Transcription for AGTHIA

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Corporate Participants

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Agthia Group –Chief Executive Officer

Fatih Yeldan
Agthia Group – Chief Financial Officer

Presentation

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

[Introductions]

I will now hand you over to Mr Ozgur Serin, sir, the floor is yours.

Ozgur Serin
Good afternoon everybody. Once again, thank you for joining us today in Agthia Group's January/March first quarter analyst and investor results conference call. I have Tariq Al Wahedi, Agthia Group CEO, and Fatih Yeldan, Group's CFO with me. In today's prepared remarks, Tariq will first talk about the quarter's highlights and update on our progress towards 2020 target. Fatih will then take over and cover the financials for the quarter. We will close the call 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 everybody. I am glad to say that we stayed on course in the first quarter of the New Year, with no surprises on our fundamental business variables.

Let me start with a recap of the top line. The group posted total net revenue of 491 million, and this represented 3.7% like-for-like growth hen compared to last year, a metric that we are closely watching in order to monitor the organic performance of our business when there are one-time or extraordinary items that impact their performance. When broken down into our business categories, we can clearly see water, food, and animal feed are our growth drivers. Together, these categories represent 78% of our group revenue. On the other hand, whereas beverages suffered from changing consumer preferences towards cheaper products and a declining market, flour continued to take a slight hit of cheap imported flour in the market, which actually overshadows our otherwise steady and strong growth in the retail channel.

In water, for sure, the biggest news for the quarter was the launch of Vitamin-D last January, offering yet another innovative product to our consumer, following up highly successful launch of Al Ain zero two years back. I will talk more about this in a few minutes.

In animal feed, we entered into an innovation and technology partnership with Trouw Nutrition HiFeed, a Nutreco company, who is a global leader in animal nutrition and aqua feed, aiming to develop a portfolio of products and services for optimised nutrition, enhanced animal performance and improved economic efficiency in poultry and ruminants for Agrivita brand.

Reinforcing our food category more than the rest, thanks to trading items portfolio. We signed an agreement with the Department of Urban Planning and municipalities to manage Abu Dhabi's and Al Ain food service centres i.e. the municipality retail outlets, open to all local people for the UAE. These outlets provide a range of fast moving consumer products at discounted products where, as Agthia, we have been present including our water, beverage, dairy, flour, and even animal feed. This agreement provides Agthia with a strong security for sustainability of our operations and further growth potential in a channel that already has a significant share in our group business.

Let's see our market share performance on the next slide. As you can see, Al Ain Water's strong leadership in bottled water category continues together with our other bottled water brands, Al Bayan PET and Alpin PET natural spring water, that is imported from our own production facility in Turkey. Overall, company share reached over 30% and still declining respective markets, both Yoplait fruit yoghurts and Capri Sun juice drinks are doing fine, maintaining share in the case of Yoplait and increasing share in the case of Capri Sun. Not mentioned above as Yoplait Petit Filous Kids a kid's yoghurt where our strong market leadership continues.

Al Ain Vitamin D in the market for consumption of the UAE consumers for three months now and the results to date are encouraging. In total, Vitamin D reached 0.4% volume share driven by weighted distribution in the same period reached 60%. Bear in mind that these results come with only two variants in the market, 330ml, and 500ml. Value shares are higher than volume share, as expected, hitting 0.8% market share due to the pricing structure of value-added Vitamin D products.

I would like to spend time of the performance of our animal feed category with a post-subsidy perspective in order to emphasise our success in weathering the growth, the challenge in the wake of subsidy. We can clearly see the chart – the key performance indicator of the P&L is progressing with a positive recovery trend over the course of the past 15 months. Revenues of 143 million is higher than the same quarter in 2017, even when the bulk back to back grain trading at 8 million sits in the last year's figure. We can see stabilisation of profitability as well, with gross profit margin reaching 19%, following a positive mix with high volume and still subsidised commercial farms and municipality outlets. Our net profit margin just below 10% is still strong, when compared to regional and global benchmarks.

For the last three quarters, we are sharing with you the turnaround performance of our loss making businesses in full transparency. We are all very pleased and excited to see that the momentum of turnaround continues. You will remember, when we closed 2017 with two business lines staying in red, out of five businesses with a cumulative loss amounting to AED 40 million for 2015 fiscal year. As of the end of the first quarter of the year, we have bakery and dairy still in an aggregate net loss of 2.7 million for the first three months ended in March 31st. An obvious question here is, so what is next for these two business lines. Let's look at the next slide.

Dairy deserves a particular highlighting here, as the size of net loss reduction was a remarkable 72% versus the same period one year ago, thanks to a combination of better mix to eliminating low margin slow moving products and lower cost. We are very optimistic for a full EBITDA turnaround in dairy business this year by virtue of several actions both on the business generation platform and on further cost optimisation.

Bakery, on the other hand, despite encouraging revenue, build up efforts and subsequent profitability improvements on account of new customers with new business, or with new businesses, is unlikely to turn profitable so far in the foreseeable future. Our action plan regarding this business unit has already been shared by the analysts and wider investment community, and let me leave it by saying that we have positive progress in this direction.

I would like to conclude my part with hopefully shedding some light on another widely question topic, is Agthia still pursuing to become a $1 billion revenue company by 2020? The answer is a strong yes, actually. We will not stop running after profitable and economic opportunities that fit into our corporate business strategy, both organic and inorganic in order to accomplish this vision, and we are not particularly concerned about the contribution by the organic portion of the equation under, of course, normal business and geopolitical circumstances regional and global, which leaves us with just over AED 1 billion projected gap towards our target. This is where we will heavily depend on a successful inorganic expansion. As of today, we have three candidates. The first one is another water acquisition in Saudi Arabia, which we aim to land by the end of this year, with a range of projected top line contribution from 0.4-0.8 billion. The second one is on the back of the new agreement that we signed that was mentioned earlier in the presentation, which will provide Agthia a strong security for sustainability of our operation and further growth potential in a channel that already has a significant share in our group business. The third one is against the backdrop of our alfalfa joint venture business, with an aim to capture a portion of the UAE Government alfalfa tender.

This concludes my section. I am now handing over to Fatih.

Fatih Yeldan
Thank you, Tariq. Good afternoon. Group revenues reached 491 million and net profit for the period has been AED 47 million. Our reported revenues and profit in the first quarter of last year were AED 521 million and AED 52 million respectively, hence both our top and bottom lines remained behind last year by 5.7% and 10.2% respectively. However, both revenues and profit of last year include transactions that don't exist or repeat in this year. These are growth calculations based on reported figures; therefore, misrepresent the true operational performance in these two periods. When adjusted for these items, we can see that both revenues and profit have actually increased versus last year on a like-for-like basis, net revenues by 4% and profit by 10%. Let me explain what these items were and how they impacted our last year reported numbers.

Let's first look at the revenues. When we consolidated Delta Water, Saudi business in the first quarter last year for the time into Agthia Group results, we did so for four and a half months because of a mid-November 2016 signing date of the share purchase agreement. Together with our consumer products, exports to Qatar that are not happening since June last year, these two items amounted to AED 19 million. Similarly, in the agri business, there was a total of AED 29 million pertaining to exports to Qatar, in addition to bulk grain trading activity that was opportunistic in nature depending on the global grain price movements.

All in all, taking AED 48 million out of last year's 521 million, there is 17 million or 3.7% like-for-like growth in our businesses.

In addition to the profit impact of abovementioned transactions, two other items that had an impact on last year's profit line (1) an extraordinary income booked following the transfer of Ice Crystal factory land and (2) proceeds from the grain safety stock contract that was later terminated in quarter four of 2017. Stripped of this, we can see a like-for-like profit increase by almost AED 10 million or 10% when compared to last year.

On this slide, we can see the change in gross profit margins of our main categories. The impact of subsidy withdrawal in flour is obvious, compared to last year, there is 50% less subsidy in the bakery channel in the first quarter of 2018, which puts pressure on our margins as expected and communicated in all platforms. On the other hand, animal feed margins are improving mainly due to higher volume in still subsidised commercial farm business. Better mix in, especially water, in favour of more premium Al Ain Zero and Al Ain Vitamin D is assuring at least maintenance of high margins and our efforts to optimise our cost at every point of the value chain is providing the extra efficiencies. Our food category is also on the right track following our remarkable achievement in profit turnaround of tomato paste, frozen vegetables in Egypt and UAE, and cutting losses of dairy and bakery businesses.

Group gross profit margin at 34.4% is 80 basis points higher than last year.

As for total year outlook, we expect to report a revenue growth between 1 and 3%, which when adjusted for items that are mentioned in the graph, would represent between 9 and 10% like-for-like growth for the year. As you will remember, our net profit projection for 2018 is to stay flat versus a year ago on account of additional hit on our bottom line in 2018 by virtue of lost flour subsidies and also a projected increase in the commodity costs. This was projected to amount to AED 55-60 million. In other words, keeping last year's profit level effectively means to recover around 60 million of hit in our P&L during the course of the year.

From a like-for-like perspective, managing to keep net profit at last year's level, would represent a net profit growth of 8-9%, as you can see on the bottom of the graph.

With this, we conclude 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]

Our first question comes from Nishit Lakhotia, SICO. Please go ahead.

Nishit Lakhotia
I have a couple of questions, one on the municipal agreement. Given that these are a bit – a bit more clarity, rather on the municipal outlets, who are eligible to buy from these outlets, is it only local Emiratis and given that it is going to be at a discounted price, will your margins here be much lower for the products that you will be selling, or are you are compensated by the Government at market price and the Government subsidises it through this. That is my first question.

Second, on the Kuwait water J/V, I believe it is going to be starting now in the second quarter, but given the condition of the water market in Kuwait after the export ban and there is so much of supply, how do you see that shaping up for your Kuwait business.

Third question is on the commodity costs; can you just again quantify exactly what is the effect only of the higher commodity price that you mentioned that you expect during this year on your bottom line. Thank you.

Tariq Al Wahedi
On municipal stores that we have now, yes, it is open for UAE nationals to come there. In terms of, yes, they are getting better pricing, but we are passing… we have better margins, actually, into this business than what we normally have, because we don't have the same spend that we normally have into other channels as well, as we are managing – we are the retailer in this channel and we are dealing directly with the customer (the consumer), so here we are saving a bunch of money that we are passing it to the consumer, so that is question one.

On question two on Kuwait, I would like to highlight a couple of things, number one, that the plant that we have in Kuwait is not massive, it is designed for the Kuwaiti market. Number two, we are bringing Al Ain water, which is value-added, and we are bringing brand equity in there that we are driving, so we are not really competing with the masses in there, but we are going with better quality water, with a pan-Arab water that is available, and our strength always comes into brand equity, quality and distribution, and that is what we have got to maintain. So we are not concerned about the market there in Kuwait in terms of expansion. We already were in that market exporting from here, so it is not a new market for us, we are just expanding and building more onto it.

On the third point on commodity pricing, I will pass this to Fatih, he will explain to you, but we have the measures to manage this price hike that happened.

Fatih Yeldan
Basically, on the commodities, when we gave the outlook for the first time, we mentioned that we will have about 15-20 million kind of impact, because that was basically coming from the wheat and also the PET increases. So that plus the subsidy change impact coming from the flour and other inflationary increases, they were basically planned to be offset by the growth in the consumer business plus the cost optimisation, that's basically what we said from the beginning. Now, we see for the second half there may be some commodity impacts coming from the global prices, but again basically they're almost all really tied to the prices, so we will not have a net-net impact on that, but the beginning one that we had from the PET and from some of the milling wheat that we had within these 15-20 million, that was the one that we are offsetting with our cost optimisations actions actually.

Operator
Our next question comes from Metehan Mete, Waha Capital. Please go ahead.

Metehan Mete
Congratulations for your good results, just [audio] of UAE market growth rates do you see in the water segment at the moment, like I think you were guiding for more like high single digits' market growth, but then we have been seeing some slowdown as well, like a deceleration in the market growth; can you comment on that, please? The second thing is that in the Saudi Water acquisition, at what stage are you at, like are you negotiating the price at the moment or are you still not there yet?

Tariq Al Wahedi
Metehan, we didn't get the first question. Let's answer the second question and then we will request you to repeat your first question, please.

Metehan Mete
Sure, my first question is about… would you comment on the UAE water market growth rate.

Tariq Al Wahedi
Sure, yes, in terms of the UAE market growth rates, I mean we are witnessing… of course, I mean there is pressure on the market in terms of prices, but… and there has been stronger competition, it has been more aggressive, but as you've seen, I mean we continue to grow regardless of this and this is mostly driven by our innovation that we have in the pipeline. I mean, we are different; we are not just selling water here, but we are selling a brand that carries lots of innovation with it and that's thanks I mean to Al Ain Zero that we had and then the big hit that we also had with Vitamin D, and I'm glad also to say that there is a new product that's coming in a couple of months that will also be very interesting as well, and this is the trend that we're going to continue. We are distinguishing ourselves. I mean, if you really look into it, you will find that we are the only company in the world that really puts so much innovation. I mean, up to our knowledge that puts so much innovation and science behind water. I mean, not beverages, not other foods etc, but water itself, so we are investing a lot into this and this is our space that we want to capitalise on in a big way.

As far as your second question was in Saudi, you said that we are negotiating pricing. I'm not sure you were…

Ozgur Serin
For the target, where we are with targets… acquisition, sorry.

Tariq Al Wahedi
Acquisition targets, okay. As far as acquisition targets, I mean we are looking into a couple of candidates now and we are assessing them. I mean, the teams are quite busy going through, looking at those as we speak, and hopefully… I mean as soon as we have something solid then that's something definitely we will be sharing with everybody afterwards.

Operator
Our next question comes from Zeeshan Bagwan, Abu Dhabi Capital Group. Please go ahead.

Zeeshan Bagwan
So my question is regarding the details that you gave on the Government agreements that you have, so what kind of revenues are you expecting from these agreements going into 2018 and '19? Can you please provide some colour on that?

Tariq Al Wahedi
You mean the [Belladia] stores?

Zeeshan Bagwan
Yes, sir.

Tariq Al Wahedi
This is not new, by the way. I mean, we were managing this. I mean, we were... but under the umbrella of [Belladia] they were managing this from 2008. We were doing 95% of the trade on that, but what happened now, we have taken the full control of the store now, I mean, to revive the consumer experience and basically we're trying to capitalise on one thing, which is very important. Today we have a portfolio of different foods. We are servicing not only the [Belladia] stores, but also servicing the [Belladia] stores, but also we are servicing Sheikh Khalifa Foundation stores, so in total we are servicing about 54 stores across UAE. We are adding more for other Government entities like Ministry of Interior and so on, so it's a growing sector for us and we are managing most of this in a big way and the idea was to take this business onto another level, because today we are servicing HOD to home delivery, so we have the widest base of network of home deliveries basically, so the idea was can we take the municipal stores to deliver to these local families and that's what we're going to work on for the next few years, to develop that business and improve that consumer experience basically. So we're expecting growth, but today we have that revenue that's coming to us; from the consumer side, we are making about 250, but overall including the animal feed it's sitting very close to about 400 million.

Zeeshan Bagwan
Do you see any pressure on the receivables from this particular segment or the receivables are pretty much intact for you?

Tariq Al Wahedi
No, no, they're perfect. They're better than any other place actually.

Zeeshan Bagwan
Okay on that case…

Tariq Al Wahedi
Just for the record, this is not being paid by the Government. We are managing the store. I mean, we are the front-end, we will deal with the consumers there, so customer service, everything is done by us, so we are dealing directly with the consumer here.

Zeeshan Bagwan
Secondly on the water acquisition business, which you said, so will it be a brownfield or a greenfield expansion?

Tariq Al Wahedi
We are working on… okay, we are expanding our assets in Saudi. I mean, this year we will have a high-speed line that will be commissioned by October, so that's what we consider our organic growth, but we are looking for brownfields in terms of acquisitions. We are not looking at greenfields.

Zeeshan Bagwan
So you said that you would be doing this CapEx of around 0.4 billion to 0.8 billion in KSA for this acquisition, so is that right?

Tariq Al Wahedi
No, this is revenue expected from the acquisition.

Zeeshan Bagwan
Okay, this is the revenue that is expected, thanks, that I what I wanted.

Operator
Our next question comes from Shankar KP, HSBC. Please go ahead.

Shankar KP
You had guided earlier that you plan to increase the capacity in Saudi water bottling. My question is how do you plan to increase your market share in terms of distribution capabilities?

Tariq Al Wahedi
Of course, when you build capacity you have also to expand on distribution and we are building the warehouses across the Kingdom. We are growing it privately in terms of our network distribution historically and this is what we always do. We own distribution internally. We don't rely on distributors, so we are expanding our distribution network in eastern and western regions. We are supplying the eastern region from here, from UAE, and Riyadh also now we are starting to cover also from the western region, but hopefully soon, as soon as the new acquisition comes up, we will be able to supply the Kingdom from various locations.

Operator
Our next question comes from Nishit Lakhotia, SICO. Please go ahead.

Nishit Lakhotia
Just two questions, one on your beverage market, beverage other than the water side, is there any number you can share in terms of what was the decline in the fruit number in this market, and family, is this the catchment market UAE itself or where else you sell your beverages? That's my first question and the other one is on the grain safety stock contract. What is that exactly that you shared, comparing your like to like impact this year versus last year, and how material was that? Just a bit more clarity on that grain safety stock contract. Thank you.

Tariq Al Wahedi
Let me just answer the second question first. This is because we are part of the Food Security Coalition here in UAE, we were the custodians of the grain custody, and it was saved in our silos. This has shifted from us to another set of silos and to another company now, and this is the change that we were referring to that we have lost. It was there last year and now this year it's not there. The impact of this is about…

Fatih Yeldan
This will be 5-6 million…

Tariq Al Wahedi
For the whole year, yes, so this is the second question. For the first question, the drop in terms of the category itself, there is an attachment by 6-7% cross, because the changing habits in terms of the consumers. We have witnessed that – I mean, as saw... I mean, the consumers are shifting either to cheaper products or they're going for healthier products, so luckily we are into the healthy segment as well and we have the fresh, and we have seen good growth coming to us in Al Ain Fresh range that we have and we just launched actually new SKUs on that, so we have the 200ml and we have the 1-litre now available to our companies of 330 now.

Operator
Our next question comes from Zeeshan Bagwan, Abu Dhabi Capital Group. Please go ahead.

Zeeshan Bagwan
I might have missed... the revenue guidance that you give going into 2020, can you please repeat that?

Tariq Al Wahedi
Sure, our strategy is to hit $1 billion. This is the revenue target that we have set in our strategic document and we were saying that currently with our organic growth we will have a gap of about AED 1 billion that we are planning to cover and include three different pillars; one will be the acquisition in Saudi, one will be the municipal stores and what we call the CSD, the community service stores that we have that will give us a nudge as well in terms of revenue; and the third leg will be the Alfalfa joint venture that we have where we will be participating into the Alfalfa market over here.

Zeeshan Bagwan
Do you see scope for margins also to improve from your current base?

Tariq Al Wahedi
Sorry, can you repeat that, please?

Zeeshan Bagwan
Yes, so do you see your margins, your EBITDA margins, to improve going forward over the next two years from their current base?

Tariq Al Wahedi
Well, as you see, this year you will see that… I mean, year-on-year versus last year we have improved from 33% GP to 34%. We have improved this year and that's mainly because of the continuous cost optimisation that we do and so on, that we continue pushing on, so that will continue and of course it's our effort, it's our aim to continue improving on margins as well.

Operator
Our next question comes from Mirna Maher, EFG Hermes. Please go ahead.

Mirna Maher
I just have another quick question about the municipality agreement if you don't mind. I understand the company was already selling some of its products there previously like flour and animal feed, but in terms of the management agreement that you were outlining, is the company going to be receiving a sort of management fee or a percentage of net income from these stores from the management or sale of items other than items in these locations?

Tariq Al Wahedi
There might be a small revenue that's coming out of the management of these stores, but it's not really the objective. The objective here is two things. One, we have secured a very important channel. That was very crucial to our business for the next coming few years. That's very important and this will allow us growth for our products and refinement, and being very close to where the buying power is in UAE, so we are very close to the local families over here. That's one side. The other side is also to improve the customer experience where everything has gone to digital and convenience, and this is where we want to take this customer experience. From 2008 until today it has been done the classical way, but now we want to capitalise on new technologies on our distribution network that we already have in place, because today we are delivering HOD to most of these families, so we know their houses, we are delivering to them etc, so can we take this to a further step and deliver to tem consumer goods overall. How will this impact us? I mean, this is a new step that we want to get into now. So when we grow and manage these stores…

[All talking]

Mirna Maher
I apologise. I was just going to say, I mean I am not sure if this is a fair statement to make or not, but the bulk of the items or the revenues generated by these stores are not just Agthia items, correct?

Tariq Al Wahedi
95% is coming from Agthia. Yeah, 95% is coming from Agthia. Everything is branded under our name, so very much Agthia stores.

Fatih Yeldan
This is Fatih. I mean, we are not only selling flour and feed there. We are selling actually water. Water is one of the top actually selling SKUs, so we are selling actually all our products, not only flour and feed, and the other items that we are calling trading items, which are the small part of the sales, but actually the big items are water, because if you look at only food part of the business without feed, water is the key one, the big one, so we are already selling these things and we are making revenue and the profit on those items actually.

Tariq Al Wahedi
We have close to 100 SKUs into these stores, by the way.

[No further questions]

Ozgur Serin
Ladies and gentlemen, thank you for joining us again this afternoon. If you have any further follow-up questions, you know how to reach me or Fatih and thanks very much again. Have a good day.