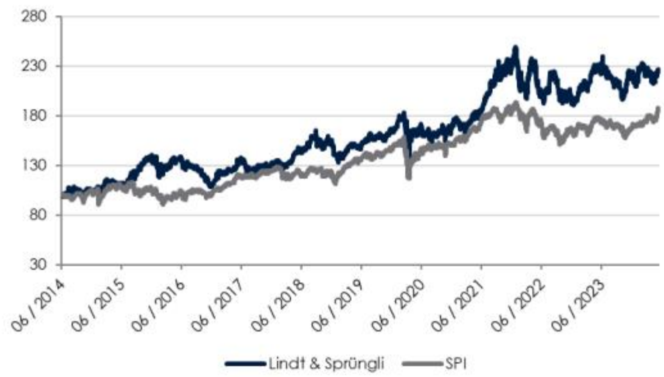
June 2024

Lindt & Sprüngli

Market profile

Country	Switzerland
Sector	Consumer, non-cyclical
Market cap (CHF bn)	25.4
52-week high / low (CHF)	116'000 / 95'000

Evolution of stock price with respect to benchmark (rebased)



Key metrics (CHF)

	2023	2024e	2025e
EPS	2859.1	2800.8	3047.2
PE	35.7x	38.4x	35.3x
Dividend Yield	1.3%	1.4%	1.5%

Executive summary

Lindt is the world's 6th biggest chocolate manufacturer with a 5.3% market share, behind Mars, Mondelez, Ferrero, Hershey, and Nestlé.

The traditional Swiss company with roots in Zurich is a global leader in the premium chocolate sector. Today, Lindt & Sprüngli produces quality chocolates at its 11 factories in Europe and the USA. Its products are sold by 36 subsidiaries and regional offices, in around 520 of own stores as well as via a network of more than 100 independent distributors around the globe. The Lindt & Sprüngli Group includes the brands Lindt, Ghirardelli, Russell Stover, Whitman's, Pangburn's, Caffarel, Hofbauer und Küfferle. With more than 14'500 employees, the Lindt & Sprüngli Group reported sales of CHF 5.2 billion in 2023.

Lindt & Sprüngli discloses sales in three geographic areas: Europe, North America, and the "rest of the world". The United States is Lindt & Sprüngli's biggest market (35% of sales), followed by Germany (15%), Switzerland (9%), and France (8%).

The global chocolate market size was valued at USD 133.6 billion in 2024 and is expected to grow at a compound annual growth rate (CAGR) of 4.6% from 2024 to 2028. The company believes that it can reach 6% to 8% growth in the mid to long term, while the market for premium chocolate is expected to grow 4% per annum. Future growth will come from emerging markets, especially Asia which boasts 6 out of the 15 fastest growing chocolate markets

One caveat is the rich valuation, as the company is considered a growth company with high quality aspects. The scarcity of such companies implies a high valuations.

Lindt & Sprüngli

Daniel Pfund, Senior Financial Analyst June 2024

Company description

Lindt & Sprüngli has been enchanting the world with chocolate for more than 175 years. The traditional Swiss company with roots in Zurich is a global leader in the premium chocolate sector. Today, Lindt & Sprüngli produces quality chocolates at its 11 factories in Europe and the USA. Its products are sold by 36 subsidiaries and regional offices, in around 520 of own stores as well as via a network of more than 100 independent distributors around the globe. The Lindt & Sprüngli Group includes the brands Lindt, Ghirardelli, Russell Stover, Whitman's, Pangburn's, Caffarel, Hofbauer und Küfferle. With more than 14'500 employees, the Lindt & Sprüngli Group reported sales of CHF 5.2 billion in 2023.

A majority of Lindt & Sprüngli's products are sold by third parties, while about 14% of total sales come from what the company calls « Global Retail », which entails its own retail stores under the Lindt, Ghirardelli and Russell Stover brands, and e-commerce (5% of sales). The largest Lindt shop in the world was opened in 2020 in Kilchberg near Zürich.

Fig.1: Lindt & Sprüngli retail store

Source: Company data, IAM research

Lindt is the world's 6th biggest chocolate manufacturer with a 5.3% market share, behind Mars, Mondelez, Ferrero, Hershey, and Nestlé.

History of the company

The story of Lindt & Sprüngli begins in 1845 when confectioner David Sprüngli and his son Rudolf Sprüngli have a groundbreaking idea: becoming the first to produce chocolate in solid form in the German-speaking area of Switzerland.

Zurich's social élite is open to the invention and discovers its passion for these sweet delicacies. After only two years, in 1847, the confectioner and his son decide to move their chocolate production from the cramped bakery in Zurich's old town to a small factory in Horgen with a direct water supply, on the upper end of Lake Zurich. They employ ten workers to ensure sufficient production.

In 1859, Sprüngli and Son open a second and larger confectionery on Zurich's Paradeplatz.

Fig.2: 75 years of Lindor
Source: Company data, IAM research

In 1879 chocolate was not the velvety, sweet and melt-in-the-mouth delicacy that we know today. Instead it was a brittle, rough-surfaced and somewhat bitter substance which was laboriously pressed into molds by hand. Chocolate at the time was far from being a feast for all senses.

In 1892 Rudolf Sprüngli retires from his confectionary business. The Sprüngli companies, chocolate factory and confectionery shops are divided up among his two sons: The younger, David, becomes the owner of the patisseries on Marktgasse and Paradeplatz, while the older brother, Johann, receives the chocolate factory in Horgen from his father.

During that time in Bern, Rodolphe Lindt, son of a pharmacist and master confectioner, intended to manufacture chocolate, which would stand out among the other products of the day. With this goal in mind, Lindt's brother August, also a pharmacist, expressed the opinion that the extra liquid in the chocolate paste, which crystallized with the sugar, should be extracted during processing. And why not add some cocoa butter at the same time to smooth out the conventional paste's texture? So Rodolphe Lindt invents the "Conche" and produces his famous "chocolat fondant". With this invention, Rodolphe Lindt was the first chocolatier ever to taste and produce chocolate as we know it today.

In 1899, Johann Sprüngli convinces Rodolphe Lindt to sell his chocolate company for an amount of 1.5 million Gold Francs (equivalent to approximately CHF 100 million today). This gives Sprüngli access to the factory and also the chocolate manufacturing secrets and the Lindt brand name. From then on, the two world-renowned, independent companies "Sprüngli" and "Lindt & Sprüngli" would officially exist.

The famous Lindt gold bunny is invented in Germany in 1952.

As Lindt & Sprüngli grows and becomes international over the years, the company's shares are listed on the Swiss stock exchange in 1986.

1998 marks a big expansion with the purchase of the American company "Ghirardelli Chocolate Company". This step is the start of a great expansion into the North

American market, the largest chocolate market worldwide. In 2014, Lindt & Sprüngli acquires another US company, Russell Stover. With that acquisition, the company is now the leader in the premium chocolate market and number 3 in the overall chocolate market in the USA.

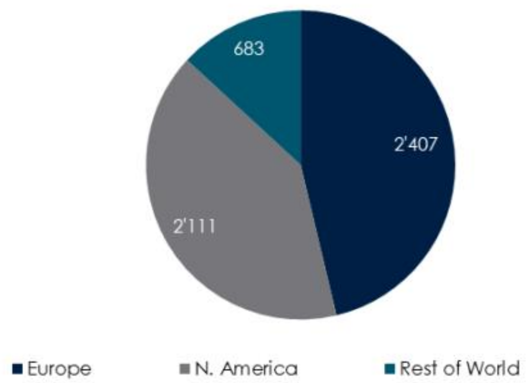
In 2020, the Lindt Home of Chocolate museum opened to the public in Kilchberg (ZH). The highlight of the attraction is the biggest chocolate fountain in the world, which is over 9 meters high.

Geographic exposure

Lindt & Sprüngli discloses sales in three geographic areas: Europe, North America, and the "rest of the world". As the chart in figure 3 shows, Europe still makes up the largest proportion of sales for the company.

Fig.3: Revenues by region

Source: Company data, IAM research



In terms of market sizes, the United States remains the biggest chocolate market in value (USD 19 billion) where Lindt & Sprüngli is only the third player with a market share of 9% behind Hershey (43%) and Mars (30%).

The United States is Lindt & Sprüngli's biggest market (35% of sales), followed by Germany (15%), Switzerland (9%), and France (8%).

Industry Overview & Competitive positioning

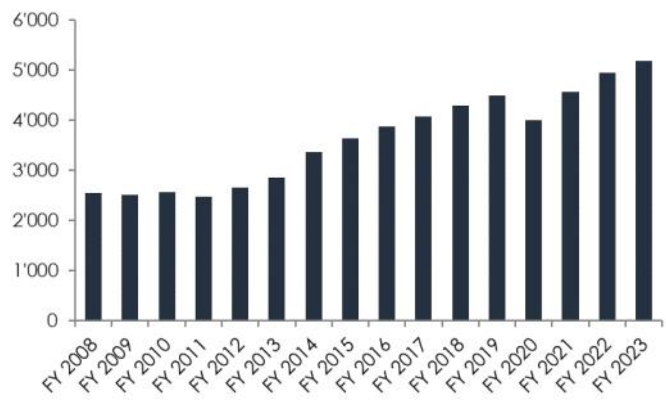
Financial analysis

Growth

We can see in the chart of figure 4 that the 15 years compound annual growth rate of Lindt & Sprüngli's revenue is 4.8% per annum, while the more recent growth is 3.8% per annum over the last 5 years, largely impacted by the poor growth in 2020 (-10.9%, of which –6.1% organic, the first organic sale decline in 25 years). The company believes that it can reach 6% to 8% growth in the mid to long term, while the market for premium chocolate is expected to grow 4% per annum.

Fig.4: Lindt & Sprüngli's revenues over time

Source: Company data, IAM research

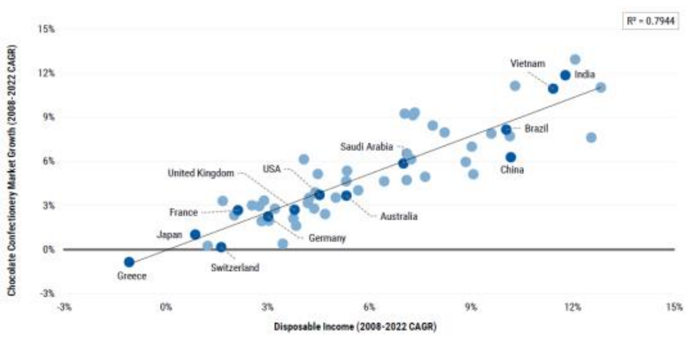


Future growth will come from emerging markets, especially Asia which boasts 6 out of the 15 fastest growing chocolate markets (India, Malaysia, Indonesia, China, Thailand, and Philippines). There is still a lot of room for Asia to increase consumption. In 2022, the consumption of chocolate per capita was only 0.2 kg in the most populous region, compared to 4.3 kg in the United States and 9 kg in Switzerland.

There is a fairly strong correlation between growth in disposable income and growth in chocolate consumption, as shown in the following figure.

Fig.5: Growth in chocolate consumption is positively correlated with growth in disposable income

Source: Euromonitor, Morgan Stanley Research



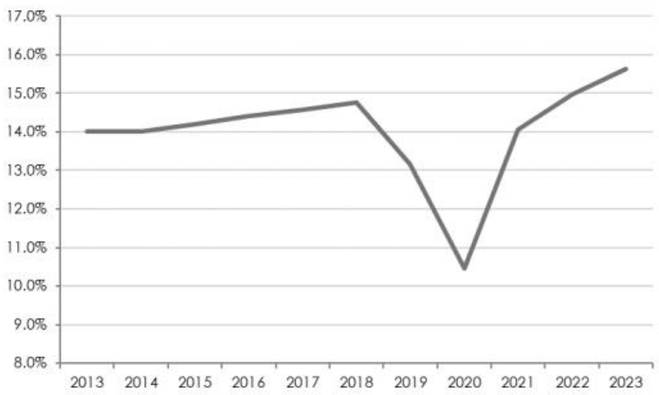
Growth will also be helped with the increasing share of e-commerce. Currently, e-commerce sales represent only 5% of total sales, compared to the peer group average of 10%. Lindt & Sprüngli is actively testing new initiatives such as ordering online and picking up at their own stores ("click & collect"), online "Maître Chocolatier" courses, or digital bunny hunts.

Margins

The following chart shows Lindt & Sprüngli's operating (EBIT) margin over time. We can see the clear impact of the COVID-19 pandemic in 2020. Since then, margins have rebounded significantly to reach an all time high of 15.6%.

Fig.6: Lindt & Sprüngli's EBIT margin over time

Source: Company data, IAM research



Management believes it can expand margins between 20 and 40bps per annum longer term.

Lindt & Sprüngli also discloses margins by region. For 2023, we can see that Europe is the largest margin contributor with an EBIT margin of 19.2%, while the North America region has the lowest EBIT margin (11.8%). This is due to lingering issues at Russel Stover, which is a business characterized by high seasonality spending. The company is actively working on bringing the North America margin up to group level by reducing the number of factories, closing unprofitable stores, and outsourcing logistic networks.

Fig.7: EBIT margin by region 2022 & 2023

Source: Company data, IAM research

	2022	2023
Europe	17.8%	19.2%
N. America	10.9%	11.8%
Rest of World	17.8%	14.9%

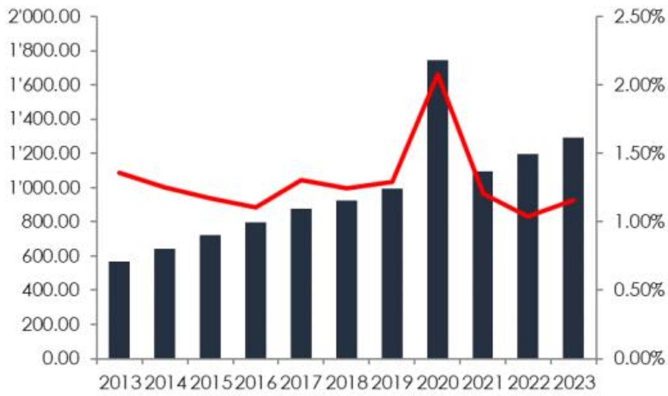
The margin in "Rest of World" was severely impacted as that region is over indexed to travel retail (still below pre-COVID levels) and boutique stores (20 new stores opened in 2023, impacting profitability).

Dividends

The chart in figure 8 shows Lindt & Sprüngli's dividend history for the last 10 years.

Fig.8: Dividends per share in CHF and dividend yield (rhs)

Source: Company data, IAM research



We must note that 2020 included a special dividend of 700 CHF for the 175th anniversary of the company. In May of 2024, the company paid a dividend of CHF 1400 (after the shareholder's approval of the accounts of 2023). If we exclude the special anniversary dividend, underlying dividends will have increased every year over the last decade. Nevertheless, the dividend yield remains quite low (lower than the Swiss market average) and the payout ratio is only around 50%.

Also, we would like to remind investors that dividends are not a tax efficient way to return capital. Indeed, the dividend comes from money the company already paid taxes on, as it cannot deduct it as an expense. Afterwards, the investor is also taxed on this same amount

(35% at source), so there is a double taxation of the distributed dividend. In contrast, share buybacks are a more efficient way to return capital back to shareholders, as they are only taxed at the company level.

Fortunately, Lindt & Sprüngli's management has understood this fiscal problem and is also a proponent of share buybacks. CHF 445 million were bought back in 2022, and CHF 555 million in 2023. The announced two year, CHF 1 billion, buyback program will last until July 31, 2024. The company will most likely announce a new buyback program with the first half results, as its balance sheet remains pristine and we don't foresee the company making any significant M&A activity for which it would need the cash.

Free Cash Flow

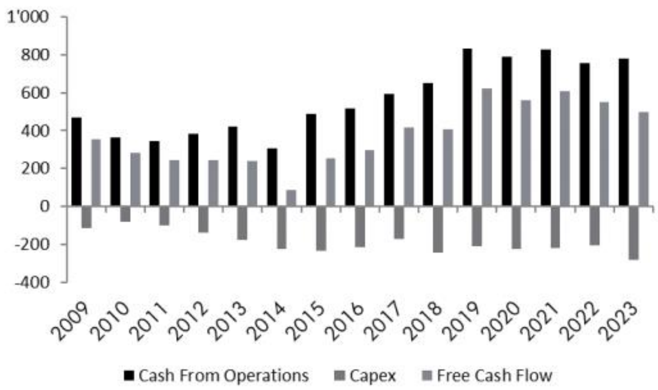
Free cash flow (FCF) is an essential component of any company and can be considered its life blood. Free cash flow refers to the cash a business generates after is has accounted for the outflow of money towards operations and maintaining capital assets. It is from FCF that the company can decide to either reimburse debt (capital allocation), make acquisitions (mergers & acquisitions), or distribute cash to shareholders (dividends and share buybacks).

Figure 9 shows Lindt & Sprüngli's free cash flow over the last 15 years.

As we can see, the company has been in the fortunate situation of always being FCF positive over the last 15 years. This is in part due to the fact that consumer staples are less cyclical than other industries, as well as Lindt & Sprüngli's market positioning and industry growth.

Fig.9: Lindt & Sprüngli's cash flow over time

Source: IAM research



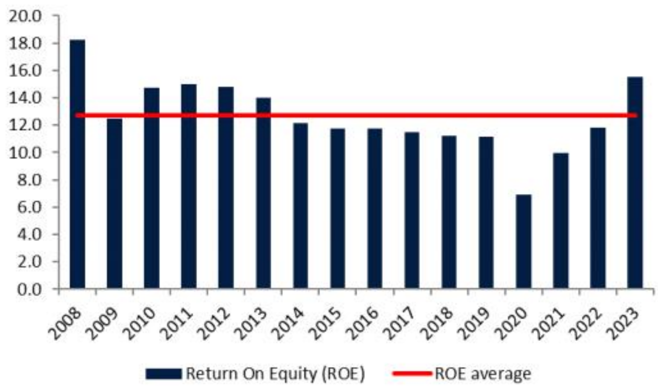
We can also note that the ratio of capex to sales is relatively stable around 5–6%, so this is not a highly capital intensive business. Nevertheless, we note that the free cash flow has stagnated around CHF 500 million over the last 5 years, never reaching the highest mark of CHF 622 million of 2019. We believe that management is not incentivized to increase the free cash flow, but rather more focused on organic growth and EBIT margin, which could be a warning sign. Free cash flow was lower in 2023 because of higher inventories.

Return on Equity

The following figure shows Lindt & Sprüngli's return on equity (ROE) over the last 15 years. The average is 12.7%.

Fig.10: Lindt & Sprüngli's Return On Equity (ROE)

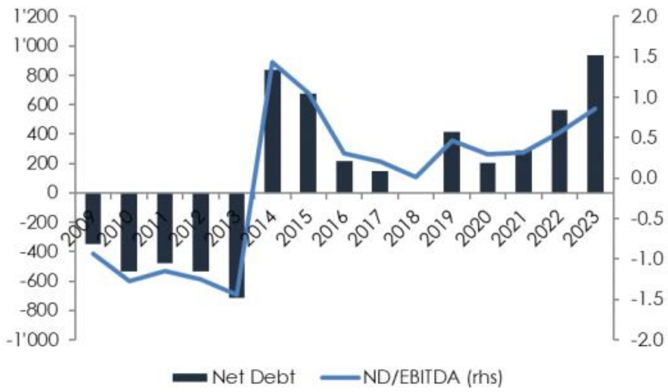
Source: Company data, IAM research



For a company to add economic value, its ROE should be above its cost of equity. The cost of equity can be calculated with the risk free rate, the market return and the beta. Which beta to use can be subjective, so this is not a science. With current risk free rates at 1.5% (the SNB short term rate), we can calculate the cost of equity as the beta times the market return minus the risk free rate. Using an adjusted beta of 0.8 and historic market return of 8%, we find a cost of equity of 5.2%. This means that Lindt & Sprüngli's is adding economic value with its average ROE of 12.7%.

Fig.11: Net Debt (ND) and ND/EBITDA

Source: Company data, IAM research



Balance Sheet

The chart in figure 11 shows Lindt & Sprüngli's Net Debt, as well as their Net Debt to EBITDA ratio. We can see that the company has always been managed conservatively, as the net "debt" position until 2014 was actually a net cash situation. 2014 marked a change due to the Russell Stover acquisition (for which Lindt & Sprüngli paid USD 1.6 billion). That year, the ND/EBITDA ratio jumped to 1.4x, which is probably at the upper end of what management deemed acceptable. Traditionally, consumer goods companies rarely leverage their balance sheets above 2x EBITDA. Since the acquisition, the ratio has gradually come down to remain below 1. Due to its healthy balance sheet, the company was able to make new share buybacks, although it looks unlikely the company will increase the debt much higher from here. Management should focus more on free cash flow management and take measures to improve its working capital.

Investment case

The global chocolate market size was valued at USD 133.6 billion in 2024 and is expected to grow at a compound annual growth rate (CAGR) of 4.6% from 2024 to 2028 (source: Statista). Volumes are expected to grow 2.1% and pricing/mix 2.5%. Lindt & Sprüngli's management expects to grow faster than the industry, targeting growth of 6 to 8% annually.

Rising awareness regarding dark chocolate as a healthier confectionery product, which consists of antioxidants that protect the skin from harmful ultraviolet rays, is expected to promote the market growth over the next few years. As per the health experts, moderate consumption of chocolate boosts serotonin that calms the brain and acts as an anti-depressant. It also releases endorphins in the body, which instantly elevates mood.

Consumption of chocolate also suppresses the release of cortisol, a stress hormone. It is preferable for the consumers to include elements in regular diet that alleviate a health issue rather than depending upon medication. As chocolate helps in relaxing the mind and inducing happiness, it is expected that sales of chocolate will continue to witness a boost during the coming years.

Chocolates are also associated with a token of appreciation, love, and happiness, which are given as gifts during the festive season, thereby propelling the product demand. They are manufactured in different shapes, sizes, colors, and product materials as per the occasion. As per the National Confectioners Association, 150 million Santa-shaped chocolates were manufactured in North America during Christmas.

Premium chocolates have a faster growth rate than regular chocolate, and are also perceived as "healthier". As premium chocolates are also more expensive, they are clearly seen as an indulgence.

Valuation

The chart in figure 12 depicts Lindt & Sprüngli's price to earnings (P/E) multiple over the past decade and its average (35.7x).

Fig.12: 12M forward P/E over last decade

Source: IAM research

As we can see, the valuation is very high, as Lindt & Sprüngli is considered as a growth stock in the industry with very high quality aspects (Free Cash Flow, Net Debt, margins...). This high valuation is the major negative point when investing in Lindt & Sprüngli. Unfortunately, the premium valuation is the side effect of quality growth scarcity. There is no way to predict how the valuation multiple will evolve over time, but we can estimate that if interest rates should rise, then the valuation multiple would contract. While it may not make sense for a long term investor to sell the shares now; it certainly is worth to wait for a better opportune entry point before buying a new position.

Risks

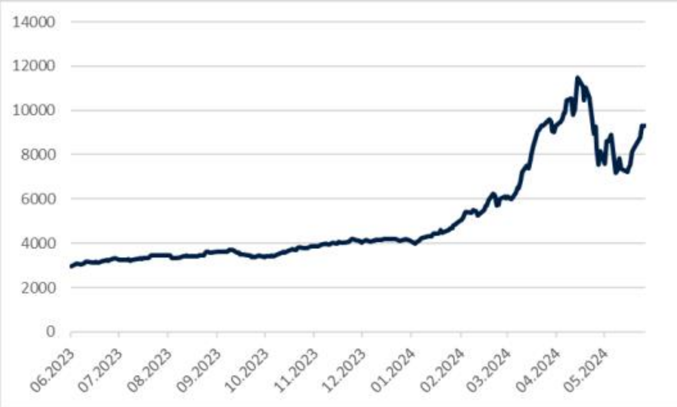
Several controversies surround Lindt & Sprüngli, and the overall cocoa industry in general. The biggest one is concerning child labor. While it seems like an impossible task to totally remove child labor from the industry, every serious actor is committed to do their best to eradicate this unhuman condition. Lindt & Sprüngli is better positioned than other chocolate manufacturers due to its vertically integrated nature whereby it can better control its cocoa bean sources (what the company calls from "bean to bar"). The task of controlling child labor is huge, as Lindt & Sprüngli works with over 80'000 farmers. In 2020, Lindt & Sprüngli achieved the major milestone of a 100% traceable and externally verified cocoa bean supply chain.

Another controversy is the sugar content of chocolate products. Consumers are eating more healthily and there is a strong demand for lower sugar content. Lindt & Sprüngli is replying to this demand by replacing traditional sugar with alternatives in order to produce "sugar free" chocolates. This is a popular trend in the United States. Nevertheless, there is no scientific study that shows that sugar alternatives can decrease caloric intake, reduce the risk of diabetes or obesity. Because Lindt & Sprüngli focusses on the high end chocolate market, we believe that they are better placed than mainstream chocolate manufacturers.

A shorter term risk is the price of raw cocoa. As we can see in figure 13, the price of cocoa has increased significantly over the past year. The price has become extremely volatile due to a poor crop season, maybe due to the El Niño effect affecting global weather patterns.

Fig.13: Price of cocoa futures over last year (USD)

Source: IAM research



While Lindt & Sprüngli hedges itself against such fluctuations, it is only inevitable that the company will be hit by higher prices. Hedging only delays the process. Raw materials make up about a third of cost of goods sold, so a rapid increase of cocoa prices could quickly impact gross margins. In order to keep operating margins stable or slightly growing, the company will have to increase selling prices. Fortunately, the premium chocolate segment is less impacted by price rises, as a percentage of total price will be less than for budget brands. Also, premium chocolate buyers are less likely to trade down to cheaper alternatives, so we are not too worried for Lindt & Spüngli.