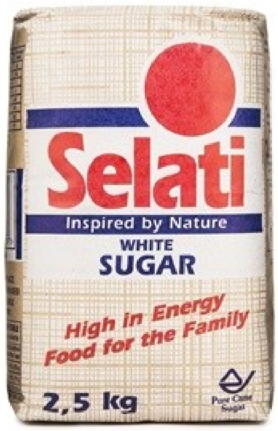
RCL Foods shows strong growth in groceries

The integration of RCL Foods' former subsidiaries (Foodcorp, Rainbow, TSB and Vector Logistics) into 'One RCL Foods' has been crucial in its move towards a more balanced portfolio. In its financial results for the year ended 30 June 2016, the group saw strong groceries growth in consumer division and solid performance from logistics division. There is a move towards a stronger, more balanced portfolio, because of significant progress with our strategic thrusts, with lowered dependency on the chicken and sugar business units.



Picture: Woolworths.co.za

This is in line with its business model of accelerating growth in higher-margin, added value categories while maximising the core, implying that the commodity components of the basket will grow smaller over time on a relative basis – although they remain a key platform for growth into Africa.

There have been major strides in transformation into one RCL Foods, with first its full year of operating under new structure and leadership.

Significant financial impacts

RCL Foods has reported a 11.9% decrease in headline earnings from continuing operations for the year ended 30 June 2016 to R849.7 million, or 98.5 cents per share, compared to the R964.5 million, or 112.2 cents per share, in the prior year. The Board approved a final dividend of 15.0 cents, relative to the 22.0 cents per share in 2015.

Revenue for the 12 months to June 2016 increased by 6.8% to R25 billion. Pre-IAS 39 EBITDA declined only by 12.8% in a very challenging chicken and sugar environment. Revenue excluding chicken and sugar increased by 13.1% to R17 billion. EBITDA (Pre-IAS 39) excluding chicken and sugar increased by 12.4% to R1.5 billion.

Three abnormal items have materially affected the results for the year ended 30 June 2016:

- An impairment of R642.8 million (excluded from headline earnings) relating to goodwill and trademarks in the milling cash generating unit. The impairment is due to lower forecasted cash flows because of a competitive trading environment and increases in the ten-year government bond yield driving up the discount rate;
- The release of a R163.3 million provision for uncertain taxation disputes raised in terms of IFRS 3 (Business Combinations) as part of the Foodcorp acquisition. This matter has now been finalised with SARS and consequently the income tax expense for the period has been reduced by R163.3 million; and
- Recognition of R67.7 million of profit after tax (headline earnings impact R118.9 million) relating to the exercise of the Zam Chick and Zamhatch put options.

Future growth forecast

CEO Miles Dally commented, “The transformation into 'One RCL Foods' has seen us make significant progress towards a stronger, more balanced portfolio, resulting in lowered dependency on the chicken and sugar business units. There is no doubt that the strategic initiatives implemented over the past three years have managed to effectively limit the downside for our business, while positioning us for future growth.”

Its transformation has also contributed to significant progress against its strategic thrusts, with increased market shares, improved customer management, and many other systems, operations and people-related synergies realised in the financial year. Its brands have become stronger over the past year, either being in top position or challenging for leadership in most categories. In the foodservice industry, RCL Foods has leveraged the expanded portfolio and strong customer relationships to both extend the basket of products in its existing quick-service restaurant (QSR) customer base and formed new relationships (Starbucks, McDonalds and Burger King). It has also strengthened relationships in retail/wholesale channels with the introduction of a dedicated sales team per customer, which allows for better focus and increased trust with customers.

High capex investment

RCL Foods substantially increased its investment in infrastructure over the past year, with more than R1 billion invested in new plant, storage capacity and systems. These included a R325 million expansion project, which has almost doubled logistics' storage capacity in Durban and Cape Town, and a new 7500-pallet facility, which was constructed in Port Elizabeth. It also invested R250 million in a new ultra-high temperature (UHT) beverage plant and an upgraded pet food plant, which will enable the group to extend product ranges and markets in higher-margin, added value products. A further R150 million was invested in integrating information systems across the business to provide a common platform, better information and improved decision-making capabilities.

Division results

Excluding chicken, the consumer division produced strong growth in all business units, achieving a 19.9% increase in EBITDA to R543.6 million, and at an increasing margin of 12.0%. The groceries category cluster (grocery, pie, beverage and speciality) grew by 10.1% year-on-year against a total market decline over the same period of 0.4% (ask'd – June 2016). Sound pricing strategies, together with solid marketing and promotional activities, have been successful in achieving robust volume growth and market share gains across a range of categories.

Including chicken, the division's EBITDA decreased by 19.2% to R701.7 million (2015: R868.8 million) with a corresponding margin of 5.3% (2015: 7.2%). The biggest crisis facing the South African poultry industry remains the massively oversupplied market because of surplus domestic volumes, as well as record levels of dumped imports. RCL Foods has steered away from commodity chicken and has deliberately reduced bird volumes, more than halving the production of individual quick frozen (IQF) from 600 tons to 260 tons a day. "Without this action, the oversupply in the market would have been even greater and the impact on profitability more severe," said Dally.

Sugar and milling division's pre-IAS 39 EBITDA decreased by 20.7% to R830.1 million (2015: R1 047.2 million) with a resulting margin of 5.6% (2015: 7.4%), driven largely by lower sugar volumes because of the drought. The use of irrigation that offered sugar a greater degree of protection than the rest of the industry during the first year of the drought, had to be moderated in the current financial year because of declining dam levels and rainfall that has been significantly below the long-term average. The cane crop decreased by 1 175 352 tons, resulting in some 152 980 tons less sugar produced than the comparable period.

The merging of Epol and Molatek into one animal feed business unit has resulted in a R6.0 billion business, which has created one of the largest animal feed companies in the country, increasing the sales footprint and product offering. Substantial commodity price increases, coupled with reduced volumes to the chicken business, resulted in pre-IAS 39 EBITDA decreasing by 3.7% to R322.4 million. The reduction in feed sales to the chicken business unit is in line with chicken's strategy to reduce bird volumes.

Impairment in the milling cash-generating unit was required due to the competitive trading environment and increases in the ten-year government bond yield driving up the discount rate. The outlook for the millbake business unit as a whole is for a substantial improvement in profitability as a result of fixing the operational issues in the Gauteng bakeries. More recently, service levels have improved, lost customers regained and damages reduced, all of which bodes well for the new financial year.

EBITDA for the logistics division increased by a commendable 26.4% to R260.7 million despite modest growth in revenue. Margin increased to 13.1% from 10.9% in the previous year. The results were mainly driven by sound cost control which has been a key focus area during the financial year. The logistics division has been successful in gaining new business to replace lost revenue, albeit in staggered intervals. Volumes in the food service industry remain resilient.

Prospects

RCL Foods believes that the local poultry industry is in a crisis. Consequently, the Board is forced to look at all options in evaluating the chicken business model. Looking forward, the headwinds of low economic growth, a volatile currency, high commodity input costs and drought impacts are real and understood.

Dally concluded, “We have made great progress on our journey towards 'One RCL Foods'. We are investing extensively in our people, our brands, assets and systems. Combined with strong leadership across the business, we are bringing a clear ‘one company’ focus to our strategic thrusts and are already gaining additional advantage and market share. Key among these strategic thrusts is our move to a more balanced portfolio, without which we would have been far more seriously impacted by the ongoing drought and the oversupply of chicken in the local market.”