are also, of course, working with our stock levels so that we could manage a couple of weeks, even if certain machines would be down for a period and continue to convert and supply to our customers. And as you stated, it's around 11-12% of our capacity. So we have capacity in other parts of Europe that could support it to some extent. So we have a very comprehensive program that considers both investments, financial hedging, as well as then supplying from factories in other countries. And we believe that with this, we will be able to manage supply throughout even very challenging conditions.

Charles Eden: Thank you.

Operator: We'll now take our next question from Linus Larsson from SEB Bank. Please go ahead. Your line is open.

Linus Larsson: Yes, sorry about that. Thank you very much. Thanks for taking my questions. First, I just wanted to clarify, did I hear you right, that you are guiding for group adjusted EBITA margin similar Q3 on Q2? Just to clarify whether I got that right in early in the call.

Magnus Groth: Hi, Linus. At first, I thought it was an Icelandic person calling in Lin Usnarson as it says here on my screen. I've been looking too much at football I think and the Icelandic team there. Hi Linus, I'm not guiding, this is just an estimate and big uncertainties. So, we expect to see very good price increases also in the third quarter, even more in the fourth quarter. This is just how it kind of plays out in the negotiations that we have, while we expect to see sequentially and year over year significantly higher input costs in in all areas. So this is an estimate and it's very difficult to say.

And to reinterate - the margins in line with Q2.

Magnus Groth: What's more important what I want to underline is that we have fantastic price momentum, and nothing goes to the sky here in terms of costs. And we are seeing continued momentum also going forward. And as I mentioned, also, increasingly this has come slower but in personal care. So we are very, very confident that we are doing everything we can and again, really, really leveraging and stretching the strength of our brand, our market positions at the same time as we are also very focused on productivity, cost savings. And eventually we will see the impact of that of course, also then in the numbers. So, overall good momentum in the business.

Linus Larsson: Absolutely. Basically, your message is that you're expecting to keep up with cost inflation in the third quarter, but not overcompensate quite yet. That may come at a later stage.

Magnus Groth: The cost inflation continues to be very high and we expect significantly higher costs in all areas, both sequentially and year over year. Also in the third quarter, which is typically the outlook that we have.

Fredrik Rystedt: And maybe Linus if I can add, just maybe something we talked about many times before is that it is incredibly complicated. I mean, it's a time-consuming process, regardless of which business area we are in to increase prices. It's the time-consuming thing. So it's not a one day issue. And of course, so have the cost increases, you negotiate on the price, and then gradually the price increases are executed. So, if the cost increases are continuing to rise all the time, then of course it's difficult to kind of get ahead really, because the cost increases that we have now, they are the ones that we will negotiate price for and get kind of additional compensation for a bit later. So, I think the reason when you say we cannot compensate, I think we are definitely compensating, perhaps even more than the cost increases. But those are for the cost increases that occurred previously. So as Magnus already said and we've said here a couple of times, is that we will have to continue to increase prices and we will do that. And with this price momentum that we have, we see all the possibilities of doing exactly that in all our business areas. It's just a time-consuming process.

Linus Larsson: Absolutely. No, that's very helpful. Thank you very much. I think it's very clear that you are successfully compensating, but my question was more relating to at what stage you will kind of get ahead of the curve. But maybe on a somewhat different note, looking at Health & Medical, there are other costs it seems SEK 180m increase year on year. Could you please shed some color on those costs? What are those? Are they, to an extent, one-off maybe relating to Russia or Colombia or anything else?

Fredrik Rystedt: So, I think Magnus said that if you look at the market kind of movements that we track specifically on indices, those are within market, but we also have inflation pretty much everywhere. So those other costs are mainly related to inflation and the factors that Magnus mentioned that we also have in the other areas, so no specific there.

Linus Larsson: Okay. Nothing one off-ish in that number?

Fredrik Rystedt: Not really, no.

Magnus Groth: Before we continue the Q&A session here, I just want to remind everyone that Joanna is also on the line and happy to answer any question.

Linus Larsson: Just one final question, if I may, on the leakproof category. You've made two acquisitions now recently. Do you intend to make more acquisitions or should we from now on, more view this as a primarily organically driven business?

Magnus Groth: Primarily organic driven business.

Linus Larsson: That's very clear. Thank you very much.

Operator: Thank you. We'll now take the next question from Faham Baig from Credit Suisse. Please go ahead. Your line is open.

Faham Baig: Hi, guys. Thank you for the call and taking my questions. I have three, if I could. Relatively quick ones, I hope. Am I right in suggesting that pricing sequentially will step up from what was recorded in Q2? And related to that, historically you have suggested that in order to compensate for the input cost inflation you need about 25% pricing. I just want to know to what we see today, what would that pricing number need to be in order to fully pass on the costs? Secondly, with regards to some of the moving parts, in terms of cost inflation, are you able to break out the transactional element of the increase in your raw materials? Because I think that was the biggest drag rather than the increase in USD terms. That will be helpful. And the final question, could I just discuss Vinda and China? Q2 actually came out from a top line perspective better than expected, but I'm sure you'll agree we still need more pricing there. Could you highlight some of the dynamics in terms of the prices being passed through, how competition is reacting to that? Because I know in Q1 the competition was not following Vinda and how that is impacting the market share dynamics. Sorry for the long list.

Magnus Groth: You want to start Fredrik?

Fredrik Rystedt: Yeah. I think when it comes to pricing in in Q3, we do not want to provide any specific numbers. So, the increase now in Q2 sequentially was very, very strong. So roughly about 6% just in the isolated quarter. So, it was a fantastic pricing quarter from that perspective, of course very much needed but nevertheless. So, I think Magnus mentioned it earlier that we will see more pricing in Q4, but there will be pricing also in Q3, partly from what we have already agreed and of course, new price increases that we will put in place in the near term. But giving an exact forecast on exactly how Q3 pricing will turn out, this is not possible to do. I can continue with the 25% because I think that's more of a statement that related to a specific category rather than the Group as a whole. I think you get a bit of a lead when you look at the margin and our financial targets. So clearly if you look at margin and much more important ROCE in where we are at this point of time, we have a significant, you can say, journey to travel to get to the 17% or more than 17% in a few years from now.

And obviously, that needs to come to a very large degree, not only but to a large degree from margin impact and of course a significant portion of that in pricing. So, I think looking at the margin is perhaps a more relevant picture. Exactly how much we need will be dependent on, of course, the development of cost inflation as we go forward, because we don't know that. I think it's fair to say that cost for Q2 has become much bigger than we anticipated. Pricing is also become bigger than we estimated. So from that perspective, all fine. Q3 clearly higher costs than we originally thought. And it's very, very difficult to say. So it's not that meaningful to give an exact number on the 25%, I think. But we will continue to increase prices and we will reach our financial target that we have set out.

Magnus Groth: The transactional impact you want to talk about that currency I guess.

Fredrik Rystedt: Yeah, good question. It's roughly about SEK 500m. So, it is actually quite a big component. But the absolute majority, of course, is related to pure price increases. But the dollar strengthening is actually not very beneficial at this point of time. So it's roughly about SEK 500m, the majority in the business area Consumer Goods, but there is also some in the others. I can give you the exact numbers if you need, but roughly that.

Magnus Groth: And finally Vinda. Vinda has the same strategy as the rest of the group to build very, very strong brands, market positions, leading go to market and again their online sales increased. They are pushing very hard for price increases. And how that will play out in the second half of the year, I don't know. But this is definitely the ambition of Vinda. This is what they are aiming for as we are in all parts of the group.

Faham Baig: Thanks, Magnus.

Operator: Thank you. We'll now take the next question from John Ennis from Goldman Sachs. Please go ahead. Your line is open.

John Ennis: Yeah. Hello, everyone. So look, my first question is on the Health and Medical pricing outlook and margin outlook, I suppose. I guess it's naturally going to be an area where it takes longer to get pricing through just by nature of the duration of contracts which you spoke about earlier. But I guess on that basis, you expecting the margin weakness here to be a bit more prolonged? Or do you have other initiatives to help in recovering margin if pricing is going to be slower than the other segments? And I guess also, do energy surcharges work in this component of the business? That's my first question on Health & Medical. And then I had a couple of quick clarification questions. The first was on the energy surcharges more broadly. I guess, do they disappear when energy prices normalize? Or in your opinion, is it effectively the same as a regular price increase? And then my other clarification on the other cost component, is it all of the transactional effects falling here or do some of that actually fall within the raw material line? And are you capturing sort of rebates or discounts within that line item? And have they evolved, which helps explain the negative movement year on year? Thank you.

Magnus Groth: Okay. I'll leave the other costs to you Fredrik. It sounds like your specialty here. And I would talk about Health and Medical. I mean, there are basically four things we can do in the Health and Medical. We can make sure that approximately 1/3 of the contract volume that we renegotiate every year, of course, that we not only come out with better margins and higher prices, but also with new and improved contract terms, which means shorter contract duration, and also with clauses and indices that gives the opportunity to compensate for raw materials. I mean, this has not been necessary. What we have seen as one of the huge benefits of this whole category, especially in Inco healthcare. I mean, in Medical, the impact is very, very small still, but in Inco healthcare, where we have a significant impact from all the oil-based materials, super absorbents, also fluff pulp.

We are working to change the contract structures to negotiate higher prices, but also as we see increased pressure on the health care systems, and expect to see that going forward, to catch the customers and consumers as they move over to self-pay. And we have an advantage here since we are one of the few actors who are both in the regulated reimbursed part of the Incontinence Care business, what we call Inco healthcare, and in the retail part or self-pay part. And then of course, there are combinations where there's a self-pay component and a top up component. So, pulling all the levers and then working very, very actively also with the public affairs in order to make sure that the reimbursement systems are healthy and to the benefit of the users and the whole sector. So, a lot of work going on there.

When it comes to energy specifically, it's not relevant for Personal Care. Personal Care uses not much energy. The energy consumption is really on the paper machines for the drying of the paper. Energy surcharges, as Fredrik mentioned, we see as any other price increase. And with the drama that you're reading about every day now, also yesterday, we don't see them going away anytime soon. They should probably be higher with what we've seen now in the last couple of days in Europe on the ongoing gas discussions. So, with that other costs Fredrik.

Fredrik Rystedt: Yeah. My specialty, as you said, Magnus. So John, thanks for that question. So, I think your question was where do you find the transaction impact? So, the minus roughly about SEK 500m that I talked about earlier. And you would find those in markets, so the market cost. In raw material basically, that's where you'll find them there. There are some transactional currency impact also in others, but they're much smaller relating to, for instance, bought in finished goods. But as I said, that's a much smaller part. I think your question was also, what about discounts? That's normally part of our productivity improvement. So if there is an increase of discounts for a raw material, that we calculate as a productivity improvement, or you can say COGS savings. And your question is, are they higher, I guess, in comparison to the last year? And they are higher actually. So, there is a positive contribution from higher discounts. But if you look at the kind of derivative or the change, that impact is actually lower than previous years. So, getting discounts or increased benefits from that perspective is a bit more challenging in this market environment.

John Ennis: That's really helpful. Thank you. I just have one quick follow up on the energy surcharges. So I guess if energy prices were to fall next year, what happens to those, the surcharge component of your price increase? Does it disappear or does it just stay there?

Magnus Groth: We have different terms for different surcharges. But in general, it's not purely mathematical. It's part of their overall kind of negotiations with our customers. So, there's no easy answer to that.

John Ennis: Okay. Thank you.

Operator: Thank you. We'll now take our next question from Fulvio Cazzol from Berenberg. Please go ahead. Your line is open.

Fulvio Cazzol: Yes. Good morning and thank you for taking my questions. Sorry, I have another one on the energy surcharge, just to understand the mechanics behind that. So, I guess I'm interested in sort of understanding how long we could see this continuing to be added to customer invoices. Is the plan to continue to include it and to negotiate the price increases? And also, how have retailers responded? Because I read an article a few weeks ago not relating to you, but it highlighted a case of a retailer charging back their supplier on other costs, such as distribution. So, wondering if you've seen any of this on your business. And then my second question is relating to the private label business, which grew faster than the overall tissue business in the quarter. I realize that you took a little bit more pricing here, but I wanted to ask if there's any contract wins that may have also contributed to this stronger growth or if you are seeing more down trading from European consumers in tissue? Thank you.

Magnus Groth: Okay. Starting with the energy surcharge, we actually have a percentage increase on top of the price that we have negotiated. That's very, very similar for all customers, both in Professional Hygiene and in Consumer Tissue, in Europe and in North America. And we are also getting energy surcharges from our suppliers and increasingly so. And this is part of the inflation that you see that's actually not accounted for in the COGS headwinds of 1280 basis points. So, this is something that not only we are doing, but many of our suppliers as well. And we will negotiate increasing surcharges or stable surcharges or taking them away depending on how costs develop. I can't be more specific than that.

When it comes to the growth of the private label business, a lot of its pricing, as you're saying, it's a combination, actually, there is some down trading. There's also some customers that we lost a year ago when we increased prices faster and more aggressively than many of our competitors that are actually coming back to us because their new suppliers were not able to actually supply them with sufficient service levels. So that's a positive. On a relative scale we had a slightly negative impact, as already mentioned, on the branded business from Russia, from the lower growth in China, even though that improved later in the quarter. So, I think that explains the dynamics overall in why private label grew to the extent it did.

Fulvio Cazzol: Great. Thank you for that.

Operator: Thank you. We'll now take the next question from Martin Deboo from Jefferies. Please go ahead. Your line is open.

Martin Deboo: Good morning, everybody. I have got some questions on Knix. I think one for Magnus and Fredrik, two for Joanna. Magnus and Fredrik, the question is around synergies. I get you're buying into growth with this business, but you're paying 35 times EBITDA for the privilege of doing that. So, the question is, what's the synergy case here, both revenue and cost? And are you quantifying that? And then for Joanna. I think, Joanna, two questions for you. One is it's clearly a North America centric business at the moment. I would imagine that part of the revenue synergy is going into Europe. But what's the competition, what's the competitive landscape like for leakproof in Europe? And who are you going to have to beat, if anybody? And secondly, Joanna, how do you feel as a sort of entrepreneur, you know, do you worry that the entrepreneurial spirit you've built will get lost inside the big corporate? So those are my questions.

Magnus Groth: Thanks, Martin. That's excellent questions. We are not expecting any synergy. This is not a synergy case in how we've calculated the pricing here. What we are buying is a global leading position in leakproof apparel we’re buying into a position, where we are the fastest growing company in intimate hygiene, we’re buying into a very, very strong market position in North America, which we didn't have before, and into the most attractive segment of intimate hygiene where we are already very, very successful. So, this is what we are happily paying for because it's and we're buying into, as Fredrik has mentioned, a very profitable company from a gross margin perspective and also profitable from a net margin perspective. So that's how we see the purchase price. Over to you, Joanna.

Joanna Griffiths: Sure. Yeah. I think that part of the strategy here and plan is to really focus on North America. As Magnus just mentioned, there's a great opportunity to help build both the Knix brand in North America, as well as the Essity family as well within North America and the United States. When we think about the competition as we think global and we do see a lot of potential for Knix on a more global scale, we certainly have had that interest in the past. To be honest with you, it's a once in a consumer product lifespan opportunity. It's a very fast-growing category, not just within North America, but globally as well. It's still predominantly smaller niche players. There is not a leading global brand as of yet. We would like to see Knix become that brand. And so, the competition is actually quite fragmented both in Europe as well as across North America as well. So that's how we think about those two things.

Finally, in terms of entrepreneurial spirit, of course, I think that I've had the privilege of spending the better part of two years actually in conversations with Essity and the team there and have spent a lot of time discussing with them how we maintain our entrepreneurial integrity, how we bring that innovation of thought to the table as we see an exciting category that's having a lot of growth. And part of the rationale is I stay on as a major shareholder is that we will continue to operate independently and to have the ability to continue with the growth and momentum that we've seen.

Martin Deboo: Okay. Thank you for that.

Operator: Thank you. We'll now take a question from Oskar Lindström from Danske Bank. Please go ahead. Your line is open.

Oskar Lindström: Hi. A couple of questions from my side. The first one is also to, I think both Joanna and Magnus. Direct to consumer sales seems to be taking an increasingly – becoming increasingly important and also taking market share from traditional retail sales. Are there any wider consequences for the Consumer Goods business and I guess Essity's business as well? For example, I mean, do you foresee a more sort of fragmented market, more niche products, more SKU's, less power of retailers, of course? I mean, are there some wider consequences of this development? So that's my first question.

My second question is on the divestment of the European private label Consumer Tissue business. What's the status of that? I know you've – it's operating as an independent company, but there were some issues with the legal separation, if you could provide an update on that.

And then my final and third question is on your comment about a better product mix, also contributing to the overall price/mix improvement in the quarter. I mean, does this mean that you don't see any real impact from consumers choosing lower priced, simpler products as a consequence of the price increases? And what's your expectation for the future on that point? Thank you.

Magnus Groth: Okay. I would start before handing over to Joanna. And then maybe Joanna you can hand over to Fredrik for the better mixed question to end with that. And first of all, when it comes to the European private label tissue division, you made some implications that we have never done. So, we are not preparing for the divestment. We are preparing for setting up a separate entity to run this independently, and that's progressing well. And when it comes to legal entities, it's not that we are having issues, it's just that it takes time really. So, that's progressing well. And I think the performance is fantastic in the private label division and also the culture and the momentum. So, it's developing quite well. Then when it comes to this big question about the impact of DTC, we could talk for hours, of course, about this. What we always say is that we want to be overrepresented in the winning channels, and by that we will kind of be on top of whatever happens. And clearly, DTC is now a winning channel. And that's one of the reasons we are so excited about the acquisition of Knix. You touched on a couple of things that I think are very, very true. One is that it is easier to carry many, many SKU's direct to consumer than, of course, in a retail store. And there's also a greater opportunity for brand building of niche brands or bigger brands like Joanna has done with Knix. Over to you, Joanna.

Joanna Griffiths: Thank you. I think what's interesting that we've seen in North America at least, is a better 10-year acceleration of e-commerce as a result of COVID. And so, I think it makes sense that you're seeing an overcorrection towards DTC because so many consumers have now changed the way that they shop. As Magnus mentioned, specifically for our category and for leakproof apparel, DTC plays such an important role. When we think about leakproof underwear, it's not just about one single pair of black underwear that you would buy in a drugstore aisle. Really, we see the future of leakproof underwear being ubiquitous with regular underwear. And for that to happen, customers have to have the ability to pick different styles and colors and to match it with their bras, et cetera. And that's where direct to consumer becomes increasingly important for two reasons. One is to be able to have the offering, and then the second is to be able to have that direct relationship with the end consumer so that you can optimize the SKU's and assortment on a go forward basis. I think that from our perspective at Knix and it certainly seems like it's in line, is that really what's important today is to be there where consumers are shopping. So, for example, for Knix, while we've been exclusively direct to consumer in the past, through our own channels, we do see the opportunity to partner with third party retailers to have that access discovery mechanism for the brand, perhaps really try a product, and then they come online to see the full assortment. And so, I think increasingly what you're seeing, at least within the North American landscape, is really more of a multichannel approach and showing up in the right way with the right assortment depending on the channel. I will pass it to Fredrik now, who will speak to the better mix question.

Fredrik Rystedt: Thanks, Joanna. It's actually quite a difficult question to answer, because I think we do see some, what you mentioned, some down trading Oskar, especially towards the latter parts and in some markets. But overall, I think demand is still very strong. And of course, the focus for the – for our company is and has been very much focused around premiumization, around the innovation. And we can just see that we have continued to see good demand for those products, especially in Professional Hygiene and in Consumer Goods. So, the mix has been quite strong. Going forward very, very difficult to estimate exactly how the down trading will play out. But so far it has actually been on the balance, a relatively marginal impact, although we see those signs.

Oskar Lindstrom: Thank you.

Operator: Thank you. We'll now take our next question from Karel Zoete from Kepler Cheuvreux. Please go ahead. Your line is open.

Karel Zoete: Good morning and thanks for taking the question. I have two. The first one is on Professional Hygiene, which has a strong quarter compared to last year as COVID is more and more to the background. I was wondering on a more high level, how has COVID changed this market in North America and Europe in terms of product, competitive landscape, et cetera? And the other question is on cash flow with margins under pressure and working capital up and net debt is now closer to three times EBITDA. How do you look at the capital allocation going forward? Are you still eager to do more M&A or less so given where we are with the balance sheet and cash out that still comes Knix and Modibodi? Thank you.

Magnus Groth: Yeah, COVID and the impact on Professional Hygiene. It's the only business area that hasn't fully recovered compared to 2019 in relation to volume when it comes to overall topline, it has by far, but volume wise, we expect to see similar volumes year over 2019 by the end of this year. So, it will take a few more quarters because it's still growing volume wise. And what we are still seeing is a higher consumption of the skin care products like hand sanitizers, soap, paper hand towels. So, hand hygiene is still something that's driving the category even after COVID is gradually subsiding. I mean, we still see COVID in many markets, of course. And as Fredrik mentioned, we are also seeing a strong premiumization actually, that the demand for our premium or strategic dispenser lines is increasing. And partly, I think because it's replacing also the jet air dryers which have become less prevalent, even if you still see them a lot following the pandemic. With that, I hand over the question on capital allocation.

Fredrik Rystedt: Yeah, Karel, good question, because we are very committed as you all know, to our capital restrictions. So solid investment grade as you know and exactly as you mentioned, we are pretty close to the thresholds in terms of net debt to EBITDA. So, from that perspective, there isn't a lot of room in our balance sheet at this very moment in time. Now stating perhaps, the obvious. So, in the first half, typically we consume working capital. In the second half, we normally generate working capital. So of course, we continue, as you have seen, to have a good cash flow. And so, we are rebuilding our strength in the balance sheet. So maybe you shouldn't expect any immediate acquisitions, but of course we will create room for further acquisitions as we go forward. But we are committed to our capital policy.

Karel: Thank you.

Operator: Thank you. We'll now take the next question from Tom Sykes from Deutsche Bank. Please go ahead. Your line is open.

Tom Sykes: Yeah. Morning, everybody. Firstly, just a couple of questions on Knix. You said a capital light model. So, I just wondered that presumably you're outsourcing all of the manufacturing and logistics. How long are those contracts and when were those renegotiated, please? Then just on the breakdown of sales of Knix, how much of the revenues are actually the core leakproof underwear and how much are other items that are advertised? Seems to be a broader way of categories that the items that Knix is actually selling. And then just for Fredrik, Magnus, just on the SG&A, please, could you just remind us or just tell us how much of the SG&A is the SEK denominated and how much is in other currencies? Just so we think about the effects further down the P&L and the SG&A line as well, please.

Magnus Groth: Okay. Thanks. Before handing over to Joanna, I just when it comes to the breakdown of the different types of products in leakproof apparel, we don't provide that number for two reasons. One is that it's competitive information. Secondly, because as we see it, it goes together. And Joanna already mentioned why from a consumer perspective, you tend to buy in pairs and both bras and underwear and I'll hand over to you now, Joanna to give more color on this and also on the capital light structure of the business.

Joanna Griffiths: Sure. That's right. As I mentioned before, we believe the future of leakproof underwear is that it will be ubiquitous with regular underwear. And so, for that reason, we do have a broader assortment so that customers can purchase our products exactly like they do any other underwear that they would buy from a major retailer. Another kind of reason behind the rationale behind the mix of assortment is especially as we enter more broadly into apparel, having our logo be something that our customers wear with pride and confidence where it's not necessarily known that it's a leakproof product. It might be or might not be. As I mentioned in the slide where I sort of outlined how we've incorporated that IP across the entire range and suite of products that we offer. I think if you go back and take a deeper look, you'll actually see that theme of leakproof across almost everything that we produce. So just to highlight that piece there. In terms of capital light, that is right. We like to do what we do best and then partner on other aspects of the business. So, we do outsource manufacturing, while we do all product development in-house and take a strong approach to product development. We do outsource manufacturing and we do outsource our fulfillment and warehousing as well. From a length of relationship standpoint, we've been working with our partners since 2016. They've been tremendous partners for us as we've scaled and continue to build their own infrastructure to keep up with our level of growth. And so that is a long-term relationship.

The last contract renewal took place a couple of years ago, I believe it was in 2019. Although we're actively in discussions now to see if there are rooms for economies of scale now that we have grown, especially coming off of 97% year over year growth last year. And then from a manufacturing standpoint, we've had long term relationships with the bulk of our manufacturers. Our main manufacturer we've been working with since 2015, and we've been diversifying our supply chain over the past few years as we continue to scale. We negotiate prices on an ongoing basis and have been able to keep our cost of goods stable over the past two years, in spite of the many challenges that I think have been highlighted today. And that has a lot to do with our growth and our volume in driving economy and offsetting some of the other pieces.

Tom Sykes: Many thanks.

Fredrik Rystedt: Yeah, Tom, maybe taking the last question, to be perfectly honest, I don't have the exact percentage there, but it would be roughly about 10%. And if you need a more exact number, we can come back to you later, but it's around that.

Tom Sykes: Okay. That's fine. Thank you very much indeed.

Operator: Thank you. We'll now take our next question from Victoria Nice from Societe Generale. Please go ahead. Your line is open.

Victoria Nice: Good morning. Our first question is on Vinda. I think as Faham said that Vinda seemed to be much better as a whole and almost unimpacted by COVID disruptions, at least outside of professional. We just wanted to clarify whether that was the case or was it largely because of the softer comparative and growth was actually still contained overall? And if so, could that catch up in the third quarter if lockdown situations improve from here? And then our second question just relates to the cost saves, which were negative as a result of inflation. Could we expect this to continue through the second half with inflation levels where they are still? Thank you.

Magnus Groth: The first question, the answer is, I don't know. What we saw in the first or in the second quarter was both very negative impacts in the beginning of the quarter from lockdowns and then I think quite a lot of restocking towards the end of the quarter. So, expect it to be lumpy and uncertain. So, I can't say about or give any outlook within – for the second half of the year. When it comes to cost saves and the impact from inflation, Fredrik.

Fredrik Rystedt: Yeah, it's very difficult Victoria to give you a forecast, but I would probably expect so. Once again, we talk about cost saving. Just to remind everyone here, what we've already said is that we have cost savings coming from various projects that we undertake and there are hundreds of them in everything from logistics within the plants, relating to material rationalization, et cetera, et cetera. So, there are hundreds and hundreds of projects that we kind of entertain on a continuous basis, and they continue to generate very, very good and healthy savings. So, the activity level is high. What is actually affecting us, and we've said this now many times, are things that we also have impacting our productivity. So, the measure we're producing is actually not the cost save, it's the cost productivity. And we use that as a proxy for cost saves. So normal inflation also comes into that as I said, so what we've seen now in the first half is a very elevated cost in terms of inflation, in terms of maintenance cost, in terms of bits of productivity generally in plants. So, there are many, many different things and we would expect probably most of these elements to stay for the second half. So, this will be, you can say, not a normal year and it will be challenging. Exactly how we play out will be difficult to say, but probably similar to the first half. Of course, as things go back to normal, we expect to see the kind of productivity and all the projects that we do, all those efficiency measures to come into the P&L once again. But for now –

Magnus Groth: Well, they are coming into the P&L.

Fredrik Rystedt: Yeah. On a net basis.

Magnus Groth: On a net basis, yes.

Fredrik Rystedt: But they are very much in the P&L. Exactly.

Magnus Groth: Yeah.

Joséphine Edwall: I think that was the last question. So, any final words from you, Magnus?

Magnus Groth: I think we – very good Q&A here covering both the fantastic growth and pricing momentum that we have based on our strong brands. We continue to face significant cost headwinds as mentioned several times. It was really interesting and exciting for me to listen also to Joanna today, and I hope that all of you also learned a lot about leakproof apparel and the opportunities in this exciting category. So, with that, I wish all of you a great summer and thank you for listening.