FY21 FULL YEAR RESULTS PRESENTATION TRANSCRIPT

Company: **Australian Agricultural Company Limited**

Date: **20 May 2021**

Time: **10:00am AEST**

[START OF TRANSCRIPT]

Operator: Thank you for standing by, and welcome to the AACo FY21 full year results release. All participants are in a listen only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question via the phone line, you will need to press the star key followed by the number 1 on your telephone keypad. If you wish to ask a question via the webcast, please enter it into the ask a question box and click submit. I would now like to hand the conference over to Mr. Hugh Killen, managing director and chief executive officer. Please go ahead.

Hugh Killen: Good morning, and thanks for joining us to discuss AACo's full year results for financial year 2021. I'm Hugh Killen, managing director and CEO of AACo, and with me today is our chief financial officer, Nigel Simonsz. I'm going to start by taking you through some of our key outcomes across our full year performance. I then once the guys through the progress we've made in FY 21. I'll provide a commercial overview, and drill down into how our brands are driving progress, and we'll then have a look at how this is playing out by region around the world. I will hand over to Nigel to take us through the financials in more detail, and I'll finish with an update on our operating environment as we move into FY 22. Let's turn now to the executive summary on slide number four.

Hugh Killen: I'm pleased to report that we've consolidated our first half performance across the full year. FY 21 has been dominated by uncertainty across many industries. In particular, food services face ongoing disruption across our key markets around the world. These risks continue despite progress in virus suppression and vaccination in parts of the world. In FY 21, our commitment to a simpler and more efficient AACo has been critical to navigating this uncertainty. This has helped us improve operating profit and statutory EBITDA in FY 21, compared to FY 20, and we've been able to deliver a positive operating cash flow result.

Hugh Killen: Our strong brand portfolio and distribution partnerships have also helped us connect with new customers and respond to changes in our markets. Overall, this has helped improve our average price per kilo, and this has been driven by increasing the proportion of meat sold through our Westholme and Downing Downs brands. The enduring value of our underlying assets has also delivered important stability through this period. We continue to see strong improvement in our property values, which continue to strengthen over the long term. And this has translated into a solid increase in the net tangible asset value of the business.

Hugh Killen: Turning to slide five. External forces in recent years continue to impact our results. Australia's overall cattle herd has declined in response to successive drought and flood challenges. This is reflected in the marginally lower AACo herd size in FY 21. While drought conditions have been eased, we continue to see below-average rainfalls across our properties. And three years on from the devastating Gulf floods, our properties there are still recovering with limited pasture response. One of the consequences of these seasonal impacts is low calving rates. These take time to float through our supply chain before impacting mature animal numbers.

Hugh Killen: In FY 21, our lower calving rates over the last three years have resulted in reduced overall meat production volumes, and lower volumes are primarily driven at 21% or $68.6 million decline in FY 21 revenue compared to FY 22. Lower volumes are expected to remain into FY 22.

Hugh Killen: Importantly, our herd rebuild has commenced, with a 47% increase in calves in FY 21 compared to the prior year. As this rebuild floats through our supply chain, we're likely to continue with some supplemental cattle purchases. More broadly, the uncertainty which has impacted FY 21 is likely to continue through FY 22. We will continue to monitor and adjust to changes in our markets, and in the wider economy. In this context, the key drivers of shareholder value in AACo remain; strong brands supported by simpler and more efficient business.

Hugh Killen: Turning now to slide six, and progress made in a challenging year. I want to go into more detail about these key value drivers and the progress we've made in FY 21. The pillars for our business remain; our values, our team, our operations, our focus on customers and consumers, and respecting what makes it possible. The key elements of our strategy remain; connecting with our customers and consumers by strengthening our brand portfolio; delivering for our customers by building the best routes to market; maximising revenue through strategic growth and investment; getting the most out of our assets and operations to optimise the value of every part of our business; investing in AACo's next 200 years through a company wide focus on sustainability; and continuing to strengthen the AACo team through our high performance culture.

Hugh Killen: Each of these elements have been critical to helping AACo navigate uncertainty in FY 21. We've continued to improve product allocation across our brands and markets to secure maximum returns. This has included further streamlining our brand portfolio. In FY 21, Westholme and Darling Downs represented 74% of our branded meat sales. In parallel, the strength of our global distribution network has enabled us to access new retail channels and online gourmet marketplaces.

Hugh Killen: This has been vital to connecting with new customers despite the impacts of COVID-19 on food service and international travel. And we've strengthened our talent and leadership capability in key functional roles across the business to keep supporting our branded beef strategy.

Hugh Killen: As a result of this work, we've proven an 8% improvement in overall price per kilo. We've generated $76 million in reduced operating expenditure compared to FY 20, and we've progressed our sustainability agenda in FY 21, including launching our beef cattle herd management carbon project.

Hugh Killen: Turning now to slide number seven. Through the challenges of FY 21, we're focused on maximising returns from every cut of meat we produce. This means ensuring the right cuts are available for the right market opportunities at the right time. This strategic market allocation has helped drive an 8% improvement in price per kilo, compared to FY 20. In particular, we're focused on: adapting to increasing at-home consumption and the rise of the home chef, including partnering with gourmet marketplaces and premium retail specialists; targeted digital marketing campaigns and improved product branding on menus and also in-store; and increasing the proportion of AACo product moving through Westholme and Darling Downs to 74% of all branded beef sales.

Hugh Killen: Today, 80% of our higher value loin and rump cuts are sold under our Westholme and Darling Downs brands. This is important because Westholme and Darling Downs have together achieved annualised price-per-kilo growth of 17% since FY 19. And this has underpinned our overall annualised price-per-kilo growth of 8% over the same period.

Hugh Killen: In addition to Westholme and darling Downs, our Wylarah brand focuses on the world's top fine dining restaurants. This market has been directly impacted by COVID-19 in FY 21. Wylarah remains a key strategic priority for AACo as the food service sector begins to rebuild. Getting maximum price per kilo has been even more important in FY 21, as we face headwinds impacting overall meat volumes.

Hugh Killen: The average F1 Wagyu lifecycle is long, at three and a half years from conception and birth through to meat production. This means that when flood and drought impact our calving rates, this takes time to flow through to reduced meat production volumes. In FY 21 we really began to feel the effects of successive years of drought and the flood on calving rates, with overall

Hugh Killen: ... sales value down 19% compared to FY 20. Securing premium prices for product through our quality brands is even more important under these circumstances.

Hugh Killen: Moving on to slide eight. On this next slide, I want to explore the benefits of branded beef sales a little more and discuss what this means for AACo moving forward. As a general rule, 15% to 20% of meat from an animal is the higher quality loins and rumps category. These cuts can be sold at a premium price through strong brands like Westholme ad Darling Downs. Since 2019, AACo's price per kilo for loins and rumps has improved 10% each year on a compound basis, and in FY 21 80% of AACo's loins and rumps were sold under Westholme and Darling Downs.

Hugh Killen: Further down the carcass, 35% to 45% of meat fits into the barbecue and secondary cut category. So far, 63% of AACo's barbecue and secondary cuts are sold under brands. 59% of barbecue cuts are now sold under Darling Downs, and 55% of secondary cuts go into branded sales. AACo has achieved 7% annual compound growth in price per kilo for barbecue and secondary custody since 2019, and we'll continue to increase the proportion of these cuts sold through branded channels. The remaining 35% to 40% of meat produces is in the trim category. At present, the vast majority of trim is sold as a commodity, with little product innovation or added brand value. This suggests there's potential to improve value derived from this category, and this is an area of potential growth which we'll be exploring the future.

Hugh Killen: Turning now to slide number nine. You can see how important our brands have to realising the value of the beef we produce. I want to delve a little deeper into how we have built the value of our Westholme and Darling Downs brands in FY 21. As mentioned above, Westholme has grown from 11% of our overall meat sales to 25% in FY 21. The team have worked hard to build brand equity and drive awareness, particularly in key markets in the US.

Hugh Killen: As you can see, Westholme more than tripled its following on Instagram this year with the majority of the audience being in the US. And in the year just gone, we launched our first paid digital marketing campaign in partnership with chefs in Australia and also the US. We've also pursued new direct-to-consumer channels during COVID-19. We've made Westholme available via the Goldbelly online gourmet marketplace in the US. And in FY 21, we partnered with Goldbelly to create online brand content, including using Goldbelly influencers to engage customers.

Hugh Killen: Jumping now to slide 10. In FY 21, we've seen the results of the work I discussed last year to refresh our brand in Korea. The team have rolled out new packaging and in-store activation across all 141 earmarked stores in South Korea. We saw support of this with a digital campaign to improve brand awareness with really significant results, and we've seen higher average consumer sales prices in FY 21. We we build the value of these brands and deliver more product through them, we will realise more value for our investors. And this is particularly important in the face of market uncertainty and headwinds in our wider industry.

Hugh Killen: Turning now to slide number 11. Through FY 21, this approach has driven positive outcomes across all our regions with the exceptions of China, Europe, and the Middle East. In North America, branded beef price per kilo is up 14% compared to FY 20. This has been driven by successive growth into retail channels during COVID-19. As discussed above, the US has been a major focus for digital and social campaigns to drive brand awareness around Westholme. And we've continued to focus on at-home chefs through meal kit product innovations and online marketplace partnerships, including with high-profile chefs.

Hugh Killen: In FY 21, we sold 19% of AACo meat North America, compared to 7% in FY 20. In Asia, we achieved 5% improvement in price per kilo compared to FY 20. This was driven primarily by the strength of our Darling Downs brand presence in Korea. Strong distributor relationships and other markets continue to support sales. We continue to respond to uncertainty in the Chinese market, which has been a traditional destination for AACo's trim product. To date, we've been effective in redistributing retail product to other markets, and we'll continue to explore these opportunities. You can see the proportion of AACo products sold in China decrease in FY 21 offset by growth from the rest of Asia and also in North America.

Hugh Killen: In Australia, we achieved a similar 5% improvement in price per kilo compared to FY 20. The biggest driver has been continued improvements in our market allocation and mix. This has involved focusing on high-quality branded product for the Australian market, and reallocating other product to higher value markets around the world. We continue to refine and build the value of our quality brands in Australia. This is important for the Australian market, but also because Australia is AACo's spiritual home. Our branded success in this market is a core objective of our global branded beef strategy.

Hugh Killen: In Europe and The middle East, AACo's sales directly felt the impact of COVID-19 on food service in FY 21. Our major retail focus in the last year has been in Asia and North America. This has resulted in a drop in the proportion of AACo meat sales going through to Europe. We'll continue to monitor food service opportunities in the region, and we're looking forward to the conclusion of free trade negotiations with the UK.

Hugh Killen: With that, I'll now hand over to our CFO, Nigel Simonsz, who will take you through the financials in some more detail.

Nigel Simonsz: Thank you, and good morning everyone, and thank you all for your interest in what has been a year of resilience in the face of significant disruption and uncertainty across our key markets. I'll now take you through the financial highlights and provide some additional context. I can report that we have consolidated our good first-half performance through the full year. And in the full year just gone, AACo delivered positive operating profit and cash flow. This is significant, given the continuing impacts of COVID-19 and the impact of recent drought and flood events on overall meat volumes. Our improved operating profit result reflects ongoing progress against our strategy, and of note we have realised an 8% improvement in price per kilo, which reflects continued growth in our brand value.

Nigel Simonsz: This improvement was offset by 19% lower meat volume available for sale in FY 21 compared to the prior year. And we have also achieved a reduction in expenditure of approximately $76 million, which includes $29 million of reduced adverse seasonal costs; $24 million of lower external backgrounding, external feed lot and processing costs as a result of low volumes; and further significant cost savings realised across the business. Our progress has been supported by our strong balance sheet. Our net asset position remains strong, driving significant improvement in net tangible asset value per share, and AACo's gearing ratio remains well within our covenants, improving 3.1% year on year. We achieved a statutory EBITDA result of 99.3 million and an improved statutory profit of 45.5 million, up from 31.3 million in FY 20.

Nigel Simonsz: And now moving on to our profit and loss statement on slide 14. Firstly, in regard to revenue, you can see an overall decrease of 68.6 million compared to the prior year, which includes the 29.6 million decrease in total meat sales in FYI 21. This reflects a 19% drop in meat volume available for sale, which is the result of lower calving in response to recent drought and flood events, which has started to flow through to meat production levels. In this context, AACo's overall 8% improvement in price per kilo has been very important to our end-of-year position. This has allowed the company to report a positive operating profit of 24.4 million in FYI 21, and 17.7 million excluding JobKeeper. AACo's cattle sales volume was lower in FY 21 compared to the prior year. This reflects elevated cattle sales last year as a strategic response to drought conditions, and these lower sales volumes were offset by higher prices in the market. On the cost side, we have seen the positive effects of our disciplined approach to operating expenditure as well as more favourable seasonal conditions. This has resulted in a combined $76 million reduction in expenditure overall. And, as noted earlier in part, this is the result of streamlining costs across the supply chain, including backgrounding, feeding, cattle transport, and processing.

Nigel Simonsz: We've also had an unrealized fair value gain of 64.3 million this year, versus 49.6 million last year. The gain in FY 21 was driven mainly by a $91 million increase in cattle values off the back of record prices in the Australian cattle market. And this was offset by lower overall kilogrammes produced as our herd enters the rebuild phase.

Nigel Simonsz: Turning now to our next slide, where we detail our positive cash flow results. In all, AACo achieved 18.4 million in operating cash flow compared to 20.1 million in the prior year, and our FY 21 result was 11.7 million excluding Job Keeper. The key drivers of these results have been better revenue management through strategic market allocation, in turn driving higher prices; continued focus on costs across the supply chain; and progress towards a simpler and more efficient AACo right across the business. You will also see on this slide a $33.8 million reduction year-on-year in net financing cashflow. This reflects a deliberate strategy to optimise finance cost payable, with no impact on total available borrowing capacity.

Nigel Simonsz: And now turning to slide 16 and our balance sheet. AACo ended FY 21 with a very strong balance sheet position, including over $1 billion in net assets. This is underpinned by strong growth in the value of our land and herd. Wider market forces have driven higher livestock prices in the short term, with positive impacts on rural land values as well. But AACo's overall strategy has been critical in growing the value of these assets over time. This strong balance sheet position means AACo retains comfortable headroom in our existing bank covenants, and this includes approximately $185 million in available borrowing capacity across our debt facilities, and our gearing ratios remained well within our target range.

Nigel Simonsz: And with that, I'll now hand back to Hugh.

Hugh Killen: Thanks, Nigel. On slide 18, as a nearly 200-year-old pastoral business, sustainability is at the core of what we do at AACo. This year we made progress on our sustainability agenda, including greenhouse gas abatement under our Beef Cattle Herd Management Carbon Project. This project is formally registered with the Australian Clean Energy Regulator. Our main focus is improving animal productivity to reduce lifetime emissions, by improving how we breed, raise, and handle our cattle. We've identified core activities to drive carbon abatement under this project, including improving animal conversions through genomic selection; increasing grazing areas through improved water access points; better pasture control through thinking infrastructure; and reduced cattle handling through improved yard infrastructure.

Hugh Killen: This work aligns with AACo's Animal Health & Welfare Committee, which we also launched in FY 21, as well as ongoing progress on our poll programme. And in parallel, we're also reducing our reliance on fossil fuels. This includes more than doubling the number of solar-powered bores on our properties. There's more to come in this space for AACo, and we look forward to talking more about this work in our second sustainability benchmarking report, which will be released later this year.

Hugh Killen: Turning now to slide 19, and changing consumer dynamics impacting our business. As we've talked about previously, long-term growth in the global middle class is driving sustainable demand for quality beef. This includes the continued focus on provenance and traceability. More recently, COVID-19 has precipitated growth in the home chef market, bringing higher-quality branded beef into the home. Direct-to-consumer channels are also growing through digital platforms, virtual cooking classes, and restaurant-quality meal kits. These consumer trends are likely to continue during COVID-19 and also beyond.

Hugh Killen: The vaccine rollout is also continuing around the world, and we are watching the impact this is having on the food service market. At the same time, geopolitical uncertainty remains a feature of our market, and this includes the Chinese processing restrictions impacting beef sales. We'll continue to monitor these changes as they roll out in FY 22 and beyond. Within this context, global beef demand remains robust, and the long-term outlook is largely positive. Population growth and rising household wealth are forecast to continue, particularly in Asia.

Hugh Killen: In 2021, beef exports are to forecast to grow by 2% to 11.1 million tonnes following declines in 2020. This includes growth in Brazil, India, and the US which will offset declines in Argentina, Australia, and New Zealand. And this has been driven, in part, by Chinese demand where the ongoing impact of African swine fever continues to drive imports.

Hugh Killen: Beyond 2021, cyclical forces in the US and Brazil are likely to limit growth in production and export, as those herds move into a rebuild phase. We expect sustainable consumer demand will continue to grow. There will continue to be a premium on provenance, traceability, quality, and product innovation. Australian producers will be well-positioned as our local herd rebuilding progresses.

Hugh Killen: Within this context, the cattle industry in Australia is facing a unique set of challenges and also opportunities. Our national herd contracted in 2020 at the lowest level in 25 years. Evidence suggests we have turned the corner, and the national herd is now expected to grow by 5% in 2021. As producers look to retain their herd in better seasonal conditions, cattle slaughter levels are forecast to reach 36 year lows in 2021. These slaughter rates are not expected to return to average levels until 2023.

Hugh Killen: In April, we saw these supply constraints drive the EYCI above 900 cents per kilo for the first time in history, and upward pressure on prices is likely to continue as slaughter rates return to average levels.

Hugh Killen: Looking forward, external forces will continue to impact AACo's overall meat production volumes in FY 22. This will be in the back of the 19% lower meat sales volumes we achieved in FY 21 compared to FY 20. On the other hand, we're already seeing a rebound in calving rates, which jumped 47% in FY 21 compared to FY 20. And as we manage this herd rebuild, AACo will conduct some supplemental cattle purchases. As always, we'll focus on improving our genetics as well as our land and animal management as we rebuild our herd.

Hugh Killen: To finish, I want to commend the AACo team for result they have achieved in a really uncertain environment in FY 21. We have faced lower calving rates between 2018 all the way through to 2020, in response to drought and flood events and in line with the wider industry. These headwinds have started to impact the meat production in FY 21 due to our average F1 Wagyu lifecycle length of three and a half years. This has driven a 19% decline in meat volumes for sale compared to the prior year with consequent impacts on revenue. These lower volumes are expected to continue into FY 22. Our herd rebuild has begun with a 47% increase in calving rates in FY 21 compared to FY 20. We've made important progress in FY 21 in the face of significant disruption to the food service sector. This is reflected in our strong price per kilo and our continued transition to high-value brand sales. This progress puts us in a good position to drive more brand value benefits across more of our cuts and categories.

Hugh Killen: Our strong balance sheet and positive full-year results give us a solid platform, and we'll continue to focus on cost discipline and unlocking value across our entire supply chain. Overall consumer demand for beef remains strong. This is likely to continue to grow over short-to-medium term. We'll continue to monitor market conditions and consumer trends on the ground, but our progress to date gives us confidence that AACo has a strong position to benefit from changing consumer demand and keep driving value for our shareholders.

Hugh Killen: That ends our presentation. I'd like to thank you all for your time, and Nigel and I are happy to take any questions.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you're on a speakerphone, please pick up the handset to ask your question. If you wish to ask a question via the webcast, please enter it into the 'ask a question box' and click submit.

Operator: Your first question is a webcast question from David Fawcett with Tendword Pty Ltd. This reads, "With Argentina banning beef exports for 30 days, what will this do to world markets and particularly AAC?"

Hugh Killen: So, I was trying to give some context around that in my prepared remarks. I think the Argentina situation is an interesting one. We've seen immediate moves in... Especially the trim complex prices moved higher overnight. I think if I take a step back and look at where we're at from an Australian perspective, obviously we're in the herd rebuild here. And so supplied through the processing is extremely challenged and that will continue for a while longer. We've seen Brazil, in particular, killing 1.5 times its normal kill, so they've gone heavily into their cattle herd as well. And now we're seeing Argentina have significant issues with internal supply and food inflation going into an election year in Argentina. So I think these are all really positive aspects in terms of outlook for pricing in global red meat sales.

Hugh Killen: The US, on the other hand, has been actually in a cull phase because they're going through quite a significant drought there and they've been killing off their herd at a very high rate, which has resulted in very good profits for processes over there. But, there is forecast to be a break in the season there you could actually see a turn around in those dynamics, in the US as well. So when I put all of those together, including Argentina and the demand that we're seeing for red meat globally in particular out of China, which has significantly spacious with ISF, as we've talked about, I think there is a chance to see, continue to move higher in global red meat globally over the next six months.

Operator: Thank you. Your next question comes from Rodney Rodwell with Oban Romford and reads, "I get the feeling we sell all the products we produce and so increasing our market penetration as little until we produce more, is this true?"

Hugh Killen: The demand for our product is extremely hard, Rodney, and as I've been trying to explain in the remarks today, we will have lower supply as the impacts of the drought and the flood run through our systems. So for us, the important thing is making sure we're getting the right price for every kilo of meat we sell. Make sure we get our market allocation and our market mix absolutely correct, which is what we've been doing, which is why I've been able to grow our brand margins by a brand revenue by 700% this year. And I think there's further opportunity for us to do that even in the environment where we have lower supply coming through. And I talked about value added product in our trim categories, for instance, the opportunity to do more there. So while there is more demand than we have from a supply perspective, and that's obviously a good thing, there is opportunity for us in terms of our businesses and our brands to make sure we get our allocation, our mix even better than it is now, and hopefully can drive prices higher as a result.

Operator: Thank you. Your next question comes from Phil Bunn with Bunn Holdings and reads, "Does AACo offer to reap online meat sales into Sydney. If not, who supplies this consumer market?"

Hugh Killen: I feel I get asked this question a lot. And one of the benefits I think of COVID-19 is you can actually get restaurant beef more easily in other markets. So in Sydney, in particularly if you go to Havericks Meat, and they've got an online marketplace and you get AACo product there, or you can go into their shop and buy from them directly and they'll portion it for you there. So there's a number of areas we can get it. Obviously direct to consumer and online is an area that we're focusing in strongly, not just in Sydney but more broadly as well. And that'll be an area for us to continue to think about and try and approach it maybe in a different way, going forward. And I've talked about this at the half year as well. There's a online marketplace in the US, it's an example called GoldBelly, which is an example of where we're actually going direct to consumer.

Operator: Thank you. Once again, if you wish to ask a question, please press star one on your telephone or enter it into the 'ask a question' box and click submit. We'll now pause momentarily to allow questions to enter the queue.

Operator: There are no further questions at this time, and that does conclude our conference for today. Thank you for participating. You may now disconnect.

[END OF TRANSCRIPT]