Agthia FY '19 Results Call Transcript

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Corporate Participants

Tariq Al Wahedi
Agthia – Group CEO
Fatih Yeldan
Agthia – Group CFO
Sahar Srour
Agthia – IR Manager

Chairperson

Nada Amin
EFG Hermes – Associate Director / Research

Operator:

Good day and welcome to the Agthia Fourth Quarter 2019 Full Year 2019 Results Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Ms. Nada Amin. Please, go ahead.

Nada Amin:

Thank you, Operator. Hello everyone and thank you for taking the time to dial in to today's call. On behalf of EFG, it's our pleasure to be hosting Agthia's Full Year 2019 Results Conference Call. I'll hand over the call to the company's IR manager, Ms. Sahar Srour. Please, go ahead.

Sahar Srour:

Good afternoon, ladies and gentlemen. Thank you for joining us today in Agthia Group's earnings conference call for the full year of 2019, hosted by Tariq Al Wahedi, Group CEO, and Fatih Yeldan, Group CFO. As usual, Tariq will first talk about the performance highlights during the year after which Fatih will cover the financial results. We will then continue with a Q&A session. For your reference, the relevant presentation is available in the Investors section of the company's website 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.

Presentation

Tariq Al Wahedi:

Good afternoon everyone. Throughout the fiscal year of 2019, the Company thrived to preserve its market-leading position across its core categories, demonstrating endurance to an intensive competitive landscape. Group revenues stood at AED 2.04 billion. This implies a 2 percent growth year on year mainly driven by our international water markets particularly in Saudi Arabia and Kuwait, Food and Flour segments, supported by 5-gallon water in the UAE. Agthia's bottled water portfolio, on the other hand, safeguarded market leadership across UAE in both volume and value share.

Group net profits for the year came in at AED 137 million. Better agri-business profitability, commitment to enhancing efficiencies via cost optimization across the entire organization and Turkey tax credit have been critical in securing 2019 profit.

Let's shed light on our market outreach achievements as we look on the next slide depicting Agthia's market shares across key categories. In a nutshell, Agthia sustains its leadership positions in water, flour, animal feed and tomato paste across Al Ain, Grand Mills and Agrivita brands. In the Water segment, we actively defended our number one rank in the UAE against an overall market earmarked by aggressive promotions and de-growth in the category's volume and value. In KSA, with the installation of the high speed line and expansion in distribution network, we managed to increase our overall market share by 40 percent across the Kingdom and make it to top 3 rank in Jeddah alone. In Kuwait, where operations commenced in September 2018, we successfully grew our volume market share to 3.5%, amongst top 10. In the agri-business, our retail flour managed to conquer number one market position despite a rationalized subsidy environment while we maintained number one in animal feed.

Elaborating more on the bottled water market and key players in the UAE retail environment, the next chart illustrates the volume and value shares of major players for the full year 2019 versus 2018.

Our flagship brand, Al Ain water, maintains its market leadership and reinforces Agthia's overall water portfolio- including Al Bayan and Alpin- record of 29.1 and 26.7 percent volume and value shares, respectively. This is an achievement in the face of UAE bottled water category continual weakening in volume and value; in which overall market size declined by 7.6 percent year on year. Alpin still holds its place as the first imported brand in terms of volume while Al Bayan increased its share in the market versus last year.

Let us check our shipped water volumes across board.

Changing consumer habits came in favor of the recorded growth in shipped volumes of 5-gallons, as we expanded our customer base specifically in homes and in Northern Emirates.

During the same period, we shipped over 76 million cases of bottled water across the UAE, KSA, Turkey and Kuwait. In the UAE, the recorded dip in shipped volumes was in parallel with overall market descent amid aggressive promotional landscape. Alternatively, robust growth momentum in our international operations continued throughout the year. In Saudi, the dual effect of the high-speed bottling line installation and the distribution network expansion all the way to Riyadh, resulted in 50 percent year on year surge in bottled water shipments. Similarly, our operations in Kuwait outperformed our internal targets on faster execution and wider market penetration.

Under the consumer business, Food segment emerges as an inevitably positive contributor to our P&L. In 2019, Food registered net revenues of AED 248 million, up 23 percent versus 2018 mainly driven by trading items and success in our Egyptian operations.

Under our Community Support Division, trading items recorded 61 percent y-o-y growth in its top-line on account of new SKUs and now constitute more than 52 percent of the Food revenues. In TP/FV, Egypt revenues were up 4 percent in AED terms despite 7 percent revaluation of EGP against AED. Meanwhile, in both Dairy and Bakery businesses, we succeeded in lowering incurred losses despite slowed-down progress in sales in line with lower overall sales environment.

Finally, on the Agri business..

Flour segment outperformed in 2019 despite pulled out subsidy environment, recording 12 percent y-o-y top-line growth on robust escalation in each of export sales, retail penetration specifically in the Northern region and wheat trading. We reiterate our team's effort in conquering number one market position in B2C channel despite pulled out subsidy environment. On the profit side, excluding the impact of the full withdrawal of the remaining subsidy in Bakeries, margins would have improved this year.

Similarly, Animal Feed recorded enhanced profitability on favorable channel mix despite lower segment sales given the drop in grain trading and the decline in market size of the small-sized farms channel.

I will now pass the line to Fatih for the financial review. Thank you.

Fatih Yeldan:

Good afternoon everyone.

In 2019, Group revenues stood at AED 2.04 billion, representing 2 percent y-o-y growth. Net revenue contribution by the consumer-business – Water & Beverage and Food – rose to 56 percent whereas the agri-business – Flour and Animal Feed – generated the remaining 44 percent of the Group’s top-line.

Water & Beverage revenues reached AED 0.9 billion as the international markets along with the 5-gallon Home & Office Delivery (HOD) business in the UAE largely offset the slip in the bottled water category in home market. Our 5-gallon business in the UAE increased their revenues by 5.4 percent on higher shipped volumes. Additionally, our international markets (KSA, Kuwait and Turkey) revenues recorded 43.2 percent growth as we successfully expanded our market share in both- the Kingdom and Kuwait. Digging deeper in the UAE, changing consumer habits came in favor of the recorded growth in shipped volumes of 5-gallons yet added pressure on bottled water category. Net revenues of Food segment, on the other hand, rose by 23 percent y-o-y largely driven by ‘trading items’ and Egypt as previously mentioned by Tariq.

Agri-Business revenues stood at AED 892 million in 2019. Flour revenues of AED 415 million recorded 12 percent y-o-y growth on higher domestic and exported volume and wheat sales. Animal Feed revenues of AED 477 million fell short of last year on reduced volume due to lower grain sales and lessened demand from small-sized farms.

Moving on to the next slide where we show Group gross profit margin.

2019 Gross margin came in at 32.2 percent versus 34.3 percent in 2018. Drop in margin was largely triggered by full flour subsidy withdrawal in the Bakery channel followed by lower bottled water pricing in the UAE which in turn was largely offset by improved gross margins in international businesses and animal feed.

Throughout the year, we succedded in enhancing our gross margins quarter by quarter up to 32.9 percent in the Q4, largely driven by the favourable mix in Animal Feed and better recorded margins in water and flour.

Moving on to Net profits..

Group net profit stood at AED 137 million. Profit shortfall is mostly coming from the full flour subsidy removal from bakeries and the decline of UAE Bottled Water market which in its turn impacted the overall industry. Other factors, including the bad debt provisioning and higher grain prices, were fully eliminated by our continuous cost optimization efforts.

This is further explained on the next slide where we are showing two waterfalls that explain top-line and bottom-line reconciliation between last year and this year.

Starting with revenues, AED 19 million from Kuwait plus AED 9 million higher Agri-pricing along with the robust growth momentum across our Food segment, KSA operations and 5-gallon water business have more than countered the AED 44 million lost revenues against lower UAE bottled water volume and value, shadowing the overall category performance during the year.

In addition to the resulting impact of the above items on profits, we highlight 4 more factors. We recorded AED 41 million of cost savings and a one off AED 5 million tax incentive from our Turkey subsidiary; both of which marginally offset the flour subsidy withdrawal and bad debt provisioning.

With this, we conclude today's prepared remarks. The floor is now open for questions. Thank you.

Question and Answer Session

Operator:

Thank you. Ladies and gentlemen, if you would like to ask a question, please speak now by pressing star one on your telephone keypad. If you are using a speaker phone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, please press star one to ask a question. We will pause for just a moment to allow everyone an opportunity to signal for questions.

Our first question today comes from Nishit Lakhotia of Sico. Please go ahead.

Nishit Lakhotia:

Hi, thank you so much for the call. I have a few questions on the performance, first on the bottle market in UAE in particular. We've seen a lot of stress and pressure on the performance of the company because of this segment, especially in terms of the profitability, and we've seen the entire water and beverage segment profitability fall considerably in 4Q. So, what exactly is the situation currently? Is Agthia giving aggressive discounts to defend their market share from the other brands like Mai Dubai, Masafi? So, we need to know exactly how the situation currently in UAE, and a bit more color on the bad debts which is, which has spiked in this year, particularly in 4Q. What exactly is this about and what should we expect going forward for this particular category of bottled water in UAE, in 2020?

And, following on this itself, how do you see 2020 developing now given the situation with the coronavirus and a lot of events being cancelled and 1Q being almost like a standstill in UAE with no real tourism in all for given the restrictions and caution by all the travelers? So, how do you see this 2020 playing out, and how are you preparing for Expo 2020 event, and what's your outlook going forward? And any guidance that you would like to share on the overall business for this year, for the key financial metrics? Thank you

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Tariq Al Wahedi:

Let me start with the stress in performance of the water category in UAE in particular. So, yes, of course, I mean the promo index continued to grow for the year of 2019, as we have highlighted in each quarter; that was an increasing competitive pricing that was going in the market. We have – we continue to grow our market share, I mean versus the map at the beginning of the year of 2019. We continued, we closed the year with a higher market share than what we started with. However, it was at a lower average selling price because of the more competitive environment.

However, if you look at our value, our value in value index, we have grown a little bit on our value share. And if you would consider how the drop in other companies versus Al Ain, you would see that Al Ain was one among the lowest that has dropped. So, going back to your question, no, we did not really discount, and we are not driving the discount in the market, but we are maintaining and protecting our market share very well, and this is part of our strategy. It's not our strategy to drive market equity, sorry, market share through only pricing, but we do it also through brand equity, which we have, we are pumping all over the city basically, or all over the country. But at the same time, it's very important also that we, with the current situation where the consumer is also price-sensitive as well, we have to be not far off from the market as well. So, definitely there is an impact, and there is some, lots of discounting that is happening in the market, but we are preserving our market share very well. The same applies to other items as well, for example flour.

Going back to your second point on bad debt, I think this year in particular the bad, or the – I wouldn't, I mean I wouldn't yet call it a 'bad debt', but it's a provision that we had due to the IFRS rules; and according to the auditors, we had to capture certain payments that were not captured on time, to have the provision for those. Those are mainly in Saudi Arabia, I mean with the growth that we had in Saudi Arabia, where we have expanded way above our last year numbers. It's naturally expected – The payment cycle in Saudi is a little bit slower than what it is in UAE, so based on our auditors, we have captured certain provision there for the – for our profit. As far as 2020 outlook with corona; yes, it's dynamically changing. Every day we have a new bit of news. So far, from our side, our sales have not been affected actually. It might be a little bit on the higher side. So, this is what we are noticing now. There are changes that are happening, in terms of habits of the consumer, but we are definitely on top of it. We have full home delivery system, we have our e-commerce system, we have our – maintaining our store availability as well and there, we're maintaining our stocks, we're maintaining our inventory really well. And we are not seeing any impact in terms of sales numbers, in terms of panic or anything.

As far as the Expo outlook, so far, I mean we had our plan for the Expo 2020, going forward. However, due to the current circumstance of corona, we don't know how that will evolve going forward. Inshallah, we're hoping that things will get better within a month or so, and this whole situation will be much better. So, going forward, actual 2020 will be caught on time, and the tourism won't be affected as well.

Nishit Lakhotia:

Okay, thank you. But just to follow up, Tariq, on the first two questions on the bottled water market and the bad debt. You mentioned it's mainly coming from Saudi Arabia. Now, we expect Saudi Arabia business to grow in the coming years as well, so should we expect this bad debts provision because of IFRS to become, you know, to grow along with it, or you expect improvement in the payment cycle in Saudi Arabia? So, that's my first question. And in terms of the net margins for bottled water, water and beverages category, it fell to almost 1% in 4Q, so it used to be between 10-12% for the year in 2019, and it used to be between 17- 18% in 2018. So, if net margin is going on a downward trend, what can we expect going forward on the margins for this important category?

Tariq Al Wahedi:

As far as the margins, as I said, I mean if promo index continues to grow this way of course, definitely the bottom line will be affected eventually. Our GPs are slightly less this year, but we still are enjoying good GP in the business. Profitability, definitely, I mean, yes. has been affected slightly, but going back to your first question in terms of the Saudi provisions that we had... As I said, we are expanding our business in Saudi. It was in lower scale; we had grown double-digit in that. And it's expected that as you grow, that you – The Saudi market payment cycle is different than UAE; it's not exactly the same. Now, of course, we are trying to stress our payment cycles, etc., but I think it's more of a macro thing rather than a Agthia thing, you know, in particular.

However, so now going forward in 2020, definitely we will continue to grow our business and expand our Saudi business. We would expect, of course, different payment cycles, I mean in Saudi, but definitely we will stress having, collecting, our payments to avoid any provisions for as we go forward.

Fatih Yeldan:

I mean, on the profit for the water and beverage, you're right; on the Q4 obviously becomes almost like nothing because of the fact that the provisioning is in Q4. So, that impacts the Saudi provision, impacts the water and beverage total category profitability. When you don't have that, you will see that you will actually end up with a net profit of still 11-12%, so the impact just coming from basically the provisioning in the quarter four for water and beverage. If you look at Q1, Q2, they were about 12-13%, then summer is lower normally, Q3 like 10, and now that 0.6 in Q4, but if you add back the impact of the provisioning, you will come to about 12%. So, that's normally what we have for the profitability and the provisioning. You know, when there are delays in the payments, and it comes with a certain number of days' delay, so basically according to the international financial reporting standards, we need to provide. So, in 2020, if the collections start getting better, then, obviously, provisioning can go plus-minus, but what we have done, obviously, whatever has to be done based on the IFRS, and so not to have any later on issues on that. So, basically it has been booked in Q4 because most of the payments were on Q3 and Q4 beginning, you know. So, we had to wait for the booking, and we waited and we booked in December.

Operator:

Ladies and gentlemen, as a reminder, please press star one on your telephone keypad to ask a question. We now have a question from Divye Arora of Daman Investments. Please go ahead.

Divye Arora:

Hi, my question is on Saudi. So, what is the strategy that you have right now for Saudi given the low oil price environment that we have started to see? So, you are looking pretty, you will, you were trying to be more aggressive in the past – to be more into the central region and even to, you know, cover the whole Saudi in terms of the water business. So, would you be maintaining the same strategy? And also, you were looking to do acquisition in Saudi in the past, so how far are you on that? And there is also a plan there if things don't – if acquisition doesn't work out, then you will go more organically and probably set up new factories in Riyadh and all. So, what are your plans on that given the current environment, given the coronavirus situation, right now. Thank you

Tariq Al Wahedi:

First of all, thank you for highlighting the new oil prices, the big dip that we all saw today. But, I can assure you that people will still continue to eat and drink, thank God. So, definitely for us Saudi is still high in our priority in terms of growth and expansion, and we've seen the results that we have achieved in 2019 with double-digit growth versus what we have achieved in UAE, for example. I mean, definitely, it's an open space for us where we could grow and expand. As far as our strategy, what we have done – I mean 2019, we have ramped up our production line over there that we have built organically, and we started and we continued building our network of distribution with a target to cover the western region and the central region mainly. And we continued to do this organically. And in the meantime, we are looking at targets to acquire in different areas across the Kingdom. We are just being selective in terms of which target should we pick, and what does it bring with it, in terms of how valuable the asset is and how it's going to help the Agthia story, basically.

As far as the corona impact over there, I mean it's going across the region. And what we are seeing in UAE, I'm sure we're facing the same thing in Saudi. Our sales numbers are very healthy as we see in the last, in this month and last month. We don't see any issue or concern so far. We are building our contingency plans. Of course, we have our business contingency plans et cetera and so on, there to manage the business. But sales so far are, everything is fine.

There is no issue.

Divye Arora:

Just a follow-up on UAE. So, what percentage of your sales are to the – let's say to the hotels and all? Because obviously, what we have seen in the UAE is that the occupancies have dropped significantly in Feb; it was down like 20% year on year. I'm sure margin was between maybe 40-50% down in this environment. So, you know, why are you not seeing an impact in UAE, so it's very hard to believe.

Tariq Al Wahedi:

Yeah, considering that Horeca, specifically in Horeca, the hotel sector, I mean the tourism sector, is almost, like, 10 – 7-10%. Not total for Horeca, because Horeca has government sector, but if you look only at the hotels, less than 10%. So, the total sector of hotels contribute our sales of less than 10% basically. In UAE alone. So, the rest of the market is totally healthy. Retail is fine, e-commerce is picking up, home delivery is really doing marvelously fine. So far, we didn't face any issue with sales.

Divye Arora:

Typically, tourists will go and they will pick up water bottles from the grocery stores, from the small retailers, you know. So, everybody should be seeing that impact in general. Not only in the hotels, but outside also that impact should be visible to you guys when you're delivering on a weekly basis to them. Are they not reducing the number – amount of deliveries that they used to take from you in the-

Tariq Al Wahedi:

No, no. Our numbers are very healthy. We're doing very, very well. We are not facing an issue.

Divye Arora:

Right, right. And have you seen any, you know, with the hospitality channels, with the volumes being down in general, have you seen any price competition there as of now, or it's too early for that.

Tariq Al Wahedi:

Price competition is always there. It is always happening. We just renewed them, many, several contracts, I mean now recently, and this is typical competition that we normally see. Nothing extraordinary happening. I'm not sure what kinds of stories you're hearing, but for us, so far, it's really very much... Yes, I mean there are issues, etc., restrictions and so on, but when it comes to the basics of food, I mean everything is as is. We didn't really notice any impact so far.

Operator:

Ladies and gentlemen, as a reminder, to ask a question, please press star one on your telephone keypad. We will now take a question from Ali Nasser of Vergent Asset Management. Please go ahead.

Ali Nasser:

Hello everyone, thank you for the opportunity. I have, hopefully, just three questions. As far as the trends you highlight with regards to consumer preferences shifting towards the five gallon and the home delivery, what is driving that firstly? And two, how are you reacting in terms of the strategy to that change? So, that's the first question.

Tariq Al Wahedi:

As far as home delivery, of course, our business in HOD continues to grow. We noticed a small shift that happened last year in UAE where people moved from PET to HOD, where HOD was growing but PET total category in UAE has shrunk by 7%. So, we noticed a total category reduction in the UAE. Now, we are among the strongest companies. I think we rank probably between number one and two for home delivery, and we continue to grow also in this year. We've taken it beyond only the five-gallon, but now we are starting to deliver beyond that as well. We're delivering in the other categories that we're selling now. And we've noticed lots of activities happening specifically from our consumer, the CSD stores that we have, where the activity of home delivery has picked up, especially in this, within this corona effect that's started to increase, we've noticed more than double-digit numbers in growth of home delivery, basically. So, we have the backbone. We are considered today, in Amazon, brand number one, selling in amazon.ae. We are the number-one brand that sells in home deliveries, more than anything else, not only in food and beverage, but more than anything else in terms of volume. So, it's picking up really nicely. We are doing very, very well with all the e-commerce businesses, as well as we have our own particular channel.

Ali Nasser:

And Tariq, just in terms of – The first part of the question is, what's driving that change from PET to HOD? Is that environmental, is that convenience, a combination? What's – why is the consumer making that kind of-

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Tariq Al Wahedi:

We believe there is a big element of sustainability that has been there. This is the belief that we have. I don't know if people are doing it for cost-saving because five gallons, the price per liter is slightly cheaper than PET. That's a possibility, but I don't – I doubt it very much. I think it's driven by sustainability. But having said that, I think it's worth mentioning to our better colleagues over here. The launch that we just had in Gulfood where we have produced the first plant-based bottle in the Middle East. And it's a bottle that is being produced from sugar, that is totally combustible, and it's picking up really, really nicely. And specifically going back to the Horeca, or hotels, we are having immense, immense interest stemming from this particular product, from the total Horeca chain.

The product has been launched only for the B2B channel. We didn't open it for the B2C, but so far it has been received really, really well. And this is – it came after the pledge that we have made to our consumer and to our investors a couple of years ago, where we have declared our five-year strategy for sustainability. And in 2019-18, we have opened our first R&N packaging center. And this bottle that we've launched in Gulfood, this Gulfood, was the first outcome from that. And part of the announcement that happened in Gulfood as well, we have signed a major agreement with Veolia, which is a waste management company, for the collection of these bottles. And at the same time, we have announced also the establishment of the first Gulf bottling water association as well, which we are cheering and we are leading for the region, in terms of all the Gulf bottling water associations.

So, the idea is really to spread the concept of sustainability. And with the information and knowhow and practice that we gained, we want to use the association as a platform for knowledge sharing, basically

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Ali Nasser:

That's great. I just wanted to ask – You mentioned the brand is number one on Amazon. But in terms of percentage of sales, what percentage of sales in the HOD comes from your platform versus third-party platforms, and is there a margin differential between the two? And who takes care of the fulfilment?

Tariq Al Wahedi:

Yeah, as far as – HOD doesn't go through Amazon. Mostly it's our PET business and our other categories. HOD still goes through our app and through our customer service, so they are totally two separate channels, okay? And as far as Amazon's percentage of our sales, it's still, of course it's low, but I'm happy to say it's more than doubling. I mean, year on year, it's more than doubling. It's growing really rapidly.

Ali Nasser:

So, interesting, what you're saying is HOD is all through Agthia, whereas the bottled water, the PET business, is a combination of Agthia and Amazon et cetera?

Tariq Al Wahedi:

Yes. Amazon, Carrefour... Yes, absolutely. you asked me about the fulfilment. We do have a fulfilment center in Jebel Ali where we are doing our own fulfilment as well as we are doing the fulfilments for Amazon, for InstaShop, for Carrefour, for all these companies we are – we have a center for fulfilment that we are catering for them

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Ali Nasser:

Very clear, very clear. That's first question. On the second one, with regards to Saudi. Where are you now in terms of – if you take out the provision for a second – on a GP and EBIT margin basis, how does Saudi look today?

Fatih Yeldan:

Yeah, I mean, Ali, you know, the provisioning obviously will not impact the gross margin. So, gross margin, it's about, like, mid-thirties, between mid-thirties and around 35-36%. So, that's quite okay. Obviously, not yet like UAE level. When it comes to your other question, and if there was no provisioning, right, if there was no provisioning in the year, so the EBITDA margin will come to about 11-12%. Now water in UAE will be about – for 2019, it will be about 14-15% EBITDA margin.

Ali Nasser:

Okay, okay. And the last question is just on the... Just on the provision itself. It's... I understand where the growth is, you know, you're required to kind of push, but just in terms of points of sale today, and are you growing in a channel – I understand that Saudi generally doesn't pay on time, but do you feel that in order to grow your share, you're pushing the product to, maybe lower quality credit? Is that something that you're happy doing for the time being to build the brand equity, or is it just a purely macro thing as far as Saudi is concerned?

Tariq Al Wahedi:

We believe that we – I mean we have a strategy for the growth into the multiple channels, because if you see, I mean, now we have, we just signed up with Al Othaim and with Panda for expansion and distribution. And this was a major step for us, really, to take and to commit, I mean, for the deliveries and into these particular two channels. So, we are trying to focus where the brand – I mean we're trying to maintain what the equity of the brand should be. So, we are trying to avoid any place where things do not show – I mean go to credible channels.

But let me just highlight, there is majority of sales that happen in Saudi that is associated with hajj. And with hajj, as you know, this is very much seasonal thing. And normally these companies that work with hajj and umrah, I mean, their payments are very, very much associated with a particular season. So, a portion of those sales went to that particular channel. And this is why these normally are associated with some payments from different associations, etc., and so on, so that there was this particular delay. And then there was the overall slowdown in Saudi Arabia as well that you could see. So, all these accumulated in terms of what the auditor saw, I mean it's a requirement for a provision product to have.

Ali Nasser:

Perfect. Just on Al Othaim and Panda is that nationwide, or is that just currently in the western region?

Tariq Al Wahedi:

The agreement is nationwide, but we are going store by store, and we are setting up distribution centers to cater for different areas. We just opened our latest Al Qassim distribution center to cater for the shops in Al Qassim, for example. So, this is part of our expansion to cover the total Saudi Kingdom.

Ali Nasser:

Okay, excellent. My last one is this, on the subsidies. Because every year there seems to be one subsidy, so I'll just – maybe if we step back, what's left today? For example, you highlighted, in the conference call, the flour subsidy impact of 32 million on net profit. Do you expect that to repeat next year, or is this a one-off? And are there other types of withdrawals that we should expect?

Fatih Yeldan:

Ali, basically when subsidy rationalization program announced, almost like four years back. This, what happened in 2019 January, for flour, it was already there, you know, if you remember we're always mentioning about it. That remaining 50% bakery channel subsidy removed 1st January 2019, and we knew that. And as you said, impact was 32 million, around 32 million. Now, in flour, only subsidy remaining is on the sales we do to the municipality, to the – basically municipality outlets where only locals can buy. And this is quite limited sales, you know, is about 6-7% of our total flour volume. And around AED 15 million subsidy, which we have in that. So, that's the only subsidy remaining. But this was not part of the subsidy rationalization program which has been announced four years back. So, basically, that is remaining until any other new thing comes. But there is nothing about that in the letter we received four years back. Now, when it comes to feed, again feed actually change happens in one go, right? When it has been announced the rationalization. Whatever has to be changed, it changes up immediately in feed, four years back. And the change was that instead of all being subsidized, only commercial farms will be subsidized. And commercial farm business was, for us, like one-third of our business kind of thing. And that part remained subsidized.

And again, there was no other step in the announcement at that time, that it will be reduced, it will be taken away or something. So, whatever had done, still remaining, and depending on the volume of subsidy amount changes, but that's about, roughly about 90, 100 million kind of an amount on the commercial farms, because mostly commercial farms sales is poultry, and the prices, the subsidized prices, are below cost. So, obviously, accordingly, we have to be subsidized. So, nothing left from the original announcement, let me say. So, whatever left, accordingly, four years back, that's what we have, and nothing to do in 2020, you know, from that kind of letter we received. But again, if something changes, you know, government takes a decision or whatever, for this remaining two, that's a different story obviously. But nothing that we are aware of or we are informed of or we are given letter or something, four years back.

Operator:

We will now take a question from Raj Sinha of HSBC. Please go ahead.

Raj Sinha:

Hi, good afternoon gentlemen. Just a few questions. The first on your balance sheet. It's quite strong. And so, I was just wondering to what extent you might think about returning more cash to shareholders.

And then the second question is around the plant-based manufacturing that you have talked about. So, just firstly to understand, is that something that you had brought in-house? Secondly, your press releases have mentioned the challenges of distributing this to the consumer segment; and I was just wondering how long would it be for you – how long would it take to get over these challenges, if at all, if at all it's possible. And then, on that again, what is the cost differential in using plant-based ingredients versus the PET?

Tariq Al Wahedi:

Sure. First of all, regarding our balance sheets, thank you so much. The intention of course of gearing up a strong balance sheet is to fuel up our growth plans. And this is what we've been declaring that we are gearing up our growth plans for further acquisitions to happen, because we have a very clear strategy for growth and M&As. As far as the second point that you highlighted in terms of the plant base, definitely the raw material is higher in cost versus the regular PET. So far, from what we've seen from the customer, they are willing to pay a little bit extra for that, because of the immense sustainability pressure on all of us. However, of course this cost differential definitely equates as you produce massively. So, economy of scale also plays a role into this, whether from our side or from the upstream, I mean from the manufacturers of the material of the plant base as well. Today, there are very limited plants that can produce this particular raw material, and it is still at very, very early stages now of development.

I think the success that we had is we were able to do two things. Number one, we were able to use this raw material in our high-speed lines, which is something that is one of, among the first few companies in the world that did this. And then the second point is, also we are able to accommodate the raw material to be suitable for the environment over here. We are among few places in the world that has fifty-degrees-plus temperature in summer time, and this impacts the shelf life of this particular plastic. I'm happy to say that we have successfully managed them and to produce that. And this is a very unique position that we have now. None of the companies in the Middle East do have that. So, hopefully we're going to benefit from this, from the sustainability point of view, leading by example for the companies in the region over here, and also getting a competitive advantage also among our, for the consumer as well. There are no exclusivities around it. It's a know-how experience that we have built over here. we are the first to bring the technology in the Middle East, yes. It's not our technology; it's something that we've taken from upstream manufacturers and that we have adopted for the region. But I'm trying to say that the region is very unique over here. The types of temperature that – First of all, water is very unique in terms of using this particular material, with water is very unique. The second point also to expose the bottle to temperatures like what we have here in the region is also very, very unique as well. And this is what differentiates us among other manufacturers in the world, basically.

Operator:

We'll now take a follow-up question from Divye Arora from Daman Investments. Please, go ahead, your line is open.

Divye Arora:

So, to understand more on the net profit bridge that you have provided. What is this other 30 million hit which you have shown over there? What is that linked to?

Fatih Yeldan:

That's mostly increases in overheads coming from different places, so in general, overall overheads, inflationary or utilities, but it's mostly coming from all, everything. Not like one specific stuff.

Divye Arora:

Okay. And in your business, what is the total – In the overall cost, what would be the utility cost? Energy and utility cost.

Fatih Yeldan:

In total cost, I mean it depends on the categories, because agribusiness is very high grain, so it is very weighted on the grain, so that's why generally any other cost becomes quite small within the total cost of the agribusiness. When it comes to the consumer categories, in consumer business you will see about, roughly about 4%. In agribusiness Within the cost it is almost like one, 1-1.5% kind of thing. Because it's mostly grain.

Divye Arora:

And we have seen, that your receivables obviously have been receivable days have been increasing continuously from last few years. So, you're now going further in Saudi where the receivable payments are stressed. So, it would be fair to assume that, right? This receivable days would probably continue to push higher from here? From the existing levels?

Fatih Yeldan:

I mean the sales of Saudi in total group sales still is not that significant, right? So, this year, because of this long payment and the things we discussed already, it impacted, but not in only Saudi. In general, the market, I mean, you guys, you are talking with so many companies. I'm sure you know probably better than us that the payments of the customers are quite slow, right? I mean, it happens in all the sectors. So, it overall impacts the total collection date. That's what we have. We have seen about actually roughly about ten days' change in our overall Agthia Group collection days, which is, I will say, probably not bad compared to what we know from the companies, what we know from the banks. So, Saudi is still small part of our business. Now we are in the middle of a lot of things. If I tell you 2020, it will be this and that. If anyone can tell you today, especially today, you know, the financial markets are crashing, many other issues, you know. Frankly speaking, I think I will only lie if I say something. I don't know. If anybody knows, let's ask him, because nobody knows today if it will be tomorrow better or not. So, collection, you know – If you forget about any other issues, you are right. Collection day is because of Saudi or something should not be growing further, you know. UAE as well. But there are lots of other issues now. So, let's see how it will go. But we are not extending extra credit... We are not extending. Is not like we are extending. We are always selling with what we have, but, obviously, liquidity in the market probably was not great, and tomorrow I don't know how it will be.

Divye Arora:

What is your exposure, let's say of your overall revenue, to the government? Agribusiness, or the water business; what is your exposure to the government, and what is the payment cycle, when you compare government versus the, let's say, the retailers, wholesalers and general?

Fatih Yeldan:

Our government sales, you know, we are selling through municipalities and the feed, and all these things, if you put together we are about plus 20%, but we don't have any problem with the government collections. So, yes, sometimes they have delays because of signature, because of this and that, but those are generally couple of weeks of delays. So, no major issue there. And payment terms also are competitive; it's not like extra payment terms that we are giving. So, it's not an issue sector for us. You know, issue sector, obviously, all the rest, private businesses that you will see, and everybody has collection from their customers, and then you, it comes to you as well. But government channel actually probably is the best one for us.

Divye Arora:

Do you think the receivables that we see around 85 days right now, that's not linked to the government? Government pays in two weeks?

Fatih Yeldan:

No, no, no. They don't pay in two weeks, obviously. They are paying also like 60 days, around 60-75 days, collect. Pretty much what you see in overall. What I'm saying is not a reason of, you know, going from 75 to 80 or something, is not because of government or something.

Divye Arora:

So, now, obviously, we're going to probably – Assuming that we're going to face a low oil environment. So, in this environment, there could be a risk of delayed payment from the government. Did you see any issues in 2015-2016, when the oil hit $30, you know, 16 or 17?

Fatih Yeldan:

No

Divye Arora:

Were there any payment issues that you faced from the government?

Fatih Yeldan:

No. And now, I mean, most of this now, the stores, also is under our management so it is actually better.

Tariq Al Wahedi:

I mean the stores that Fatih just mentioned, they come under our management and we collect the cash from the consumer directly. But it goes into the treasury of the government, then they get it, they pay it back to us, basically. We are managing the store front end and back end, it's just the management of payment. So, the exposure actually to government, I think it's very small, I mean, that we're having. And, yeah, in the past we never faced any issue with that, to be honest.

Divye Arora:

And the bad debt provision that you took this year was 27 million. So, what can we assume on the recurring basis? You said because of the accounting issues and all, you know you had to take a big one-off provision. But then going forward, what should we assume, every year?

Fatih Yeldan:

Recurring, generally we are having actually not more than 4-5 million. And again, this year, out of that 27, is about 4 million is, let's say, recurring, right? So, that was basically it is. Now, as I said, now for this year, anybody's guess, depending on all the things. Now is that today, you are asking this question, very difficult to answer. I don't know this market, what will be, what the world will be. I think after few days, few weeks maybe we understand better. But normally, normally, correct, if everything else we forget, you will not have more than, you know, 4- 5 million, 6 million, which is very, very small if you think about 2 billion sales we have. So, we had actually great performance on the bad debt. So, that was never going above that number, although we have thousands of customers, 2 billion sales, correct, we never had an issue. Saudi, yeah, growing, different canal, channel, different this, so we are experiencing, but it has been mentioned in the call as well, from your friends as well, that saying, generally, in Saudi, what we understand, certain channels, payment terms or collection, let's say, not terms, but collection is really, really very, very slow. We are also hearing the same from the credit bureaus in UAE. It takes a lot of time; they pay but it takes a lot of time. But you know, the international financial reporting standards, they don't understand this. We need to book it. So, I cannot say I will take it after twelve months. Maybe I will take it, yes, but according to the, I will say, accounting rules, I have to book it. So, like, I will not get it. Or I will not get all of it, or I will, you know – there is a very complicated calculation behind. So, that's what has been done. But recurring, normally, as I said, not for more than 4-5 million so far, and you can see actually in the past year financial performance and financial statements, you will see similar numbers.

Divye Arora:

And also, have you written off anything? Any receivables in Saudi, or this is just?

Fatih Yeldan:

No, no, no. We didn't write off anything because there is no one – No, I mean actually there is not like anyone escaped or something, so there is nothing to write off. And even legal cases are only few. So, we had to provide because of the accounting rules, and we provided. So, we will see how later 2020 collection will go from these customers, correct? So, again, generally, they say it takes some time, 12-18 months to collect because their collection is linked to certain places as well, because of the seasonal sales. We will, I think, experience this, this was for us first for certain channels, so we will see if this becomes true for us as well, because most of the sales, as an end of the year, we were talking about six months, seven months maybe, time passed. So, we don't see yet this 12-18 months part, right? So, I think we will leave and see how it will go for these customers. Customers are there, they are in the business, so that's the kind of a good part of it. So, there is no written-off anything, basically, just provisions.

Divye Arora:

And you were saying there were a few legal cases, you know. What are the total claims? What is the size of that? So, legal cases mean, obviously, somebody has not paid you, and then you have, you know file a case against them, right? That's what you're saying

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Tariq Al Wahedi:

All of them not paid, right? That's why you are putting a bad debt provision. Why I will put bad debt provision? Because you have customers which not paid, right? And if any of them, you know, you don't see him any more, or close the shop or something, or some other stuff, you can open the legal case, right? So – But legal case part is much smaller than the bad debt provisioning, that's what I'm saying. Because governments are there; they're in the business.

Divye Arora:

All right. And I remember last time, you know, in the third quarter conference call, you told us that Saudi margins, Saudi EBITDA margins are around 16%, and UAE EBITDA margins are around 20%. Now, you just said that Saudi EBITDA margins are 12% and UAE EBITDA margins are 14%. How come it changed so much versus what you told us in the third quarter conference call?

Fatih Yeldan:

I don't really remember third quarter, whether I said like this, but these are the numbers. I mean, maybe if Q4 or the bad debt provisioning etc. may obviously impact the things, but. I don't remember it. If you have anything, you can send us, we can tell you exactly what kind of number it is.

Divye Arora:

And what is – Can I ask you, what is the decline in the UAE EBITDA margin in 2018 versus 2019? UAE EBITDA margin in the water business.

Fatih Yeldan:

So, basically, the decline in the water, right? So, the water category declined, obviously, it fits almost all of it to the bottom line, because both pricing and the volume almost comes, you know, bottom line, impacting the bottom line, because the profit margin on the water, correct, or gross profit... gross margin on the water including the fixed almost like 70%. So, when you lose the volume, the market declines, and the pricing, both of them, comes to the bottom. So, you can say most of it is the UAE water market decline.

Divye Arora:

And this last thing on Saudi. The Saudi, I think you are now close to 80% utilized. So, in 2020, if the acquisitions they don't work out, let's say, so how much growth can we see in Saudi further, based on your existing capacity? There can be, let's say, you can have 90% utilization, not beyond that, right?

Tariq Al Wahedi:

Normally, we operate at 90% utilization, but we also have – in case we are running short of capacities, we have options to co-pack, always. So, we always have that option to get an immediate inventory once needed.

Divye Arora:

So, we can expect you to reach 90% utilization by this year, by end of this year, in Saudi?

Tariq Al Wahedi:

Yeah, that's the plan. That's within the plan, yes.

Operator:

There are no further questions over the phone at this time. I would like to turn the conference back over to our hosts for any additional or closing remarks.

Sahar Srour:

Thank you all again for joining. If you have any further questions, please don’t hesitate to contact me. Thank you.

Operator:

Ladies and gentlemen, this concludes today’s call. Thank you for your participation. You may now disconnect.