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Transcription for AGTHIA

October 29th 2018

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Presentation

Operator
Ladies and gentlemen, welcome to Agthia Group Third Quarter 2018 results conference call and webcast.

[Introductions]

I now hand over to your host, Mr Ozgur Serin. Sir, the floor is yours.

Ozgur Serin
Good afternoon, ladies and gentlemen. Thank you for joining us today in our call for Agthia Group's 9-month year-to-date through to September 30, 2018. As usual, we will start with Tariq with highlights from the quarter as well as matters of significance behind overall Group performance to date. Fatih will then take over and cover the financials for the period, completing the prepared remarks with an outlook for the total year. We will then continue with the Q&A session. The presentation slides that support the prepared remarks are available in the Investors section of our company web site at www.agthia.com. Please note that this call may contain forward-looking statements, which should be considered in conjunction with the disclaimer included in the presentation. Over to you, Tariq.

Tariq Al Wahedi
Thank you, Ozgur, and good afternoon everyone. We left a particularly strong quarter behind us from a net profit perspective, and this was because of higher sales volumes, enhanced category and product mix, and greater efficiencies across the entire Group. Record-high group gross profit margin at

34.7 percent certainly helped, and it is a remarkable achievement when prevailing market conditions are taken into consideration.

The quarter has also seen us officially starting commercial operations of United Khaleeji Water Co., our joint venture bottling plant in Kuwait. In addition to Al Ain regular water that is produced in sizes of 200, 330, 500, and 1500 ml, we also offer Kuwaiti consumers Al Ain Zero no-sodium drinking water, Al Ain still and sparkling water in glass bottles, and Alpin Natural Spring Water exported from the UAE. We started very well in Kuwait, ahead of our internal distribution and sales targets, and this only encourages us in pursuit of our ambitions in this important market.

In our flagship category Water, our brands gained share when compared to last year. The Water category in the UAE also kept the growth momentum so far in this year. I am covering UAE water market and our brands' performance on the next slides.

Let's start with our brands first and then situation in the market will follow.
At 30 percent, our overall volume market share is 134 basis points higher than last year.

A similar situation occurs in value share where at 28 percent, we are one full percentage point higher than last year. Al Ain Water is doing particularly well, especially in modern trade, supported by Al Ain Zero and Al Ain Vitamin D. Alpin still maintains its place as the second imported brand in terms of volume while Al Bayan is consistently increasing its month-on-month share in the market.

The good news is that we notice an acceleration in volume growth in the bottled water category – from around 5 percent to around 6 percent. It is not very surprising to see this. On the contrary, it would have been worrying if we had not seen this uptick in volume when the market is flooded with heavily promoted products. Consequently, category value declines by 2.3 percent, denoting lower effective pricing especially in modern trade, mostly in the form of promotional offerings.

Inevitably we have been a part of this dynamics to protect our volume share with reasonable sacrifice in the value. I believe the fact that we are gaining share not only in volume but also in value is a proof of the success of this strategy. Thanks to our disciplined response, the net impact of this unfavourable pricing has only been 0.8 percent on our bottled water top line, much less than the extent of it on the overall category value, while we still managed to grow volume.

Before I move onto our other businesses let's look at our shipped volumes with a view on our geographical diversification as we are now producing bottled water in 4 different countries.

In the period, we shipped just over 52 million cases of bottled water in our facilities in the UAE, Turkey, Saudi Arabia and Kuwait. As we can see, UAE represented over 80 percent of this volume.

In UAE, our volume growth continues with the support of Al Ain Zero and Vitamin D in addition to Alpin and Al Bayan. Please note that although not covered above, our 5-Gallon water business has also displayed a strong volume growth in the UAE at year-on-year 10 percent mark.

As you know we produce Alpin in Turkey and ship it to multiple markets in Europe and GCC including UAE. It is very pleasing to see Turkey progressing on the right track now after some years of net losses. In year-to-date nine months, Turkey is now almost a million dirhams in profit versus a period loss of around 200 thousand last year. This is mainly because of change of our business model there that allowed us to disproportionately focus on exports. Invoiced in hard currency, this model also provides us with a shield against Turkish Lira's devaluation.

With a particularly strong last quarter in Saudi, our year-to-date bottled water volume is 5 percent ahead of last year. To meet demand during Saudi's peak season, we had to use co-packing options this year but with our new 80 thousand bottle per hour high speed bottling line up and running by the end of December 2018, we will leave this operational hurdle behind us with much higher efficiency levels than before. On another front, on the human resources side, it is also encouraging to see progress in filling business-critical positions which we had been supporting from the UAE to ensure an uninterrupted business. We are investing a lot of time and effort behind building the right human capital including fast-track development of existing employee base using our internal Agthia Academy, and this is a strong testament of our long-term vision and objectives in the Kingdom.

Let's have a look at our other businesses, starting with Food. Food business is thriving, both revenue and profit wise. Overall revenues grew by 13 percent thanks to excellent performance in both TP & FV and Trading Items segments. Trading Items, which are the backbone of our Municipality sales channel, grew a remarkable 40 percent and 99 percent in revenues and profit, respectively. In TP & FV, Egypt displayed a similarly noticeable performance by growing the top line by 25 percent and the bottom line by 125 percent over the same period of last year. New offerings in our product range in our Municipality stores in the UAE and continuous new customer acquisitions in B2C channels in Egypt are the main drivers of both business units' performances.

Dairy continues to suffer from the general market contraction in the UAE. The table on the slide is showing us the scale of the problem in two sub-segments, which are our strongholds with our Yoplait branded products. It is a good achievement to maintain our market positions under these circumstances. My last slide is on Animal Feed and Flour.

Only the numbers have changed in Animal Feed whereas there is not any major fluctuation in the fundamentals. Both revenue and profit grew on a L4L basis, with net profit doubling over last year because of strong gross profit and lower overhead expenses. Higher volume with better mix in favour of still-subsidized commercial farms and better cost management have contributed in this performance.

Late in the quarter we encountered small volume drops (up to a thousand tons a month) in dairy farms, due to these farms cutting their herd sizes amid low milk prices mainly because of a Saudi-driven glut in the market. As much as an issue totally driven by factors outside our industry and control, it affects our customers and we are working hard to identify relevant solutions to mitigate the impact of this issue.

We do not have any negative surprises on Flour side either. On the contrary, at a time when we were expecting our costs to increase due to rising grain prices, we received some "offsetting" good news on subsidy in Bakeries whereby withdrawal of the remaining subsidy has been postponed until the end of the 2018. In another channel, modern trade retailers, it is worthwhile mentioning that our strong growth continues, reaching 22 percent year-on-year, gaining us share in this channel.

This concludes my part, and I am handing over to Fatih for the financial review. Thank you.

Fatih Yeldan
Good afternoon everyone. In the first eight months of 2018, Group revenues reached AED 1.49 billion. Group net profit for the same period has been AED 159 million.

As you know by now, both revenues and profit of last year included transactions that do not exist or repeat in this fiscal year. Therefore, business growth calculations based on reported figures misrepresent the true operational performance between these two fiscal periods. When equalized for such items under "Like-for-like" column above, we can see that our net profit in 2018 indicates to a strong 9 percent growth with our top line remaining flat versus the same period in 2017.

On the next slide I am taking you through these differences and their impact on our reported figures in a lot more detail. On the waterfall diagrams on the right-hand side we have a breakdown of these items in 2017 P&L. On revenues, the largest item, at AED 51 million, is coming from back-to-back grain trading. As Agthia we are not in grain trading business but when opportunities present themselves with reasonable profitability, we are obviously more inclined to capture them than not. 2017 was a good year in terms of finding and capturing these opportunities and we were able to trade more than 70 thousand tons. This year it is zero.

Two other items that create difference are exports to Qatar and the additional one and a half months of Saudi acquisition consolidation; they add up to another AED 32 million.

Taking these into the equation, we can see that last year's reported AED 1.57 billion revenues has a new base, and that is AED 1.49 billion. In other words, same as what we achieved in this year so far in 2018.

On the profit side, in addition to the obvious profit impact of above-mentioned items, there are two more: 1) the proceeds from the land we sold and 2) the proceeds from the cancelled wheat security stock contract. All in all, these represented AED 19 million within last year's AED 165 million. When adjusted for that, the growth in the net profit of our "ongoing businesses" is obvious – 9 percent increase over last year.

As Tariq mentioned at the beginning, we have reached a record-high 34.7 percent group gross profit margin for the first eight months of 2018. My next slide will give us a lot more detail in terms of gross margin so let me briefly talk over the other P&L lines. We are doing very well in keeping our expenses under control; at 24.1 percent ratio to net revenues, they are approximately 80 basis points lower than 2017 on a like-for-like basis.

Accordingly, net profit margin is 10.7 percent, and represents an improvement both versus reported and like-for-like 2017 margin.

Group gross profit margin was 34.5 percent for the first half of the year, which was a record then. 3 months on and we have a new record at 34.7 percent. In addition to increasing weight of consumer business in Group revenues, higher volume with better product mix and unwavering cost optimization efforts across the Group are the main reasons behind this performance.

Although the numbers changed, stories behind them stayed more or less same as they were three months ago. Slight decline in water and beverages are driven by heavy promotional pricing in the market. In Food, strong top line growth resulting in more business scale drives the profitability whereas in Feed favourable product mix is the main cause of gross margin increase. In

Flour, lower subsidy still has an impact on the gross margin in year-to-date numbers. In all businesses, cost savings in both procurement and processing of materials have also contributed to a great extent.

2018 is almost over and we have a much better visibility on how we'd end 2018 financially.

And I am glad to say that, we are on our way to deliver a flat profit line versus last year despite all the headwinds including lower pricing, subsidies and higher raw material costs. Lower Flour subsidy in the first half of the year and higher material costs are projected to have a full-year AED 60 million negative impact on our costs, which we are recovering via our cost savings and efficiency initiatives at approximately an equal amount.

We estimate that we will finish the year with revenues around AED 2 billion mark. Similarly, this will still mean 2-3 percent growth over last year's like-for-like revenues.

This concludes our prepared remarks, and I am now transferring to the operator for the Q&A session. Thank you.

Question and Answer Session

Operator
[Operator instructions]

We have a question from Sandeep Srinivas from FIM Partners. Please go ahead.

Sandeep Srinivas
I have three questions, the first two are related. Can you comment on your receivable days? It looks like it has deteriorated over the last one year and how has that impacted your funding strategy, because I see that your short-term debt has kind of creeped up a bit. Are you using the short-term debt to fund your working capital there?

Fatih Yeldan
Basically, you are having, obviously, correct observation in the trade receivables, there is an increase, and that is obviously basically coming because of the longer collection days, around 12-13 days, which is closer to

about 15%. Now, we have higher, actually, collection days, longer collection days, so this reflects the market situation, I think, not only in UAE but overall in GCC. You know that the payments generally made by all the entities a bit later than usual, we don't see, the good news, we don't see any bad debt out of this, and we didn't have any significant bad debt case during 2018, but obviously you are right that it impacts basically our sales outstanding, as I said, by about 12-13 days and this is obviously whenever we need money we are using our working capital line and we are funding ourselves accordingly, but overall, I mean, the company generates cash still. If you look at the EBITDA, less CapEx, less dividends, the company still obviously generates cash, but the receivable situation lowers that cash a bit and whenever we need during the month we use our working capital credit line.

Tariq Al Wahedi
By the way, our market situation compared to the total market is far and much better in terms of the receivables. As Fatih just mentioned, the impact overall is about 10 or 12 days we have in our receivables versus the market.

Fatih Yeldan
We were collecting around 70 days. Now it's about 80 days.

Sandeep Srinivas
Is it a deliberate strategy to acquire market share or it's just a market trend that you have to give an extended receivable period?

Fatih Yeldan
Yes, basically. It's not a strategy or something. The only thing is the market condition is like that, so they are actually… everybody is paying we can say, but they take a bit more time to pay, so there… probably the same story there, the customers are paying a bit late then they pay to us a bit late, the circle goes like this. The good thing is that we don't see major change for the last months when we see. It is pretty much at a similar level. It doesn't go higher, but versus last year we have 10-11-12 days around difference in the collection days.

Sandeep Srinivas
May I ask you how concentrated is your receivable book?

Tariq Al Wahedi

How concentrated?

Fatih Yeldan
Actually, you know, overall we have like 5,000 customers and so all of them we can say on credit there is not that much cash customers except few in the Agri business, and in our case you have to put together easily… if you put first top 50 you will hardly get like 25-30% of receivables, so there are many, many accounts, which makes the receivables up, so it's not that very much concentrated I would say.

Sandeep Srinivas
My last question is on your strategy going forward. I read that you're also thinking of entering Asian markets. Can you give me a bit more of that, what is your plan and which countries you are getting, and also if you can please give me update on your Saudi and Kuwait – Kuwait, you kind of touched upon it, but if you can give me more on the utilisation rate and all that, it would be helpful.

Tariq Al Wahedi
Let me start with Saudi first and you could see that volume-wise we can't really catch up now and this was foreseen from the beginning of the year. We were caught up with our volumes and that and basically compared to last year we are 5% more in terms of volume, and luckily the high-speed line now is installed, commissioning is starting I think within this week, so hopefully by end of the year it will be commercially viable and ready to start producing, to cater and give us additional 200% [correction: 100%] capacity for our expansion in Saudi. As far as our Asian expansion, we are looking… of course we are looking at opportunities beyond the GCC market. We have expanded the brand from just a UAE-centric brand to become a GCC brand a while ago and then we started to look at it as a pan-Arab brand, and now we are seeing… I mean, basically we are trying to find where would be the best markets for us in the next four or five years to go in Asia, and Asia markets are quite large with big populations and we are still… it's very early days for us to look into which markets we should go for. So I cannot really give you much information as of yet, no.

Again, Kuwait, you guys might recall from the last conference call, the plant has started, we are commercially up and running and we are doing quite well, ahead of even our budget numbers now.

Sandeep Srinivas

One last question on the Saudi operations. You're fixing some issues on the distribution side in your Saudi operations. Can you please give me a view on that?

Tariq Al Wahedi

Sure. We have enhanced… there were a couple of issues. Number one, with these changes in regulations for visas and so on we faced some difficulties to recruit people fast enough for our expansion for trucks and to find the right manpower. The issue has been fixed now since last August and our ranking now in the system, in the HR system in Saudi, has become platinum now, and now I think the issue of visas has been sorted out. We have fixed also our warehousing networks that we had in there into more… into warehouses that are within the city. For example, if you look into Jeddah for example we have moved our warehouse into a new warehouse that's in the middle of the city to shorten the number of trips that the trucks are making. We are building more sub-distributors now for the Kingdom to allow us for faster distribution now and we've seen that penetration that's happening now, so if you look at our region sales you would see, for example, Riyadh now has almost gone up by 300% for example in revenue. So, the expansion is still going, I mean, our network of warehouses, our fleet and sub-distributors as well.

Sandeep Srinivas

Thanks a lot for your time, have a good evening.

Tariq Al Wahedi

Thanks.

Operator

Our next question comes from Fatma Doseri, SICO. Please go ahead.

Fatma Doseri

I just have two questions regarding your animal feed. The first one is how much is the growth and volume came in from municipality outlets, and the second is could you please elaborate further regarding the improvements in feed margins?

Fatih Yeldan

The municipality is about one-third of the volume, so one-third around, it comes from municipality outlets. When it comes to margin improvements, as you may know, around again one-third of our business is with the commercial farms and before it was about 25%, now it is more than 30%, so that improvement actually in the mix of our sales improves our gross margin. That's one of the reasons, because that subsidized sales, they have higher margins, and also not because of only subsidies but they are basically pricy products and more value-added products, because they are poultry items or they are dairy items. They are not like basic easy-to-produce items like, for example, mixed grain, so those items, obviously they're having much more value and accordingly higher margins anyway. On top of that, we have across the organisation we have cost optimisation without the need of subsidy or something. We are actually optimising the costs across the organisation to keep the profit levels that we have in the company, so obviously this happens as well in the feed business. These add as well, so these are the main key reasons [inaudible]. Also, just to add, on all other items where there is no subsidy, if there is a price increase in the grains, that is reflected to the price accordingly, so we don't get any hits on the margins in the feed products, so all this together actually helps us to improve the margins so far.

Fatma Doseri
Are these margins sustainable at the new levels of over 20%?

Fatih Yeldan
I mean, if there is no subsidy change I think it… yes, it is. Around 20%, yes. If there is no subsidy change.

Tariq Al Wahedi
And there is nothing on the horizon that that subsidy will be changed. We already went through the subsidy removal in the last couple of years and now this is the final stage that we've been through since last year basically.

Operator
Our next question comes from Karim Abbas, Franklin Templeton Investments. Please go ahead.

Karim Abbas
Hi guys, my two general questions, the first one is a follow-up on the cost question and the second one is more of a market outlook question, so on the cost side, some of your savings probably helped with your gross margins, but as well you've been looking at a lot of savings in your SG&A, so my question is once things clear up economically for the region and growth returns, do you expect some operational leverage to give you a boost in your overall, say, your EBITDA margins as a whole over the coming years or do you expect your SG&A

to just grow in line with your revenues? Also, on the cost side we heard in the news an announcement about potential electricity price cuts and we weren't certain if Agthia was considered as part of the industrial or commercial businesses, so if you have an update on whether you guys will be getting some kind of electricity price reduction, so that's on the cost side.

On the market outlook side, so, yes, we know that things are still tough right now. We had an update from I think Majid Al Futtaim, they were saying that they see sentiment starting to improve for retail in the UAE, and just we were wondering if you guys have some early indications of how the following 12 months might unfold. Is the pressure easing or is it still very difficult?

On the flour side, is there going to be any change in legislation or do you see any change in the environment for these low-cost flour imports?

Tariq Al Wahedi

Okay, let me start in reverse. On flour we are working closely with the Government over here. Actually I just came from a meeting now discussing this topic very closely and I think we are lucky because now we have a minister for food security that gets appointed and she has this file high on her agenda. She is preparing a full programme to support the food security industry in UAE and that will be tasked by the Prime Minister's office for approvals. I mean, we don't know yet exactly how the programme will look like, but inshallah it will be very positive news.

On electricity point, we all heard the news. We verified it further and the news that we got so far is Abu Dhabi will not benefit from this reduction, but it's mainly for North Emirates, so our facilities in North Emirates like Ajman and Dubai and Sharjah, and the rest of the Emirates, will benefit from this. By how much we don't know yet. I mean the early indication is that they will match the price in Abu Dhabi, but we don't know yet to be honest. I mean, we didn't receive anything official on that, so we cannot budget anything on that or we cannot have it… I mean, we cannot pocket that in hand yet.

As far as the market sentiment, I mean from our perspective I think, yes, I mean I am starting with the announcements of both UAE and Saudi in terms of the highest budgets ever to be announced. That's already sending good sentiment to the market. The last meeting that happened in Saudi for the future investments, that was very positive as well. Also, I saw the recent results in terms of construction projects in Saudi Arabia, a high number, it was announced today by SICO actually, and I saw the number is quite high and this is the beginning of seeing money circulating in the market basically, because that brings population, brings more people to handle and manage these projects basically. We see light at the end of the tunnel, but we cannot be bullish yet about it. We tend to remain flat for our outlook for next year, but we see light at the end of the tunnel.

Karim Abbas
Thanks on the cost savings, just for the operational leverage, whether you see that your revenues can outpace your SG&A in the future?

Fatih Yeldan
I mean, now on the cost optimisation you can imagine in the last 2.5 years low-hanging fruits already collected, correct, so we still continue obviously cost optimisation and we will need them for next year. As you can imagine, we'll have still subsidy removal impact. I mean, assuming that subsidies fully will be removed on the flour as of 1 January then there is an impact for 2019, so first this is something that we have to offset again through cost optimisation and cost organisation, so that should in a way reduce our overheads and, as Tariq mentioned, we are obviously continuing to grow in the revenues for next year on the reported numbers, so from that perspective next year overheads should not be very high growth versus the top line, but on the profit level, surely the subsidy will have a quite big impact, which we are working to offset it by the growth of our business and then the cost optimisation programmes again.

Karim Abbas
Okay, thanks a lot.

Fatih Yeldan
Thank you.

[No further questions]

Ozgur Serin
Thank you very much for your participation. We appreciate your attendance although it's a late time and if you have any further questions, you know how to reach us, and with that it's goodbye from us.