12 September 2016

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, 53 weeks to 17 September 2016, which are scheduled to be announced on 8 November 2016.

Trading performance

The underlying operating performance of the group has been ahead of our expectation in the second half and the further weakening of sterling during the period since the EU referendum has resulted in a translation benefit. With no material transactional effect in the period, as a result of forward currency purchases and fixed contracts, our expectation for the full year results is now for earnings per share to be marginally ahead of last year.

Operating profit for the group will now be ahead of last year. The net interest expense will be similar to last year with the benefit of a lower average level of borrowings up to the point of acquiring the Illovo minorities being offset by an adverse translation impact on non-sterling interest. The underlying tax rate is expected to be close to last year.

These results expectations take into account a change in our accounting policy for the valuation of Illovo's sugar cane roots in line with an amendment to IAS 41 which now permits the valuation of such assets at cost less accumulated depreciation. This has the effect of reducing the year's operating profit by £8m in the current year, with a restatement of the adjusted operating profit for 2015 to reduce it by £10m to £1,082m. Last year's adjusted earnings per share have been restated to 101.5p.

Currency and financial markets

As noted in our last trading update, if current sterling exchange rates continue they will have both positive and negative effects on the group's operating profit next year. There would be an adverse transactional effect on the profit margin on Primark's UK sales, a favourable transactional effect on British Sugar's margins and a translation benefit on group profits earned outside the UK.

The last quarter has seen a marked decline in UK long-term bond yields which are used to value defined benefit pension obligations for accounting purposes. At these levels we expect a year end deficit on the group's UK pension scheme of some £200m compared to last year's small surplus. This will result in an increased service cost and a higher interest charge next year. There will be no changes on a funding basis until the next triennial valuation which is due in 2017.

Net debt

This has been another year of good cash generation after funding higher capital expenditure both for Primark and the food businesses. Year end net debt is expected to be a little higher than last year end after the purchase consideration of £245m for the Illovo minority buyout and a negative translation effect on non-sterling denominated borrowings.

Grocery

At constant exchange rates, Grocery revenues are expected to be marginally ahead of last year with a good underlying performance. They include the benefit of a 53rd week but were again held back by commodity price deflation. Operating profit at constant currency will be higher than last year with a further improvement in margin. Revenue and profit will both benefit from favourable currency translation.

Twinings Ovaltine finished the year strongly, led by the Twinings brand in Australia and the US and a return to growth for Ovaltine in Thailand. Twinings' UK value market share increased following its relaunch last year and continued marketing support this year. The brand is the clear market leader in Australia and the successful 'Tealand' television advertising campaign, which has driven further growth in Italy, has recently been rolled out in France and Japan.

Against a background of retailers continuing to discount bread heavily, revenue at Allied Bakeries held up well this year driven by a substantial increase in volumes. The continuing success of Kingsmill Sandwich Thins saw investment in a second production line which came on stream in April. Silver Spoon gained new contracts and benefited from a relaunch this summer, but low retail sugar prices maintained the pressure on its margins. Wider distribution and a targeted home-baking marketing campaign drove an increase in Billington's revenues and Allinson maintained its position as the UK's leading bread flour brand. The full integration of Dorset Cereals with Jordans and Ryvita has delivered the expected savings in operations. International expansion has driven excellent growth for Jordans and Dorset, which also increased their UK market share, but Ryvita lost crispbread sales in a very competitive UK market.

In North America, Mazola oil revenues were marginally below last year despite distribution gains, as pricing remained under pressure from competing vegetable oils which had a raw material cost advantage throughout the year. Mexico's results were disappointing as unfavourable exchange rate movements and competitor pricing pressure reduced volumes and margin.

Revenue at George Weston Foods in Australia will be ahead of last year in a deflationary market and operating profit increased. The Don KRC meat business was much improved with a return to more normal bought-in raw material prices and good volume growth in pre-pack products. Production efficiency remains a management priority and continuous improvement at Castlemaine drove efficiency gains in the second half, with further opportunities identified for the coming year. Following last autumn's Tip Top relaunch, bread and breakfast bakery both performed well.

Sugar

Underlying revenue and adjusted operating profit for AB Sugar for the full year, at both actual and constant currency, will be ahead of last year. A reduction in EU stock levels and an increase in world sugar prices resulted in a strengthening of European sugar prices which benefited our Spanish business. However, with most of British Sugar's contracts agreed on an annual basis, there will be no material impact on its results from the improvement in pricing until our next financial year. All of our sugar businesses have delivered substantial cost reductions again this year through a combination of continuous improvement, business transformation, capital expenditure and procurement activities.

In June, we completed the buyout of the minority interests in Illovo Sugar Limited for a purchase consideration of £245m. As previously noted, in order to align Illovo's financial year end more closely with that of the group, Illovo's results will now be consolidated for the year to 31 August. For our 2015/16 financial year this will be an 11 month period. The results for AB Sugar will also reflect the change in accounting policy for the valuation of Illovo's sugar cane roots as described above. Following these changes the reported operating profit for AB Sugar will be in line with that of last year as restated.

UK sugar production for the 2015/16 year was just short of 1.0 million tonnes as planned, in order to reduce excessive stocks from the prior year, with a smaller contracted growing area and average beet yields. Above average rainfall in June slowed the growth of the new crop for the 2016/17 season and, combined with a further small reduction in the contracted area, we expect a further reduction in sugar production next year before beet supplies are restored to more normal levels in 2017/18. Delivered beet costs for the 2016/17 campaign will be lower than this year.

In Spain, the operating result improved significantly with the benefit of lower beet costs, higher production and better pricing. Total production for the year is estimated to be 474,000 tonnes of which 449,000 tonnes was from beet and 25,000 tonnes was from raw sugars co-refined in the beet factories in the north.

Beet sugar in north China made a small profit with the benefit of increased production to 159,000 tonnes, with record performances at both factories. In the south, production of cane sugar reduced to 284,000 tonnes as a result of a reduction in the area under cane and poor sugar content.

Illovo expects to produce 1.17 million tonnes of sugar in this 11 month period compared with last year's 12 month's production of 1.64 million tonnes. An improved sales mix and further cost savings across the business contributed to an increase in full year profit. The new refinery in Zambia was completed on time and was commissioned in July.

Sale of our cane sugar business in southern China

We are announcing today that we have reached agreement to sell our cane sugar business in southern China to a consortium led by Nanning Sugar, a leading producer in the region which has the support of the Guangxi government. Upon completion of the transaction, which is subject to third party consents and regulatory approvals, we will receive consideration for our shareholdings in the business together with the repayment of related loans.

Agriculture

UK agriculture faced a number of challenges this year and in that context AB Agri performed well delivering an adjusted operating profit that is expected to be just below last year. Good results from the specialist businesses and a strong finish for Frontier Agriculture were more than offset by lower UK feed profits.

In the UK our pig starter feed business had a strong year but the smaller UK sugar beet crop resulted in less beet feed availability which adversely affected revenue and profit at AB Connect. Frontier achieved record grain procurement volumes from farms and benefited from strong grain exports in the second half of the year.

The pace of development of our international operations has increased. AB Vista, our animal nutrition and technology business, achieved further volume and market share growth driven by strong sales of its two leading feed enzyme products, Quantum Blue and Econase XT. In feed ingredients, the acquisition late last year of a small business in Spain was followed by investment in a new starter feed factory to supply the Spanish pig market. The recent acquisition of Agrokorn in Denmark provides an exciting platform for further growth in specialist proteins for pigs, calves, poultry, fish and pets.

AB Agri China enjoyed a good year due to its continued focus on sales into the fast growing larger-farm sector and the development of our service business aimed at integrated international livestock producers.

Ingredients

Ingredients' revenues are expected to be ahead of last year and operating profit will again be substantially ahead with a further improvement in margin.

AB Mauri, our bakery ingredients and yeast business, delivered a third year of significant profit recovery and, most encouragingly, from all regions. The Americas contributed the major part of AB Mauri's profit. New bakery ingredient product launches, targeted at the faster growing market segments in North America; further progress in South America, despite continuing economic difficulties; and higher output from the yeast factory in Veracruz, all delivered increased profits for the region in the year. We made further progress in China this year including the rationalisation of production facilities with the closure of the old factory site at Harbin. A key driver of the development of the business has been the recent investment in the US and UK Centres of Excellence and the expansion of the bakery ingredients R&D centre in the Netherlands which will be completed next year.

ABF Ingredients made further progress. Our speciality lipids business, Abitec in North America, had an excellent year with success for its range of products designed to enhance bioavailability of molecules in pharmaceutical and nutraceutical applications.

Retail

Sales at Primark for the full year are expected to be 9% ahead of last year at constant currency. A higher proportion of this year's new store openings were in the second half giving a weighted average increase in selling space of 9%. There was a two percentage point benefit from the 53rd week this year. Like-for-like sales are expected to be minus 2%, affected by unseasonable weather - warm weather in the pre-Christmas period and a very cold March and April. Ireland delivered a strong performance throughout the year, Spain, France and Austria traded well and the Netherlands and Germany improved. The UK performance was in line with the group with good trading in periods of more typically seasonal weather. As a result of the weakening of sterling, we expect sales at actual exchange rates to be 11% ahead.

The operating profit margin this year is expected to be close to that achieved in the first half. The transactional impact on Primark's margins from the weakening of sterling against the US dollar, particularly since the EU referendum, will have no effect in this financial year as a result of our practice of taking out forward currency contracts when garment purchase orders are placed. However, at current exchange rates, margin will be adversely affected in the new financial year. Primark is committed to leading the value sector of the market with its on-trend product offering and maintenance of its price leadership position in clothing.

During this financial year we will have opened a net 1.2 million sq ft of selling space, bringing the total estate to 315 stores and 12.3 million sq ft at the financial year end. A net 22 new stores have been opened and there have been two temporary relocations in Oxford and Grimsby pending redevelopment. The second half of the year was a very active period with the opening of 16 new stores and 0.9 million sq ft of selling space. New stores this year comprised our first store in Italy, at Arese northwest of Milan, a 135,000 sq ft Spanish flagship on Gran Via in Madrid, three stores in each of France and the Netherlands, seven in the UK, four stores in the northeast of the US and a store in each of Germany, Portugal and Austria. Four stores were extended including a 49,000 sq ft increase in the selling space at Creteil in Paris, which doubled the size of the store only two years after its opening.

In the US, awareness of the Primark brand started at a low level and has continued to grow. The brand has been well received with very positive customer feedback, particularly for its exceptional value for money and the breadth of its product range. We are encouraged by the most recent openings in the regional malls at Danbury, Willow Grove and Freehold Raceway.

1.3 million sq ft of new space is currently planned to be opened next year. Five stores are planned for Germany, two more Italian stores in Florence and Brescia, and notably an 89,000 sq ft store in the centre of Amsterdam. Three more stores will be opened in the northeast of the US, bringing the total to eight, and an extension to the Downtown Crossing store in Boston is planned which will increase selling space by 20%. A 32,000 sq ft extension to the Oxford Street East store will also be opened ahead of the important Christmas period.

Our new warehouse at Islip, Northamptonshire is now operational and relocation of capacity from Magna Park will be completed early in the new financial year. The new distribution centre at Roosendaal in the Netherlands is on track to open early in the new calendar year.

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Notes to editors

Sale of our cane sugar business in southern China

AB Sugar is an industry leading group in the international markets for sugar and sugar derived co-products. Following this sale, it has operations in the United Kingdom, Spain, southern Africa and northern China with an annual processing capacity of some 4.4 million tonnes of sugar and 600 million litres of ethanol.

AB Sugar entered the Chinese sugar market in 1995 with the acquisition of its first cane factory through the Bo Qing joint venture in Guangxi province. The business sold today comprises five cane sugar factories with annual production capacity of some 600,000 tonnes of sugar held through controlling interests in four joint ventures.

ABF in China

After this disposal, the group will have some 4,500 employees in China. The businesses include yeast and bakery ingredients; animal feed; production for export and domestic sales of Twinings and Ovaltine; and a beet sugar business in northern China. The beet sugar business comprises two well-invested fully-owned factories in Zhangbei, Hebei and QingQi, Inner Mongolia, which together produced 159,000 tonnes in the last financial year.