

Company Name: Herdez  
Company Ticker: HERDEZ\* MM  
Date: 2015-07-24  
Event Description: Q2 2015 Earnings Call

Market Cap: 18,360.00  
Current PX: 42.5  
YTD Change(\$): +7.06  
YTD Change(%): +19.921

Bloomberg Estimates - EPS  
Current Quarter: N.A.  
Current Year: 2.036  
Bloomberg Estimates - Sales  
Current Quarter: N.A.  
Current Year: 15964.143

## Q2 2015 Earnings Call

### Company Participants

- Gerardo Canavati, Chief Financial Officer
- Andrea Amozurrutia, Head of Financial Planning

### Other Participants

- Luis Miranda, Analyst
- Jeronimo Contreras, Analyst
- Mauricio Martinez, Analyst
- Daniel Sanchez, Analyst

### Presentation

#### Operator

Good morning, everyone and welcome to today's Grupo Herdez Second Quarter 2015 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; Ms. Andrea Amozurrutia, Head of Financial Planning and Grecia Dominguez, Investor Relations Manager. Please go ahead.

#### Gerardo Canavati, Chief Financial Officer

Thank you, Jason. Good morning everyone and thank you for joining us. We are pleased to report a solid quarter for the Group. As expected, we experienced solid organic performance, and at the time incorporated a strong quarter of Helados Nestle. Andrea will provide an overview of our performance in the period, and then I will share a few more operational details with you. As usual, we will be happy to take any questions you may have at the end. Andrea?

#### Andrea Amozurrutia, Head of Financial Planning

Thanks, Gerardo. This was our fourth consecutive quarter of topline growth and expanding margins. On the one hand, we continue to experience an underlying trend of sequential recovery across much of our portfolio. And on the other hand, our hedging strategy helped minimize the impact of a stronger dollar.

Let's take a look at performance by segments. Starting with Mexico core where sales rose 7.7% over last year. About half of that growth is attributable to volume gain, reflecting a steady improvement in the domestic consumption environment, both year-over-year and on a sequential basis, as well as the tactical pricing we've put through in April of this year to partially offset the impact of a stronger dollar.

In terms of portfolio highlights, canned vegetables, jam, mole, pasta, salsas, cheese and tomato products which combined represent about one-third of the sales registered double-digit growth rates. On the exports front, sales rose

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11.3% on a peso basis, but inventory adjustments of MegaMex and raw material constrains hindered growth in dollar terms.

In the frozen division, we obviously benefited from the incorporation of Nestle, and even more so this quarter given it's traditionally the strongest in the year. But I should highlight that the year-on-year decline in Nutrisa is marginal at this point, and we expect to close the gap towards the end of the year.

The main factor affecting comparable figures is that the mix of formats for our stores has changed in the past 12 months. We have closed larger formats versus opening smaller ones, which have fewer transaction per store but with higher returns.

In terms of the consolidated gross margin, all business segments showed improvement, while lower raw material prices and our hedging strategy contributed importantly. We can specifically highlight the improvement in the frozen division, where the benefits of the Nutrisa restructuring process led to a more profitable sales mix.

In addition, keep in mind that the second quarter is the high season for Nestle, which helped absorb fixed cost. Of course, SG&A structure displays also higher than the average of the Group and combined with expenses related to the new store openings at Nutrisa, in the past year, SG&A increased as a percentage of sales. Nonetheless, consolidated EBIT rose 34.6% over last year with 1.8 percentage points expansion in the margin, while EBITDA rose almost 36% with the margin expansion of more than 2 percentage points.

In terms of the unconsolidated income, well, we saw an 8.3% improvement on these lines, underlying performance in dollars of MegaMex was down, so it is the effect of the strengthening dollar that affect these performance.

Lastly, at the bottom line, consolidated net income rose 22.5% in the quarter to MXN405 million with a 30 basis point expansion in the margin. And for our financial position, the company's cash at quarter end was nearly MXN1.4 billion, which is lower on a sequential basis due to the dividend payment made in May, and capital expenditures of 224 million. Our net debt to EBITDA leverage ratio remains healthy and flexible at 1.7 times.

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

## **Gerardo Canavati, Chief Financial Officer**

Thank you, Andrea. I only want to touch on a few additional factors this morning. First, well the consumption environment in Mexico continues to improve on a sequential basis. We are keeping a close eye on the US dollar and the impacts on all the fronts of the consumption. We have already locked down a big piece of our cost for this year with our hedging program. But 2016 is looking increasingly challenging. If the peso remains at this level, we will evaluate further pricing actions in the fall of this year, particularly in categories with dollar denominated inputs.

The second topic I want to cover is the Nestle business. We are very excited about what we're seeing and finding a lot of opportunities everywhere. This quarter was even better than expected. We assume seasonality would be beneficial, but we're already seeing additional upside with the introduction of freezers and innovation. And that is before we have even begun addressing the opportunity of market segmentation. We are confident that we will be able to drive substantial growth with good margins starting in 2016. Since this year we will allocate a significant amount of resources to the integration. In the fourth quarter, we'll start integrating the order to cash process. We will not see better margins in the remaining of the year because of these integration issues.

The third and final point I want to make is on MegaMex. Top line growth has been weak due to shortages at the frozen division. Fortunately, our other brands have been experienced strong growth. In the recent weeks, we have experienced improvements in supply chain that will help us deliver our pre-tax income targets. Meaning, it will be slightly above last year's in dollar terms.

Having said that, we are maintaining our guidance for 2015, that is Mexico core in net sales growth of high single digits, almost all of the growth in Frozen division coming from Helados Nestle; EBITDA margin between 16.8 and 17.3; and consolidated net income margin in the 10 to 11 range, as a percentage of sales. Due to the peso volatility, we

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see limited risks to this forecast, which will be updated accordingly.

That concludes my prepared remarks this morning. So we are now ready to take your questions. Jason?

## Questions And Answers

### Operator

Thank you. (Operator Instructions) And we'll take our first question from Jeronimo Contreras at GBM.

### Jeronimo Contreras, Analyst

Hello, congratulations on the results, and thank you for taking my question. By referring to Mexico's core division, we have seen outstanding levels profitability for the last two [ph] quarters. Can we assume the profitability levels on a normalized basis that you have in 17% due to structural changes in the industry? Are these results temporary due to benefits from the higher prices that you have been implementing, and from the lower raw material prices? Thank you.

### Gerardo Canavati, Chief Financial Officer

Good morning, Jeronimo. We have experienced higher margins, and we have stated that these are due to seasonality in terms of commodity and exchange rates. We are projecting a range between 17% and 18% for Mexico core. So depending on what will happen with the exchange rate, we'll update that. But we see maintaining that level of margin going forward, in terms of EBITDA margin.

### Jeronimo Contreras, Analyst

Great. Thank you very much.

### Operator

And we'll take our next question from Mauricio Martinez at GBM.

### Mauricio Martinez, Analyst

Good morning, Gerardo and Andrea, thanks for taking my question. I was wondering if you can share with us your CapEx for the rest of the year, and if you can give us also for 2016?

### Andrea Amozurrutia, Head of Financial Planning

Good morning, Mauricio. We think that the guidance will stay, that if you remember will be around MXN1 billion. So we don't see any changes there. In terms of next year, it will definitely come down a little bit, because as you remember, the main part of the CapEx for this year is for the new tuna vessel, so we will have that, and we will not have expansion of the distribution as in this year. So it will probably come down to the MXN500 million to MXN600 million range.

### Mauricio Martinez, Analyst

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Thank you, Andrea. And do you think if there is any chance that you can break this CapEx down by business?

### **Gerardo Canavati, Chief Financial Officer**

For this year, the majority of the CapEx is (inaudible).

### **Mauricio Martinez, Analyst**

Okay. Thank you. Perfect.

### **Operator**

(Operator Instructions) We'll go next to Luis Miranda at Santander.

### **Luis Miranda, Analyst**

Hi, good morning, Gerardo, Andrea and Grecia. Gerardo you mentioned as well as Andrea about the risk related to the FX. I know, you could just elaborate a little bit into the raw materials. What's your outlook for the second half and if you're seeing any risk or -- then if you can be short-term there? Thank you.

### **Gerardo Canavati, Chief Financial Officer**

Good morning, Luis. Definitely we are seeing benefit in terms of the traded raw materials in dollar terms. The big issue is that, the release that we have seen is not enough to offset the 10% drop in exchange rate. So if you look at this year, we are seeing that the dollar is 10% and in the last 12 months is 25% up. So that's not enough to compensate in raw materials. We are experience in soft commodities very low prices, we are seeing prices that are in the five year low, and we don't see -- we don't expect any big pressure in soft commodities as all the sectors of commodities are coming down. But in the end, these are very low prices from a historical basis.

### **Luis Miranda, Analyst**

Thank you. And I have -- just in the case of -- in terms of expansion, for the year, what do you think is going to be the -- what do you forecast to be the number of stores at the end of the year?

### **Gerardo Canavati, Chief Financial Officer**

Well, we guided that we are going to open about 60 stores, so we will maintain that guidance so far.

### **Luis Miranda, Analyst**

Okay. And that's net openings, yes or --?

### **Gerardo Canavati, Chief Financial Officer**

Net of openings. Correct.

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## Luis Miranda, Analyst

Thank you, Gerardo.

## Gerardo Canavati, Chief Financial Officer

Net of (Technical Difficulty)

## Operator

(Operator Instructions) We move next to Daniel Sanchez with BTG Pactual.

## Daniel Sanchez, Analyst

Hi, Gerardo, Andrea. Thanks for taking my question and congratulations on the results. My question comes on your current hedging strategy. I would like to know at what price this is, and in which date will these hedges expire, will we see the full impact on the third quarter or until the fourth quarter? Thanks.

## Gerardo Canavati, Chief Financial Officer

Good morning, Daniel. We usually don't give specifics on the levels of our hedging. But what we can say is that, they will expire on third quarter, so fourth quarter will have a piece of open prices that are incorporated to our forecast of the full-year.

## Daniel Sanchez, Analyst

Okay. So in the third quarter we will still not see the impact, it will be similar, seen the first and in this second quarter?

## Gerardo Canavati, Chief Financial Officer

Yes, you'll see an impact -- you will see an impact, but this is a rolling program. So you will see an impact, but it's not going to be significant impact considering current prices.

## Daniel Sanchez, Analyst

Okay, very well. Thanks.

## Operator

And we'll now take a follow-up from Luis Miranda at Santander.

## Luis Miranda, Analyst

Thank you. Just a follow-up on MegaMex. You were mentioning the supply problems you were having on the division, and you expect a recovery in growth. I was wondering if you could give us just a little bit more of color of what the problem, and if this recovery that you expect for the second half should be the trend that we -- the normalized trend

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going forward into 2016? Thanks.

### **Gerardo Canavati, Chief Financial Officer**

Sure. I would say Luis that, what happened in the last months at MegaMex is that, we may have over dose on our own innovation. So we over extended our capabilities in order to launch significant number of products that we are backing down from those. So what you can expect in terms of sales performance is avocado, we had this brand and the wholly brand are still going to outperform, and we will be very flat in our other businesses, and we are making significant changes in the structure of our Frozen business, in order to have to prefer profitability than growth. So we may be flattening out our top line growth, but we're going to focus on profitability. So I hope that answers your question.

### **Luis Miranda, Analyst**

That helps a lot. Thank you.

### **Operator**

And we'll take our next question from Jeronimo Contreras at GBM.

### **Jeronimo Contreras, Analyst**

Hello. Just a follow-up question. We just saw -- in the previous, organic revenues falling by low single digit, should we, I mean, we expect organic revenues to recover throughout the year, right. I mean, you will have an easy comps for the second half, right?

### **Gerardo Canavati, Chief Financial Officer**

We will have an easy comps for the second half. I think Jeronimo that the -- instead of easy comps is more comparable. Our sales are more comparable starting this quarter, because the portfolio are extremely aligned and we rationalize all the supplements that we're not selling according to the brand. So from this quarter -- from second quarter to the future, that includes the second half and next year, we are -- we will experience not easy comps, but more comparable, in terms of products, and we are increasing the number of listings and we are increasing our segmentation. So we should see, as Andrea was mentioning, an improvement in terms of transactions and an improvement in terms of same-store sales going forward.

### **Jeronimo Contreras, Analyst**

Okay. And could you give us a sense of the growth, I mean, should we expect the mid-single going to high-single digit growth in terms of organic sales?

### **Gerardo Canavati, Chief Financial Officer**

In what period are you talking about?

### **Jeronimo Contreras, Analyst**



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For the second half.

## **Gerardo Canavati, Chief Financial Officer**

Second half, as we mentioned earlier, all the growth of the Frozen will come from Helados Nestle. So, if you extrapolate that figure, Nutrisa will be practically flat.

## **Jeronimo Contreras, Analyst**

Perfect. Thank you very much.

## **Operator**

And at this time we have no further questions, so I'd like to turn the call back over to your speakers for any additional or closing remarks.

## **Gerardo Canavati, Chief Financial Officer**

Thank you again for participating in the call this morning, and we look forward to speaking with you next quarter. Please do not hesitate to contact us if you have any questions in the interim. Have a good day.

## **Operator**

This does conclude today's conference. Thank you for your participation.

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