Transcription for AGTHIA

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Corporate Participants

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Agthia – Group CEO

Fatih Yeldan
Agthia – Group CFO

Sahar Srour
Agthia – IR Manager

Presentation

Operator
Ladies and gentlemen, welcome to Agthia Group First Quarter 2019 results conference call and webcast. I will now hand you over to your host, Miss Sahar Srour, Investor Relations. Madame, the floor is yours.

Sahar Srour
Good afternoon, ladies and gentlemen. As most of you already know, Ozgur is leaving and I will be taking over as the new Investor Relations Manager. I'd like to thank you for joining us today in Agthia Group's earnings conference call for the first quarter of 2019, hosted by Tariq Al Wahedi, Group CEO, and Fatih Yeldan, Group CFO. As usual, Tariq will start with the quarter's performance highlights following which Fatih will take over and cover the financial results for the period. We will close the call with a Q&A session. For your reference, the relevant presentation is available in the Investors section of the company's 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.

[Disclaimer]

Over to you, Tariq.

Tariq Al Wahedi
Good afternoon everyone. We started 2019 with a relatively strong foot especially in terms of delivering top line growth. Overall, Group net revenues increased by 3.4 percent and reached AED 508 million. Food segment businesses and Flour have been the engines of growth, supported by 5-gallon water in the UAE and bottled water in our international water markets—Saudi Arabia, Kuwait, and Turkey.

In bottled water in the UAE, Al Ain Water's distant market leadership in both volume and value share continues. However, I should mention that the pricing stress over the value of the category still hangs in here, against a market backdrop of accentuated promotional activity. As a matter of fact, the overall market continued to remain in de-growth territory with its value size down 1.1 percent versus last year.

The Group has delivered AED 40 million net profit in the first quarter. When compared to the same period of 2018; we can clearly see that the negative impact of the water-pricing situation has been augmented by the planned withdrawal of the last tranche of the remaining subsidy in Flour. Excluding flour subsidy, Q1 2018 net profits would have come at AED 38 million.

During Gulfood exhibition this year, as has become a tradition for us, we announced the launch of 5 new products. Additionally, we initiated reporting our Sustainability practices under ESG framework. I will urge all of you to visit our 2018 Annual Report to see the depth and breadth of our Group's Sustainability activities.

Let's look at the bottled water market and the players in the UAE retail environment.

The charts on the slide depict the volume and value shares in percentages across major players for the last 12 months ending February 2019 versus 2018.

The most important message here is the sustainable and healthy market leadership of Al Ain Water. Al Ain Water has 28 percent and 26 percent market share in volume and value, respectively, in the current reading. Taking into account Agthia's other brands Al Bayan and Alpin waters, total company volume share stands at 30 percent while value share is 28 percent.

As a further sign of our brands' strength, I want to highlight even higher market shares as per the latest February 2019 exit data. Al Ain Water alone reached almost 30 percent volume share whereas overall company share passed 32 percent. Alpin claimed volume leadership among the mineral water brands.

Before I briefly cover our other businesses, let me show our water shipped volumes across board.

Strong growth momentum in our 5-gallon water home-and-office-distribution business in the UAE carries on thanks to new customer acquisitions. In the first three months of this year, we shipped more than 5 million bottles across the UAE.

In the same period, we shipped over 17 million cases of bottled water across the UAE, KSA, Turkey and Kuwait. It is noteworthy to reiterate our endurance in the UAE market under demanding competitive circumstances. Robust international operations played a remarkable role in supporting the home market and upholding the rationale behind our expansion strategy. In Saudi, bottled water volumes escalated by 27% y-o-y driven by new retail-outlet acquisitions, largely facilitated by the installation of the new high-speed bottling line that boosted our small bottle manufacturing capacity in the KSA by more than 150 percent. In Kuwait, we continue to increase our locally produced Al Ain water shipped-volume run-rates month after month on the back of fast and wide market penetration. We expect Kuwait's performance to continue to improve with Al Ain Zero starting to be produced locally since the beginning of April this year.

Let's have a look at our other businesses, starting with Food.

Food segment continues with an outstanding top and bottom-line performance. Overall revenues grew by 41 percent driven by both Trading Items and TP/FV segments. Trading Items more than doubled y-o-y revenues on account of new range of products that are added into our 'Community Support Division' portfolio. In TP/FV, Egypt continued its turnaround performance with both revenues and profit increasing versus last year.

In Dairy, although shipped volumes were up by a notable 10 percent, revenue recovery was not as fast due to spill-over promotional environment. Notwithstanding, we significantly reduced our cost base in this category, and our net loss has declined about 60 percent.

Finally, on the Agri business …
We had a particularly strong quarter in Flour with revenues increasing by 14 percent y-o-y.

Both wider retail penetration specifically in Dubai and the Northern Emirates, and higher wheat sales brought higher volume. A price increase, which was executed mainly to partially counter higher global wheat costs, amplified the positive impact of higher volume at revenue level. Profitability however was lower, expectedly, mainly as a result of full withdrawal of the remaining subsidy in Bakeries.

1st quarter was not as flourishing in Animal Feed. Although lower demand in the domestic market was a factor in the 12 percent decline in revenues, much lower grain sales than last year was the main ingredient in this performance. On a good note, though, our profitability has improved due to the favourable volume mix that we manage to maintain in still-subsidized commercial farms.

A price increase to counter for higher grain costs has also contributed positively in profit.

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

Fatih Yeldan
Good afternoon everyone.

In the first quarter of 2019, group revenues reached AED 508 million. Consumer businesses posted a total of AED 282 million, increasing by 8.6% y-o-y. In addition to the strong performance in Food segment on account of higher sales in Community Support Division and Egypt, bottled water in international markets and 5-gallon water in the UAE have both contributed in this growth.

Overall, total Water revenues were up 2% y-o-y despite a much slower momentum in bottled water in the UAE as we continued to defend our market share in a heavily promoted market. In Food, revenues grew by 41% y-o-y largely driven by new products in the Community Support Division portfolio, and tomato paste and frozen vegetables both in Egypt and the UAE.

Agri-segment revenues recorded AED 226 million during the period. Flour contributed AED 101 million, posting 14% y-o-y growth on higher domestic volumes and wheat sales. Animal Feed, on the other hand, came in at AED 125 million, staying 12% behind last year largely because of lower grain sales—non-core business; processed feed was only 2% short of last year.

Group net profit for the same period stood at AED 40 million and was AED 7 million less than last year. Please note that there was approximately AED 9 million flour subsidy income in last year’s profit that is not available anymore. In addition to the impact of fully withdrawn bakery channel subsidy, lower bottled water pricing was another factor that put pressure on our current period profit. Various cost optimization initiatives helped confine the impact of adverse pressure on profit to a great extent.

Let’s elaborate more on water pricing on the next slide.

This slides depicts the bottled water market with a perspective on the price depression that has been taking place since the second quarter of 2018. Above chart shows Al Ain Water’s net average case prices by quarter, indexed to 100. Yet, it is fully representative of the underlying market as we are the market leaders and gaining share.

You can clearly see the sharp dip in the second quarter of last year, which was mainly triggered by lower spending power and shifting consumption trends in the wake of the changes in the surrounding economic environment such as introduction of VAT. Intensive and widespread promotional offers, mostly in the form of price discounts and/or free product offerings through so-called value packs, led to a significant decline in prices from the first quarter levels.

Since then, although there are signs of recovery in the relative pricing situation, it still is behind the higher prices of Q1 last year. In our own case, this approximately amounted to a gap of 5 percent, as depicted on the chart above.

The two waterfalls explain the reconciliation between last year and this year revenues and profits.
Let's first look at the revenues. Two items that affected top-line are lower grain trading and water pricing. In Q1 2018, grain sales exceeded current quarter's by around AED 11 million. Lower water pricing in comparison with Q1 2018, which Tariq has already covered above, resulted in AED 6 million lower revenues. AED 4 million from Kuwait, and AED 11 million higher pricing across Agri-businesses in parallel with increased grain costs have largely offset the negative drivers. Strong Food business in addition to higher KSA and 5-gallon water performance resulted in the additional "organic" growth, carrying our net revenues to AED 508 million mark.

On the profit side, in addition to the profit impact of above-mentioned items, there are 3 more factors to highlight. The first one is the zeroed-out subsidy in the bakery channel of Flour that used to be subsidized at a rate of 50% last year—this amounts to AED 9 million, as shown on the chart. More than countering this, there were approximately AED 7 million of cost savings and a one off AED 5 million tax incentive from our Turkey subsidiary.

Let's shed some light on gross profit margins.

On the slide we can see the Group gross profit margin since quarter one of 2018.

Current quarter group gross margin resided at 31.4% versus 33.1% in Q4 2018 and 34.4% in Q1 2018.
Lower quarter on quarter margin is mainly attributed to the full flour subsidy withdrawal in the Bakery channel. In addition to the impact of flour subsidy, lower bottled water pricing is another major driver in the drop in current period gross margin in comparison with Q1 2018.

With this we conclude today's prepared remarks. The floor is now open for Q&A. Thank you.

Question and Answer Session

Operator
[Operator instructions]

Our first question comes from Zohaib Pervez, Al Rayan Investment. Please go ahead.

Zohaib Pervez
Is there any guidance on the profit and revenue for 2019?

Fatih Yeldan
On the revenues, we expect to record between 2-4%, which is in line with what we had delivered in Q1. For the profit, we expect to be flat versus last year, excluding the flour subsidy impact.

Zohaib Pervez
And with the flour subsidy, we will expect it to be lower.

Fatih Yeldan
That is true. We don't expect to recover the subsidy which is about AED 30+ million. On top of the subsidy, grain prices, especially wheat, were significantly up versus last year. Water pricing as well in Q1-to-Q1 had a quite significant impact on bottom line. Basically, those impacts will be covered by other initiatives. The subsidy itself, however, we don't expect to be fully offset. This is why our guidance is basically in line with last year without subsidy.

Operator
Our next question comes from Veeshan Bhagwan, Abu Dhabi Capital Group. Please go ahead.

Veeshan Bhagwan
I have a question on the water segment. Could you provide some colour on, do you see the price improvements which we have been seeing in the last four quarters the same to sustain for 2019, and how do you see the market shaping up in 2019 for the water business.

Tariq Al Wahedi
Basically, I think the panic that happened in quarter two last year has gone away. The market is coming to an equilibrium now and the prices are adjusting. This doesn't discount the fact that competition is still fierce and promotions are high in the market and ongoing. However, we are seeing good stability across UAE, Saudi and Kuwait, Oman as well, in terms of pricing. Now, whether prices will go back to previous levels, I am not so sure about that as there has been changes in the market. But we are definitely seeing recovery and stabilisation in the prices post Q2 2018.

Veeshan Bhagwan
For ex-UAE, which is KSA and Kuwait, what kind of run rate do we see for 2019 in the water business?

Fatih Yeldan
For Saudi operations, we are expecting 20% growth in revenues. Kuwait, last year, we only operated for four months, so this year we will have full year impact. Obviously, we will have at least three to four times of last year's revenues in Kuwait because of the annualisation impact and growth on top of it. As such, growth in Saudi and Kuwait is quite big versus 2018 numbers. So far, we are on track.

Veeshan Bhagwan
Are the margins in international markets compared to UAE margins? How do they stack up? For bottled water.

Fatih Yeldan
Water margins in KSA and Kuwait are below UAE, but a couple of impacts there. UAE revenue is like four times of Saudi and 30 times of Kuwait, so you don't have the same size yet. This is one of the critical factors. Additionally, the market leadership situation in the UAE obviously helps in the pricing. Years ago, when Al Ain was a small player in the market, we were also having our gross margins at c.30%, and then moved up to 50%, so basically, we expect the similar thing to happen abroad, but pricing pressure is there as well. However, surely pricing will be improving versus what we currently have and it will be approaching UAE levels in the coming years. That is normal because of, as I said, the size especially.

Veeshan Bhagwan
Is it right to assume that it is around 30% at current levels?

Faith Yeldan
It is high 30%.

Veeshan Bhagwan
one last question was on the trading items, so we saw 100% jump in revenues, could you just give more understanding what led to this kind of jump in your revenues for the trading business?

Tariq Al Wahedi
The reason for growth in trading items is because, if you recall – we have taken over the management of community service stores. Additionally, as part of the agreement with the Municipalities, we angled towards increasing the number of SKUs, as part of the mandate that we have for the support of the community. It turned out to be quite profitable and the growth has been phenomenal.

Veeshan Bhagwan
So the similar run rate, do we look to maintain it for 2019?

Tariq Al Wahedi
Yes.

Veeshan Bhagwan
Just a follow-up on this, so now that we have subsidy withdrawal from all our business segments, so are we looking to significantly raise prices in any of our product segments, basically, to negate the impact that we are seeing from the removal.

Fatih Yeldan
Just to make some clarification on what you said. There were subsidies in flour, in both bakeries and municipality channels, with bakeries being a big part of it and municipality quite a small part. Now, the one that has been removed fully is the one from the bakery channel, so basically there is still some subsidy (a small amount) remaining in relation to the sales that we do

in municipality channel. So municipality subsidy is still there and there is no plan to remove it. There is no instruction about that.

In feed, the commercial farms channel which is about 30% of our feed business, was kept subsidised since the first day of subsidy rationalisation and will continue to be subsidised.

Now, to your question on the feed, when the subsidy withdrawal program came and only commercial farms were left to be subsidised, we increased our prices to a great extent. That has been done for the feed segment. When it comes to flour, in retail, subsidy has been fully removed a couple of years back. Accordingly, we adjusted our prices in retail, which is about 8% of our business. When it comes to bakery, first of all, there was full subsidy, then half of it was removed, now the other half is completely removed. We did some price adjustments, but if you recall from the previous calls or face to face meetings, in flour, we are not able to adjust prices to the full non-subsidised levels, because of the fact that there are many cheap flour coming from Ukraine, Turkey and other countries, which was putting pressure on our ability to increase prices to the level of no subsidy. We also see more competition coming from other UAE players. As such, we managed to increase the prices, across different channels by 10% to 20%, but not back to the level of non-subsidised flour.

That is basically what happened in the flour and feed with regards to pricing while the subsidy is removed. Now, again, when this subsidy is removed as of January, we adjusted some of the prices, but not to the extent of full recovery of the subsidy.

Tariq Al Wahedi
As for the grain costs, we try to pass over the increments to the customers.

Veeshan Bhagwan
One last thing is, do we run any risk of the subsidy removal in commercial farms of municipality channel? I guess these are the only two channels, right, which are left now, which has subsidy.

Tariq Al Wahedi
Under the strategy that spilled out from Government, that is not foreseen in the near future.

Veeshan Bhagwan

How much would it be as a percentage of your revenues, the total subsidy that you are still getting from these two channels?

Fatih Yeldan
The remaining subsidy is less than 5% to total revenue, not to subsidised sales.

Operator
[No further questions]

Sahar Srour
Thank you all, again, for joining us. If you have any further enquiries, please don't hesitate to contact me.

Good evening from every one of us. Goodbye.
