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Agthia Q2 '20 Results Call Transcript

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Corporate Participants

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Agthia – Group CEO
Ammar Al Ghoul
Agthia – Group CFO
Sahar Srour
Agthia – IR Manager

Chairperson

Nada Amin
EFG Hermes – Associate Director / Research

Nada Amin: Hello, everyone. My name is Nada Amin. I am part of EFG Hermes’ consumer and retail team. It’s our pleasure to be hosting Agthia’s first half 2020 results conference call. The management will begin with a presentation and then we’ll open the floor to Q&A. I will hand over the line to Miss Sahar. Please go ahead.

Sahar Srour: Thank you, Nada. Good afternoon, ladies and gentlemen. Thank you for joining us today in Agthia Group’s earnings conference call for the first half of 2020, hosted by Alan Smith, Group CEO, and Ammar Al Ghoul, Group CFO. On behalf of all of us at Agthia, we wish you are keeping well and safe.

Alan will first talk about the performance highlights during the period after which Ammar 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, Alan.

Alan Smith: Good afternoon everyone.

In the first half of 2020, Agthia Group demonstrated resilience and agility in dealing with the uncertainty imposed by the COVID-19 pandemic and its influence on the operational environment across our markets. Enforcement of lockdowns and movement restrictions caused business disruptions, logistics transformation and changed consumer demand patterns. In response, we reprioritized our resource allocation across our flexible supply chain to ensure business continuity and products availability at appropriate cost. We increased stocks of essential F&B products, accelerated our e-commerce presence and doubled the number of delivery trucks for home delivery service to cater for the consumer needs and support the community while adhering to the highest standards of quality and safety. We continued to stand by the consumer trust and loyalty in our brands. This has been proven by (i) a sustainable leading market position across core categories despite headwinds, coupled with (ii) Al Ain Water, our flagship brand, ranking number one most chosen beverage brand in the UAE and number six most chosen FMCG brand in the overall UAE market as per Kantar’s Brand Footprint Ranking 2020.

In the first half of 2020, the Group generated AED 1.09 billion revenues. This implies a 2.6 percent growth year on year largely driven by our Flour, Food and 5-gallon water segments. Group net profits came in at AED 42 million.

Moving on to the following slide, let us look at the bottled water market and key players in the UAE retail environment.

The 2 charts depict the volume and value shares of major players for the last 12 months ending May 2020 versus 2019. Agthia’s portfolio—Al Ain Water, Al Bayan, and Alpin— preserved a leading market position in the retail channel with respective volume and value shares at 29.1 and 26.1 percent. Our flagship brand, Al Ain water continues to defend number one ranking in the UAE despite an aggressive competitive landscape.

Let us check our sold water volumes across board.

Our 5-gallon water business in the UAE recorded strong growth in volumes and sales on higher demand particularly from homes and retail channels which overcompensated headwinds in the corporates channel.

During the same period, we sold over 35 million cases of bottled water across the UAE, KSA, Turkey and Kuwait. In the UAE, the descent in volume largely came in as a result of lower consumption from restrained tourism and COVID-19 impact on the food service channel.

In Kuwait, operations continued to perform well, whereas in KSA, sales were largely hit by the enforced short-term reality of void religious tourism and elevated movement restrictions in the Western region while reflecting on our adopted strategy of improving quality of credit sales.

Moving on to the next slide..

Under the consumer business, Food segment is inevitably a positive and growing contributor to our P&L. Food segment net revenue increased by 27 percent driven by boosted demand for Trading Items and TP&FV in both UAE and Egypt in response to COVID-19.

Trading items which constitute 52 percent of Food revenues, recorded 25 percent year on year growth in its top-line as we capitalize on our swift response to imminent challenges by opening 2 new branches, adding new SKUs and activating home delivery orders and drive through facility since the first quarter of the year.

In tomato paste / frozen vegetables, revenues from UAE and Egypt grew by 32 percent versus last year as we expand to the catering channel, increase market share and accommodate for consumers' increased demand. As for Bakery, we recorded higher sales as a partnership with local authorities to support their food security initiatives. Meanwhile, dairy sales continue to be largely impacted by the closure and/or partial operations of Eateries.

As for profitability, the overall food segment margins enhanced on elevated volumes and efficient supply chain.

Finally, on the Agri business..

Flour segment posted a strong top-line growth of 29 percent versus last year driven by higher domestic demand, wheat trading and export sales (including an order to the World Food Program-WFP in the first quarter). Additional milestones under the flour segment are maintaining number one leading position for retail flour (volume) and improving overall segment profit margin versus last year.

On the other hand, Animal Feed revenues lagged 7 percent behind last year on lower grain trading and lessened local demand amid new controls to restrict commercial farms from trading subsidized animal feed in the open market.

I now pass the line over to Ammar for the financial review. Thank you.

Ammar Al Ghoul: Good afternoon everyone.

Group revenues grew by 2.6 percent y-o-y reaching AED 1.09 billion in the first half of 2020. Net revenue contribution by consumer-businesses reached 54 percent whereas agri-businesses generated the remaining 46 percent.

Consumer-business revenues dipped by 2 percent y-o-y, reaching AED 584 million out of which the Water & Beverage segment posted sales of AED 412 million and Food segment the remaining AED 172 million. The rally in each of the Food segment, Kuwait operations and 5-gallon water business was largely offset by the slip in Bottled Water sales in UAE and Saudi.

Agri-business revenues recorded AED 506 million and grew by 9 percent y-o-y on higher Flour sales as elaborated by Alan.

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

Current quarter gross margin came in at 31.4 percent versus 31.8 percent in Q2 2019 and 29.9 percent in Q1 2020.

Higher quarter on quarter margin is largely driven by higher volumes across each of Bakery and tomato paste & frozen vegetables coupled with enhanced efficiency in the distribution of 5-gallon business.

In comparison with Q2 2019, the slight drop in margin is mainly attributed to the unfavourable sales mix with higher contribution from the Food segment.

Next let's talk about Net profits.

Group net profit prevailed at AED 42 million. Enhanced agri-business profitability, cost optimization and excluding the one-off tax credit recorded in Turkey last year marginally lessen the aggregate impact of (i) the unfavorable sales mix with lower volumes from the bottled water category in both UAE and KSA, (ii) bad debt provisioning against longer collection days in international markets and (iii) extra manufacturing and logistics costs borne to guarantee business continuity amidst unprecedent times.

We note that excluding one-offs (H1 2020 bad debt provisions variance and H1 2019 Turkey Tax credit), net profit shortfall will be halved.

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 39 million related to WFP Flour order plus AED 19 million higher wheat trading have largely countered the lost revenues against lower volumes of beverages on excise tax and of bottled water in both UAE and KSA on restricted demand from struggling food service segment and tourism amidst COVID-19. Robust growth momentum across our Flour and Food segments, Kuwait operations and 5-gallon water business resulted in the additional "organic" growth, taking our net revenues to AED 1.09 billion.

In addition to the resulting impact of the above items on profits, we highlight 4 more variances. We recorded AED 9 million of additional profits from the agri-business along with the enhanced efficiencies across our value chain which more than offset the one off AED 5 million tax incentive from our Turkey subsidiary recorded last year and this year's bad debt provisioning against longer collection days in international markets.

With this, we conclude today's prepared remarks and the floor is now open for questions and answers. Thank you so much.

Coordinator: Our first question comes from Nishit Lethotia from SICO. Nishit, please go ahead.

Nishit Lekhotia: Thank you for the call. I just have one question on your Water and Beverages segment. In terms of profitability, this segment is just not making any money. Just to compare, in last three quarters Agthia has made not even AED 2 million from this segment while last year those three quarters together has made AED 200 million.

This is a huge delta, and this used to the growth segment of Agthia. I know there are issues with Saudi, collections and the bad debts and provisioning and water stress on the UAE, but, still, even if we look at the profitability, in 4Q 19 it was just AED 1 million. There was this stress on the segment before the pandemic hassle. When can we see this segment coming back to its old levels of profitability? Now, what's the management view on it? Thank you

Alan Smith: Thank you for the question. I think a couple of points to pick up on here. In the UAE, the water category up until 2016 was growing at around 5% in terms of volume, and around 2.5% in terms of value. Over the last couple of years, the market has contracted somewhat, with the categories declining about 5% per annum. That, coupled with increased competitive pressure in the market, has obviously made the market more competitive.

If we look at the recent trends that you referred to, you picked up on a couple of the key issues, firstly, if we look at the UAE, in H1 year-to-date, because our water is so omnipresent, in terms of every channel in the UAE, the negative impact on the HORECA, so hotels, restaurants and cafes, plus convenience channels, plus offices, has obviously had a negative impact on overall demand in the market. But this is purely related to COVID.

On the other side, we've seen strong or robust demand in retail channels, so in the big key accounts that business has continued to do well. And if you look at what's happened with home delivery, obviously, with the lockdowns, people have been ordering more water online. We've pivoted our operations to focus more on our route to market and make sure that we're able to get to as many consumers as possible. That gives a little bit of a summary of how the UAE market's been impacted over the first half of the year.

Now, when we look at Saudi Arabia, there are two aspects to the challenging water business in Saudi Arabia. Firstly, we've had the constraint caused by the fact that the religious seasons in Saudi have been impacted. Obviously, there's been the lockdown in Saudi, which, in many cases, has been more challenging than the UAE. And on top of that, we've made some prudent decisions around how to manage our exposure in the markets given the provisions that we've had to make in the books over the first half of the year to reflect the fact that there's lower liquidity in Saudi and the broader region, decisions that we've had to make in the short-term which we believe, as demand starts to bounce back and as the market starts to stabilise, and Saudi will benefit us, moving forward.

Kuwait, on the other hand, has done very well. Kuwait has grown, in terms of volume, around 75% for, actually, this year, and in terms of revenues, grown around 50%. Kuwait is an emerging market for us. It's a business that's growing, and we're gaining market share.

We're confident that as the market bounces back in UAE, we'll be able to leverage our strong market position. And, obviously, in Saudi Arabia, we're fixing the fundamentals and look forward to seeing that business there grow again in the future.

Nishit Lekhotia: Thank you so much.

Coordinator: We've got a couple more questions, one from Imad Chukrallah from Amwal Capital. Imad, please go ahead..

Imad Chukrallah: Thank you, guys, for the presentation. Alan, you've joined a couple of weeks ago, and I'm curious about your view on the business lines the company's in, on where do you see opportunities for growth from a strategic point of view. How are you approaching the company and if there has been any, let's say, targets that have been set by the board, any specific metrics you're working towards? Thank you.

Alan Smith: Thank you for the question. I joined on the 5th July. I think what we can say is the recent structural changes in the organisation signal intention to reframe the growth strategy Agthia. The changes, however, are very recent, so we're currently undertaking a strategic review, and we'll be ready to talk more about that in the coming months.

That said, if we look at what is framing or what is driving the rethink, obviously, we're looking to create or enhance shareholder value. The strategy that we're working through is being built around a few simple principles, firstly, very consumer-focused. We're looking at what's important for consumers today, to develop products and then invest in categories that address those needs. That's one frame of reference. The second thing is the strategy will be customer- and channel-focused. We'll continued working closely with strategic retail partners, we'll refocus on expanding ecommerce and obviously continuing to make our products as accessible as possible to as many people as possible. We'll be looking at expanding into new categories and markets that will build our footprint across the region. And then the fourth and probably the most important pillar for us to enable the agenda I've just outlined is we will refocus on capability.

We have good talent in the organisation. We'll look at business processes, and we'll also look at systems to efficiently support the agenda that we're setting down. So very detailed and deep analysis. We are trying to reframe what the future looks like in terms of a growth perspective, and we will hope to come back to you all in the near future to outlay that plan in more detail.

Imad Chukrallah: Very clear, thanks, Alan. The involvement of the board, obviously there have been some changes at the board level, at the parent level and so on, do you think we could see Agthia more positioned along the food security line of the country or anything along these lines in terms of the product? Is there anything at that level, you think? Any changes we could expect there?

Alan Smith: What we want to do, and I touched on the fact that we want to, obviously, enhance our value, I think, first and foremost, the parent company, the board and, obviously, ourselves, Agthia, are very much in the consumer product space. What we're talking about is building brands, investing in brands, growing value by entering into segments which we think are attractive, and, as we said, address consumer needs.

So very much a consumer product group, is what we'll be looking at, and that's the core of the strategy. Rather than looking at food security or commodity-based businesses, we're more looking at consumer-based businesses. And that's the idea that's shaping our thinking.

Imad Chukrallah: Clear. And would M&A be, let's say, at the heart of that strategy, or you would think it'll be more drive organically? How would you think about that? Or is it a bit early?

Alan Smith: I think the way we're looking at this, we're ruling everything in and we're not ruling anything out, if you see what I mean. I think, given our footprint today is largely in the UAE, we have presence in Kuwait, in Saudi, in Turkey and Egypt, which, with the exception of the hiccups we've had in KSA, we're confident that those markets will continue to grow.

But we also know that we need to build scale in those markets, so we're going to look at... Certainly, M&A is on the agenda. In terms of what, where, how, that's still being worked through. But our growth strategy will be built around strengthening our position in the UAE, expanding our footprint regionally, and also continuing to leverage the experience and the strong brands that we have in our current portfolio.

Imad Chukrallah: Very clear, thanks so much and good luck.

Coordinator: Thank you, Imad. We currently have no further questions

Alan Smith: Thank you very much. I think if I just reflect on the half-year-to-date, I'd like to compliment the Agthia Group and the Agthia team on their ability to react to what has been an unprecedented situation. I think our agile supply chain and our teams have been able to pivot quite quickly to react to changes in demand and trends in the market. We've been able to work to make sure that product is available at all times.

We've taken strategic decisions to increase our stocks of raw materials, and we continue to be motivated to make the right decisions in the short-term to grow value in the long-term. Agthia as a group will continue their track record of bringing interesting and new innovations to the market, and we look forward to speaking to you next quarter.

Coordinator: Ladies and gentlemen, this concludes today's call. Thank you for joining.