



## GRUPO HERDEZ FOURTH QUARTER RESULTS CONFERENCE CALL TRANSCRIPT

### CORPORATE PARTICIPANTS

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

**Andrea Amozurrutia Casillas**, *Head of Corporate Finance*

**Grecia Dominguez**, *Investor Relations Manager*

### CONFERENCE CALL PARTICIPANTS

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

### PRESENTATION

#### **Operator:**

Good morning, everyone, and welcome to Grupo Herdez Fourth Quarter and Full-Year 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.

I would now like to turn the call over to Mr. Gerardo Canavati, the Company's Chief Financial Officer; Ms. Andrea Amozurrutia, Head of Corporate Finance; and Grecia Dominguez, Investor Relations Manager. Please go ahead.

#### **Gerardo Canavati Miguel:**

Thank you. Hello and good morning, everyone. We are pleased to report solid underlying performance in the quarter which helped drive annual performance of double-digit growth in consolidated net sales, gross profit, and EBITDA, in line with guidance and despite the external challenges we faced in the year.

Andrea will start with an overview of our results in the period, including the Nutrisa impairment, and then I will share our guidance for 2016. As usual, we will be happy to take any questions you have at the end.

Andrea?



**Andrea Amozurrutia Casillas:**

Thanks, Gerardo. This was indeed a challenging quarter in some respect. With the role of our FX hedging that affected the cost of goods sold in Mexico, a tough top line comparison base, and low seasonality at Helados Nestlé, that pressured our profitability towards the end of the year. However, an improving consumption environment, the benefits of a stronger dollar for exports, and income from unconsolidated companies, as well as remarkable commercial execution, helped to mitigate some of those challenges.

Let's take a look at performance by segment, starting with Mexico core. Sales rose 1.5% over last year, in part due to volume growth, and the remainder attributable to tactical pricing we put through in April and September to offset the impact of higher input costs. Innovation and commercial execution have been a key pillar of our growth each year. Some of the successful launches this quarter included gluten-free Barilla pasta, new varieties of McCormick mustards, and Búfalo hot sauces, as well as the continued rollout of the new Herdez soups and creams.

As for Export sales, the nearly 50% jump is due to inventory replenishment for MegaMex, where you may recall we had some shortages in raw materials during the year, as well as the benefit of a stronger dollar.

In the Frozen division, sales growth of 71% reflected the incorporation of Helados Nestlé. At Nutrisa in the fourth quarter, for the first time in 24 months, we registered an increase in traffic for same-store sales, driven by frozen yogurt performance. While it is still too early to call this a trend, we are confident that the results of our restructuring, portfolio rationalization profits, as well as innovation initiatives, have begun to come through as expected.

In terms of the consolidated gross margin, we registered a 1.2 percentage point decline in the quarter due to a stronger dollar that impacted our dollar-denominated costs. SG&A in the quarter also rose as a proportion of net sales due to the incorporation of Helados Nestlé, with less absorption than in other quarters because of seasonality, as well as integration-related and other expenses accrued over the year. Considering these factors, SG&A expenses in Mexico core were contained in order to reach our EBIT target for the year.

On the other hand, as you have noticed, Nutrisa's performance during the past two years have lagged compared to the original expectations and that is why we had to recognize a non-cash impairment charge of Ps. 450 million on the Other Expenses line, in compliance with International Accounting Standard 36. As a result of gross margin pressure, the higher expenses structure, and the impairment charge, EBIT for the quarter fell about 80%.

At the EBITDA level, however, where we added back the impairment, the decline was 12%. On an annual basis, EBITDA margin of 17.7% surpassed the sustainable long-term level of 17%. Consolidated net income totaled only Ps. 20 million due to the aforementioned factors. Excluding the impairment, consolidated net income in the quarter would have declined 3.1%. At year-end, we are very pleased to have reached our guidance for 2015 despite the headwinds experienced in the last months.

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



**Gerardo Canavati Miguel:**

Thank you, Andrea. I would like to elaborate on the prospects of our Frozen division. The improvement in consumption, coupled with more targeted initiatives, are helping drive positive numbers in terms of traffic for Nutrisa's comparable stores. On the other hand, we have remodeled old stores and launched new Frozen products which have also helped drive traffic. We still have a long way to go in the Commercial products portfolio, but as we introduce new products, we expect a better performance in this segment's KPIs.

In terms of the expansion strategy, we opened a net of 58 stores in 2015 and we expect to continue at this pace for the coming years. There's a huge opportunity for expansion across the country.

At Helados Nestlé, we have very exciting initiatives, which, coupled with new freezers hitting the market, give us reason to believe that 2016 will be a great year. As mentioned in the last call, the integration of the order-to-cash process started in December and this will help increase profitability going forward. We expect the Frozen division to grow in the high teens with EBITDA margins nearing high single-digits for this year.

Regarding MegaMex, we still see inventory challenges due to new specifications and requirements for certain categories from the FDA. But, considering the improvements in Don Miguel and the favorable performance of our power brands, 2016 should be very good.

Excluding acquisitions, free cash flow for the year was Ps. 804 million. Leverage ratios remain comfortable and we just enhanced our debt profile, refinancing our dollar-denominated debt to a five-year bullet loan, extending the average maturity of our total debt to five years.

Regarding our guidance for 2016, we remain optimistic about the consumption environment. That said, the stronger dollar is having a significant effect on gross margins that will be partially offset by price increases. Our pricing strategy will be monitored closely during the year and we will tactically trespass (phon) part of the pressure according to inflation.

We expect Mexico core sales growth in the high single-digit; Frozen sales growth, as I mentioned, in the high teens; so total net sales for the year will grow in the low teens—this considers a full 12 months for Helados Nestlé; EBITDA margin between 15.5 and 16.5—that will translate to a decline between 100 and 200 basis points compared to 2015; consolidated net margin of 9% to 10%, about 70 basis points lower than 2015.

We have budgeted approximately Ps. 1 billion in cap ex for the year; 40% of this amount is carryover from 2015 and the rest is related to growth initiatives, with about one-third related to the Frozen division for new stores, remodeling stores, and new freezers. As a result of these numbers, free cash flow in 2016 will remain tight, in the range of Ps. 400 million to Ps. 500 million.

That concludes my prepared remarks this morning, so we are now ready to take your questions.

Alicia?



**Operator:**

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

We'll go first to Luis Miranda, Santander.

**Luis Miranda Valenzuela:**

Yes. Hi, Gerardo, Andrea, and Grecia. Just, Gerardo, I wanted to ask you for some color in terms of the top line performance of Mexico core. I mean, the growth—and I understand that the base of comparison was not easy, but I don't know if you could give us some color in terms of volume pricing during the quarter, and specifically if there was any material difference among categories for this. After the track record you had throughout the year, what would you like to have seen to be a moderate growth in the quarter? Thanks.

**Gerardo Canavati Miguel:**

Thank you. Good morning, Luis. Are you referring your question to the quarter or the year?

**Luis Miranda Valenzuela:**

To the quarter specifically.

**Gerardo Canavati Miguel:**

Okay. There was some underperformance in some categories because the comps were very tough. So four out of eight categories that comprised 80% of our sales, grew double-digits; two of—one of most important categories were down, one related to our pricing strategy in tuna and the other one related to price increases that due to elasticity would make soft volume in the quarter. But the main reason was that the fourth quarter of 2015 was a great quarter in terms of sales, so we managed to increase in several categories volume and some price. When we think about the full year, we can think that the price was approximately 3% above inflation and the rest came from volume increases.

**Luis Miranda Valenzuela:**

Perfect. Thank you, Gerardo.

**Operator:**

Once again, that is star, one if you would like to ask a question at this time; star, one, please.

It looks like we have no further questions.



**Gerardo Canavati Miguel:**

Okay. Well, 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:**

Thank you. That does conclude our conference for today. We thank you for your participation.