



Transcription for AGTHIA

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Corporate Participants

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Agthia – Group CEO

Saeed Akram

Agthia – VP of Corporate Finance

Sahar Srouer

Agthia – IR Manager

Presentation

Operator

Ladies and gentlemen, welcome to Agthia Group's First Half 2019 results conference call and webcast. I now hand over to your host, Miss Sahar Srouer, Investor Relations Manager. Madame, please go ahead.

Sahar Srouer

Good afternoon, ladies and gentlemen. Thank you for joining us today in Agthia Group's earnings conference call for the first half of 2019, hosted by Tariq Al Wahedi, Group CEO, and Saeed Akram VP Corporate Finance. In today's call, Tariq will first talk about the performance highlights during the period after which Saeed will cover the financial results given that Fatih is on leave. 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. Over to you, Tariq.

Tariq Al Wahedi

Good afternoon everyone. The first half of 2019 has unfolded with a relatively strong foot in terms of maintaining leadership, delivering top-line growth and protecting profits. Group net revenues of AED 1.06 billion demonstrated a 5.4 percent year on year growth. The bottled water in our international water markets specifically Saudi Arabia and Kuwait along with the Food and Flour segments played a vital role in contributing to revenue growth. In the UAE, Agthia's bottled water portfolio succeeded in preserving market leadership in both volume and value share.

Throughout the period, the Group booked AED 84.1 million of net profit. Owing to our adaptability to unfavorable conditions and focus on cost optimization, we were able to materially limit the collated impact on profits



of external factors such as zero subsidy receipt against flour sales in the Bakery channel, the upsurge in wheat and feed grain costs and lower average price of bottled water in the UAE.

Let's take a closer look at the bottled water market in the UAE retail environment.

The charts show the volume and value percentage shares of major players for the last 12 months ending May 2019 versus 2018.

As evident, Al Ain water sustains its market leadership and preserves Agthia's overall water portfolio- including Al Bayan and Alpin- record of 30 and 28 percent volume and value shares, respectively. It is worth highlighting that the overall market erosion exceeded Agthia's registered decline in value. This is an accomplishment in the light of a persistent descent in market value of bottled water category in the UAE in which MAT May 2019 market size declined by 2.5 percent versus last year.

Our shipped water volumes are depicted on the next slide, by geography.

Starting with our 5-gallon water home-and-office-distribution business in the UAE, H1 2019 shipped volumes recorded 9 percent growth compared to the same period last year on the back of new customer acquisitions.

When it comes to bottled water, over 39 million cases were shipped across the UAE, KSA, Turkey and Kuwait. In the UAE, our sustainable brand equity demonstrated endurance against adverse market conditions in which Agthia's bottled water volumes remained almost flat versus 3.9% y-o-y decline in the overall UAE retail volumes. In its turn, our international operations rallied to uplift the home market. In Saudi, the dual effect of the high-speed bottling line installation and the distribution network expansion steered the 70% y-o-y registered increase in bottled water shipments. In Kuwait, ramp up in execution continues as we foster shipped-volume run-rates to reinforce wider market penetration.

Moving on to other businesses, let us start with Food.

Strong growth momentum in the Food segment carries on. Trading items and Tomato Paste / Frozen Vegetables in Egypt played a remarkable role in increasing the Food segment net revenues by c. 30 percent y-o-y. Trading Items, on its own, grew its top-line by more than 70 percent supported by new range of products that are added into our 'Community Support Division' portfolio. In TP/FV, Egypt revenues recorded 18% y-o-y growth on higher volumes.



In Dairy, the team's endeavors enabled us to increase volumes and lower incurred losses despite extended promotional environment.

Finally, on the Agri business..

Flour displayed a 12 percent y-o-y top-line growth driven by higher volumes on expanded retail penetration, exports and wheat sales coupled with increased prices to partially counter elevated global wheat costs.

Profitability would have improved this year should we remove the impact of the full withdrawal of the remaining subsidy in Bakeries.

Alternatively, Animal Feed posted healthy profit margins on the back of a favourable volume mix towards still-subsidized commercial farms and boosted prices to partially offset higher grain costs. Such efforts came in to mitigate lower demand from small-sized farms which in its turn dragged revenues down by 7 percent.

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

Saeed Akram

Good afternoon everyone.

The Group generated AED 1.06 billion net revenues during the first half of 2019, up 5.4 percent y-o-y.

Consumer-business net revenues reached AED 597 million, increasing by 10 percent y-o-y. Water and Beverage revenues for the period stood at AED 461 million, up 5.1 percent y-o-y mainly driven by international markets and home and office distribution business (HOD). Saudi operations proved robust progress in distribution, recording 38.4 percent top-line growth. In tandem, the ramp up in execution in Kuwait supported the outperformance of the international portfolio. In its turn, the 5-gallon HOD business in the UAE displayed resilient top-line growth of 7.4 percent as shipped volumes were on the roll. On the other hand, price promotions in the Bottled water in the UAE resulted in reduced value growth while maintaining relatively similar volume levels despite a shrinking market. Conversely, Food sustained its remarkable growth trajectory with net revenue up by 29.6 percent y-o-y. "Trading Items" which constitute more than 50 percent of Food revenues drove this growth, posting more than 70 percent y-o-y rise in its top line supported by new products range.

Agri-Business net revenues prevailed at AED 465 million. Flour displayed a 12 percent y-o-y revenue growth, stimulated by higher domestic volume and wheat sales. Animal Feed revenues of AED 260 million lagged 7 percent behind last year mainly as a result of lower volume due to reduced demand from small-sized farms.



Let's shed some light on gross profit margins.

On this slide we depict Group gross profit margin since quarter one of 2018.

Current quarter group gross margin resided at 31.8% versus 31.4% in Q1 2019 and 34.7% in Q2 2018.

Higher quarter on quarter margin is largely driven by the favourable mix in Animal Feed. In comparison with Q2 2018, the drop in margin is mainly attributed to full flour subsidy withdrawal in the Bakery channel, lower bottled water pricing and higher commodity prices. We will get into more details on slide 12.

Let's now move on to Net profits.

Throughout the period, the Group booked AED 84.1 million of net profit. Accounting for the approximately AED 17 million flour subsidy in last year's profit that is no longer available, net profit shortfall is largely reduced to single digit. Separately, our determination in defending our market share, expanding geographically, increasing agri-pricing and carrying on with cost optimization initiatives, materially reduced the remaining shortfall should we aggregate the imminent pressures on profit.

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.

Let's start with revenues. AED 11 million from Kuwait and AED 14 million higher Agr-pricing have more than offset the AED 9 million lost revenues against lower water pricing in the UAE during the period. Strong growth momentum across our Food segment, KSA operations and 5-gallon water business resulted in the additional "organic" growth, taking our net revenues to the AED 1.06 billion mark.

In addition to the resulting impact of the above items on profits, we further shed light on 4 more factors. There were approximately AED 20 million of cost savings and a one off AED 5 million tax incentive from our Turkey subsidiary; both of which largely offset the AED 17 million withdrawn subsidy in the bakery channel along with the AED 20 million rise in grain costs.

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 Nishit Lakhota from SICO. Please go ahead.

Nishit Lakhota

I have a few questions on the performance for the Q2. The first one on the flour segment. We have seen decent overall performance in the agri business, but if you can just highlight how the competition is now within the flour segment and are you seeing a lot of competitive pressure from international [audio] into the flour order that is subsidising in terms of the pressure in the flour segment.

Also, on the other side, on the animal feed, though, the favourable mix helped your business in terms of margins, there is obviously some pressure that you are talking about in terms of on the smaller farms, so what is your outlook there and what is the strategy to counter that in terms of your decline in volume that you have seen.

Finally, on your guidance, is your guidance for the full year similar to what you have said earlier in terms of revenue growth of 2-4% and profit to be flat if you remove the subsidy impact. That is it. Thank you.

Tariq Al Wahedi

I will answer the first two, I will leave the outlook for Saeed to answer. On the first two, as far as the agri business, what happened is as you can see we continue to grow our market share. We are adjusting nicely to the current market situation, dumping of other countries, or competition that is available locally. I think we are coming to a fair play and same level ground, basically, for all of us now. We are adapting very nicely to the current situation, as you can see from the results.

As for the commercial farms and animal feed, we have noticed lots of dumping happening from neighbouring countries in terms of things like poultry and milk, which has reflected on our sales in terms of dairy farms and poultry farms, which has affected our volumes. Instead, we focused on increasing the profitability and focusing on where profit makes a difference, basically, and selling more valuable products to the consumer.

When it comes to the outlook for both, UAE will always continue to be an open country and it is just a matter for us to adapt to it and manage and I



think we have demonstrated endurance. The first half is the resilience of our strategy and how we are adapting to the overall market in general.

The last part of your question Saeed will answer.

Saeed Akram

I think as you have already referred to the last call, our aim is to maintain this flat rate in profits in the coming period, minus the subsidy. Obviously, this is the aim and hopefully we will be successful but keeping in view the challenging environment and the change in the consumer behaviour some time, so those are the challenges, otherwise our aim is to go forward in the same momentum.

Operator

Our next question comes from Mohamed Zein, Beltone Financial. Please go ahead.

Mohamed Zein

I noticed in Q2 the selling and distribution expenses were up 18% year-on-year and 7% q-on-q. If you can shed some light on the reasons behind that.

Saeed Akram

Three or four components which are contributing to this growth. One, Kuwait is a new business, so last year there was almost nothing, but now we have a full-fledged operation, so that is contributing almost around 3-4%. Second, the growth we see in Saudi required accordingly investments in infrastructure like transportation, so the cost is increasing. There was one more element, which is like if you probably learnt from the last meeting that we now have the administrative control of municipality stores, so as we had to take over their administration part, we incurred additional costs. Plus, we have also invested some money in our warehousing locally. These are the four key elements which are attributing to the increase in our expenses. Plus, we have a couple of million or 2-3 million more spending on the marketing and promotion expenses.

Operator

Our next question comes from Ali Al Nasser, Vergent Asset Management. Please go ahead.



Ali Al Nasser

A few questions from my side, I just wanted to follow-up on the last question that was asked with regards to the selling and distribution expenses. Do you book promotions under that line or are promotions for bottled water booked under cost of goods sold, so that would be my first question.

Saeed Akram

Mostly it is booked on the top, but there are some activities which are falling under the category of like advertising and some major promotions, so that comes below.

Tariq Al Wahedi

As Saeed said, the majority of our promotions is captured in cost of goods.

Ali Al Nasser

I know it is probably difficult, but can you just talk a little bit about the competitive environment and if possible quantify the impact that promotional activity has had on your margins at the gross level.

Tariq Al Wahedi

Overall, what you can see from the results that we have announced today is, that the market is showing mixed signs, basically, so it depends on the category, you will have different symptoms that we are seeing. Specifically, I presume you are referring to the water segment in particular, and in water we are seeing that the total category has suffered recess of 3.9%, while we have maintained our volume to be flat. The value has deteriorated as well, but in both of them we managed to be above the market in terms of pressure.

Now, if you look at the market report and you see the promotional pressure that is coming from all the brands, it definitely has increased quite a bit. Ramadan, which occurs in quarter two, definitely has pushed the promotional activity much higher in that regard.

Normally, Q3 is a little bit slower, but in Q4 things do pick up again in terms of pricing and so on, and normally you see a slight price increase on Q4.

Our average selling price overall has increased, so if I were to explain specifically, we are on the increase of our average selling price and we are pushing prices to go higher, although there is, of course, pressure from promotions and so on.



Ali Al Nasser

Just to confirm, Tariq, your average selling price you said increased, is that year-on-year or just if you look at kind of...

Tariq Al Wahedi

I am talking month-on-month. Month-on-month, we are increasing. Definitely Ramadan was one of the lowest points that we normally have in terms of average selling price, but after Ramadan, our average selling price has been increasing gradually.

Ali Al Nasser

Just on water, obviously, Saudi is growing in terms of its contribution. Can you talk about, as of close of June, what is the contribution of Saudi to the water revenue and where are we in terms of its full potential? Maybe just related to that, on the distribution side, have you expanded beyond the Western region at this stage, and can you just talk about the distribution gains that you have made in Saudi.

Tariq Al Wahedi

I think overall our international business has contributed 15% to our top line overall. Now, specifically, if you look into the water volumes, international has contributed about 25% of our volumes, specifically on water, and this is a big jump for us that we are already witnessing. Of course, this only became possible with our expansion in production and our recent expansions in modern trade there, so today we have entered accounts like Al-Othaim, Panda, other modern trade accounts and we have expanded to the central region and still I would say our Eastern region expansion is still shy and not in its full potential. Definitely, Riyadh is growing in very strong numbers, as we speak.

Ali Al Nasser

I understand that, initially, you would probably be wanting to take market share, so it wouldn't necessarily reflect your full margin potential. How do you see the economics of Saudi versus, say, the UAE in terms of the bottled water evolving over time and do you see the same level of discounting in the market.

Tariq Al Wahedi

The pricing pressure of course is the same in both areas. Historically, you wouldn't expect margins in Saudi to be the same margins like in UAE,



however, we had very good success in terms of Saudi. Our average price has also been increasing in Saudi of selling over there, which is also helping us covering our distribution costs, because we are expanding geographically as well. To be honest, the door is open, the brand is well received by consumers, it is well accepted, the brand equity is building up nicely over there and we are doing excellent. We are looking at further expanding our capacity in there as well.

Ali Al Nasser

Last question is more on the financials, I noticed you took out some debt in the quarter, and I was just wondering if that debt will be used for any future investments or are there working capital considerations.

Saeed Akram

No, we have not really. There is one that we paid off one long-term loan, that is it, otherwise there is no other plan for that one.

Operator

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

Zeeshan Bagwan

I have a question on your foods business, so what I see is the trading items part of the business is contributing. Its contribution to the total revenue has been growing significantly. How should we look at this business for the remainder of 2019?

Tariq Al Wahedi

Of course, this goes back to the retail outlets that we have taken and the municipality stores that we have taken and our new store branding that we have relaunched again, it is called 1971 and as we can see the growth in there is quite remarkable, because we are building the full category into these outlets. We continue to forecast that the growth will continue to be double-digits as we go.

Zeeshan Bagwan

Does this segment command lower margins versus tomato paste and frozen vegetables and other business segments.



Tariq Al Wahedi

I believe the GP is slightly lower than these items, but not by far. I think it is lower by maybe around 5% or so, but they are important to cater for the consumer experience. Once they come to these retail outlets, they definitely are looking to have a full basket of items. They won't come only specifically for our tomato paste or frozen vegetables or water, but they want to also get the chicken, they get the eggs and get aluminium foil etc and so on. You want to make sure that you are catering for that requirement as well and we are achieving a profit on that one, so it is adding up to the bottom line.

Operator

Our next question comes from Michel Salameh, Arqaam Capital. Please go ahead.

Michel Salameh

I have a question about the water bottling market in the UAE. What are your expectations for next year in terms of the pricing environment and do you expect any benefits from the Expo in H2.

Tariq Al Wahedi

As far as the bottled water market, I think the Gross Profits that we are experiencing now will continue to remain the same. Actually, we are forecasting maybe slightly better enhancement with the announcement of UAE in terms of improving the electricity tariff that is going to come, so that would help with a few percent, actually.

As far as the market, my understanding is all the manufacturers are aware of this pricing pressure that has happened to the market and I think there is an intent also to increase water prices slightly in the market. Yet to be seen for the next half of the year, but definitely, this is our intention is to be increasing our average selling price as we go.

As far as Expo 2020 part of your question, of course, we are expecting a big slipover to come. We, as a leading international water company, we have big plans for that already lined up and our campaigns are just ready to be launched in year 2020 for that.

Operator

We have another question from Nishit Lakhotia from SICO.



Nishit Lakhotia

Just a follow-up question on the market conditions on the bottled water. Within the UAE, how do you see Abu Dhabi and Dubai as a market? Are both markets equally competitive or you see weakness and pricing pressure more than one particular market, I would say, Dubai versus Abu Dhabi, so any views on that.

Secondly, on your Saudi bottled water business, are you making money at the bottom line currently for delta and is there any acquisition plans that you have for another company or enhancing your distribution within, say, Riyadh and the other aspects of Saudi Arabia. Any update on that would be very helpful.

Tariq Al Wahedi

Your first part of the question is Abu Dhabi compared to Dubai, I think it goes – month-on-month it goes different, so sometimes you notice very aggressive campaigns happening in Abu Dhabi versus Dubai, and the other way around it happens. Overall, I think the market is being treated as one, because when it comes to modern trade, it is the same channel whether it be in Carrefour or LuLu or Union Coop etc and so on, so it is the same network of retailers. Overall, it averages out to be the same.

As far as Saudi and the bottom line, yes, we are making profit now because we have increased our volume and we started to make profits on the bottom line, so we are going in the right direction. As far as expansion and acquisition, we are looking definitely for organic expansion, that is definitely for sure and we are looking for having multiple plans to reduce our distribution cost because the geography is quite vast in Saudi. Whether that comes organically or it comes as an acquisition, we are exploring both and we are testing many companies that are available for sale as we speak.

Operator

[No further questions]

Sahar Srour

Thank you all for joining. If you have any further questions, please don't hesitate to contact me. Have a good evening everyone. Thank you.