



# GRUPO HERDEZ

FIRST QUARTER 2019

CONFERENCE CALL TRANSCRIPT

## CORPORATE PARTICIPANTS

Gerardo Canavati Miguel, CFO

Andrea Amozurrutia Casillas, Deputy Finance Director

Grecia Dominguez Leyva, Investors Relations Manager



## CONFERENCE CALL PARTICIPANTS

Luis Miranda, Santander

Felipe Ucros, Scotiabank

## PRESENTATION

Operator:

Good morning everyone, and welcome to the Grupo Herdez's First Quarter 2019 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.

At this time, I would like to turn it over to Mr. Gerardo Canavati, CFO and CEO of the Frozen Division. Please go ahead, sir.

Gerardo Canavati Miguel:

Thank you, Anna. Good morning everyone. Thank you for joining us on this conference call.

We kicked off 2019 with a very positive note, achieving a record of net sales for a first quarter in the Preserves segment by selling 112,000 tons.

To review the quarterly performance, I will now turn the call over to Andrea Amozurrutia, our Deputy Director of Finance. Afterwards, I will give you an update of our Frozen segment performance and will open the floor to any questions you might have. Andrea?

Andrea Amozurrutia Casillas:

Thank you, Gerardo. Good morning everyone.

Before reviewing our numbers for the quarter, we want to make sure that you are all aware that as of January 1, 2019, it went into effect the implementation of IFRS 16 leases. The above had a net negative impact in the income statement of MXN 5 million, which represents 1% of consolidated net income. On the contrary, EBITDA experienced a positive effect of MXN 83 million which represents 10% of total for the quarter. In the statement of financial position, our assets reflect a rate of use of MXN 737 million while liabilities increased by MXN 744 million registered of leases or lease liabilities.

Having said that, I'm going back to our quarterly numbers. Net sales increased 10.8% compared to the same period of last year to more than MXN 5 billion, driven by solid volume growth in the Preserves segment that grew 12%. The categories that outperformed were vegetables, canned tuna, ketchup, homestyle salsa, jams, mayo, pasta and tomato puree. The main growth drivers were, on one front, innovation. The Herdez Salsa which is a result of the cocreation initiative of Presume Tu Salsa carried in 2017 and 2018 drove volume growth and increased our market share more than 2 percentage points in retail after only a few months of its introduction.

The second, higher penetration. This quarter, an example of that was our performance in the tuna category which registered a low single digit growth rate compared with a mid single rate decline of the category overall. As you may recall, we haven't been very disciplined in our pricing strategy and have been introducing products with higher value added in order to premiumize our portfolio.



The Frozen division reported MXN 720 million in net sales, with cheese almost 7% higher than during the same quarter of last year, driven by price increases implemented in the quarter for (inaudible) as well as volume growth across the latter and Nutrisa as well.

Exports were MXN 346 million in the period, almost 5% higher than in the same period of last year. Half of the growth is explained by the strengthening of the dollar while most of the remaining is the result of price increases in the homestyle salsa category.

In the operating front, EBIT rose 2% to MXN 638 million with a margin of 12.2%, or 1.1 percentage points lower than in the same period of last year. Excluding the effect of the implementation of IFRS 16 on EBIT, it would have totaled MXN 625 million, which translates to a 12% margin, 1.3 percentage points lower than in the same period of 2018.

The main driver of this decline was the unfavorable sales mix of the Preserves segment due to increased sales on canned tuna and vegetables, as well as a MXN 2 million loss registered in produce due to higher raw material cost, particularly in Nutrisa, and advertising and distribution expense.

Equity investment in associated companies totaled MXN 229 million for the quarter, with cheese 8% lower than in 2018, mainly explained by higher costs and expenses at MegaMex.

While MegaMex sales increased 5.6% in the quarter, profitability was affected by higher raw material costs, particularly avocado, and low absorption of fixed costs and expenses at the guacamole production facility. As well, SG&A was impacted by the electric log-in device rule which has required the installation of monitoring devices for service hours and driving breaks.

As mentioned at the beginning, the implementation of IFRS 16 resulted in a net impact of MXN 5 million in the consolidated net income. Excluding this effect, the consolidated net income would have been MXN 522 million with a margin of 10%, only 40 basis points lower than in 2018.

Consolidated EBITDA totaled MXN 827 million in the quarter, 10% higher than in the same period of 2018. All of this increase is explained by the benefit of the MXN 83 million attained by the implementation of IFRS 16. It is important to mention that approximately 60% of this amount or benefit registered in the consolidated EBITDA is the result of—comes from the Frozen division and the rest from Preserves.

As of March 31, 2019, our cash amounted MXN 2 billion, practically unchanged when compared to the same quarter of last year after paying dividends and repurchased shares, and is mainly due to the improvement of working capital metrics.



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Interest bearing liabilities totaled MXN 6.6 billion with an average life of 4.8 years and an average cost of 8.6%.

On the cash flow front, we generated MXN 421 million from operations. It is worth highlighting that the implementation of IFRS 16 does not have an effect on cash flow.

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

Gerardo Canavati Miguel:

Thank you, Andrea. Now, I'm going to give you a small update on the rollout of the Nutrisa images. So far we're going to do 100 stores this year. It's going very good. When we ask our consumers about the image, 94% like the image, so we're very excited about this new opportunity, and obviously from this quarter, we are seeing some Nutrisa products roll out in modern trade.

In terms of traffic and average development, obviously our quarter is not comparable due to seasonality, but considering that, our traffic was higher in the low single digits to total and slightly flattish in comps, so considering the seasonality of Lent, it was a very positive number.

In terms of (inaudible) Nestle where this quarter we have higher expenses in the Frozen division, all this was expected because we are increasing our visibility program with our customers. Starting this year, we are painting some mom and pop stores, we are giving some promotional—we are doing a lot of promotional activities and products, so that's the increase in our SG&A. We are very encouraged about this, and we are expecting to hit our numbers as expected for the full year.

Lastly, you are already aware of the resolutions of our shareholders meeting that was held yesterday. We want to highlight just a few.

First, the shareholders meeting approved the cancellation of 18.8 million shares that we currently had in Treasury, and were accumulated through the share buyback program. As well, the dividend was increased by 10% to MXN 1.10 paid in two dates. In combination, this represents a total return to shareholders of 7%.

Second, the shareholder meeting announced the incorporation of a new member to the Board. Anasofia Sánchez Juárez Cardoze is the CEO of Waze Mexico, so we are very pleased and welcome Anasofia, and we are sure that she's going to make a lot of contribution to the Board.



Having said that, we now open the call to your questions. Please go ahead, Anna.

Operator:

Yes, sir. Thank you. If you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star, one if you would like to ask a question. We'll pause for just a moment.

Once again that is star, one if you would like to ask a question. We'll now take a question from Luis Miranda with Santander.

Luis Miranda:

Yes. Hi Gerardo, Andrea, good morning. Just a couple of questions. The first one is with regards to the performance of the Preserves division. You mentioned the sales mix, and I understand you're having a very good performance on the tuna division. What's your outlook for the short to medium term? Is there something that we should be expecting in terms of sales mix, (inaudible) this trend to continue? Or, should we expect some improvement in the medium term from the performance of other categories?

If you could give us some color on—I know it's difficult because of the Easter holidays and the start of the year, but your sense of how is the consumer behaving in Mexico? Thank you.

Gerardo Canavati Miguel:

Okay. Thank you, Luis. In terms of performance, obviously as Andrea mentioned, first quarter was very strong in terms of tons. If we take the seasonality (phon) because first quarter of 2018 was very soft because there was a lot of inventory building on the fourth quarter of 2017, but if we compare our first quarter with the first quarter of '17 we still see some low single digit growth in tons. I would say that in Preserves, we had a strong performance but most of it on inventory build-up.

Now, the consumer environment, as we have mentioned prior, has been a little bit soft, even though this environment should be stable because of all of the social programs that, by the way, we understand that they are very far behind schedule, and also what we believe that what was a headwind for consumption was all the restructuring of the government in terms of all the bureaucracy that was laid off; obviously, that has an impact.



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We don't think we will repeat this growth level on going forward, but we are expecting in the mid single digits, okay?

In terms of sales—that's in tons. In terms of sales, we are expecting high single digits. Probably 2 points lower than we had in the first quarter in terms of Preserves.

Now, talking about consumption in terms of traffic to the malls, in our 500 stores, we saw in this quarter a very strong January. February was softer. We have had great weather that has helped us to recover a lot of the traffic. When we measure April, where all the holidays were in, we have very strong numbers of transactions, in the high single digits. Obviously, we need to monitor this in both months, March and April. We are very encouraged about the numbers but we are expecting to keep it in the mid single digits.

What was your other questions?

Luis Miranda:

No, no. That was the question, something related to the mix. If the mix in the Preserves should be relatively stable with this?

Gerardo Canavati Miguel:

No, no, no. The mix, obviously in this season was we sold a lot of tuna because of the seasonality, and as you know, tuna has a lower gross margin. We do not expect the same mix going forward. In fact, our gross margin was lower because of this mix. Even though our gross margin will be lower the full year, as we mentioned in our forecast, we are expecting probably 100 basis points lower, but it's going to recover in the rest of the year, a little bit. We're still going to end approximately one full point in gross margin due to price increases in raw materials, as we mentioned, and in packaging materials.

Luis Miranda:

Thank you, Gerardo. That was very clear. (Inaudible), you mentioned traffic volume. In terms of the average ticket, how is it behaving? You have made several initiatives and one of them is the app. I know that it might not be a complete driver, a material driver, but how is experience? How is people adopting that as of today? Thank you.

Gerardo Canavati Miguel:



Ticket is flat. Ticket is completely flat.

Luis Miranda:

Okay. Okay. Thank you, and ...

Gerardo Canavati Miguel:

In terms of (inaudible). Okay?

Luis Miranda:

Okay. Thanks, Gerardo.

Operator:

Once again, that is star, one if you would like to ask a question. We'll pause once more.

We'll now take a question from Felipe Ucros with Scotiabank.

Felipe Ucros:

Yes, good morning everyone. Thanks for the space for questions. I wanted to go a little deeper on the results of Presume Tu Salsa. Obviously when you see innovation at a company and it works so well, it's great to see it.

Can you give us any more details about what type of growth you have exhibited since the introduction, and whether it's tapering off or you're still seeing those incredible growth rates, and what you expect for the rest of the year? Also, if you could give us an idea of what percentage of the mix of the portfolio that has ended being.

Secondly, I wanted to focus a little bit on Nutrisa. You mentioned the introduction of Nutrisa products into the retail channel, so I wanted to see if we could get some more details of what the plan is on kind of this segment in the business. Thank you.

Gerardo Canavati Miguel:



Hi Felipe. I will ask Grecia Dominguez to answer your innovation question, and then I will follow-up with the Nutrisa piece.

Grecia Dominguez Leyva:

Hi, Felipe. We introduced the new varieties of salsa back in September of last year, and in the first six weeks we achieved 2.5 percentage points growth in market share in retail. This quarter, we introduced the other to a specialty, and we also saw 3.5 percentage points in market share.

Salsa represents 12% of our total sales. Still these specialities are quite small when compared to the total amount of the salsa category, but we are very optimistic about the performance and how it help us on the profitability level, but also in terms of top of mind and increasing the size of the category. We are still growing a bit ahead of the entire market.

Felipe Ucros:

Thanks, Grecia, for that color. If I get it correctly, you gained 2.5 percentage points in the first quarter after the launch, and then 2 more this quarter, so 4.5 in total. Right?

Grecia Dominguez Leyva:

Yes, yes.

Gerardo Canavati Miguel:

Let me complement. What all these initiatives in terms of innovation are doing is obviously our price point is higher in terms of innovation, and then this helps us diametize (phon) the category. When you have a category flat, we are growing more than the category and we're gaining market share in a lot of these products. In some categories, this innovation—I'm talking about salsa specifically—but help us to gain probably one point of market share. You can say that on point is not significant, well, when you have 45% or 60% of market share to gain one with an innovation, it's a great achievement of our marketing strategies.

Going forward, that's what we're going to do in a lot of the categories. We're talking about mayo, salsa, pastas, teas, ice cream, for example, where also all this innovation has helped us gain a couple of points of market share when we are in the middle of—in the mid-teens.





This is driving our growth and our engagement with the consumers, with new products and with great communications.

Felipe Ucros:

This is great color.

Gerardo Canavati Miguel:

Thanks. In the Nutrisa—okay, this is also the same thing. What are we doing? First, we are launching products for other channels. Let's talk two initiatives that are rolling right now. First, you will see some Nutrisa products, popsicles, sticks, Nutrisa sticks in convenience, in the convenience channel, together with our Nestle efforts.

Two, you will see some multipacks in clubs. Right now you can go to Costco and you can buy the first frozen yogurt sandwich in Costco. You will see other initiatives as multipacks and new flavors in the traditional supermarket.

We are trying to segmentate (phon) the products and we will continue to launch some products in new channels. Obviously, there's no overlap with the stores because they are two moments of purchase: one is impulse and the other one is take-home. Okay?

Felipe Ucros:

This is fantastic. Great color. Congrats in that effort. Maybe if I can do a follow-up on the innovation one. The first question that I wanted to ask you, when you talked about the mid-teens, were you talking about the percentage of innovation within the portfolio?

Gerardo Canavati Miguel:

No. I'm talking about the market share that we have in modern trade in ice cream. When we do our innovation and we launch multipacks or have (inaudible) take home new products under the La Lechela brand, for example, we have gained 2 full points on these initiatives of market share. Okay? Our goal, as Grecia said, was 5% of sales.

Grecia Dominguez Leyva:



On innovation.

Gerardo Canavati Miguel:

On innovation. Our goal is to have 5% of our sales in innovation.

Felipe Ucros:

Okay, got it. You're measuring it as last 24 months, right?

Grecia Dominguez Leyva:

Just last 12 months.

Gerardo Canavati Miguel:

Twelve months.

Felipe Ucros:

Last (inaudible). Sorry, can you repeat that?

Gerardo Canavati Miguel:

Yes, sorry.

Felipe Ucros:

Twelve or 24?

Gerardo Canavati Miguel:

Twelve.

Felipe Ucros:

Okay, great. That's different than how most measure. Okay.



Great. This is great color. Very helpful. Thanks a lot and congrats on those results, very impressive.

Gerardo Canavati Miguel:

Thank you.

Operator:

There are no further questions. (Inaudible).

Gerardo Canavati Miguel:

All right, well, thank you for your participation in the call today. Please do not hesitate to contact us in the interim. Have a good day. Thank you, Anna.

Operator:

You're welcome, sir. Once again, that does conclude today's conference and we thank you all for your participation. You may now disconnect.

