



GRUPO HERDEZ

THIRD QUARTER 2018 RESULTS

CONFERENCE CALL TRANSCRIPT

CORPORATE TRANSCRIPTS

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CONFERENCE CALL PARTICIPANTS

Luis Miranda, Santander

Felipe Ucros, Scotiabank

PRESENTATION

Operator:

Good morning, everyone, and welcome to Grupo Herdez's Third Quarter 2018 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, Chief Financial Officer. Please go ahead, sir.

Gerardo Canavati Miguel:

Thank you, Audra (phon). Good morning, everyone. As usual, we will start with an overview for the quarter and then an outlook for the year. In the end, we will take any questions you may have. Andrea, please go ahead?

Andrea Amozurrutia:

Thank you, Gerardo. Despite lower than expected consumer trends, net sales in the third quarter increased 8% compared to the same period of last year to achieve Ps. 5.2 billion. Net sales in the Preserves division grew 7.6% with outperformance in the mayonnaise, marmalade, mole, mustard, pasta, tea, and tuna categories, while performance by channel was solid across the board.

Among our commercial initiatives for the quarter, we launched the sequel of Bierdes (phon) campaign, for a Livelier World, directed to sustainable initiatives such as ocean cleaning and packaging recycling. This year, we have already installed 50 machines in the largest cities of the country, more than doubling the number in 2017, creating a powerful initiative that positions the Herdez brand as a responsible and pioneer brand. As well, we launched this quarter the Winner Recipes of the Presume tu Salsa campaign to the marketplace, and in a couple of months they have already added 1 percentage point of share to our salsa penetration in the country. As a matter of fact, these two initiatives won an Effie Award this week. We are very excited because this is the most relevant recognition in the marketing and advertising field not only in Mexico but internationally.

In the mole category, we launched a portfolio in a premium price point when compared to the regular varieties that highlights original flavors, creating value for the category and reaching new consumers.

Under the McCormick brand, we continue to extend the portfolio with the introductions of new varieties, such as ginger with lemon, in response to global trends in the segment with accelerated growth that also helps us to strengthen our leadership in the category.

In the Frozen division, net sales reached Ps. 823 million, 9.3% higher than the third quarter of last year, driven by Helados Nestle, volume growth in retail and the contribution of new products, such as the new versions of Pela Pop, Wholly Donut (phon) and Lalacherra (phon) Popsicles that contributed almost 7 percentage points to the growth in the quarter.

For Nutrisa, the increase in average ticket and a sequential improvement in traffic resulted in a 4% growth in same-store sales.



Exports reached Ps. 356 million, 10.2% higher than the same period of last year, due to volume increases in home-style salsa and mayo, as well as the benefit of the strengthening of the U.S. dollar when compared to last year.

Consolidated gross margin in the quarter reached 38.6%, a decrease of 1 percentage point compared to the same period in 2017, mainly explained by an unfavorable sales mix in the Preserves segment.

Consolidated SG&A as a proportion of sales declined 80 basis points to 26.2% due to the absorption of fixed expenses, resulting mainly from sales growth in the Frozen segment combined with an easy comp due to the donations for the earthquakes registered in the third quarter of last year. It is worth highlighting that SG&A relative to net sales in the Frozen division decreased 4.5 percentage points to achieve 54.6% of sales.

EBIT in the quarter at the consolidated level rose 8.7% to Ps. 672 million, with a stable margin of 12.9%. EBIT margin in the Preserve segment decreased by 50 basis points to 14.8%, resulting from the impact of the unfavorable sales mix.

In the Frozen segment, EBIT margin reached 8.1% compared to 3.5% in the same quarter of last year.

Consolidated EBITDA totaled Ps. 802 million in the quarter, almost 6% higher than the same period in 2017. EBITDA margin reached 15.4% or 30 basis points lower than the same period of last year, mainly affected by the gross margin contraction seen in the Preserves division.

Majority net income totaled Ps. 241 million in the quarter with a margin of 4.6% or 1 percentage point higher than in 2017. This increase is explained by MegaMex's performance, a lower tax rate and the sequential improvement seen in Frozen.

Regarding MegaMex, net sales totaled Ps. 3.3 billion in the quarter, an 11.5% increase compared to last year, driven by a balanced mix of price and volume and a better sales mix. Guacamole and home-style salsa categories continue to outperform the portfolio, both in volumes and sales terms.

Consolidated net cap ex in the quarter was only Ps. 71 million, which was primarily allocated to maintenance and new stores for Nutrisa.

Cash flow from operations totaled almost Ps. 800 million in the quarter, thanks to the recovery of accounts receivables related to the regularization of collection after the new billing system (inaudible).



Consolidated net debt to EBITDA in the quarter totaled 1.3 times, less than one half our internal target, while net debt to consolidated stockholders equity reached 0.26 times.

I will now turn the call over to Gerardo.

Gerardo Canavati Miguel:

Thank you, Andrea. During the quarter, Nutrisa received the declaration of 'Famous Brand' from the Mexican Institute of Industrial Property. In addition of being appraised (phon) for the passion and dedication of all our associates, this recognition drives us to offer the best quality in our products, a wide variety in our portfolio, and the best service to our customers. This is the fifth brand of the group to receive this declaration, a firm statement of the power of our brands.

MegaMex is having an outstanding year, with strong tailwinds regarding consumer trends, consumption and innovations. Herdez and Wholly are growing double-digit, with strong household penetration. Currently, guacamole is just one third of avocado household penetration, so we are very excited of the opportunities going forward. But remember that our success attracts competitors. The marketplace is becoming very competitive and low fruit prices do not last forever. Having said that, we need to temper our expectations going forward. Avocado prices are extremely volatile and comps may get tougher in the next quarters.

In Preserves, our performance has been in line with the flattish environment. We do expect a slight pickup for the next quarters, something in the low single-digits. Our marketing strategies, as Andrea mentioned, have been a big booster of performance and we will continue to renovate our go-to-market approach.

We are very encouraged with the results of our execution in Frozen. Helados Nestle is ripe for growth with sound innovations and go-to-market strategies. While traffic in Nutrisa is down when compared to last year, we have made significant progress in improving our customer experience at the store. However, nothing comes for granted. Our headwinds include input cost, such as higher raw materials due to recent flooding in the northeast of the country, electricity cost that have skyrocketed, freight in Mexico and the United States, and of course, the dollar.

We expect to finish 2018 within our lowered guidance; sales growth in the mid single-digit range, while EBIT, EBITDA, and net income will grow in the high single neighborhood.

At this point, we will open the line and take any questions you might have.

Operator:



Thank you. If you would like to ask a question, please press star, one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow the signal to reach our equipment. Once again, it is star, one for questions. We'll pause just a moment. Again, if you do have a question, please press star, one.

We'll go first to Luis Miranda at Santander.

Luis Miranda:

Yes. Hi Gerardo, Andrea. Good morning. Thanks for taking my call. I have two questions. The first one is on the Preserves. I just want to get some additional color, if this softness in the consumer, it's creating a much more—a more promotional environment, if you're seeing competitors becoming more aggressive? I know that this is a relative term and this is subtle changes, but additional pressure in pricing, and if there's any specific category where you're seeing this?

With regard to the Frozen division, I understand that the modern trade usually is not one of the biggest channels for the distribution of ice cream, but on the press release you mentioned that the growth in modern trading (phon) - I don't know if we have seen a very important growth here - and if you could elaborate here on the outlook. Thank you.

Gerardo Canavati Miguel:

Good morning, Luis. Yes, indeed, this flattish environment, where volume growth is near zero as a category level, has created some competitive challenges, and definitely, we have seen a lot of price pressures in our major categories. Ex tuna, we are okay. Mayo, tomato puree are very stable. Tuna is down. Tuna is what's making this, our volumes totally go down, and there are other—some categories that are stable, like growing 1% or 2%, but overall it's practically flat.

Your second question regarding...

Luis Miranda:

The growth of the modern trading in Nestle.

Gerardo Canavati Miguel:



Okay. Modern trade, yes, we have been growing there. If you do some market research you have seen that our fridge have more product, more expense (phon). It is still small. We believe we will continue to grow more with innovations for take-home. For example, with boxes with several popsicles, more value-added than mainstream. Recall that mainstream in this channel would be vanilla, chocolate and Neapolitan flavors. We really don't want to compete in that segment because it's highly competitive. We see more value with value-added products.

Luis Miranda:

Perfect, that was good. Gerardo, can you give us an update on the outlook for the deployment of the freezers?

Gerardo Canavati Miguel:

Well this year remember that there's no deployment of freezers. We just bought about—just a few freezers for refurbishment. We are ready to buy more freezers for growth next year, probably north of 10%.

Luis Miranda:

Okay, perfect. Thank you.

Operator:

As a reminder, if you do have a question, please press star, one.

We'll go next to Felipe Ucros at Scotiabank.

Felipe Ucros:

Yes, good morning everyone and, as always, thanks for the space for questions. Let me ask you a couple of questions around Frozen and also around innovation. On Frozen you guys had some problems last quarter because of the redistribution of refrigerators. I wanted to know how that has advanced, if you're done with the movement of refrigerators around the system, or if we should see some more in the coming quarters and if we saw some of it in this quarter. Maybe also talk a little bit about the brand revamp that you were doing at Nutrisa stores, how that's going. I mean, we got a chance to see some of the stores in Mexico on our last visit, but I wanted to see how that was going and if you have some definite plans for next year regarding a continuation of this revamp program. Then maybe if you can also give us an idea of whether



you have a measure of innovation. Some companies have a measure that basically tells us what percentage of the product lines has been introduced within the next three years. I don't know if you guys have a measure like that that you could give us. Thank you.

Gerardo Canavati Miguel:

Good morning, Felipe. In terms of Helados Nestle, last quarter we were very specific that those charges were one-offs and we have seen this improvement in third quarter. Now, when moving freezers around is an ongoing concern, so we do not expect the kind of activity that we had in the first half of the year but is something that we are doing continuously. We are—we made a few changes in our execution in the last three or four months, so we do not expect this magnitude of charges going forward.

In terms of Nutrisa, so far we have about 10 to 12 stores. When we did the revamp of the 10 stores, the whole store, including floors, including everything, so so far the opinions that we have measured from our customers of these 10 stores has been extremely favorable, more than 90% like or more than like the new image. So, this is going to be an ongoing concern. We would go—we'll have to close a store for eight weeks as we did for the top four stores. We're going to go slower on the big stores and higher on the small stores. I think the answer is very obvious because that's one of our lower expectations in sales that our top stores were closed too much time. So, we're going to take our time in order to change the images of the ongoing stores.

Your third question about measurement of innovation, that depends on each brand. I think that a category of Frozen, where innovation is very high, should be in the mid double-digits. We are far behind that, but it's something that we try to—that we're going to work on that going forward. With this brand portfolio that we have is very—it's very unique to have a lot of innovation. The other categories is extremely low, probably in the mid single-digits.

Felipe Ucros:

Okay, that gives a very clear idea. If I can do a follow-up on Nestle. More than the actual charges I was interested on whether the operation for moving them is still ongoing and whether you're seeing an impact on sales because obviously the idea is to optimize the footprint, right? So, more than the charges last quarter which were clearly one-offs, I'm interested in seeing if you're still in the process of executing this project or how much more there is to go...

Gerardo Canavati Miguel:

Yes.



Felipe Ucros:

... and what results you're seeing on the top line.

Gerardo Canavati Miguel:

So, when I refer that this process is recurring, the difference between recurring and the program that we started this year was, let's say, you take probably 10,000 freezers, to do it at once, so as long as we don't have sales or sales with one client for a specific period of time, we would move that freezer and find another client. So, that would be some ongoing and the rate of ongoing should be probably between 4% and 5% of the current freezer base.

So, it's part of our business. It's almost the same as in Nutrisa that we will always have some closure of stores, of underperforming stores. The big idea is to lower that number and increase our occurrence (phon) accurate of opening stores or putting some freezers.

Felipe Ucros:

Okay, very clear. Thank you.

Operator:

As a reminder, if you'd like to ask a question, please press star, one on your telephone keypad. We'll pause just a moment.

At this time, there are no further questions. I'll turn the conference back over to Management for any closing remarks.

Gerardo Canavati Miguel:

Thank you for participating in today's conference call. Please do not hesitate to contact us if you have any questions. Thank you, Audra. Good day.

Operator:

You're welcome. That does conclude today's conference. Again, thank you for your participation.

