



## GRUPO HERDEZ FIRST QUARTER RESULTS CONFERENCE CALL TRANSCRIPT

### CORPORATE PARTICIPANTS

**Gerardo Canavati Miguel**, *Chief Financial Officer*

**Grecia Domínguez Leyva**, *Investor Relations Manager*

### CONFERENCE CALL PARTICIPANTS

**Álvaro García**, *BTG Pactual*

**Luis Miranda**, *Banco Santander Mexico*

**Juan Guzmán**, *Scotiabank*

### PRESENTATION

**Operator:**

Good morning everyone, and welcome to Grupo Herdez First Quarter 2017 Results Conference Call. Before we begin, I would like to remind you that this call is being recorded, and that information discussed today may include forward-looking statements regarding the Company's financial and operating performance. All projections are subject to risks and uncertainties, and actual results may differ materially. Please refer to the detailed note in the Company's press release regarding forward-looking statements.

I will now turn the call over to Mr. Gerardo Canavati, the Company's Chief Financial Officer. Please go ahead, sir.

**Gerardo Canavati Miguel:**

Thank you, Cecilia, and good morning, everyone. For today's call, we will start with Grecia Domínguez from Investor Relations, who will provide an overview of performance in the quarter. Then I will touch on our financial strategy and wrap up our call before we take any questions you might have. Grecia?



**Grecia Domínguez Leyva:**

Thank you, Gerardo. We delivered a good first quarter. Performance across all segments was better than expected. From top line to bottom line. From preserve, previously Mexico Core, to Megamex, Helados Nestlé, and Nutrisa. Net sales totaled \$4809 million, an 11.1% increase compared to the same quarter of last year. This increase was primarily driven by pricing actions taken in the last 12 months in preserve and double-digit growth in Helados Nestlé.

Net sales by channel show a similar growth trend, with retail and food service outperforming, while canned tuna, vegetables, and mayonnaise categories surpass average growth.

Consolidated gross margin reached 39.4% in the first quarter, two percentage points higher than the same period in 2016. Two-thirds of the margin increase is explained by the benefit of price increases and the “first in, first out” inventory revaluation.

Consolidated SG&A, relative to net sales, was 25.7% in the quarter, compared to 25.9% in the same quarter last year. By segment, it is important to highlight that in the frozen division we experienced a significant reduction of expenses coming from Nutrisa as a result of the shift in strategy and the focus on recovering profitability.

EBIT in the first quarter totaled \$672 million, with a margin of 13%. That is 2.4 percentage points higher than the same period in 2016. The increase in EBIT was primarily due to solid top line performance, a better sales mix in the preserve division, and a lower SG&A in the frozen division.

Net financing costs totaled \$119 million, 5.5 percentage lower than compared to the same period last year. This was mainly due to our lower exchange rate loss when compared to last year.

Performance in Megamex continues to drive the growth in equity investment in associates, which total \$225 million, a 50% increase compared to the same period last year.

It is important to note that approximately half of this gain was due to a mark to markets from favorable hedging provisions.

Lastly, majority net income totaled \$259 million, a 58% increase from the same period in 2016.

With that, I will now turn the call over to Gerardo.

**Gerardo Canavati Miguel:**

Thank you, Grecia. Indeed, it's nice to have all of our businesses show an improvement at the same time.

In preserves, volume was shy of last year's tonnage, due to a record tomato crop that made our puree less competitive against fresh tomatoes. In tuna, on the other hand, where demand is highly elastic. Despite these shortfalls, we feel confident in closing any gap and hitting our growth and EBITDA margins as guided.

Brand awareness in frozen is paramount through different marketing strategies. Same stores traffic at Nutrisa was positive despite the calendar effect, and margin improved significantly. Results this quarter show our efforts are taking us in the right directions. But we still have a long road to go.



Customer satisfaction is on the rise, and we will continue to favor profitability versus growth, rationalizing SKUs and improving customer experience.

Finally, during the quarter we closed, net of openings, three shops. For the rest of the year we expect net openings to be around 20 points of sales.

Our financial strategy continues to be focused on implementing the right tools and strategies to provide as much visibility and stability as possible to our business due to the market conditions. We have taken advantage of the recent appreciation of the peso and soybean oil performance in order to increase coverage. We are significantly hedged for the remainder of this fiscal year.

In terms of our financial position, we're working towards extending our average maturity debt profile and managing interest rate and foreign exchange risk. As of our capital expenditures in the first quarter, we have already spent 20% of the budget and we will continue to execute the investments as planned.

This concludes our prepared remarks for today's call, and at this point we are ready to open the line and take any questions you might have.

**Operator:**

Thank you. If you would like to ask a question, please signal by pressing star, one on your touch-tone telephone. If you are using a speaker phone today, please make sure that your mute function is turned off to allow your signal to reach our equipment. Once again, that is star, one to signal for a question today.

We'll go first to Álvaro García of BTG.

**Álvaro García:**

Hi, Gerardo, hi Grecia. Hope all is well. I have two questions. One is on activity through April; I know we had the holiday but if you could maybe comment on how volumes have been behaving in the Mexican core segment through April. Two on exports: I noticed an abnormally high EBITDA margin on the exports division and I was just curious as to if there was any particular one-offs. Thank you.

**Gerardo Canavati Miguel:**

Good morning Álvaro. Our volumes in the preserve segments are a little bit shy. We continue to see the tomato pasta effect. We had a very first two good weeks, but we are expecting to be a little bit shy, more of the same trend of the first quarter. Obviously, in our other segment, in frozen, April is going to be very good because of the seasonality of the Lent season.

On your second question on margin, there is a change in the way we price our exports. From—starting from January we've changed from a peso-denominated agreement to a dollar-denominated with a band. So, you will see a little bit more, let's say, volatility, but it's—now it's dollar-denominated. In the last eight years, it has always been—the shipments to Megamex has been denominated in pesos while McCormick has always been in dollars.

Okay?



**Álvaro García:**

Okay so just to clear up the last points, so all costs used to be booked in pesos, and are now being booked in dollars?

**Gerardo Canavati Miguel:**

Not the cost: our selling price, we used to sell to Megamex in peso-denominated. We changed that since January to dollar-denominated, with a floating band, (inaudible). So now that is helping the export margin, where traditionally it was in the low single digits, and now you can see high single digits, but now is going to depend on the exchange rate.

**Álvaro García:**

Yes. Okay. That's clear. Okay. That's fair. Thank you very much.

**Gerardo Canavati Miguel:**

You're welcome.

**Operator:**

Our next question comes from Luis Miranda of Santander.

**Luis Miranda:**

Hi Gerardo, Grecia, good morning, thanks for taking the question. Gerardo the question regarding pricing. We have seen a very I will say a strong pricing activity. I don't know if you could give us a going forward, if you believe that you need additional price increases. I know that at this time is difficult but believe that you might need some additional push in prices.

The other is with regard competition. Are you seeing competition following these price increases? I guess it might change with category to category, but if you're being price-setters or -takers? Thank you.

**Gerardo Canavati Miguel:**

Good morning Luis. You said it very good. Depends on the category, if we setters or takers, so. In a few categories like tuna, we are takers. In others where we are the leaders, we are setters. So, we still expect to have some price increases in the second quarter that are already built in in our guidance, and particularly is going to be in one or two categories that, because of seasonality, need some adjustments. But we do not expect more price increases for this year, because volumes are not that strong as expected, so we would invest more on promotion activity in order to incentivize our demand. When you see these price increases from the last 12 months, we did four price movements last year, depending on the category. In January, we took all the portfolio around inflation; we have seen our competitors in the same range, so we think all the industry is moving in the same direction.



**Luis Miranda:**

Okay, (inaudible) if I may ask also, just within this—the performance of the different channels, have you seen any material difference among smaller trade or wholesalers?

**Gerardo Canavati Miguel:**

Yes. There is some overlapping between the two channels that go to the same client, that would be food service and club stores. So particularly in this quarter we saw a soft club but higher food service. They did not compensate because of the size of the markets are extremely different. On the other hand, wholesalers perform—give me one second please.

In this particular quarter, wholesalers under-performed retail. But traditionally we have seen wholesalers perform better because they have a smaller ticket than retail. In the first quarter, we haven't seen that yet. But the difference between the channels are extremely low, we're talking about 200 basis points of difference.

**Luis Miranda:**

Okay. Very useful. Thank you. Agraciado.

**Operator:**

Again, that's star, one for any other questions at this time, again star, one if you would like to enter the queue.

We'll go next to Juan Guzmán of Scotiabank.

**Juan Guzmán:**

Hi everyone, thanks for taking my question, and congratulations on the quarter results. Ask three questions for you.

First, we want to know whether you are serving in the Mexican consumer this weeks. Have you seen any specific trend or changes in consumption within your categories?

My second question is about currency hedges. I don't know if I understand well but we know you were only covered for the first quarter and not for the rest of the year. Has this changed?

We have observed some efficiency gains in terms of SG&A. The only driver for this has been the lower SG&A at your frozen division, or was there reduction also attributable to a seasonal effect? Thanks.

**Gerardo Canavati Miguel:**

Okay. Good morning Juan. Okay, on your first question, we haven't seen any habit changes in our categories. We've seen same trend. On your second question, indeed, we are significantly hedged for the whole year, in terms of both commodity risk and exchange rate. So, we have taken out those risks from our P&L for this year, mostly. Your third question, about SG&A, our SG&A as a percentage of sales



were practically the same in the preserve segment, we're talking about 20.4, and the reduction in frozen came about 400 points in Nutrisa stores. So, practically, in preserves, is very stable.

**Juan Guzmán:**

Great. I would follow up: at what rate are you covered in terms of Mexican pesos? On the SG&A part, this SG&A reduction is mostly attributable to the frozen division efficiency gains, or there is a seasonal effect related to a first quarter?

**Gerardo Canavati Miguel:**

No, there's no seasonal effect, because first quarter in frozen is the weakest. So, it comes more from efficiencies and slashing SG&A and increasing our sales. So, in our exchange rate, I can say that we are a little bit around 5—about 2% or 3% of market rate. We have more than 80% covered this year.

**Juan Guzmán:**

Great. That's very helpful. Thank you very much.

**Gerardo Canavati Miguel:**

You're welcome.

**Operator:**

With no further questions in queue, I'd like to turn the conference back over to Mr. Canavati for any additional or closing remarks.

**Gerardo Canavati Miguel:**

Thank you for participating on today's conference call. We look forward to speaking with you next quarter. Please do not hesitate to contact us if you have any questions in the interim. Thank you.

**Operator:**

Again, ladies and gentlemen, this does conclude today's conference. We appreciate everyone's participation today. You may now disconnect.