Transcription for AGTHIA

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Corporate Participants

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Fatih Yeldan
Agthia Group – Chief Financial Officer

Presentation

Operator
Ladies and gentlemen, welcome to Agthia Third Quarter 2017 Nine Month 2017 Results Conference Call. Today's speakers are Mr Tariq Al Wahedi, Chief Executive Officer, Mr Fatih Yeldan, Chief Financial Officer, Mr Ozgur Serin, Vice President Investor Relations, and Corporate Communications. I now hand over to your host, Mr Ozgur Serin. Sir, please go ahead.

Ozgur Serin
Thank you very much. Good afternoon ladies and gentlemen. Thank you for being with us today in Agthia Group's nine months to date results conference call. As usual, I have Tariq with me, Group Chief Executive Officer, and Faith our Chief Financial Officer. In today's session, we will first go through our prepared remarks that are supported by respective slides on the presentation in front of you. The same presentation is also available in the Investors Section of our company website at www.agthia.com.

[Disclaimer]

Following the prepared remarks, we will turn the call over to your questions. With that, it is over to you, Tariq.

Tariq Al Wahedi
Thank you, Ozgur, and good afternoon everyone. As it is no surprise to any one of us, water is continuing to be our growth engine throughout the group. Together with the contribution from Saudi, we recorded strong double-digit growth figure. Organically, our bottled water and five-gallon business in the UAE have also posted strong 9 and 15% revenue growth. Given the slowdown in consumer spending and change in consumption patterns across the region, this is substantial performance. Even better news is that while we are growing

our water and beverage top line, we are doing it more profitably with higher margins because of a better mix and lower operating cost.

Let us have a look at what is happening in our agri side of the business, first, will be animal feed. I believe we talked enough of subsidy in the past, but I still would like to turn to above figures in order to nail it down. Last column of the table on the slides shows the volume in which we sustained the impact of subsidy changes. You will remember that we had estimated to lose between 8,000 and 9,000 tons because of subsidy changes. With one year over now, we see that our losses have stabilised at around 5,000-6,000 tons, which is lower than our estimate. What has been more distinctive this year was the cancellation of the Government's concentrated pellet tender and it is not small. We managed to compensate most of this unexpected loss through increased trading activity, but there are two catches here. One, profitability of the trading business is much lower. Two, trading is not something to rely on for closing gaps, as it is heavily dependent commodity prices and inventory. As a matter of fact, we recently saw an increase in the stock levels of regional players, which forced us to change our fourth quarter plan. The silver lining in the whole [inaudible] episode is that the farmers need a replacement product to feed their livestock, which it happens to be the sheep feed and barley, and we are benefitting from this.

To a much smaller extent numerically, but still worth to make a note of is the impact of Qatar situation on our exports volume. It only directly interrupted our feed exports to this country, but also had an indirect effect on our local feed sales, as farms have also stopped their business to Qatar.

Let's look at flour now. One of the after effects of subsidy changes has been the proliferation of imported flour. Imported flour was always available in the UAE thanks to one of the lowest custom duties applied on this product, mostly on the shelves of supermarkets for the consumers. When a surplus of capacity in their home market coincided with the removal of subsidies here in the UAE, it kind of created a perfect storm for the UAE millers, and with 15-20% cheaper band than the prevailing prices, they started to find their inroads to B2B channels too. Although there is a mountains of barriers in front of these brands when it comes to the customer service, support after delivery, or even the heritage of the local brands in especially the bakeries, it is still potentially a contingent issue for, at least, the short-term with such attractive price points. On our part, the situation not only costs us between 1,000-2,000 tons per month, but more importantly, slows us down and take a price increase following gradual subsidy withdrawals. Let me tell you that we are actively pursuing counter measures internally as well as industry-wide, and now we will move to the food.

Although we are really very proud of the profit improvement that we accomplished in our food business, slowing top line growth is making us uneasy. We are in a prolonged environment where consumers are cautious and constantly looking for discounts and promotions while keeping away from discretionary items like fruit yoghurt or even juices. It is in this environment that Yoplait is not declining, but it is not growing either. Tomato paste, frozen vegetables is suffering from similar issue driven by the same consumer concerns. In this category, discounts and price promotions have reached the point where we had to choose profitability over further volume.

On the other hand, we are breaking records in our CSD community support division, where we are doing business in the municipality outlets of Abu Dhabi and Sheikh Khalifa Foundation stores in Abu Dhabi and Dubai and several other Government entities for their employees' purchases. The business model is trading of items which now range from tea, coffee, tissue, and poultry and is very profitable. Egypt is moving in the right direction with complete profit turnaround. The top line declined in dirhams because of the devaluation, but grows in a healthy way in local currency, with more profitable B2C channels slowly but surely taking bigger share from our business.

Finally, in the bakery, although our efforts are encouragingly paying out on the top line, they are not enough to break this business even in the near-term. Work is under progress for this next move.

With this, it is over to you, Fatih.

Fatih Yeldan
Thank you, Tariq, and good afternoon everyone. Let me start with the revenues. Group revenues reached AED 1.6 billion and recorded an increase of 2.9% over last year. Drivers behind the growth have not changed since our previous announcement. While consumer business continued to grow in aggregate, agri business decline slowed down from 14 to 12%. Within the consumer segment, water is clearly driving the pack, additional, reinforced by Delta water in Saudi Arabia. Both Capri-Sun and Al Ain Fresh are being adversely impacted by the deceleration of beverages category in the UAE, as consumers downscale their discretionary spending.

Capri-Sun has additionally been hit by Qatar blockage in the third quarter. There is moderate growth in food, but when we look at the category, taking Egypt out due to last year's devaluation impact then the growth over the last year stands at a strong 8%. As Tariq mentioned before, our CSD channel is the driving force behind this performance. On the Agri side, in animal feed, lack of CP tender and interrupted state of exports created additional drag over and above the new post subsidy variables. In flour, the most recent wave of subsidy withdrawals arrived in the bakery channel, effective from July 1st. Although we applied for authorisation of price increase, which is currently under process, execution of the increase, once approved, will prove to be complicated owing to the cheap imported flour which Tariq explained about earlier. We have now taken this into consideration in our forward planning for the near future.

Net profit for the first nine months of the year has been AED 165 million, which is AED 35 million less than last year. You can see on the slide that flour and feed profits declined AED 89 million mainly because of subsidy removals, and this was largely offset by higher profits in the consumer business and cost savings on part of the head office expenses. Higher water volume with a better mix, significant loss reduction in underperforming businesses, and additional cost savings by virtue of a strict cost optimisation programme since the beginning of the year have all helped recover as much as AED 77 million back from AED 112 million of lost subsidies in the first nine months of the year.

Let's have a look at our gross margins. Clearly, the group's margin is a product of consumer business margins, the top blue line, and Agri business margin at the bottom of the graph depicted in orange. Two different forces are at work here that are actually helping the group's margin out of the distress of the Agri business-induced subsidy burden. Higher share of higher margin consumer business in our group portfolio, that's the critical thing which impacts… keeps Agthia overall margin unchanged. I would not be shying away from emphasising that this is too good to be a mere consequence. To the contrary, it is a direct result of foresight and strategic planning, and meticulous execution of the strategy. It is on account of this preparedness that we are able to protect both our revenues and margins with as low damage as possible, given the magnitude of the change that has taken plan in Agthia's playground.

One factor that already has its imprint on this year's profit protection effort is our start action on our operating costs; creating efficiencies all around the organisation, but especially in our manufacturing processes, has always been a priority for us. This year, we took one step forward and turned our attention to SG&A. The result is summarised above: cost savings of AED 13 million in nine months, directly flowing down into the profit line. The cost increases in overheads is mostly the full year impact of last year's recruitments as well as inflation and cost increases.

Let me touch on one more point before I move to the next slide. We often receive a question on Saudi overheads that its ratio to net sales compares higher to the one in the UAE water business. There certainly is a trace of truth in that as there indeed is room for some improvement in the cost structure of Saudi operations, and at Agthia, we have a proven track record to identify and capture them. However, there is also one thing that is being missed, and it is that our water and beverages overhead ratio in the UAE is higher than the

Group average by 3 to 4 percentage points due to higher selling and distribution costs especially in the 5-gallon home and office distribution business. When these two factors are taken into account, let me assure you that Saudi overheads are reasonable and under control.

With last quarter's call, we started to give you more insight into our underperforming businesses and here comes the update on them. On the left you can unmistakably see the trend and speed of recovery in 2017. What used to eat away AED 40 million from the profits back in 2015 will have been reduced to an estimated AED 12-13 million by the end of this year. Nine months to date, the loss stands at AED 10 million and is AED 12.6 million less when compared to the same period of last year. Most of these businesses are under our food umbrella and Tariq has already covered them in his part. In addition to them, Turkey is in the above figures, where we used to incur losses at several millions of dirhams each year. As of nine months of this year, Turkey's loss is less than 200 thousand dirhams – effectively breaking even. Although devaluation of the last month will create some problems, Turkey is structurally on the right trajectory now after our intervention in the business model at the beginning of this year.

Now, let's close with our outlook for the total year after third quarter results. We had a rather disappointing September, like no other in history. Despite Back to School, we have noticed much less shopper traffic with already diminished spending levels. As a matter of fact, when we compared our like-for-like September sales to last year, we noticed only 1% betterment. This we believe is a solid reflection of the general slowdown in the marketplace; although we have a track record to beat the market even under these circumstances, and although we know we have plans to ride our momentum, this situation compels us to be more prudent than jubilant in our estimates.

Adding the other developments listed above on the slide, we revised our total year revenue and profit estimates down for 2017. Our expectation is to reach a revenue growth between 1.5% and 2% over last year, whereas the profit is expected to record 17-18% decline, which means our 2017 profit would be around AED 46-48 million less than last year. In a year where removal of subsidies and a higher utility price took away more than AED 150 million from our bottom line, it also means that through the right and timely actions, we have taken almost more than AED 100 million back into our profit line.

This concludes our prepared remarks, thank you for listening to us today. I am now handing over to the operator for the Q&A session.

Question and Answer Session

Operator

We have no questions. Dear speakers, back to you for the conclusion.

Ozgur Serin

Thank you very much, everyone. If you have any further questions after this moment, you know how to reach me, so we will be more than happy to answer any questions that you might have. As a reminder, this presentation is available on our website and the transcript will also be available as soon as we have it. Thank you very much and have a good day.
