Transcription for AGTHIA

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Corporate Participants

Tariq Al Wahedi
Agthia – Group CEO

Fatih Yeldan
Agthia – Group CFO

Presentation

Operator
Ladies and gentlemen, thank you for joining us today in Agthia Group's earnings conference call on the company's 12 months results for the year ended December 31 2018, hosted by Mr Tariq Al Wahedi, Group CEO and Mr Fatih Yeldan, Group CFO.

[Instructions and disclaimer]

Over to you, Mr Tariq

Tariq Al Wahedi
Good afternoon ladies and gentlemen. This is our fourth call covering our performance in 2018, so all of you, you are up to date on matters that defined our canvass. The actions we have taken and the results we have accomplished, however, here is a good opportunity to wrap the year up, so let me start with that.

Agthia, now, is predominantly a consumer product company. Accordingly, we are now more exposed to material shifts and public consumption habits, and the competitive practices deployed in the marketplace. 2018 has seen no shortage of any of these two dynamics right from the beginning of the year until the end. The heart of the matter is that we displayed quite strong performance in our key performance metrics across our product portfolio. In a year which was earmarked by changing consumer preferences and aggressive competitive reaction to this change, we have defended our market share volume and revenues without compromising profitability, resulting in a net profit ahead of consensus estimates.

Let me now elaborate on these further with the next slide. Agthia to be market leader in water, flour and animal feed, tomato paste, with Al Ain, Grand Mills and Agrivita brands. I will have further insights on water in the UAE on the next slide. In 2018, we shipped 70 million cases of bottled water, 57 million cases in UAE; the remaining 30 million was shared by Saudi, Turkey, and Kuwait, at 10, 2 and 1 million respectively. All three locations grew versus last year with the UAE increasing by 5%. Additionally, 30 million bottles of five-gallon water were shipped in the UAE, Oman, Saudi Arabia, and Turkey for our household and office consumers. UAE volume has grown also by 10%. In flour and animal feed, our volume reached 750,000 tons in 2018. A combination of higher volume, better mix and several price increases in the course of the year have helped us maintain our top line at 2 billion mark in 2018, despite significant competitive pressure, as Fatih will explain later. This represents around 2% like-for-like growth over 2017.

We grew our gross profit margin to 34.3% and increased net profit to 211 million in 2018. The growth of the food segment is a remarkable contributor and I have a separate slide for that.

Last but not least, the successful turnaround of Egypt and Turkey that started two years ago is noteworthy to mention, with sustainability, solid profit lines and gradually growing businesses.

How did we achieve this? How did we overcome these obstacles? Besides many other factors, I will stress out the compelling factor of our innovation drive in the past two to three years. Since the launch of Al Ain Zero which has been a phenomenal success in 2016, we developed and launched Al Ain Vitamin D and Al Ain Bambini Water as a response to the evolving health and wellness needs and preferences of our consumers. Both products are very specialised in the way they are produced, as well as the needs they are addressing.

Just a couple of weeks ago, we announced during Gulfood, the launch of our new innovative product named Al Ain Zero Bromate. Also, Al Ain Water Box specialising for picnic trips. Grand Mills Vitamin D flour and Yoplait lactose-free yoghurt, all these products are firsts of their kind in the region or in the world. In addition to creating additional choices of purchase for our consumers at premium segment, an additional benefit of our specialised water products is that they add completely new points of sale to our go-to market model, which is pharmacies and hospitals.

What is happening in the UAE water market and to our shares? You will remember that volume has been growing, albeit at the cost of category value, mostly because of some fears, price competition to help defend or gain market share. This picture stayed very consistent from the early months of the past year. At the end, although market volume has grown around 5%, category value declined by around 2% in 2018, when the impact of VAT is excluded from the above market reading figures. At 27.9% volume and 26% value share, Al Ain Water grew both metrics in 2018. Agthia total volume market share stood at 30% together with Alpin, Al Bayan waters. As expected, our value growth was marginal due to overall price pressure in the category.

Nevertheless, I believe the fact that we are gaining not only volume but also value share is a strong proof of the success of our strategy and execution in the marketplace.

Food, excluding flour, displayed an outstanding growth performance at 16% on the back of very strong results in Egypt and the community support division business unit in the UAE. In Egypt, revenues increased by 25% due to retail expansion and higher export. Community support division or what we call CSD covered Abu Dhabi Al Ain municipality stores in addition to Agthia stores spread out in UAE, and it constitutes the backbone of our Government partnership programme that allows members from a wide range of Government organisations to purchase various food and non-food products at more affordable prices. In addition to regular Agthia products, there is an additional trading items portfolio that we offer to our customers in these stores.

Overall, the CSD grew their revenues by 67% over last year, becoming a major revenue source for the food category. Trading items grew also by 47%. New Agthia stores and higher store traffic in the existing municipality outlets due to new Government organisations joining the partnership programme in 2018, resulting in higher volume and revenues. Tomato paste and frozen vegetables category grew 4% over last year on account of renewed focus on the portfolio, as well as the new packaging artwork. In tomato paste, our brand Al Ain is the market leader in the UAE. Dairy business under the Yoplait brand remained behind last year in parallel with the decline in overall yoghurt market in the UAE. Bakery revenues declined because of a phased-out contract with Monty's Bakehouse.

Finally, on the agri business side, both flour and animal feed increased like-for-like revenues by around 2% each. Combined revenues posted about 0.9 billion in 2018. Animal feed displayed resilient performance in 2018 despite stronger competition and grew on a like-for-like basis, mainly on account of higher volume in municipality outlets and commercial farms. In addition to price increases in parallel with global commodity cost price changes, we had particularly strong results in flour in Northern Emirates despite strong competition. Like-for-like volume was successfully kept flat versus last year and better pricing brought the incremental revenues. Profitability has declined in parallel with lower subsidy and partly because of higher commodity costs towards the end of the year.

With this, I will be handing over to Fatih to carry on.

Fatih Yeldan
This slide shows us group's net revenues and profits in 2018 in comparison to those of the reported and like-for-like 2017. As you know, by now, both revenues and profit of 2017 have included financial impact of transactions that did not exist or repeat in 2018 fiscal year. Like-for-like column eliminates the impact of these from 2017 financials to depict and equalise perspective between the two years.

Group revenues in the 12 months that ended on 31st December 2018 reached AED 2 billion. Net profit for the same period has been AED 211 million. Whereas net profit increased by 2.1% versus reported 2017, net revenue stayed short by 2.3%. On the other hand, the like-for-like comparison shows that both revenues and profit have grown 1.9% and 11.5% respectively.

Let's move to the next slide to look at them in more detail. We have two waterfall diagrams on the chart to explain the reconciling items between reported and like-for-like 2017 financial results. Back to back grain trading, exports that we discontinued and additional one and a half months of Saudi consolidation following the acquisition are the items that have impact on both revenues and the profit. On the profit side, there are two more items and they are namely the one-time gain on sale of land and income that was associated with the wheat securities stock contract with the Government that was phased out at the end of 2017. We can clearly see on the left-hand side of the slide that when these items are considered, 2017 revenue has a lower base of AED 1.96 billion, over which 2018 revenue of 2 billion represents a real growth of 1.9%. similarly, the profit [audio] in 2017 drops to AED 189 million of which the group has generated AED 20 million more profit in 2018 or 11.5% growth.

Here we have the full line consolidated P&L for the last two consecutive years. I would like to take your attention to the operating and non-operating expenses section of the P&L. We have already talked on the revenues and I will cover the gross margin in more detail on the next slide. You all know about our cost saving programme that we started two years ago. Although, the magnitude of savings is diminishing year-on-year for obvious reasons, we have no loss of appetite or drive in our efforts to optimise our costs continually, creating efficiencies in and eliminating all unnecessary costs from our processes. The result is another year with lower operating expenses by as much as AED 13 million in 2018 and note the growth in the operating profit from AED 204-209 million, even with the absence of AED 12 million of other income in 2018, this is a remarkable accomplishment.

Let's look at the gross margins on the next slide. The group have attained a gross profit margin of 34.3% and that was 125 basis points higher than 2017. While the margin of agri division has improved to 23% because of higher animal feed margins, consumer division remained more or less stable at 44%. Consumer businesses weighing more in group revenues is a factor behind higher group margin. This share was approximately 55% in 2018, and it was 53% in 2017. The main ingredients in the higher margin are certainly the higher volume with better product mix and unwavering cost optimisation across – efforts across the company.

Slight decline in water and beverages is driven by a drop in the margin of Saudi Arabia, which was heavily affected by low promotional pricing in the consumer markets all through the year.

In food, growing scale of business brings higher profitability, whereas in feed, favourable product mix is the main cause of gross margin increase. In flour, lower subsidies still has an impact on our gross margin in total year numbers, as there was full subsidy in 2017 first half. However, deferral of the removal of the remaining bakery subsidy in the second half of 2018 by the Government has had a positive effect on flour margin mostly by offsetting the unfavourable impact of the higher wheat prices.

Now, the floor is open for Q&A. Thank you.

Question and Answer Session

Operator
[Operator instructions]

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

Nishit Lakhotia
I have two questions, one on the Saudi business, water business Delta. If you can give more clarity on the current operating environment in Saudi Arabia for Delta and what's the update on your expansion plan and the outlook for 2019 for Saudi Arabia's water business? That would be helpful. I can come to the second question after this.

Tariq Al Wahedi
Of course, Saudi Arabia has been a very interesting market for us. We took over Saudi about a year and a half ago and, of course, we went through a total revamp of the existing plan that's in there, so we continued to preserve our market share and then we started also putting the new second-line, the new high-speed line in there, which got commissioned and we had an increase in our capacity going to the market. At some point, I mean last year we had limitations in capacities, which forced us to go back with other manufacturers, which has impacted our profitability. The other points, also, we… of course, I mean, we cannot deny the pricing in the market has suffered from lots of competition. The price point has changed compared to the previous years and so there has been change, but our volume is growing. We are gaining market share in there, we are gaining distribution; we are expanding the [water] region, we are gaining through different channels. Now, we are most modern trade channels. We are in all general trade channels. We are in key accounts in Riyadh and the Central Region. We are also penetrating with Eastern Region in key accounts and through wholesalers. We are also not fully in the Southern Region or Northern Region. We do have our plans for expansion both in distribution and capacity as well. We are looking forward to having bigger capacity in Riyadh area, and we were exploring to have that either organically

or inorganically, so we have been quite active last year looking or searching for that.

Nishit Lakhotia
How is the financials of Saudi Arabia looking like in terms of the revenues and profitability year-on-year? Has it improved? I mean, you don't share the exact numbers, but has it moved up or how has it been overall to the group?

Tariq Al Wahedi
No, the top line has dropped because of the pressure on pricing in the market and, as I said, I mean we… at some point we were… we ran out of stock. We couldn't find capacity. We had to go and [inaudible] and that also has impacted our bottom line as well, so it was another impact that impacted us last year, basically. If you compare us to the previous year, you would see a small drop in the top line and also in the bottom line, and also we got affected as well. Again, we are going into a transition stage where we are turning around all the assets that we have acquired, and today we are adding our twist, I mean with the branding and Al Ain brand equity, building also access to the market, the proper access to the market, getting quality controls in there. The standard that we see here in UAE is done on the same level in Saudi Arabia as well, and that of course takes time for us to implement and to get our market share in there.

Nishit Lakhotia
I was a bit perplexed on the goodwill, you know, on the Saudi Arabia. I see from your annual report that the discount rate you used for goodwill as commissioned for Saudi Arabia has dropped from 13.45% to 8.4%. How much in such an environment you are reducing the discount rate for goodwill?

Tariq Al Wahedi
For what? Sorry, what exactly you said, what numbers?

Nishit Lakhotia
13.45% to 8.4%, the goodwill discount rate for Saudi Arabia operations.

Faith Yeldan
I don't have the numbers with me. You can send an email and we can check it, but the thing is all the calculations actually are checked and actually led by third party experts on these things, and fully audited obviously, so if there is any change that means that's a check that has been verified with the third parties, but if you can send an email then we can check and come back to you

with a concrete answer, because now I don't have the numbers in front of me. Assuming that the numbers that you are giving is right that means it's the verified numbers, the audited number, but we will come back to you if there is a better answer on that.

Nishit Lakhotia
Okay and just one second also on Saudi Arabia, generally, on the financials side, the receivables, if you can just shed some colour as to why we are seeing this stretch in your working capital, how is the environment right now, and we see that even the past due receivables over 180 days is increasing while your provisions were lesser than last year, so can you just give more colour on your working capital and the environment right now on this?

Fatih Yeldan
On the receivables side, you are right. Receivables increased. That is one part that is coming from the VAT, because last year there was no VAT. Partly it's that, but the rest is more I will say late payments coming from most of the market players in the markets, both in UAE and Saudi. Surely, this is not only for us, but for all the companies in the market, that is surely a slowdown in the collections, so there is no bad debt story, but it is more like slower collection, so we have about 12-13 days slower, including the government entities and the big key accounts and everything. So there is no bad debt, so there is nothing to do with the bad debt provision, and as you can see from the financial statement as well, IFRS 9 and everything has been fully applied, so there is no… so our provisions are perfectly fine, but when it comes to receivables, yes, receivables increased. Now, it has been stabilised. The last two, three quarters it has been increased and then if you see it doesn't go further up, it is… now we see pretty much the same number, is around 75 days and it is pretty much stable there. We started the year quite well with the collections, especially from the government entities. They put some liquidity in the market, but generally market liquidity impacts us as well.

Nishit Lakhotia
Okay and the subsidy on flour is out, right? I mean the final [audio] January on the flour or is it still there?

Faith Yeldan
Subsidy is out. Only subsidy on the flour is on the sales to municipalities, so Government channel, which is about 7, 8% of our business that remains and other part of the subsidy, it was on the bakeries, removed.

Tariq Al Wahedi

I would like also to share with you something. Allow me to just mention this. It wasn't mentioned on the previous slides that we had. In Gulfood, we have taken the chance to make our sustainability statement that we made out to the world, that we announced our sustainability programme that we are going to do for the next five years, which basically has many verticals in it, including the announcement that by year 2021 we will have up to 10% recycled [PET] into our production, 5% will be plant-based as well, and we will be working with the Ministry of Environment and Climate Change. We will be spreading out some reverse vending machines in the whole country as well, so we have taken several initiatives and we are quite proud of this initiative.

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

Nishit Lakhotia
Just one more question on your water and beverage business side, you have been mentioning about the price competition and promotions on the water side, especially in UAE, but it's interesting to see that your gross margin in water has still remained the same despite severe price competition environment, so how did you manage to achieve this?

Fatih Yeldan
There are two reasons. One is we sold more. Volume is more; we grew the volume by 5%. It's automatically absorbed obviously from [fixed] so it helps on that. On top of that, cost optimisation is in all the P&L lines, so some of that obviously is within the cost of goods sold, so this actually adds more volume and cost optimisation so better mix, like we have Al Ain Zero and everything…

Tariq Al Wahedi
What helped also value added [products] like Zero and Vitamin D. I mean, these are higher-priced and they helped, averaging out higher prices for overall, so that's why we are pushing the innovation much, much harder, because that gets out of commoditised markets and commoditised prices.

Fatih Yeldan
The one that Tariq was mentioning before, it was to your question on Saudi as well, because Saudi you were asking and about profits, so Saudi profit was impacted and sales was impacted because of the lower pricing, and there since our almost first year there, full year, we didn't have that much cost optimisation yet, so that's why there was not that much offsetting items, so you are hit by 5, 6 million on the top line and then it hit us on the bottom line,

the pricing, but hit this market the same way as well, but here in the UAE we fully offset that with the cost optimisation and volume, and evaluate it.

[No further questions]

Ozgur Serin
Good afternoon everybody, this concludes our call for today and the Q&A obviously. If you have any further questions, you know how to reach us. Both Fatih and I will be available for answering these questions. We have one question which we are following up in addition to that one you can please contact me, we are also going to be available in EFG's conference for the next two days, so hope to see some of you over there. Have a good evening.
