Transcription for AGTHIA GROUP

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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 Group Fourth Quarter and Fiscal Year 2016 conference call and webcast. Today's speaker will be Mr Ozgur Serin, Vice President Investor Relations Corporate Communication. Sir, please go ahead.

Ozgur Serin

Thank you, Ayan. Good afternoon and thank you for being with us today. I am joined by Tariq Al Wahedi, our acting Chief Executive Officer, and Chief Operating Officer, and by Fatih Yeldan our Chief Financial Officer.

Before we begin, let me remind you that you can find this presentation in the Investors section of our company website at www.agthia.com that supports today's prepared remarks by Tariq and Fatih.

Additionally, this conference call may contain forward-looking statements which should be considered in conjunction with the disclaimer for forward-looking statements contained in the presentation.

Following the prepared remarks, we will turn the call over to your questions. In order to allow as many people to ask questions as possible, we request that you limit yourself to one question. If you have multiple questions, please ask your most pressing one first and then re-enter the queue for any additional ones.

Now, I am turning the call over to Tariq.

Tariq Al Wahedi

Thank you, Ozgur, and good afternoon everyone.

Today, I will cover some key highlights focusing around execution of our 2020 strategy before handing over to Fatih for more detailed financial performance of the company.

2016 has been a year where we had to face not only a persistently declining consumer spend in the UAE but also a completely new trading environment in our flour and animal feed businesses following rationalization of subsidies in the middle of the year.

As you can see on this slide, which compares our volume growth in green columns against category growth in grey columns, underlying market sizes in all our core categories except water have contracted to remarkable extends. And in water, what used to be double-digit rates has remained in single-digit growth territory. Juice drinks, fruit and kid's yogurt segments have all contracted. It's worth noting that overall Juices category that includes juice drinks segment has declined by a staggering 13 percent in volume when compared to previous year.

Given these circumstances, we did very well, and managed to grow ahead of the market in line with our strategic objective of growing organically. Before talking about how we managed to do this, let's have a brief look at our key brands' market shares in the UAE.

Here are the value shares of our major brands in the UAE together with their respective market positions as per AC Nielsen. Al Ain Water reached a record 24.5 percent value share, increasing the lead versus nearest competitor to 700 bps, and further reinforcing its leadership. In the meantime, Alpin, our Turkish natural spring water has become number two in the Turkish Bottled Water sub-segment, reaching just under 1 percent share, where the leading brand's share is only 1.5 percent. Capri Sun increased its share to 11 percent in the Juice Drinks Single Serve segment, now sharing the second place. Al Ain Tomato Paste maintained its leadership at 23.5 percent whereas Frozen Vegetables is the only brand where we lost share. In Flour, despite we have been losing volume share after we doubled our shelf prices following the removal of subsidy, we increased our value share by 200 bps to 20 percent. Finally with Yoplait in Value-added segment we became number two player with 12.9 percent value share.

I would like to focus on bottled water for a few more seconds. Let's look at the next slide.

Al Ain Zero has been a great success story not only for the year 2016 but a major stepping stone and a confidence booster in our transformation to a "brand" company.

In a matter of six months, it captured a value share of 4 percent, which took other similar competitor brands at best two years to achieve. Al Ain Zero is a breakthrough sodium-free bottled water that reflects Agthia's commitment to be in constant touch with evolving consumer needs and remain ahead of the curve by being innovative in a mostly commoditized market like water.

We can also see on this slide the composition of bottled water market in the UAE. Top 3 brands make almost 55 percent of the market, namely Al Ain Water, Masafi and Arwa. Mai Dubai has been building share but still wandering in single-digits after almost 3 years, taking share from all but us.

We can also see that our two other brands, namely Alpin and Al Bayan are together adding up to another 1.5 percent market share.

Let's now look how we did this.

Here is a summary of our commercial wins that are behind our successful results in 2016. And as you can see there is much more than Al Ain Zero here.

In the consumer businesses side, in addition to Al Ain Zero we also introduced Al Ain Fresh juices to the tastes of our retail consumers with a longer shelf life, complementing an already existing 3-day shelf life portfolio in the institutional and HORECA channels. Using unique High Pressure Pasteurization (HPP) technology, which allows preservation of taste and nutritional values intact for longer shelf life without any additives or preservatives, we introduced five flavors in retail trade channels. There is still work to be done for this product to find its fair share and potential in terms of increasing penetration and distribution, and we are vigilantly working on that.

All through the year our efforts to increase distribution and acquire new customers across the UAE but especially in Northern Emirates bore fruit; although there still is room for further gains we have much stronger growth rates attributable to northern emirates in 2016.

Entering ambient bakery segment brought scale to Bakery business using existing capacity thus reducing absorption-driven losses. We have plans for further building the scale up both in ambient and frozen bakery in 2017 nevertheless, our strategic direction for making a definitive go-no go decision for this business by the end of this year has not changed, and we are taking actions in both directions.

We would not do justice if we left the importance of the Municipality outlets unmentioned in our performance in 2016. As being their sole supplier in several products but especially in Water, we are successfully amalgamating our "expertise in the product lines that we are competing" with our "leverage of being a semi-government company". We expect more to come thru Municipalities in 2017.

We are doing very well in our 5-Gallon water business thanks to the Al Bayan acquisition of late 2015, which outperforms our pre-acquisition objectives both financially and in terms of synergies. This is not a market that is subject to retail audit by independent parties but internally we know that we are now a very strong number two in this segment, closing the gap to the leader slowly but surely.

And finally, in Flour and Animal Feed, both of which have been subject to unprecedented changes in their commercial and competitive canvas due to

Abu Dhabi government's decision to rationalize subsidies, I am extremely proud of the work our teams have produced. Rather than the changes themselves, our fast and effective action in defending our brands and market shares in response has characterized the whole situation. This has helped us first to contain, and then to minimize, the adverse financial consequences of subsidy rationalization on our businesses, which I will not repeat here as I know most of you, if not all, have already been fully briefed by both Fatih and Ozgur in various forums since July last year.

Let's now see how these fit in the overall framework of our 2020 target and associated strategies.

The scorecard on the slide is clearly indicating that we are on the right track in terms of execution of identified strategies to take us to our 2020 target. We already talked about our organic growth drivers in the UAE so let me touch upon the other pillars.

Our ambition to become a stronger Juice and Dairy player via M&A continues despite one attempt that was very close for completion failed late in 2016.

On the other hand, 2016 has been a milestone in our ambitions to become a leading regional water brand owing first to our JV partnership in Kuwait to set up a water bottling operation there, and later to the acquisition of 100 percent of the shares in the water business of Delta Marketing Company, based in Jeddah, Saudi Arabia, which also owns and produces "Al Ain" brand water in the Kingdom. The Saudi transaction is expected to be completed this week allowing us to consolidate in Group results in the first quarter.

In Flour and Animal Feed, after the change in subsidy regime, we shelved our capacity expansion plans. Notwithstanding, we have not stopped thinking out of the box in either of these businesses; while in Flour we stepped into the adjacent "Bakery Ingredients" category with the introduction of bread-making ingredients like Yeast, Bread Improvers, Cake Mixes, in Animal Feed we are evaluating a partnership in Alfalfa business with one of the world's leading hay and grain companies. In both fronts, you will hear more in the coming weeks.

The strategy to carve our smaller or underperforming businesses out of their previous structures and combine them under Emerging Businesses proved to be right; while aggregate revenues grew by 30 percent, losses diminished by 56 percent, reducing to low single-digit million dirham figures. As I mentioned before, strategy here did not change: we will have made a conclusive call regarding the future of these businesses with Agthia Group by the end of the year, and submit a proposal to the Board.

Finally, while we are identifying and capturing any meaningful opportunity to improve our operating margins, we are also keeping an eye on maintaining a talented organization that will take us to 2020.

I would like to conclude my part with our priorities in 2017, and hand over to Fatih for financial performance review.

Leaving elaboration to our upcoming meetings and calls when we can easily check performance against every one of them, I'd like to assure you that we will stay course for hitting our target for 2020, focusing on execution of our strategy with a touch of value-adding innovation to continue to outperform and stay ahead of competition. As we are now progressing into the half year, we have already taken many initiatives into their next life cycles to help us achieve our 2017 targets.

With that, thank you all for listening patiently, and over to you Fatih.

Fatih Yeldan

Thank you, Tariq, and good afternoon everyone.

As the title reads, it was another year of strong financial performance, a true reflection of our commercial and operational actions that Tariq has perfectly summarized above.

Net revenues passed 2 billion dirhams, an 8 percent growth over last year, in not as buoyant an environment as it used to be in the recent years. All categories except Animal Feed contributed in growth with Water leading the pack, and I will cover this in more detail in the coming slides.

Gross profit margin continued to improve: reaching 34.5 percent, it is 253 basis points ahead of last year. All business' margins improved except for Animal Feed, where subsidy rationalization hit harder and earlier than Flour. Relentless work and investment behind bringing efficiency to all our processes, conscious efforts to keep overhead costs under control and certainly lower procurement costs of our major raw materials have all contributed their fair share in this performance. All in all, our bottom line reached 254 million dirhams, an increase by 10 percent over last year. All other details regarding the P&L as well as the balance sheet are available in the financial statements that are posted on our web site.

Let's dig a bit deeper into the revenues.

Before delving into categories let me show you the contribution by agri and consumer businesses in aggregate.

As you can clearly see, there is more behind 8 percent growth: there is consumer businesses segment growing at a staggering 20 percent, driven by Water, and there is agri businesses segment, managing to hold the ground despite a major shift in business dynamics on the back of subsidy changes. This is visible on the slide in the second half performance of agri businesses, when we started to feel the impact of the change.

Moving on to the next slide.

Flour at 434 million dirhams grew by 2 percent. A flat domestic UAE business was uplifted by better performance in both exports and wheat trading platforms.

Animal Feed, on the other hand, declined by 2 percent, recording 669 million dirhams in 2016. Subsidy here played a larger and longer role, pushing our domestic UAE performance 5 percent lower than the previous year, partially recovered by higher commodity trading.

Water, at 652 million dirhams now, is already the same size of the historical revenue leader of the Group, the animal feed business. And this is even before the Saudi results kick in in this quarter! Growing 20 percent over the previous year, and Al Bayan has undoubtedly been a strong contributor in this performance.

In Juice, Capri Sun experienced a challenging year with new school regulations and downsized spending by consumers, slowing our growth momentum. Fresh juices, on the other hand, had a good year boosted by the launch of Al Ain Fresh juices in the retail trade, and contributed positively.

Still relatively small at 33 million dirhams, Yoplait continued its double-digit growth momentum, delivering 29 percent higher revenues than the previous year.

Finally, as Tariq has also mentioned, our Emerging Businesses became the second largest growth contributor in the Group, reaching 143 million dirhams of revenues.

To put our 2017 outlook in proper perspective, we must bring attention to forces that are having their impact on the business environment that we are operating in.

In addition to a persistent slowdown in consumers spending levels, and the first full-year impact of subsidy rationalization, we started the year with utility tariff increases in Abu Dhabi in the range of 80 to 90 percent. We are also witnessing in the first quarter that there is a slowdown in the Government's routine annual concentrated pellet tender, which has an impact on our animal feed business at the least from a phasing point of view.

As you can see on the slide, we have initiatives in place to protect both our revenues and profits, like creating new revenue streams as Tariq mentioned earlier, or investing in energy conservation projects to reduce our costs. After all, it is owing to this constant mentality of ours that allowed us to offset more than 100 million dirhams of lower subsidy and deliver 10 percent higher net profit in 2016, to pleasant surprise of most, if not all, of you. Nevertheless, there is a limit for how much we can compensate when external cost challenges of these magnitudes keep coming over us.

Hence, we have a prudent outlook into 2017, especially on the profit end.

Although we still expect the top line to grow at single-digits, and this is excluding the Saudi acquisition, we believe it is only realistic to expect lower bottom line in 2017 by single-digit percentage levels.

With this, I would like to hand over to the operator for Q&A. Thank you.

Question and Answer Session

Operator
[Operator instructions]

We have a question from Fatema Al Doseri from SICO. Please go ahead.

Fatema Al Doseri
I just have a question regarding your volume. You used to disclose them, so if you don't mind disclosing your volumes for flour and feed, and bottled water in Q4.

Ozgur Serin
I can… I can give you the total year volume and then you can find for Q4 very easily, but otherwise you can come back to me later on. Flour is 316,000 tons, feed is 673,000 tons, 54 million cases of bottled water, and 20 million cases of 5-gallon.

Operator
[Operator instructions]

Our next question is from Sandeep Srinivas from FM Partners. Please go ahead.

Sandeep Srinivas
My question was regarding the gross profit margin, which you have earned in the fourth quarter compared to last year for the agri business. I see that that has increased by around 200 BPS. It's kind of counterintuitive given that you don't have the subsidies in the fourth quarter of 2015. Can you please comment on that?

Fatih Yeldan
Basically, you know, in the quarter three, if you look at those quarters given last year's, you will see a low margin in 2015 as well, so there is some seasonal mix impact coming helping us to get this improvement on Q4, but that will not be sustainable, because now Q4 you see about 27.8%. However, before like always we mentioned after the subsidy rationalisation, for agri business you should expect to have around 25%, because that's the mix… there was a high flour mix, which helped the total and the seasonal and the grain prices, but it will not be kept at said level.

Operator
Our next question is from Divye Arora from ADS Securities. Please go ahead.

Divye Arora
My question is linked to the impact of dollar on the animal feed business, if the dollar is going to weaken then what sort of an impact do you see on the feed, and also if you can give some colour on the water business code that you expect in 2017? Thank you.

Fatih Yeldan
Water, we still expect double-digit growth, but small double digits, around 10-11%. When it comes to your first question on the grain, what we see from our projections and the market, we don't expect in major change in the grain prices, which will impact on our feed cost, and we are covered for the next 6-7 months.

Divye Arora
Okay, but how do you hedge the currency risk?

Fatih Yeldan
Currency for what? I mean, dollar, dirham, which risk exactly are you talking about?

Divye Arora
You're importing it mainly from which country exactly, the feed? Is it Brazil or…?

Fatih Yeldan
It's coming from different places, not from Brazil really. It comes from Canada. It comes from Europe. It comes, say, from all over the world, you know, like a basket you can say, but are quite solid in dollars yet behind the scene there is some exchange impact – you are right. If there will be some significant change in the dollar itself, the grain prices in the world in dollar may go up, but we don't see in the future there's any impact of this yet and the market is pretty much stable, and as I said, we are covering already in the next 6-7 months almost; last quarter only less uncovered for us, so we will not have any impact if anything happens within 2017 I would say.

Divye Arora
Okay, so if dollar, say, depreciates by 5% against… on the average against the currencies that you're exposed, what could be the impact on you?

Fatih Yeldan
It will be only exchange, nothing else. Everything remains the same. You would have probably around AED 6-7 million… sorry, 6-7 million… yes, you can say around $6-7 million impact, but if… as I said, that would be the only change, unlike nothing else will work in our favour, right, like better temperatures, better rain, better this, better that. There are lots of things behind the grain prices available to everything, not only the exchange, but if only exchange goes like this, what you are saying, that will impact us pretty much in the same level.

Divye Arora
So you were saying a 5% impact will be $6-7 million, a 5% depreciation…

Fatih Yeldan
Yes, yes.

Operator
Our next question is from Fatema Al Doseri from SICO. Please go ahead.

Fatema Al Doseri
I have two more questions, if that's okay. The first one is regarding your PET. How much do you have secured for 2017? The second is regarding your ZERO water. What percentage of your volumes revenue is actually from water and from ZERO water, and how much do you expect it to contribute in the future?

Fatih Yeldan
Now, the PET, we are covered for another three, four months, so you can say until July we are covered, and so we will be buying soon for the next… the remaining four, five months from the water PET prospective [inaudible]. In the Al Ain ZERO, in retail now almost 30% of our sales is Al Ain ZERO volume, but when it comes to net-net impact, it's close to 10%, because the rest is getting cannibalised, and after six, seven months, so it may still go up in retail. We also now have it in the municipality channel. They are also doing well, so again, that's the first month of the sales, so there is room to increase there as well, and it helps in our margins; I'm sure when you look at the numbers you see the impact already in quarter four, our water business profitability gross margin is much better than the previous month.

Fatema Al Doseri
Could you share how much margin you are making on ZERO water compared to your normal Al Ain water?

Fatih Yeldan
ZERO water is about 55% on the average and Al Ain regular is around 50%.

Fatema Al Doseri
Sorry, is around what? I couldn't hear that.

Fatih Yeldan
55%.

Operator
Our next question is from Mustafa Salih from Blakeney Management. Please go ahead.

Mustafa Salih
Just a quick question from me; I just wanted to clarify the guidance you mentioned for gross margin for the feed, the agri business this year? Is that 25% gross margin for the combined for full year 2017?

Fatih Yeldan
25% we expect for combined, yes, agri business. If you recall, before the subsidy it was around 29-30% and we are expecting to have increased about 400-500 in total, and that's what we see now in 2017, so the year will be around 25%. The quarters may move plus/minus because of the phasing of the sales, the mix of the sales, plus the purchase price of grains is not the same every month, so obviously it impacts the cost of the quarter different, but however for the total year we expect to be around 25%.

Mustafa Salih
After factoring in the higher utility prices?

Fatih Yeldan
Yes, yes. Mustafa, the electricity is more impacting the consumer business.

Operator
[Operator instructions]

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

Sandeep Srinivas
Can you please give us an update on your Kuwait and Saudi projects, regarding the timeline and the final capacity?

Tariq Al Wahedi
On Kuwait, we expect commissioning to start around June-July of this year and we expect that we go commercial by end of this year, expected to be

November or December; expected capacity to be around 26,000 cases. As far as Saudi, we are finalising acquisitions this week. We will go live basically… so we are taking over basically the operation, we will run it; this is already a running project, so we will be upgrading capacity target by next year, but for now we will be optimising what's existing now.

Sandeep Srinivas
So the first line which you want to introduce in Saudi that's going to be only in 2018?

Fatih Yeldan
Yes, it will be in 2018. It will be a high-speed line, yes.

Operator
[Operator instructions]

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

Ozgur Serin
Thank you ladies and gentlemen for participating again in this call and as usual if you have any further questions, you know how to reach me and thanks again – bye-bye from all of us.