23 February 2015

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 interim results to 28 February 2015 which are scheduled to be announced on 21 April 2015.

Underlying trading remains in line with expectations and, as noted in our last trading update in January, we continue to expect a marginal decline in adjusted earnings per share for the group for the full year. As previously indicated, the adjusted operating profit for the first half is expected to be lower than last year. Sterling has strengthened against most of our major trading currencies which has had a negative effect on the translation of overseas results. Adjusted earnings per share are expected to be in line with last year, largely benefiting from a lower tax rate. Primark has performed well and its expansion is continuing, Grocery is expected to deliver a first half operating profit in line with last year, and Ingredients and Agriculture have made excellent progress in operating profit building on their very positive performances last year. As previously indicated, profitability at AB Sugar will be substantially lower.

Cash flow and funding

We expect an operating cash outflow in the first half of the year. Working capital will increase, largely reflecting a higher level of sugar stockholding, while capital expenditure will be comparable with last year. £60m was spent on the acquisition of Dorset Cereals last October. Net debt at the half year is expected to be some £0.8bn, similar to the position at the last half year, reflecting the acquisition, a higher level of working capital and a £107m translation impact on our non-sterling denominated net debt.

Sugar

The profit outlook for Sugar in the full year remains unchanged. Revenue in the first half will be substantially lower than last year with profitability close to break-even. The second half will benefit from performance improvement initiatives and the non-recurrence of last year's cost of restructuring the EU sugar businesses. EU sugar prices, as previously indicated, have been lower in the period leading to lower revenues and margins for both the UK and Spain, although there has been some recent stabilisation. Given the difficult commercial environment, AB Sugar has focused on the management of its cost base: a continuous improvement programme across all businesses, overhead reduction, and lower beet and cane costs.

The campaigns in the UK and Spain were excellent with record factory performances and high product quality achieved throughout the period. We have benefited from a large UK crop and good extraction rates. UK sugar production in the current year is now estimated to be 1.44 million tonnes, compared with last year's 1.32 million tonnes.

The wheat-fed bioethanol plant operated by Vivergo Fuels in Hull is now achieving rated output and is focused on maintaining efficient production. However, as announced at the beginning of February, the interim results will include a non-cash exceptional charge of £98m to impair the group's investment in this joint venture with BP and DuPont, as a result of the continuing fall in crude oil and bioethanol prices, and the further weakening of the euro against sterling.

Illovo's production season is almost complete and off-season maintenance is now well under way. Total production volume will be marginally lower than last year as a result of drought in South Africa but elsewhere volumes have been higher. Zambia achieved record sugar production and we will be implementing plans for further development of the factory to increase sugar refining capacity, to supply higher quality sugars to the regional market. The new potable alcohol distillery in Tanzania is operating effectively with consistent production achieved throughout the period. Low-cost imports held back domestic prices in Tanzania, in Malawi the appreciation of the kwacha held back domestic sales volumes, and next season's volumes in South Africa are not expected to recover from this season's low levels.

We have already announced our intention to cease sugar operations at our factories at Yi'an and BoCheng in Heilongjiang province in north east China. Achieving beet yields sufficient to provide these factories with an adequate supply of raw material, at a competitive cost, has been particularly challenging and we concluded that these factories were likely to remain uneconomic for the foreseeable future. We also announced action to be taken to reduce associated overheads. The group's interim results will include a loss of some £128m, reflecting the write-down of assets and including one-off cash costs of £18m, all of which will be excluded from adjusted operating profit. Following this action, we expect all of our remaining sugar factories in China to be cash generative, even at current low sugar prices.

Agriculture

At AB Agri, excellent trading by AB Vista and strong commercial and operational performances across the businesses will drive first half adjusted operating profit well ahead of last year. An abundant availability of forage crops and falling commodity prices will result in revenue being lower than last year for our UK feed business.

Further strong growth in the Americas for Quantum Blue, our phytase feed enzyme, and encouraging sales in the EMEA region were the principal drivers of AB Vista's performance. In China, despite weak market conditions, our compound feed business performed well with success for its strategy of targeting feed sales to large farms. The industry in China is moving from traditional backyard farms to larger, more professionally managed, farms demanding higher quality service, differentiated products and food safety credentials which our business is well placed to deliver. Frontier Agriculture, our joint venture arable operation, traded at similar levels to last year and, after a slow start, sales volumes of crop inputs are now improving as UK farmers commit to fertiliser purchases.

Grocery

Revenue and profit in the first half are expected to be close to last year at both constant currency and at actual exchange rates with the translation benefit of a strong US dollar offsetting weakness against sterling elsewhere.

Twinings Ovaltine made excellent profit progress in the period. Tea sales grew in the UK and Australia, where record market shares were achieved, and very strong growth was realised in its developing markets of China and India. Profit growth was driven, not only by higher sales, but also by lower manufacturing conversion costs and further operating efficiencies in the integrated tea supply chain. Ovaltine continued to perform well in its developing markets.

The UK bakery market remains intensely competitive with a combination of over-capacity in the industry driving manufacturers towards marginal pricing, and retailers seeking to prove their value credentials in essential shopping items such as bread. As retailers drive for value and range simplification, already tight margins have come under further pressure and Allied Bakeries' profit will be lower than last year as a result. Since its acquisition last October, Dorset Cereals has traded well and its integration with Jordans Ryvita is on track.

At ACH in North America, Mazola achieved strong volume growth following increased investment in advertising and marketing. Volume and market share growth was achieved by Capullo in Mexico where margin also benefited from lower oil costs.

This was a disappointing period for George Weston Foods in Australia. Bread margins have been reduced by a combination of competitive price pressure and retailers featuring bread in their drive for lower prices. Higher-cost and variable-quality raw materials reduced margins at our meat business, Don KRC, in the first half, but we expect to benefit from supply improvements in the second half of the year.

Ingredients

Revenues in the first half are expected to be ahead of last year at constant currency and broadly the same as last year at actual rates. Operating profit for the half year will be well ahead of last year, with a good recovery in yeast and bakery ingredients and a stronger performance from ABF Ingredients.

Revenue and profit improvement at AB Mauri was achieved in most areas of the business as benefits from the continuous improvement programmes were delivered, particularly in the optimisation of the supply chain. However, trading conditions in South America proved to be challenging due to high inflation in Argentina and Venezuela and an economic slowdown in Brazil. In January we opened a new technology centre in St. Louis, Missouri which will enhance our ability to support customers in North America with a range of yeast and bakery ingredient solutions. The integration of the bakery ingredients business in western Europe, which was acquired last year, is progressing to plan. Good progress was made in the period in the newly integrated yeast and bakery ingredients business in Australia and New Zealand.

ABF Ingredients delivered excellent growth in sales and profits in the first half driven primarily by the enzyme business.

Retail

Sales at Primark are expected to be 16% ahead of last year at constant currency driven by an 11% increase in retail selling space and very high sales densities in stores opened during the last year. As a result of the weakening of the euro against sterling, total Primark sales are expected to be 12% ahead of the same period last year at actual exchange rates. All five of our French stores opened over the last year have traded exceptionally well. Sales for the group in the last three months, including the important Christmas period, were strong and cumulative like-for-like sales have improved since the January trading update and are now level with last year. Total first half like-for-like sales growth for the group was held back by the unseasonably warm weather in the autumn across northern Europe and the impact, on existing stores, of new store openings in the Netherlands and Germany. However, total sales in northern continental Europe were well ahead of last year.

Operating profit margin in the period has been in line with expectations, although lower than last year as a result of a higher level of mark-down.

Retail selling space has increased by 0.5 million sq ft since the financial year end and, at 28 February 2015, 287 stores will be trading from 10.7 million sq ft of retail selling space. We opened ten new stores in the period including the relocation of the Northampton store to much larger premises. We opened four stores in the Netherlands, bringing our total there to 12 and increasing space by some 60%, and three stores in Germany including 80,000 sq ft in Dresden. We have a very strong pipeline of new stores in Europe extending over a number of years. We continue to expect the increase in selling space for the current year to be less than 1.0 million sq ft including further stores or extensions in Germany, Belgium and the UK.

Significant investment has been made, and is planned, to expand warehouse capacity in Europe. At the beginning of this year the capacity at Torija in northern Spain was doubled and the extension of our Mönchengladbach warehouse in Germany, which increased capacity by 60%, is now fully operational. We plan to open a new warehouse in the autumn in Bor, on the western border of the Czech Republic, to service stores in Austria and Germany.

Good progress has been made in building the management team in the US in anticipation of our launch in late 2015. We have signed eight leases for stores in the north east of the country, including seven from Sears. Six store locations have now been announced including Downtown Crossing in Boston and five in the following shopping malls: King of Prussia and Willow Grove Park, PA; Staten Island, NY; Danbury Fair, CT; and Freehold Raceway, NJ. A lease has also been signed for warehouse space located in the Lehigh Valley area of Pennsylvania.

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