



GRUPO HERDEZ FIRST QUARTER 2018 RESULTS CONFERENCE CALL TRANSCRIPT

CORPORATE PARTICIPANTS

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Grecia Domínguez Leyva, *Investor Relations and Corporate Affairs Manager*

CONFERENCE CALL PARTICIPANTS

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Juan Guzmán, *Scotiabank Global Banking and Markets*

PRESENTATION

Operator:

Good morning, everyone, and welcome to Grupo Herdez First Quarter 2018 Results Conference Call. Before we begin, I would like to remind you that this call is being recorded, and that the 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. At this time, I'd like to turn the call over to Andrea Amozurrutia, Head Corporate Finance and Treasury. Please go ahead.

Andrea Amozurrutia:

Thank you, and good morning, everyone. As usual, Grecia and myself will start with the overview for the quarter and the outlook for the year. Then, Gerardo will join us to take any questions you might have at the end. Grecia?



Grecia Domínguez Leyva:

Thank you, Andrea. Consolidated net sales totaled MXN 4.7 billion, a 2.2% decrease compared to the first quarter last year, primarily due to a streamline—streamlining of clients' inventory and high inventory levels in the wholesale channel in the fourth quarter. We also saw a slower pace in demand in categories such as tuna. However, it is worth noting that despite the above mentioned factors, our market share across our portfolio remained stable, and even increased in categories such as pasta, ice cream, cheese, marmalade and home-style salsa. In the Frozen division, net sales increased, as explained by double-digit growth rate in same-store sales at Nutrisa, along with solid performance of Helados Nestlé in DSD despite very cold weather in the first two months of the year.

Exports increased by 21.9% to MXN 330 million, following a strong performance in MegaMex. Consolidated gross margin reached 39.1% or a 30-basis point decline compared to the same quarter last year due to an increase in larger presentation with a lower price per gram in Preserves, on top of a tough comp in the first quarter of last year, and a 2.3 percentage point decline in the exports front due to higher volume to MegaMex, and our new pricing strategy to become more competitive in the market.

Consolidated SG&A related to net sales reached 26.2% compared to 25.7% in the same quarter of last year. This margin difference resulted from a 1.3 percentage points increase in preserve, mainly related to lower absorption of fixed expenses, which was partially offset by a 4 percentage points decline in Frozen segment resulting from higher sales and lower cost and SG&A.

Consolidated EBIT and EBITDA dropped in the quarter by 6.9% and 3.4% respectively. EBIT margin in Preserves segment decreased by 1.4 percentage points due to sales mix impact combined with higher SG&A. In the Frozen, the EBIT margin reached 2.8% versus minus 3.3% last year, a swing of 6.1 percentage points, explained by a combination of higher sales and lower costs and expenses.

MegaMex performance remained strong with net sales of MXN 3,194 million and EBIT of MXN 544 million, an increase of 1.9% and 7%, respectively. The outperformance continued to be Herdez and Wholly Guacamole. Now I will turn the call over to Andrea.

Andrea Amozurrutia:

Thank you, Grecia. As we have shared with you in the last 18 months, we have been fine tuning our marketing strategy in order to be closer to our consumers through three main pillars: Differentiated products, messages that connect emotionally with consumers, and lastly, initiatives that promote responsible consumption habits in line with our sustainability strategy.

This quarter was not the exception. We launched a special selection of marmalade in the self-service channel with a differentiated flavor offering that highlights our attributes of flavor and quality. We also launched a new mayonnaise campaign that celebrates the emotional relationship between consumers, and shows how our brand loyalty remains throughout generations. The campaign highlights the product's main attributes and prompts for new ways of consumption.



Lastly, you might recall that in 2017, we launched our for a livelier world campaign, aimed to keep our beaches clean and generate awareness of responsible consumption habits while engaging with juice audiences. In 2018, the campaign is focused on the tuna category and particularly on our Herdez brand. As for our McCormick portfolio, you may remember that our partner, McCormick & Company, completed in August of last year the acquisition of Reckitt's food division, which included French's Mustard and Frank's RedHot salsa. Well, this quarter, we incorporated these products as part of our Mexico offering. At the end of the quarter, both products represented approximately 1% of consolidated net sales.

Regarding MegaMex, our business continued to show a stellar performance in the quarter, as Grecia mentioned. Our Wholly Guacamole brand reached an 18% growth in sales, mainly driven by food service. While Herdez grew more than 20%, remaining the fastest-growing salsa in the United States. Our recent innovations included Herdez guacamole salsa, roasted roja, verde salsas and Wholly hand-scooped products continued to perform exceptionally well in the marketplace. We are proud to share with you that MegaMex was praised by Progressive Grocer magazine in its December issue, recognizing it as a category captain for all ethnic foods for 2017.

Going back to our consolidated numbers, net cap ex reached MXN 98 million in the quarter, which was primarily allocated to the increase in the production capacity of our salsa and tomato purée line.

Cash flow from operations totaled MXN 48 million. In this regard, we are seeing that our working capital is requiring additional cash flows due to opportunities on electronic invoicing and our clients streamlining inventory initiatives. Despite the challenges we have faced this quarter, we remain cautiously optimistic about the remainder of the year in order to meet our end-of-the-year goals.

This concludes our prepared remarks for today's call. 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 telephone keypad. If you're using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star, one to ask a question.

We'll take our first question from Álvaro García with BTG.

Álvaro García:

Hey, good morning. Andrea, Grecia, my question is on—my first question is on the shares you bought back. It represents roughly 1% of your outstanding shares. I'm just curious as to what the plan is, if you're going to cancel them or if you're going to sell those back into the market? Sort of your strategy there. My second question is on Nutrisa. Have you seen any sales results from the new looks? I think the Perisur sold as a new look and maybe Monterrey as well. Have you seen any sales figures yet or are they—are those—let's say, revamp looks are not there yet?

Andrea Amozurrutia:

Álvaro, on the first question, differently from what we have considered in the past, where the share buyback program has been helping liquidity of the stock. As of today, and as you mentioned, we are considering the cancellation of those shares. We haven't taken any decisions yet but you will—this is an analysis that we'll conclude in very short term. In the next couple of months, we will take a position on that. Regarding Nutrisa, at this point, we haven't seen any conclusive results from the new image. The sales, actually, of the both—of both points of sales that we have in Perisur have been performing very similar. We can say that it is very early to call for any result from the change.

Álvaro García:

Okay. That's helpful. Thank you. I will stop here and cycle back if I have another question. Thank you.

Operator:

Again, that is star, one to ask a question.

We'll take our next question from Juan Guzman with Scotiabank.

Juan Guzmán:

Yes. Hi. Good morning, Grecia and Andrea, thanks for the space for questions. First one is related to this inventory rationalization that you saw in Preserves. What was the size of this impact? Is it a one-time or will it—or will that have a longer effect on your results through the year?

Andrea Amozurrutia:

Well, an important part of—an important part of the reduction in sales fees consequence of that adjustment in our client inventory—we definitely think that the size of the impact is a one-time effect. But as we mentioned in the speech, we see that some of our clients are focusing more and more on streamlining its inventory. We should not see an impact of this magnitude going forward, because on the other hand, we will be more cautious about managing the inventories that they have in their warehouses.

Juan Guzmán:

Okay, that's helpful. I have an additional question. Can you discuss

Andrea Amozurrutia:

The other thing I was going to say is that, as we mentioned in the press release and in the call, it was a combined effect of streamlining on some customers but also there was additional inventory on wholesalers in the fourth quarter. That basically impacted our volumes for them in the first quarter. The good thing about all of this is that we didn't see any impact on the sellout of our products as our clients. Basically, it is just an inventory adjustment and we are not seeing that impact going into market shares.



Juan Guzmán:

Great, understood. I have an additional question. Can you discuss about the micro-dynamic environment you're seeing in Mexico? We are observing that in our consumer segment, as a whole, we are looking good reports on the retailer side but food companies keep describing tough consumption environment in Mexico. I don't know if you can comment what you're seeing there?

Andrea Amozurrutia:

Well, definitely, we were expecting better results for the first quarter, considering that the third and fourth quarters of last year were pretty strong. We see this on categories such as tuna. As we mentioned, tuna faced a very challenging environment in the quarter, despite the seasonal effect of the holy week. We do see that consumers are a little bit more cautious about spending, but we haven't seen—and in some—very specific categories, we are seeing very aggressive competition in terms of pricing that is also a reflect of the environment, but at this point, we think that the market will keep stable, and we don't see a drastic change going forward.

Juan Guzmán:

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

Operator:

Again, that is star, one to ask a question.

We'll take our next question from Álvaro García with BTG.

Álvaro García:

A quick follow-up. I was wondering if we could zero in a little on tuna, actually. You mentioned the weak performance in the quarter. What do you think drove it? You obviously had the positive calendar in fact, but what do you think drove the weakness in, sort of, across the category? What are, let's say—what do you think other competitors—it would be—was it something that from other competitor that you saw in terms of pricing that impacted you particularly or was it across the entire category? I'll leave the question there.

Andrea Amozurrutia:

Well, it was across the entire category. What has happened in the categories is that, if you consider the prices of the last 18 months, the price increases have been significant. As you remember, this is a category that have faced very challenging conditions in terms of pricing because it became very cheap protein. As of today, I would say that it is not the case. Basically, we think that there was some substitution, and well, that's it.



Álvaro García:

In that context, sort of—in the context of—not that tuna is in a cheap protein anymore, but that's shifting a bit, given the price increase we've seen, you think there is room for Herdez to sort of make more of its brand within the tuna category? My point being, being able to sort of take out your—the quality of our brand more under this type of tuna environment?

Andrea Amozurrutia:

Well, that's actually—what we have done—particularly on Herdez in the category. We changed the image in the second half of last year, and it was aiming at—communicate the value of our product regarding quality and the content of the product. Yes, we continue to have these separated strategies for Herdez and the east and—well, at this point, and as you may recall, we have mentioned that the strategy for this category is not to defend our market share, but to keep correct balance between top line and profitability.

Operator:

That is star, one to ask a question.

It appears that there are no further phone questions at this time.

Andrea Amozurrutia Casillas:

Thank you for participating in today's conference call. We apologize because we have some problems connecting Gerardo to the call. Please, do not hesitate to contact us if you have any questions in the interim. Thank you and have a good day.

Operator:

Thank you for your participating in 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.