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 53 weeks to 18 September 2021, which are scheduled to be announced on 9 November 2021.

Trading performance

Adjusted operating profit in the fourth quarter for both the food businesses and Primark is anticipated to exceed our expectations. Primark's operating profit margin in the period was strong despite lower than expected sales and Sugar will deliver a much-improved profit year-on-year, led by a very strong performance in Illovo.

For the full year, we now expect AB Sugar to deliver an even greater improvement in adjusted operating profit over last year than previously expected and Primark's adjusted operating profit, stated before repayment of job retention scheme monies, to be ahead of last year. Our outlook for the Group's adjusted operating profit, stated before repayment of job retention monies, is now expected to be above last year excluding the benefit of the 53rd week this year.

The net balance of interest expense, lease interest and other financial income will be lower than last year. The Group's full year effective tax rate is still expected to be in the region of 31%. Taking this all into account, including the overall trading performance, we expect adjusted earnings per share for the full year to be ahead of previous guidance and marginally ahead of last year excluding the cost of repayment of job retention scheme monies.

The strengthening of sterling against most of our trading currencies will result in a loss on translation this year of some £35m.

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

Net cash

Our expectation is that the year end net cash before lease liabilities will now be some £1.9bn, compared to £1.6bn at the end of the last financial year, despite the impact of the pandemic on Group trading. This outturn reflects the strong cash generating capability of the Group and good working capital management. The improvement in net cash since our last trading update is driven by the Group's higher operating profit and lower than expected Primark inventory.

Grocery

Grocery revenues are expected to be ahead of last year with adjusted operating profit lower than in the last financial year primarily driven by weaker corn oil margins at ACH. Profit also includes a one-off charge of £5m for further restructuring in Allied Bakeries.

Twinings and Ovaltine continued to make strong progress with both brands delivering growth. Ovaltine sales growth was primarily in Thailand, China and Switzerland, and was supported by the continuing success of new product launches in a number of countries. Twinings revenue growth was driven by strong new product launches and good performances in France and North America. Twinings has become the leading tea brand in France.

AB World Foods, Silver Spoon and Westmill sales were significantly ahead of pre-COVID levels and maintained the sales uplifts achieved last year. We increased marketing support to drive the Mazzetti brand in Acetum, delivering good growth in the US, the UK, the Netherlands and Germany. At Allied Bakeries, sales reduced following our decision to exit the supply of bread to the Co-op. Cost reductions arising from a further consolidation of our operations mitigated the loss of contribution from these sales.

As expected, adjusted operating profit for ACH will decline compared to last year, with margins impacted by the later phasing of price increases following a sharp increase in corn oil cost. Substantial price increases have been implemented over the year and a further price increase has been announced. Revenue at George Weston Foods in Australia is expected to be ahead of last year, excluding the benefit of the 53rd week this year. Adjusted operating profit will be lower, mainly driven by a decline in the Don meat business, where although we have seen some recovery in foodservice, we are still experiencing volumes lower than last year. Yumi's delivered strong growth with share gains in its existing products and successful new product launches.

Sugar

AB Sugar had a strong fourth quarter and revenue for the full year is expected to be 7% ahead of last year. This growth was driven by particularly strong domestic and regional volumes for Illovo as well as by higher prices in Europe and Africa. Adjusted operating profit will be ahead of expectation and substantially ahead of last year. All businesses continued to deliver savings from the ongoing performance improvement programme.

We expect demand in the European market to be in excess of production again this coming year.

UK sugar production of 0.9 million tonnes this year was well down on the 1.19 million tonnes produced last year, due to adverse weather conditions at the time of planting and the severe impact of virus yellows on sugar beet. Looking ahead, as we start the sugar campaign this September, our production forecast for next year is over 1.0 million tonnes with a reversion to normal yields more than offsetting a reduced planting area. Our sales in the UK this financial year have been strong. Work to restart the Vivergo bioethanol plant early next year is on track. The recent transition to E10 in blended petrol underpins the strong demand for bioethanol from fuel blenders.

In Spain we have seen an increase in revenues reflecting strong demand and higher prices, although operating profit margin was impacted by lower volumes from the northern beet crop. As a result of our current view of the prospects for yield and sugar content from beet sugar and our expectation of higher volumes but lower margins in our raw refining operation, we will make a one-time non-cash exceptional charge of some €100m to write down the net asset value of this business.

Illovo revenues are expected to be ahead of last year driven by strong domestic and regional sales particularly in Zambia. Sugar production was ahead of last year and although the disruption to production in Tanzania and Mozambique last year was not repeated, there was some disruption this quarter to the operations in South Africa and Eswatini as a result of civil unrest. Higher sales and a much-improved sales mix, combined with efficiency gains from the performance improvement programme, will deliver a higher than expected operating profit. Following the profit decline last year, the recovery this year is very strong and operating profit will exceed the profit delivered two years ago. In May we announced the expansion of our operations in Tanzania which will more than double our sugar production when commissioned. The additional volumes will be sold domestically and this project will be a major contributor to the Tanzanian government's objective of moving towards sugar self-sufficiency.

Ingredients

Ingredients revenues will be up on last year and adjusted operating profit is now expected to be ahead driven by strong trading in AB Mauri.

In AB Mauri demand for yeast and bakery ingredients remained strong in South America with price increases offsetting the significant cost inflation in that region. The growth of non-dairy creamer product sales in Brazil continued and the expansion of our Brazilian yeast plant is well underway. In North America, demand for retail yeast reduced but sales still remained well ahead of pre-pandemic levels. In Europe sales to the foodservice and craft channels have increased following the easing of many of the COVID-19 restrictions.

In ABF Ingredients, all businesses experienced an acceleration of market demand recovery in the last quarter. Enzyme sales to the bakery, food and textile markets continued to grow and achieved an all-time high, driven by growth in markets outside Europe and new product launches. Animal feed enzymes saw some competitive pricing pressure. Ohly, our yeast extracts and seasoning powders business, continued to make good progress in the food and health markets. Abitec sales grew in the pharmaceutical and nutritional lipid markets.

Agriculture

AB Agri sales were well ahead of last year. Revenues in our UK compound feed business and in China were well ahead with the successful recovery of higher commodity and energy costs through feed prices. Competitive pricing pressure increased in animal feed enzymes and impacted margin at AB Vista. Taken together, adjusted operating profit is now expected to be ahead of last year.

Retail

Sales in the second half of this financial year are expected to be some £3.4bn and include trading for the 53rd week. Primark's operating profit margin in the second half, stated before the charge for repayment of job retention scheme monies, benefited from a significant reduction in store labour costs and lower store operating costs and is expected to be over 10%. Our forecast for the full year adjusted operating profit, stated before repayment of job retention scheme monies, is now ahead of the profit delivered last year.

Like-for-like sales in the third quarter were 3% ahead of the comparable period two years ago reflecting the very strong trading in the UK and those European regions where stores had reopened. Customers came back to our stores with enthusiasm and sales reflected some pent-up demand with very high basket sizes. Our sales in the fourth quarter were affected by the impact on footfall as a result of the changes in public health measures in our major markets to control the spread of COVID-19 and its Delta variant in particular. Trading in the fourth quarter varied considerably across the estate with a big impact in our major markets of the UK and Spain. However, we have seen a significant improvement in trading as the period progressed, from a weekly decline in like-for-like sales of 24% at the start of the period to a decline of 10% in recent weeks. For the fourth quarter as a whole, like-for-like sales are expected to be 17% lower than the same period two years ago.

In the UK our sales were affected by the rapid and significant increase in late June and early July in the number of people required to self-isolate following contact tracing alerts – the "pingdemic". Data shows that high street footfall was impacted by the caution displayed by many consumers at that time. The self-isolation rules were then eased in early August. Correspondingly, like-for-like sales showed a consistent improvement through the period from a decline of 24% in the first four weeks of the quarter to a decline of 8% in the last four weeks. Data for the UK clothing, footwear and accessories markets, which includes all channel and online sales, for the 12 weeks from 31 May to 22 August showed that Primark had the same value share of the total market compared to the same period two years ago.

In Continental Europe, the like-for-like sales were impacted by the performance of our stores in Spain and Portugal where the decline of foreign tourism caused by restrictions in international travel reduced our footfall. In addition, tight restrictions on store customer numbers were in place in Portugal for most of the period. Like-for-like sales for both these markets showed a decline of over 30% for the quarter compared to two years ago. In France, the requirement for the "pass sanitaire", evidencing a personal immunity to COVID-19, was introduced in early August and led to footfall declines.

US like-for-like sales in the quarter, excluding the Boston Downtown Crossing store which has now been downsized, were 3% ahead of the same period two years ago. In contrast to Europe, the US has had minimal public health restrictions.

The quarter saw a continuation of the trend for 'comfort living' with strong sales of leisurewear such as leggings and cycle shorts, and continued demand for seam-free matching separates for women. We also saw a good response to the launch of new licensed product with the womenswear Disney paisley range proving particularly popular. Sales of our autumn/winter ranges have started well and, as families look ahead to autumn, our back-to-school ranges started strongly with demand for our great value essentials such as children's t-shirts and socks.

Inventory at Primark during the last lockdown increased by some £400m above our normal levels. Following the reopening of all our stores, inventory levels have returned to normal and all spring/summer inventory brought forward from last year has been sold and the autumn/winter inventory held over from last season will be sold in the coming months. We are experiencing some delays to the handover of some autumn/winter inventory caused by port and container freight disruptions. These delays are expected to reduce the inventory at the year end by some £200m compared to expectation with a corresponding increase in cash on hand.

Margin in the second half benefited from a significant reduction in store labour costs, driven by lower store headcount and improved labour scheduling, and lower store operating costs. The lower store headcount has been achieved through natural attrition. The repayment of monies received from the job retention schemes in the UK, Republic of Ireland, Portugal, Czechia and Slovenia this year has been charged in the second half at £96m.

Looking ahead to our next financial year, operating profit margin will continue to benefit from lower store labour and operating costs. Our forecast is for the effect on margin of supply chain and raw material inflation to be broadly mitigated by the transaction currency gain arising from the weaker US dollar.

We expect to open a new store in the Fashion District of Philadelphia in the US on 16 September and so by the year end we expect to be trading from 398 stores and 16.9 million sq ft of retail selling space, an increase of 0.7 million sq ft over the year. Fifteen stores were added this year: four stores in the US; four in Spain; two in Italy, and one each in France, the UK, the Netherlands and Poland, as well as our first store in Czechia. We relocated to new premises in Southend, UK. One of our first stores to open in the Netherlands, a small store in Alkmaar, was closed during the period. Downsizing of the Downtown Crossing store in Boston was successfully completed in September. The three German stores which were downsized last year have shown sales results in line with pre-downsizing levels.

COVID-19 restrictions have held back our progress in developing the pipeline of new stores. We are experiencing some difficulty in accessing and evaluating potential sites and in negotiating with potential landlords. In the next financial year, we are planning to add a net 0.5 million sq ft of additional selling space. We will add four new stores in Italy, the largest being Milan Via Torino, four new stores in Spain and one store in each of the US, Czechia and Ireland. We expect to see an acceleration in new store openings in future years.

As we look ahead, digital has a critical role to play as part of Primark's marketing mix. We are progressing the initial design and development for the new digital platform and recruitment of new talent to create a new digital capability within the business is underway. A new and improved customer-facing website will be launched in the next calendar year. Improved functionality will allow us to showcase a much larger proportion of the Primark range and to provide customers with range availability by store. We are also strengthening our digital marketing capability to enable us to deliver more personalised content to customers.

ESG

We held our first ESG briefing in March, which covered the Group's strategy and governance in relation to ESG factors, provided an in-depth review of Primark's processes to provide assurance of its supplier practices, as well as an overview of the key factors for the Group. This presentation is available on our website. Our next briefing is on 17 September and will focus on Primark's sustainability strategy, designed to reduce Primark's impact on the environment and to improve the lives of people in its supply chain. A new customer campaign will highlight Primark's commitment to make more sustainable fashion affordable for all. A further briefing is due to be held in early 2022 and will focus on the environmental factors that are most material for the Group.

Financial leverage policy

The Board's treasury policies are in place to maintain a strong capital base and manage the Group's balance sheet to ensure long-term financial stability. They are the basis for investor, creditor and market confidence and enable the successful development of the business.

The Board has approved a financial leverage policy for the Group. In the ordinary course of business, the Board prefers to see the Group's ratio of Net Debt: EBITDA (on an IFRS16 basis and before exceptional items) to be well under 1.5 times at each half year and year end reporting date. In exceptional circumstances, the Board will be prepared to see leverage above that level for a short period of time.

The Group holds substantial net cash balances, which reduce its net debt, which in turn include lease liabilities, and most importantly ensure that it has sufficient liquidity to meet unforeseen requirements.

Notes:

1. *Two year like-for like sales*
   This measure enables measurement of the performance of our retail stores compared to our experience in 2019, which was before any of the economic effects of COVID-19. This measure represents the change in sales at constant currency in our retail stores adjusted for new stores, closures and relocations. Refits, extensions and downsizes are also adjusted for if a store's retail square footage changes by 10% or more. For each change described above, a store's sales are excluded from like-for-like sales for two years. No adjustments are made for disruption during refits, extensions or downsizes, for cannibalisation by new stores, or for the timing of national or bank holidays. It is measured against comparable trading days in each year.
2. *Exceptional items*
   Exceptional items are items of income and expenditure which are material and unusual in nature and are considered of such significance that they require separate disclosure on the face of the income statement.
3. *Adjusted profit and earnings measures*
   Adjusted operating profit is stated before amortisation of non-operating intangibles, transaction costs, amortisation of fair value adjustments made to acquired inventory, profits less losses on disposal of non-current assets and exceptional items. Adjusted profit before tax is stated before amortisation of non-operating intangibles, transaction costs, amortisation of fair value adjustments made to acquired inventory, profits less losses on disposal of non-current assets, exceptional items and profits less losses on sale and closure of businesses. Adjusted earnings and adjusted earnings per share are stated before amortisation of non-operating intangibles, transaction costs, amortisation of fair value adjustments made to acquired inventory, profits less losses on disposal of non-current assets, exceptional items and profits less losses on sale and closure of businesses together with the related tax effect. Items as defined above which arise in the Group's joint ventures and associates are also treated as adjusting items for the purposes of adjusted operating profit, adjusted profit before tax, adjusted earnings and adjusted earnings per share.
4. *Constant currency*
   Constant currency measures are derived by translating the relevant prior year figure at current year average exchange rates, except for countries where CPI has escalated to extreme levels, in which case actual exchange rates are used. There are currently two countries where the Group has operations in this position - Argentina and Venezuela.
5. *Net cash before lease liabilities*
   This measure comprises cash, cash equivalents and overdrafts, current asset investments and loans.
6. *Task Force on Climate-Related Financial Disclosures*
   In response to amendments to the FCA's listing rules, published in December 2020, relating to the Task Force on Climate-Related Financial Disclosures, a separate section of the annual report for this financial year will include disclosures around climate-related matters. We will focus on governance as it relates to climate change and will incorporate information currently disclosed in other published reports such as the CDP report. Work is underway to ensure compliance with the rules in the annual report for the 2022 financial year.

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