

Talks at GS

Angus Thirlwell

CEO and Co-Founder, Hotel Chocolat

Khamran Ali, Moderator

Recorded: May 20, 2022

Angus Thirlwell: Deforestation through cocoa has been a kind of stain on the chocolate industry for-- well, since it started. But now that we know that that's a severe problem for the world and humanity, there's kind of no excuse not to do something about it.

[MUSIC INTRO]

Khamran Ali: Good afternoon, everybody and welcome to Talks at GS. I'm Khamran Ali, from the UK Investment Banking team in the Investment Banking Division. I'm delighted to welcome Angus Thirlwell, CEO and Co-Founder of Hotel Chocolat. Since Angus opened the first Hotel Chocolat store in 2004, the company has grown into a multi million-pound chocolate empire with 125 shops and cafes, a hotel, and a school of chocolate.

Hotel Chocolat is focused on sustainability and inclusive growth, from its commitment to improve the lives of farmers to organic farming and sustainable packaging. Angus, thank you for joining us today.

Angus Thirlwell: Delighted to be here. Thank you.

Khamran Ali: So, Angus, do you want to quickly talk about your background to start with? We know your father founded Mr. Whippy, the ice cream business. What did you learn from your father? And if you could just talk a bit about how you started off with entrepreneurship.

Angus Thirlwell: I was very lucky to grow up in a family where there was always a kind of tingle of excitement around business. And my father used to come home and just talk about what had happened. And it couldn't help but trickle into me when I was a young boy.

And the kind of allure of being sort of out there and shaping events in some way through the opportunity of business, I suppose, took hold.

And the other big point that he made to me, because I was always coming up with slightly hairbrained schemes for business ideas was, "Just calm down. Look, you'll find something that you really love. And then follow that. Don't try and make up money-making ideas. Find things that you've got an affinity for, you're interested in. And that will be the most authentic way for you to start thinking about ideas. Don't chase the money. Chase the kind of connection, if you like, the long-term sustainable interest in it."

Khamran Ali: Let's just start talking about Hotel Chocolat. That's probably the reason why everyone's here. So, do you want to talk a bit about what Hotel Chocolat means, its strategy, and what you think are some of the unique selling points of the business?

Angus Thirlwell: When we created the Hotel Chocolat brand name, it was on a business that had already had a little bit of momentum going. And we were able to be really clear sighted about what Hotel Chocolat was going to stand for.

So, firstly, at the brand level, if you like, it's about originality. We're not going to try and copy the 200-year-old European chocolate heavy weights that are out in the industry, in control of the industry. We're going to be fresh thinking. We're going to do things in a contemporary way. We're going to be authentic. And for us that meant rolling back the increasing sweetness that had started to pervade in chocolate.

Sugar is the cheapest ingredient that goes into chocolate. So, you don't have to look very far to realize why chocolate progressively has become sweeter and sweeter.

And then thirdly, we were going to be really ethical. And that meant making a proper connection with agriculture. And linking that to the consumer end of a luxury good that has enough profit in it to be able to make it right on the agricultural end.

So, that was our opening position. And I think fast forward to where we are now, we're still very true to those ideals. And the way it's manifested itself in our product range is that we are very strong in chocolate to eat. We've also got a

dimension of pourable chocolate with our in-home Velvetiser drink system and a bottled product with vodka in. So, we've kind of lived those ideas and brought some freshness to the market.

And in terms of our distribution model to connect with customers, I think we've also shown originality in that we're an unusual chocolate brand where the majority of the sales, or just over the majority in the UK, are online now. Even though we have a growing position with our 125 UK stores as well. So, it's very much a weaving of those channels together. But it's direct to consumer. Whereas most of the chocolate in the world is and continues to be sold through big supermarkets. So, it's been a sort of slower and more investment-heavy route. But ultimately, I'm very happy with where we've ended up with a big direct database that we can talk to, we can listen to, and we can be very close to with no intermediaries in between us.

Khamran Ali: In 1993, you were one of the first businesses to actually offer chocolates via e-commerce. Could you talk about what led to that strategy and the impact of that and how it's formed what Hotel Chocolat is

today?

Angus Thirlwell: We had a business model at that time which was all about fast delivered chocolate gifts. We were already focusing on delivered gifts to try to bring something different to, really, the only gift that was deliverable in those days, which was, you know, flowers. And so, we thought we had something that could provide a viable alternative. It came with a message card, and you'd have to kind of phone up an order with your credit card.

We got approached by a big, American tech business that was investigating whether the internet could become a commercial forum. And they identified and found us, God knows how, in Royston, as being a kind of business model that could port across and be an early proof point.

So, they said, "Look, here's the deal. We'll design this thing called a website for you. It's free of charge. And you just give us this percentage of the sales." And coming from a tech background, we kind of understood conceptually what it could do. We were excited about being pioneers and getting an early understanding there.

So, we did it. And it started to work. So, we then moved quite rapidly to a second and third iteration of our website. And it's really been the center of our model ever since.

Khamran Ali: We'll just shift topics a bit and talk about your High Street presence. So, your first ever store, I think was in 2003/2004 in Watford. And you've got around 125 shops and then 30 stores on top of that in Japan and [UNINTEL]. Can you just talk about why physical locations are such an important part of your culture, brand, and how people think about Hotel Chocolat?

Angus Thirlwell: Yes. With our subject matter, it is quite tactile. It's rich in storytelling. And it lends itself very well to a conversation and tasting a sample. So, that's something that is probably over indexing on the Hotel Chocolat brand and the category we're in compared to other retailing brands. But I believe it does apply to other kind of models as well.

And really what it comes down to is what is the best way to find new customers? And once you've found those

customers, stay in close contact with them? And we've been able to make digital recruitment work as well as physical store customer recruitment. And what we've seen is through the dynamics of the markets, sometimes digital advertising is really expensive, and sometimes some campaigns work for a while and then they tire, and you need to find another campaign angle. What we're seeing at the moment, and this is sort of well publicized with digital models, is that there's a lot of inflation in digital marketing costs. So, when we're looking out at the range of opportunities available to Hotel Chocolat right now, rents have normalized down a bit because of market conditions. Whereas the cost of accessing Facebook customers has gone up.

And really, we're talking about the same thing. It's how do you find a platform to talk about your brand to audiences? And that's the way we've always looked at it.

Khamran Ali: Shall we just talk quickly about COVID-19 in light of that physical presence? One, how did you as a leader, CEO of a large business with lots of employees, cope and react with that? And then second of all,

obviously, your High Street presence, shifting your strategy maybe more online. How did you cope with the last two - three years?

Angus Thirlwell: When the news about the pandemic was coming into the UK, it was just before Easter. We had three weeks to go until Easter. We had made all our Easter eggs and everything. And we'd shipped them all out to our 126 locations. And then rushing towards us was a prospect of having to close them all. And basically, rely on our digital model, which tends to have its orders earlier. So, didn't have as much stock there because we'd had most of the orders. So, we're thinking, all right, this is like a perfect storm where we're going to be uniquely badly hit because of our Easter business model.

We mobilized everybody that was sort of like a Dunkirk spirit to get that chocolate back to the center. And we trimmed our online range down so that we could work safely. And we bundled products together as well to avoid the picking operation, limiting the bandwidth. So, we had to make some pretty draconian adjustments to the online model. But it just went bananas.

We saw 200 - 300 percent-- well, actually, at peak more, 500 percent increase in digital. And it kind of saved our bacon. Totally.

Khamran Ali: Can you just talk a bit about-- obviously COVID had a big impact on your business. But you've come out of that with some new products. A new business model around subscription.

Angus Thirlwell: Yeah. So, post pandemic what we've seen is that we now have a digital business in the UK that's two and a half times the size of what it was before. The profile of that tends to be more gift based. And the physical stores have a larger proportion of self gifting.

So, what we're seeing really is families activating different parts of their household budget for Hotel Chocolat. Maybe for the first time discovering how good it feels when you send a gift to another family, and they call you up to say that they really liked it and it made them very happy. As well as buying chocolate for your own family.

Khamran Ali: So, shifting topics slightly. The obvious point, your business is about chocolate. But the other thing that I think you're really well known for is sustainability. And as you look across even the UK landscape, you're really at the forefront of ESG and being seen as an ethical company. So, could we just spend a bit of time talking about that the? So, let's just start with you acquired a cocoa farm in Saint Lucia in 2006. Can you just tell us what drove you to that decision and why, more generally, being ethical, sustainability, is such a core part of your business model? And maybe something to do with the view as well?

Angus Thirlwell: Well, the decision to buy an old cocoa farm and really get to understand agriculture was driven, initially, by a desire to find out everything about cacao so we could make the best chocolate. So, initially, it was about the growth of the best products we could possibly make.

Once we became farmers of cacao, we realized that-- and bear in mind, we were quite a young business at that point. We didn't know a lot about the supply chain for cacao. And

that's actually changed quite a bit, but not enough in my book, amongst the chocolate industry.

So, we pitched ourselves into this enterprise of becoming farmers and figuring out how to do it and made, you know, lots of mistakes. But gradually, we realized that it was a kind of busted system. The farmers are at the very end of the supply line. There is typically somebody else who aggregates all the power about whether you're going to be able to sell the beans or if you can, can you sell all of them? And if you can, what price you're going to get. And will you get an order next year? All that type of stuff. So, there's not really a very-- and this is the Caribbean, a very orderly market.

So, we initially focused on supplying beans back to our own business. And in that we were very lucky we had an ongoing kind of trusted customer that I could put my other hat on and say, "Yes, we're still going to be buying those beans next year." But we realized that the other farmers on this Caribbean Island didn't have the same thing. So, we set up a program where we guaranteed to buy every single bean. We dramatically increased the price of the beans to a

level that we knew from our own efforts that would turn a profit. And we encouraged the farmers to go back growing the cocoa in an environmentally responsible way.

So, we spent over ten years really honing that model, learning everything we can about the best way to grow cocoa that is a balance of yield, but also respect for nature. And linking well with communities. And we've called this gentle farming, which is a philosophy that brings in a dimension of doing the right thing for the planet, as well as achieving living incomes for cocoa-growing families. So, that is something that we've launched in Ghana, actually, just last year. And is a culmination of everything we've learned so far.

In Ghana, we don't own that many farms ourselves. We're working directly with independent farming families. And we went on a road show to persuade farmers that this was a good idea, to adopt shade planting. And to foster a biodiverse way of growing cocoa over and above the previously trained in monocropping approach. And we got great support.

So, in essence, cocoa trees are little apple tree-sized things. And they really grow best in a shaded environment like the Amazon basin where they come from. The development of cocoa over the last hundred, 200 years has been the cause of masses of deforestation. Very similar to palm oil. So, there's a kind of clash of locations. So, cocoa likes to grow around the equator. Unfortunately, the equator is also the tropics where most of the world's biodiversity resides. And so, deforestation through cocoa has been a kind of stain on the chocolate industry for-- well, since it started. But now that we know that that's a severe problem for the world and humanity, there's kind of no excuse not to do something about it.

The gentle farming program rewards farmers for planting out shade trees and creating a kind of mini rainforest light environment. Promoting insect life and more plants. And reducing moisture evaporation from the soil so that the effects of global warming don't ruin their livelihoods as well. It also reduces the use of chemical inputs. So, all in all we've got something that we've spent ten years learning on our own dollar on our own farm. And now we're taking that to all the cocoa communities that we work with.

So, it's progress, not perfection. We have more installments yet to deliver on general farming, which are going to come up in the following years. But where we are now is we've got the program underway. The Ghanaian government really support it. And we're making payments directly to farmers to take them up towards a living income.

Khamran Ali: And do you think growing and processing your own cocoa, and not all your competitors do that, do you feel as though that's a competitive advantage?

Angus Thirlwell: Two levels. One is we wouldn't be in a position to come up with an evolved program like this for our sustainability agenda if we had not been cocoa farmers. So, you know, we feel that we had to get the soil under our fingernails, and we had to learn about it to demystify all the kind of excuse mongering that goes on in big cocoa conferences around the world where they always end up blaming the African farmers' low productivity. Well, you know, actually western farming isn't really a model for holistically great stuff for the environment. Maybe the African farmers got it right to have a slightly lower

productivity but be gentle on the environment. And we should make that work financially. There's enough profit in the industry. So, that's one big competitive advantage.

The other one is through the innovation lens where being close to the cacao bean means that we look at things in a very different way than a classic sort of European chocolatier with a bowl of whipping cream and kind of a kitchen, there's a bigger dimension to this thing. And it has to start with the agriculture and the bean. And that's led to our more cacao, less sugar mantra, which gives us differentiation in the market. And also, to our broad positioning and our drinkable chocolate as well.

Khamran Ali: And you talked about gentle farming in Ghana. I think it'd be good if you'd just elaborate on that and what you're trying to do to improve the lives of farmers.

Angus Thirlwell: Yeah. So, currently we've got about 2,500 farmers, mostly in the eastern region. And the way it's organized in Ghana is that the Ghanaian Cocoa Broad guarantee to buy every single bean from the farmer. That's the great bit.

The slightly more difficult bit is that all the revenues go into the [UNINTEL] in Ghana. And cocoa is broadly about 20 percent of the GDP of Ghana. It's the way they make their economy tick. So, the cocoa farmers are really helping to fund hospitals, roads, et cetera. And they are pegged at a certain government mandated revenue. Obviously, they can earn more by increasing their yield. But that tends to be a bit more volatile and a bit difficult to influence.

We spent a long time thinking about how can we bring a model that takes the best of the guaranteed buyer aspect of the Ghanaian Cocoa Board, but actually just pays more. Not because it's charity. But because it's worth it. We know as cocoa farmers what the worth of cocoa is. And in our view, with our business model and our supportive customers, the cocoa is too cheap.

So, unilaterally, we've decided to make inflation of our own design and said we're going to pay farmers a supplement at the end of the season of 100 cedis, which is the Ghanaian currency, per bag. Which is a significant uptick for this first inaugural year. In order to achieve that, the farmers

are asked to join our general farming program.

Khamran Ali: How do you think about the future of Hotel Chocolat as a business? And then it'd be interesting to hear where you want to go geographically. Where do you think you'll be in five years?

Angus Thirlwell: We've activated two of the largest consumer economies: Japan and the USA. So, we're very focused on those markets. There's a load of headroom left in the UK market. What we're really thinking is that we've created a lot of new opportunities in the business, particularly through the drinkable chocolate aspect. And a lot of the near future is going to be about developing those models, optimizing them, bringing them to a wider audience.

But we're not on a kind of rampage around the world to open up in every country. We've got quite an appetizing opportunity ahead if we can continue to build in Japan and the USA, as well as the UK. Beyond that, obviously, there are other developed markets which would be attractive to us. So, all in good time.

In terms of the outlook on chocolate, I think we know that we're facing into a world that has become more scary. A world that's become more expensive for many families as well. So, people are going to need joy. We can aspire to play a role there. Families are going to need value for money. So, we're going to continue to focus on making sure that we're really worth it.

And I think the competitive set, obviously, we look at. But not very often. We tend to try to plow our own furrow first and then just kind of be aware of what other people are doing. But we maintain that we don't have a lot of direct competition because of the way that we've created the Hotel Chocolat business model.

Certainly, we're very strong in gifts. And in the gifting market there is all manner of things. You know?

Champagne. Discretionary-- scented candles. You know, you can name it as a huge, huge market. And that market is typically about five times bigger than the chocolate self purchase market in all big markets. So, we're very aware of the brand credibility in being a suitable gift brand.

And in our estimation, that starts with being a cocoa former. We're doing, learning, trying to be humble and learning everything we can about it. And then we're manufacturing as well. And then we have a great team of trained Hotel Chocolat people who would love to have a conversation and offer you a chocolate sample.

So, when you roll all that out, we think we've got a good model. And we're looking, cautiously optimistically, ahead. But it's just more of the same really. We love what we do. We make people happy through chocolate.

Khamran Ali: Thanks a lot, Angus. We appreciate your time.

Angus Thirlwell: Pleasure.

This transcript should not be copied, distributed, published or reproduced, in whole or in part, or disclosed by any recipient to any other person. The information contained in this transcript does not constitute a recommendation from any Goldman Sachs entity to the recipient. Neither Goldman

Sachs nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this transcript and any liability therefore (including in respect of direct, indirect or consequential loss or damage) is expressly disclaimed. The views expressed in this transcript are not necessarily those of Goldman Sachs, and Goldman Sachs is not providing any financial, economic, legal, accounting or tax advice or recommendations in this transcript. In addition, the receipt of this transcript by any recipient is not to be taken as constituting the giving of investment advice by Goldman Sachs to that recipient, nor to constitute such person a client of any Goldman Sachs entity. This transcript is provided in conjunction with the associated video/audio content for convenience. The content of this transcript may differ from the associated video/audio, please consult the original content as the definitive source. Goldman Sachs is not responsible for any errors in the transcript.