9 September 2019

Associated British Foods plc

Pre Close Period Trading Update

Associated British Foods plc issues the following update prior to entering the close period for its full year results for the 52 weeks to 14 September 2019, which are scheduled to be announced on 5 November 2019.

Trading performance

Our full year outlook for the group is unchanged, with adjusted earnings per share expected to be in line with last year. Strong profit performances this year from Primark and Grocery are expected to be offset by the anticipated decline in AB Sugar.

Interest

Net interest expense will be lower than last year following the maturity of $310m of private placement senior notes in March and lower debt in high interest markets. As previously explained, an increase in other financial income will reflect the increase in the surplus of our defined benefit pension schemes between the 2017 and 2018 year ends.

Currency

Two thirds of the group’s operating profit are earned outside the UK and the weakening of sterling against our trading currencies, particularly towards the end of the financial year, will result in a translation gain this year of some £10m.

References to growth in the following commentary are based on constant currency unless stated otherwise.

Net cash

Free cash flow will be higher than last year with the biggest factor being lower capital expenditure. Lower expenditure in the food businesses follows the recent completion of some major capital projects and the lower Primark spend this year reflects the planned later phasing of next year’s store openings and the consequent timing of store fit out costs.

Year end net cash is expected to be some £900m, compared to net cash of £614m last year.

Grocery

Grocery revenues are expected to be ahead of last year with adjusted operating profit well ahead. This profit includes a £12m one-time cost for the closure of the Twinings tea factory in China in the first half and so, on an underlying basis, profit growth was excellent. Margin improvements were delivered by George Weston Foods in Australia, ACH in the US, Twinings Ovaltine and Acetum.

Twinings Ovaltine made good progress this year. Twinings delivered strong revenue growth following the success of Cold Infuse teas, while the development of our herbal teas range included good growth from Superblends in the UK and new launches in Australia and France. Ovaltine sales growth was supported by the continuing success of new product launches in Switzerland.

At Allied Bakeries revenues progressed this year following price increases agreed with a number of customers. As previously advised, the termination of our largest private label bread manufacturing contract will lead to a volume loss in our next financial year. We are taking steps to reduce our capacity and will shortly close our Cardiff bakery. The costs of closure have been included in our full year outlook for adjusted operating profit. During the coming year we will continue to focus on reducing operating losses within the business.

Jordans, Dorset Cereals and Ryvita delivered an improved manufacturing capability, with the commissioning of the new Ryvita bakery in Bardney, Lincolnshire, and transferred muesli production to a state-of-the-art facility in Poole, Dorset. AB World Foods enjoyed a successful year with strong growth in the UK and internationally, particularly in the US.

At Acetum we benefited from a full year of ownership, while margins improved as grape must prices returned to lower levels than the exceptionally high level that followed the poor grape harvest in 2017. Investment was made in the launch of the Mazzetti brand in the UK, while international sales increased particularly in Canada and Australia.

ACH performed strongly this year, with excellent margin improvement driven by lower oil commodity costs, further market share gains in Mazola corn oil and improved trading in Mexico. George Weston Foods in Australia delivered excellent margin and operating profit growth through ongoing cost reduction, procurement gains and a first year of ownership of Yumi's.

Sugar

AB Sugar revenue and adjusted operating profit will be down on last year, as previously advised, with lower EU sugar prices having impacted our UK and Spanish businesses and a poor crop affecting sales volumes in China. In July we expected the full year profit decline in Sugar to be reflected in the first half. This has indeed been the case, with delivery by Illovo of their later phasing of sales and profit. Our full year outlook is unchanged.

EU stock levels have tightened during 2018/19 as a consequence of lower sugar production in the last campaign. Indications are that EU sugar production for 2019/20 will remain at this lower level following a further reduction in the crop area which will largely offset improved beet yields. As a consequence, stocks are forecast to remain low which should underpin the higher spot EU sugar prices. Our UK and Spanish businesses have continued to contract sales for next year at improving prices during the summer.

In the UK, sugar production of 1.15 million tonnes was significantly lower than last year when beet yields achieved record levels. Next year's production is expected to be higher than this year, with an improvement in beet yield more than offsetting the reduction in crop area.

In Spain, we concluded the contracting of beet volumes with growers for the 2019/20 campaign at reduced prices from last year. This led to our contracted crop area reducing by one third and beet sugar production is expected to be around 205,000 tonnes. This lower beet sugar production will be compensated by increased raw sugar refining. We expect an improved operating result for Spain next year arising from higher sugar prices and these lower beet costs.

Sugar production at Illovo is expected to increase slightly to 1.72 million tonnes this year, driven by further improvements in cane yields. Profitability will be in line with expectations, with particularly strong performances in Tanzania, Zambia and Eswatini offsetting weaker results in Malawi and South Africa.

In China, sugar production of 149,000 tonnes was well down on last year as very poor quality beet hampered factory production and sugar extraction which, combined with low domestic sugar prices, will produce a loss in this financial year as previously advised. The new crop is well established and some recovery in beet quality is expected.

Agriculture

AB Agri revenues will be well ahead of last year, driven by higher feed volumes and higher feed prices reflecting an increase in raw material costs. Adjusted operating profit has, however, reduced following the loss of high margin co-products from the Vivergo bioethanol plant, following its closure last autumn, and lower sales of sugar beet feed.

Speciality Nutrition, our premix and starter feed business, successfully commissioned a new factory at Fradley Park, Staffordshire. Profits were lower than last year which benefited from unusually high vitamin prices. Frontier improved its result from grain trading following high wheat prices in the first half and increased market volatility.

Sales and profit at AB Vista declined reflecting an increasingly competitive phytase enzyme market but we are encouraged by the launch of Signis, our innovative animal digestion aid. Profit fell in our Chinese feed business with lower sales to the dairy and pig sectors.

Ingredients

Ingredients revenues will be ahead of last year, while adjusted operating profit is expected to be in line.

In AB Mauri, sales in North America increased supported by product innovation in bakery ingredients and higher yeast prices to recover increased input costs. Although our businesses in South America generally performed robustly, sales and profits in Argentina were impacted by the challenging economic environment, increased competition and the application of hyperinflationary accounting. On 31 May we completed the acquisition of Italmill, a supplier of specialist bakery ingredients from a well-invested facility in the north of Italy.

We recently announced our intention to form a yeast and bakery ingredients joint venture in China with Wilmar International. This will combine our existing activities in China and technical expertise with their extensive sales and distribution capability. Completion is subject to the receipt of regulatory approvals. The joint venture will build a major yeast plant to be co-located with Wilmar's facilities in north east China.

Sales and profit at ABF Ingredients were modestly impacted by a lower contribution from animal feed enzymes. AB Enzymes continued to grow in the bakery and other food markets and increased its international sales. Ohly, our yeast extracts and seasoning powders business, made good progress in the food and health markets. PGPI, our US protein extrusion business, delivered strong sales growth of plant protein crisps.

Retail

Sales at Primark for the full year are expected to be 4% ahead of last year at constant currency and actual exchange rates, driven by increased selling space partially offset by a 2% decline in like-for-like sales. Sales growth in the fourth quarter increased, driven by an improvement in like-for-like performance. Early trading of the new autumn/winter range has been encouraging.

Primark has performed well in the UK where sales in the total clothing, footwear and accessories market have been weak. We continued to deliver a significant gain in market share, with sales growth of 3% and a like-for-like sales decline of 1%. Sales growth was driven by a strong contribution from new selling space. We have been encouraged by our customers' reaction to our new store in Birmingham High Street which showcases our full product range and new food and beverage and beauty services.

Sales in the Eurozone are expected to be 5% ahead of last year at constant currency, with particularly strong sales growth in Spain, France, Italy and Belgium. The contribution from our new stores in Bordeaux, Seville Torre and Ljubljana exceeded our expectations. Like-for-like sales fell by 3%, driven mainly by a weak performance in Germany where we have strengthened management and initiated focused marketing.

Our US business continued to deliver strong sales growth, driven by excellent trading at the Brooklyn store, which opened last summer, and like-for-like growth. This, coupled with the lower operating costs arising from the selling space reduction in three stores, will result in a significantly reduced US operating loss. Our tenth US store at American Dream, New Jersey will open this autumn to be followed by Sawgrass Mills, Florida later in 2020 and we have exchanged contracts on a store in State Street, Chicago.

The first half operating margin of 11.7% was well ahead of the same period last year of 9.8%. This was driven by a weaker US dollar on contracted purchases, better buying and tight stock management. As expected, margin in the second half will be lower reflecting the effect of a stronger US dollar on purchases. Stock has continued to be managed tightly and markdowns in the second half are now expected to be in line with the good performance last year. Our full year outlook for operating profit is unchanged, with margin ahead year-on-year.

The strengthening of the US dollar during this year and the recent weakening of sterling will increase the cost of goods for next year. We anticipate achieving some mitigation from reduced materials prices, the favourable effect of exchange rates in sourcing countries and better buying. Combined with a more typical level of markdown, we expect a reduced margin next year.

Retail selling space increased by a gross 0.95 million sq ft this year, with 14 new store openings. Four stores were added in the UK; three in Germany; two in Spain; two in France and one each in Belgium, the Netherlands and our first store in Slovenia. We relocated to new premises in Birmingham High Street which, at 160,000 sq ft, became our largest store. The smaller of our two stores in Oviedo, Spain, was closed and the size of our store in the King of Prussia mall in Pennsylvania was reduced. This brings the total estate to 373 stores trading from 15.6 million sq ft compared to 14.8 million sq ft a year ago.

In the next financial year, we are planning to add a net 1 million sq ft of additional selling space, weighted to the second half. France and Spain will see the most space added and we expect to open 19 new stores together with a number of relocations and extensions. The major new stores will include Paris Plaisir, Lens and Calais Cité Europe in France, Milan Fiordaliso in Italy, Bilbao Gran Via, Barcelona Plaza de Cataluña and Seville Lagoh in Spain, Rotterdam Forum in the Netherlands and Trafford Centre in the UK. Our first store in Poland will open in 2020 in Warsaw, taking Primark to its thirteenth country.

Brexit

Our businesses have completed all practical preparations should the UK no longer be a member of the EU and contingency plans are in place should some of our businesses experience disruption at the time of exit.

Adoption of IFRS 16 *Leases*

The group will adopt IFRS 16 in the 2020 financial year and the 2020 interim results will be our first financial report prepared under this new accounting standard. We will transition using the modified retrospective approach, under which the comparative period is not restated. While this is a significant change in financial reporting, our business model remains unchanged and our balance sheet remains robust.

The effects of adopting IFRS 16 will be calculated based on our transition date of 15 September 2019 and on bond yields as at that date. We expect to recognise lease liabilities at transition of some £3.5bn, the vast majority of which relate to Primark's leasehold store estate. For Primark, IFRS 16 will result in an increase in operating profit margin and a reduction in its return on capital employed percentage to the mid-teens due to right-of-use assets being recognised on the balance sheet. The results of our Food businesses are not significantly affected. Our current projection is that the adoption of IFRS 16, if applied to this financial year on a pro forma basis, would result in a reduction in the group's adjusted earnings per share of no more than 2%.

We will report under existing accounting standards in our 2019 annual report in November. Our annual results presentation will outline the pro forma impact of IFRS 16 on the 2019 financial statements and metrics.

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