Transcript of EAC H1 webcast, 16 August 2012

Due to problems with the sound quality of the EAC H1 webcast recorded on 16 August 2012, please find below a transcript of the presentation and subsequent Q&A session:

President & CEO, Niels Henrik Jensen:

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The agenda is the usual. I will take you through the Group highlights. I will talk about the businesses and the development in those during the first half, and I will look at the remaining year. And Michael will take you through the numbers of that.

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So turning to the Group highlights, the consolidated revenue in local currencies obviously driven by the Interdean acquisition and also to a degree pricing increases in Plumrose. We met our plan for the first half, but the difficult macro environment is beginning to affect both businesses.

During the half year we paid a dividend to shareholders of DKK 5 per share and we received an interim dividend from Plumrose of USD 12 m in March. But we have not received any more dividends or royalties during the first half.

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So let me return to the Santa Fe group companies.

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The Relocation Services continue to execute on strategy. We are integrating the companies according to plan and meeting our process plan on the way including the coordinated sales and marketing activities throughout the Group based out of London. We are materializing the sales synergies that we have assumed and we are continuously signing up new international blue-ship customers for new contracts around the world. We have been surprised to some degree that some of those contracts though completed are not getting effect for periods that stretched between 2-12 months.

The expectation in terms of results for the Santa Fe Group were assumed to be affected both by the positive sales synergies and of course also by the negative synergies that would occur as we lose support from partners that are now our competitors. We have of course on the top line also been affected by the internalization of sales. These sales that are the between the group companies are of course now eliminated in the accounts which has contributed to reducing growth from what it would have otherwise been.

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Looking at the Moving Services segment growth is obviously also driven by the Interdean acquisition in this segment and in Australia we saw an overall growth of 3 per cent, driven by the international business though. We have experienced a considerable reduction in domestic long range moves and intense competition in prices as a result of that. However the International Business grew by double digits and more than compensated for the decline in the domestic market. So a very satisfactory development.

In Asia we saw a decline due to the loss of support as I mentioned before from the competitors and companies that used to be our partners that are now our competitors and elimination of intercompany sales. But we actually in Asia performed over our expectations for the quarter.

In Europe we are slightly above the result of the last year for the first half with fine performances in Germany, France, Spain and Portugal. All of them are also above last year but we have seen a contracting market overall and particularly weak in the UK and Switzerland. The UK being our single largest market of course has had a proportionate effect on the results.

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We have also seen very strong performance in the Relocation Services. Growth has been driven by Interdean as well. But we have also experienced very strong underlying growth in Europe and particularly Asia. Australia is not a big market for relocation services but we are developing that and we have signed up some promising contracts in this regard which we feel bodes well for the future development of relocation services in Australia.

We have experienced double digit growth in the Asian market for relocation services and Europe did well with a new focus, dedicated sales services in combination with the new corporate customers that we have managed to get on board in the relocation services sector.

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We experienced double digit growth in the Records Management business. We had quite high activity levels resulting in revenue growth of 19 per cent in local currencies with volumes almost 18 per cent up as a result of the continued build-up of storage levels – particularly of course in Asia. The small operations in Spain and Portugal that we acquired with the acquisition of Interdean are businesses under development and we will continue to build both these businesses and also expand in other emerging markets – not just in Asia but also in Central and Eastern Europe in the future.

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We opened a new warehouse in France and we hope that it will contribute to additional positive growth in the French market. We expect it will assist us both to improve efficiency and to presenting us with better sales and recruitment platform for the organisation in France as a whole. It is a 6,000 sqm office and warehouse, which is very centrally located just south of Paris on the ring roads and close to the airports there.

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Revenue grew by 1.1 per cent excluding Interdean if you measure it in local currencies. Obviously with Interdean it was a local currency change of 70 per cent and essentially unchanged EBITDA overall. Excluding Europe EBITDA margin was 7.4 per cent compared to 7.6 per cent.

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Anyway, the outlook for the year is a revenue of around 2.5 bn essentially unchanged with an EBITDA margin revised down from 8.5 to around 7.5 per cent.

The domestic market in Australia is not expected to pick up through the rest of the year but we expect that the low market in domestic will continue to be offset by a better market in International. We have continuous slow economic growth in Europe and slower phase-in of new contracts than expected. But nevertheless a positive development and in Asia continued FDI investment will continue to boost the activity the country contribute to a continued positive development in the Asian market.

None of the effects that we have seen are considered to be long-termed. We maintain our long-term target of 5 per cent annual growth rate and 10 per cent EBITDA margin.

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To say that we have a challenging business environment in Venezuela is to state of the obvious.

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But much to our surprise we really have seen no trace of the alleged positive GDP development in the economy. We have also not seen any government initiatives to boost the consumption as it is otherwise usual in election years. Hence even the relatively lower inflation we are experiencing this year has eroded purchasing power further and the demand for consumer goods/consumer staples continue to decline. We saw a decline last year of about 10 per cent. It looks like something like a similar magnitude this year.

We have made the best use possible of our strong brands. We spent quite a lot of money on marketing. We have had a lot of product launches to support sales and it has been successful as we have managed to see only a slight decrease in our own branded products whereas we have growth in other segments and basically have managed to maintain our market position.

Unfortunately, this is a year where new labour contracts are under negotiation for all our employee groups and capacity has been affected by the trade unions’ go slow initiatives and other steps they have taken to improve their position in the negotiation process.

The general business environment is affected by political and economic uncertainties ahead of the presidential election scheduled for 7 October and is obviously also contributing to the reticence of the consumers in the market.

We have not seen introduction of price controls and we do believe that we will not see them in the foreseeable future, if ever. And finally we have seen Venezuela entering into the MERCOSUR common market. We are following the development in that regard. We are not able to assess how that will influence our business over the next 4 years during the transition period.

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So revenue growth driven by price increases and we have been able to increase our sales volumes of fresh meat, co-packing products, pigs and feed stuff. However, the margin is affected by a comparatively high cost in raw materials compared to first half of 2011 where many of our raw materials were acquired at an exchange rate of 2.60. We have had salary increase for blue-collar workers in March per the existing labour agreement. We have also increased our A&P expenditure.

So translated into an EBITDA margin of 9.2 per cent compared to the 12.4 we realized last year, but after a comparable increase in the total revenue of 34 per cent.

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Obviously, the outlook for the remaining year has been adjusted quite severely. We have based the outlook on the USD exchange rate of DKK 6.0 versus the 5.6 we used previously. And we are now assuming that we will have an EBITDA margin of around 6.5 per cent versus the previous 9.5 in the previous outlook.

This is due to the higher costs of sales. Our input costs are going up very considerably through the sharply increasing prices for especially feed stuff in the world market. The drought situation in the US and in other areas are causing world market prices for grains, corn and soy to sky rocket and that will affect us quite considerably in the last half. There is also a very technical hyperinflationary accounting effect on aging of inventories which accounts for 0.6 per cent of the EBITDA margin adjustment.

We have had a new labour law which affects labour costs and a reduced work week which leads to more overtime. We are also seeing other taxes and levies, like old governments looking for tax revenue. The Venezuelan one is doing exactly the same, and also the local authorities are now charging excessively high levies and charges for simple – but necessary – operating permits.

If you combine that with the soft market and the reduced price elasticity that we have as a result of that – that obviously will be a negative mix and that is exactly what we expect will affect us in the remainder of the year.

We continue to see the fiscal imbalances building – I am sure you are following that as well – and it is impossible to say, but there is a risk that we will have a devaluation either later this year or beginning next year. It depends who wins the election 7th October and what the economic policies of the new government will be. So it is nothing which we can easily foresee.

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But in summary, first half came out on plan. Second half margins will be under pressure – particularly in Venezuela and hence we have revised our outlook for the whole of the year. And I will turn you over to Michael.

CFO, Michael Østerlund Madsen

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Thank you… First of all, let me highlight a couple of key factors impacting the H1 reporting. We continuously report Plumrose under hyperinflation and here in particular you have to be aware of the translation taking place in accordance with the end of period exchange rate. In this case a DKK/USD exchange rate of 590 versus 516 last year. And further the acquisition of Interdean and La Montseratina are included in H1 2012 figures, which was not the case – at least not for Interdean and very limited for La Montseratina – in 2011. Lastly, in general the numbers are affected by favourable exchange rates relative to DKK.

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The reported revenue came out at 3.5 bn under hyperinflation and assets comparative to last year, Interdean and La Montseratina are included in H1 2012 figures as well as a positive currency effect of almost DKK 400 m.

EBITDA margin at 4.7 – more or less detailed by Niels Henrik for each of the segments. Financials, net a cost of DKK 30 m – primarily interest expenses in Venezuela. And to a certain degree offset by a monetary gain under hyperinflation.

Tax expense of DKK 56 m – again under hyperinflation which adds a lot of complexity. Further there is a non-recognized deferred tax asset in the parent company and the fact that the farms in Venezuela are tax free, and it all affects the tax expense and the effective tax rate quite a lot.

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Moving on to the balance sheet: If we look at the working capital employed – it is decreased since beginning 2012 primarily because there was achieved a decrease in trade accounts receivables in Venezuela. At the same time trade account payables increased. And in terms of net interest bearing debt, a slight increase – not least because we finally, I would say – have succeeded to complete the refinancing of the Interdean acquisition. As per end of June DKK 119 m was up-streamed to the parent company and beginning July we have up-streamed further DKK 174 m. And that has at the same time impacted the cash and cash equivalents. End of half year DKK 30 m was in the cash of the parent company – obviously increased with the DKK 174 m up-streamed in July from Santa Fe.

Return on invested capital: a modest 8 per cent this time and at the same time it can be mentioned that operating cash flow from Plumrose has been very strong in H1 – not least because they have achieved a substantial reduction in the working capital.

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Outlook as mentioned revised – on the revenue line it is an upgrade to DKK 8.5 bn solely driven by the currency exchange rate between DKK and USD and on a consolidated level EBITDA margin is downwards adjusted to 6.5 per cent versus 8.5 per cent in the previous outlook.

And for currency we now forecast a DKK/USD rate of 6.0 versus 5.6 in the previous outlook and no changes are assumed in exchange rate between VEF and USD. Continuously 4.3 and with that I will hand over to the Q&A.

Q&A session

Thank you. We will now begin the question session. If you have a question please press star and then one on your phone. If you wish to be removed from the queue please press the hatch key or the pound sign. If you are using a speaker phone you may need to pick up the handset first before pressing the numbers.

Andrew Carlsen from Handelsbanken is online with a question.

Andrew Carlsen: Yes, good day. My questions are primarily related to the Santa Fe group. First of all, the H1 result we saw, and I am thinking especially about the EBITDA margin - is there any surprise, negative surprise in the relatively low margin or did it come out as expected?

Niels Henrik Jensen:

It came out as expected. In Australia we had a substantially lower performance in the domestic businesses, but that was on the overall level more than outweighed by better performance in the international business. Then we had a better performance than expected in Asia and we had a slightly lower performance in the UK and Switzerland than expected. But those offset each other, so over all we came out on the level we expected.

Andrew Carlsen: So basically you were expecting that Interdean would continue experiencing negative EBITDA in Q2 - Is that correct to assume that?

Niels Henrik Jensen:

That is correct.

Andrew Carlsen: Okay. Then the change in guidance for the whole year - is that because Interdean is not going to deliver in the second half year or is it the remaining Santa Fe group that is struggling.

Niels Henrik Jensen:

I would not say that a downwards adjustment of one per cent in EBITDA means that we are struggling. But we are seeing a contracting market and even though we are taking market share we believe, we will continue in a negative market development throughout the year and that will affect the general pricing level. So our expectation is adjusted because of that.

Andrew Carlsen: The reason why I am saying struggling is that I am trying to bridge the margin you guide for 7.5% and basically Q3 is a peak season in Europe and in the rest of Santa Fe. Is that correctly assumed?

Niels Henrik Jensen:

In Asia and Europe. Correct.

Andrew Carlsen: In order to bridge your guidance to reach the 7.5% this would basically require that both Interdean and Santa Fe would deliver double digit EBITDA margin around 13-14% in Q3. Is that possible and has that ever been done before?

Niels Henrik Jensen:

We typically in our peak season deliver very high margins, yes.

Andrew Carlsen: okay so assuming something upwards above 13% is not unrealistic in peak season?

Niels Henrik Jensen:

No not at all.

Andrew Carlsen: Okay. Thank you. That was that.

Kenneth Leiling from Danske Markets is online with a question.

Kenneth Leiling: Yeah hi. It is Kenneth Leiling here. First of all my question comes to the Venezuelan business. It sounds pretty coarse all the negative you are talking about by the second half of the year. So essentially, this margin in Q2 was somewhat weaker than it was for the first half year as a whole. I must admit I sort of struggle seeing how your margin in Venezuela should go from around 4% in Q2 to around 7% in the second half of the year obviously on the guided basis. Could you just explain how that works? Sort of up against the very cautious comments you have given about the environment.

Niels Henrik Jensen:

Yeah, even though we have the reduced price elasticity we do have price increases planned. We are also not giving up on the hope that we will be capable of selling Christmas material, we are just saying that we are not going to reach the level that we anticipated when we gave the outlook for the year.

Michael Østerlund Madsen:

Kenneth you have to be aware of the inflation there. I can hear that you are counting on inflated number. The inflation for H1 was only 7.5 % whereas the inflationary number for the full year is 22%. So that will impact your figures. And the calculation you are doing between quarters is to a certain extend flawed as well. So bear that in mind.

Kenneth Leiling: Okay. So you do not need a 7% margin the second half of the year to reach an average margin of 6.5%?

Michael Østerlund Madsen:

We might on a mathematical basis but part of it will be delivered by inflation, so to speak.

Kenneth Leiling: Okay. How much of that is delivered by inflation?

Michael Østerlund Madsen:

I do not have the numbers present but I can just hear the way you are calculating this, you cannot do it as straight forward as you are doing.

Kenneth Leiling: Okay. I just want to make sure I heard you correctly. Q2 margin in the Santa Fe business is exactly as expected. I mean, it seems sort of strange that you would expect such a low margin in the quarter. Is that because you knew that there would be for instance one offs that would depress the numbers that we cannot see or… Could you just comment on that?

Niels Henrik Jensen:

Essentially the EBITDA margin from last year to this year is unchanged. The only difference is the inclusion of the European business.

Kenneth Leiling: Yeah. And it seems for the half year as a whole the Interdean perhaps did not generate any profit on the EBITDA at all. Is that correct?

Niels Henrik Jensen:

Well it's a usual low season situation.

Kenneth Leiling: Okay. And was that the case last year as well? I am sorry I do not have the comparative numbers. I just want to make sure that…

Niels Henrik Jensen:

We have not published the comparative numbers because we did not own Interdean last year before August. But as I have said we are ahead of last year in Europe.

Kenneth Leiling: Okay. Thanks a lot.

Hans Gregersen from Nordea is online with a question.

Hans Gregersen: Good afternoon. It is very difficult to hear what you are saying but if I understood some of your previous answers then you say that quarter two is exactly as expected. Was that correct for Santa Fe?

Niels Henrik Jensen:

Yeah. I said that the overall number for Santa Fe on a group level is as expected.

Hans Gregersen: Yeah okay. So that brings me to the question. So the profit warning you are issuing for Santa Fe is then entirely related to the third and fourth quarter? And as far as I can see it must be related to something in terms mixes as you are maintaining your revenue target. What is it that suddenly is moving so much weaker in quarter three and in quarter 4 that you need to issue a profit warning? That is what I struggle to understand.

Niels Henrik Jensen:

The competitive development in the markets mean that we will see declining prices and declining profits as compared to our expectations.

Hans Gregersen: But I noticed in your initial comment Henrik you talked about a severe price pressure due to the consolidation. Is that globally – where is that taking place because this is not something you touched upon before?

Niels Henrik Jensen:

It is particularly domestically in the markets in Europe and in Australia that we are seeing a situation where you can say that the consolidation that is taking place is also leading to a shakeout in the market place where there is a certain degree of desperation setting in – I would say – which reflects on prices. In terms of the development in our ability to acquire the contracts that we expect and to continue to develop our business with the global accounts that we are focusing on that is going according to plan. But as I also mentioned some of these contracts – even though they are completed and signed – are not taking effect in the sense that we are starting to get volume from the contract immediately. What we are seeing is that we can spend up to maybe 18 months fighting for a contract going through all of the processes that are required by the purchasing department, the various organisations, the tender bids and so forth before we get to the point of signing the contract. And from then on there can be up to even a year before we in effect start seeing the volume play out in our business.

Hans Gregersen: Okay and that is fair. But what I still struggle to understand Niels Henrik is that this is not a new issues. This must have been going on in the industry all along. So how come this suddenly becomes a surprise? This is what I can't understand.

Niels Henrik Jensen:

I have to agree with you that we probably should have foreseen that there was a bit of deferral on that. But that is never the less the situation.

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Hans Gregersen: But then coming back. As you are maintaining your revenue base unchanged and you are cutting your margins quite significantly – at least from my perspective. That must imply that something is going on on the mix side. What is that? And I mean you set up some margin targets and you had some plans for breaking up the company. I mean obviously theses targets must be delayed or what sort of plans do you have for those to catch up.

Niels Henrik Jensen:

You mean looking into the future?

Hans Gregersen: Yeah.

Niels Henrik Jensen:

I am not really in a position to talk about our 2013 budget numbers.

Hans Gregersen: Sorry. I understand that you cannot talk about numbers but I mean when you issue a profit warning I would assume that internally there will be some discussions about how to catch up on plans – not specific numbers – but rather plans for where to go. I mean – this must have sparked some discussion about; can we actually reach the target we have been setting forward and, what do we need to do. I mean, what I am getting at is; should I expect any sort of extra costs for restructuring charges or how are you going to show the market that you will be able to live up to the targets?

Niels Henrik Jensen:

Yeah well it will be a combination of cost savings obviously and further emphasis on marketing and also a focused effort to bring about the volume from the contract signing in a much quicker pace than what we have seen.

Hans Gregersen: But how can you do that. I mean, you have told us before that there is a significant surplus capacity in the industry so I guess it is the customer who decide and so far they have decided not to move too quickly. I mean, what can you do – it is not to bash you – but I mean can you give any sort of signal of what you can do in order to accelerate the phase from you taking the contract on board for real.

Niels Henrik Jensen:

Yeah. I mean we are really working on it and it is a question of working on a local level. So when you sign a contract on central level then making sure that all contact points with the customer is activated immediately so that the local stations of the company with whom you have the contract are aware that there is a contract and they have to ship under that contract and not under the old arrangement. So it is a more focused and coordinated effort to embrace the customer immediately.

Hans Gregersen: Okay. My assumption that this is a mix game where something is gone wrong. Is that correct or…?

Niels Henrik Jensen:

I am not sure [I understand your question…?]

Hans Gregersen: I mean you maintain the same revenue guidance but you are cutting your margins so there must be something on the cost on the mix side that is causing this margin decline.

Niels Henrik Jensen:

You know the top line in this business is not a really good guidance of what is going on. So you cannot use it to that fine-tuned degree. What we are seeing is price pressure and that is affecting us but it is not necessarily affecting the top line because so many other items are in the top line.

Hans Gregersen:

Okay. Thank you.

Niels Henrik Jensen:

You are welcome.

Daniel Petersen from SEB is online with a question.

Daniel Petersen: Hi there. Daniel Petersen here. I have a couple of questions related to Plumrose. First of all the 8% EBITDA margin in Plumrose in the second quarter under old accounting is that sort of a clean margin? What I mean is that this year you have no positive effect from CADIVI and on the other hand you have the new higher salaries as well implemented. Is the 8% sort of clean in that way?

Niels Henrik Jensen:

You mean clean of one offs?

Daniel Petersen: Yeah. You can say on offs and you know the last year you had the benefit from lower raw material prices right from the CADIVI regime and so on. So assuming that raw material prices are the same going forward then the 8% is sort of a rough guide – it is clean in that sense.

Niels Henrik Jensen:

Right. But I think what we are trying to say is that the raw material prices will not remain the same going forward.

Daniel Petersen: I am aware of that but I am just saying that there are no particular one offs or anything in the second quarter?

Niels Henrik Jensen:

There may be some residual raw materials that have been acquired at 2.60 in the first quarter.

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Daniel Petersen: Okay. But it should not be in the second quarter?

Niels Henrik Jensen:

No

Daniel Petersen: And also just to double check. You are still not affected by the potential price caps. Is that correct?

Niels Henrik Jensen:

That is correct. Well we have seen that there is essentially only one industry that has been effected and that is personal care products for some reason and they have then announced that they were going to look at the pharmaceuticals next. But they have not done that yet so…

Daniel Petersen: okay. More operationally – now with these higher raw material costs hitting you – is there any sort of political will maybe changing or maybe trying to open up for more cheaper imports or something like that. Any help there at all?

Niels Henrik Jensen:

We are buying at world market prices so I do not think that will be an issue. We could buy raw material that is frozen – pork – cheap but that would be like competing with ourselves so we are not particular keen on seeing liberalisation on that. So I think I have to say no. I do not think there are any expectations that we are doing to see a political initiative to bring cheaper raw materials to the country.

Daniel Petersen: Then what are you going to do or what can you do to try and combat these rising costs and not only on raw materials - because that is obviously difficult - but then what is in your power, what can you do?

Niels Henrik Jensen:

Essentially we can only raise prices and that is the tool we are using. We are pretty good at it as you know. But obviously it has its limits when we are seeing price increases of a magnitude that we are discussing here.

Daniel Petersen: Off course. One final question on royalties. As far as I could read still no royalties out of Plumrose back home to Denmark. What is the chance that you will get any royalties at all before there will be another devaluation of the Bolivar?

Niels Henrik Jensen:

Fairly slim but the devaluation does not necessarily have to affect the existing receivables. We have seen that before. The government has recognised that the currency exchange rate enforced for payments that were in line would be the one that was paid out irrespective that there was a subsequent devaluation. And I would expect that if we have a government in place that is more say interested in giving incentives to international investors to invest in Venezuela they would apply exactly that technique.

Daniel Petersen: Off course. Thank you very much.

Niels Henrik Jensen:

You are welcome.

Andrew Carlsen from Handelsbanken is online with a question

Andrew Carlsen: For the second half in Santa Fe is Interdean still going to be dilutive on the EBITDA margin or is it going to be higher or lower than the rest?

It's still going to be lower than the rest. We have the peak season in Australia kicking in in the fourth quarter and we have peak season in Santa Fe in the third quarter. Both of them will have higher average margins than the Europa business.

Andrew Carlsen: Okay. Thank you.

Hans Gregersen from Nordea is online with a question. Just go ahead Hans.

Hans Gregersen: Sorry. Just one follow-up question. I did not understand the answer on the import cost for grains. How far down the road do you think you will have to walk before you will be able to higher prices to overcome what is going on in the international grain markets?

Niels Henrik Jensen:

As you know we are constantly testing the market. We have scheduled price increases. We are trying to be ahead of the curve. But obviously we cannot increase prices by what corresponds to a 60% increase in the cost of corn and soy beans in one go. So the market will determine. We'll try to put up prices as much as we can and we will then use discounts and so forth to test the level at all times. But to give you a definite time scale that is not feasible. But we will not be able to raise prices sufficiently within this year to recoup the increase in cost that we will see from feed stuff.

Hans Gregersen:

Okay. Thank you.

Kenneth Leiling from Danske Markets is online with a question.

Kenneth Leiling: Yeah hi. It's just to clarify again. Interdean in the first half of 2011 – did you say that at that point in time it also did not contribute to earnings or what? How did you phrase it – was the earnings up, or better this year and the first half year than it was last year or could you just remind me?

Niels Henrik Jensen:

Yeah. I said that the Interdean business was slightly up on performance versus last year so far.

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Kenneth Leiling: Because I am looking at some of the notes and it says that between January 1st 2011 and until the end of July Interdean generated an EBITDA of 35 million so does this mean that a month in July can generate that much earnings from that business? It seems like a very high seasonal development.

Niels Henrik Jensen:

I'm not sure that I fully understand your question but yes, you could have a monthly level of around that.

Kenneth Leiling: Okay. We can do it off line afterwards because… Yeah okay. Thank you so much.

We have no further questions at this time I will now turn the call back to your host.

Thank you very much.