UAC of Nigeria PLC
H1 2020 Results Conference Call Transcript

Date: Thursday, August 06, 2020 3:00 PM WAT
Speaker: Mr. Folasope Aiyesimoju (Group Managing Director, UAC of Nigeria PLC)

1. Presentation

Operator: Good morning, and good afternoon, ladies and gentlemen, and welcome to the UAC of Nigeria Half Year 2020 Results Conference Call. The conference call will be hosted by Mr. Folasope Aiyesimoju, Group Managing Director. Following prepared remarks by UAC's management team, an interactive Q&A session will start.

I would now like to hand the call over to Mr. Folasope Aiyesimoju. Please go ahead Sir

Folasope Aiyesimoju *(UAC Group Managing Director)*

Welcome
Good day, and welcome to our results presentation for the first half of 2020. My name is Fola Aiyesimoju, and with me today are Kunle Oriola, our Group Finance Director; and Funke Ijaiya-Oladipo who heads Investor Relations. I hope that you and your loved ones are safe and healthy, and thank you for making time to join us today.

As we have done in previous sessions, I will aim to go through prepared remarks in 15 to 20 minutes, leaving sufficient time for Q&A. In addition to providing insights regarding our performance for the half year, I will also discuss the recently announced partnership between Custodian Investment PLC and UAC as regards UPDC.

Macroeconomic review
I will now ask you to turn to Slide 5. As we are all acutely aware, Nigeria, along with the rest of the world, continues to grapple with the impact of COVID-19, which has negatively impacted the operating landscape. As you are no doubt familiar with the macroeconomic indicators, I will focus on key takeaways, which are that we expect economic contraction, rising inflation and challenges with foreign exchange availability and rates.

Current operating context and response to COVID-19
Please turn to Slide 6. Here, we focus on the impact of the economic landscape on our businesses, and we assessed impact depending on where businesses lie on what we consider the essential spectrum. At one end, and least affected from a top line perspective, we have our Animal Feeds & Edible Oils businesses, considered essential. And on the other hand, we have the Quick Service Restaurant business, considered more nonessential. In between, we have the Packaged Food & Beverages, Logistics and Paints businesses for which the impact has been mixed. For example, our water business has performed strongly and the on the go-snacks business less so, particularly in April, during the most stringent phase of physical distancing in Nigeria.

In the QSR, business, in-store dining has declined and delivery has increased. Our focus is on delivering performance in spite of tough operating conditions. Achieving this will require overcoming a number of significant headwinds, including reduced aggregate demand and increased competitive intensity; rising input costs with suppliers citing the foreign exchange environment; global supply chain disruptions, which have impacted production in certain segments; and we have experienced project delays on account of travel restrictions and challenges shipping plant and equipment.

On Slide 7, we highlight our continued focus on ensuring the health and safety of our employees and stakeholders, improving the resilience of our operations and ensuring business continuity, acting as responsible corporate citizens, giving back to those most vulnerable in our communities and critically focusing on opportunities for growth in spite of challenging conditions.

Key developments

May I please ask that you turn to Slide 9, which provides insight regarding our recently announced partnership with Custodian Investment PLC. Last year, we indicated the intention to unbundle our interest in UPDC to our shareholders with the key motivation being the differences between UPDC and the rest of our operating segments. Over the course of implementing the planned unbundling, we entered discussions with Custodian, the conclusion of which we assessed relative to the proposed unbundling. Discussions led to UAC and Custodian executing binding agreements for Custodian to acquire a 51% interest in UPDC at a price per share of 82.5 kobo with 85% of consideration payable immediately on closing and the balance upon certain conditions.

We determined that the transaction with Custodian presents superior value to the unbundling for three primary reasons. Firstly, UAC crystalizes cash proceeds; Secondly, we achieve our strategic objectives. And finally, we receive units in the UPDC (REIT), which is a profitable, cash generating with potential future upside. Also of significance is that UPDC benefits from the introduction of a strong anchor shareholder, which improves its prospects for future value creation, from which UAC will benefit via its retained stake. As at June 30th, we carried our stake in UPDC at a value of NGN 17.2 billion. The transaction values our stake in UPDC at NGN 14.4 billion, including the deferred contribution component, but we will also receive units in the UPDC REIT worth NGN 2.5 billion at yesterday's prices, bringing total value to UAC of NGN 17 billion.

Financial performance highlights

I will now ask you to turn to Slide 11, which summarizes our financial performance. As I mentioned on the full year 2019 earnings call, we sold a controlling interest in MDS to our partners, Imperial Logistics and as such, MDS is no longer consolidated with our numbers. We adjust 2019 financials to exclude MDS for ease of comparison. Results for the half year were disappointing, with operating profit down almost 70%. Performance was impacted by two primary factors: COVID-related disruptions to sales and by extension gross profit and increased operating expenses as we made necessary investments for growth.

Revenues for the half year were down 2% relative to 2019, significantly impacted by results for the month of April when revenues declined relative to April 2019 by more than 30%, and we recorded an operating loss for the month of NGN 500 million. It's important to remember that this was the most stringent phase of physical distancing in Nigeria, in which performance was dependent on government approvals for the operation of factories and movement of people and goods. The 8% decline in gross profit and 130-basis-point reduction in gross margin was also largely on account of performance in the month of April in which gross profit declined by about 50% and gross margin was down 500 basis points.

In spite of the challenges in April, our Animal Feeds & Edible Oils business and Packaged Foods & Beverage business recorded similar levels of revenue and maintained gross margins relative to 2019 over the course of the half year, indicating resilience and recovery in the months of May and June. Our Paints business, which was hardest hit due to the production restrictions and supply chain disruptions in April, recorded a 20% decline in H1 2020 revenues and gross profit relative to the same period in 2019. Again, the decline here can largely be isolated to the impact of the month of April. The Quick Service Restaurant business faced restrictions to store openings and recorded negative performance over the period.

Overall, we acknowledge there is a lot of work to do to deliver our growth aspirations, but are encouraged by recovery following the most stringent phase of physical distancing, during which we faced challenging but necessary restrictions to our ability to operate as governments took aggressive measures to restrict the spread of COVID-19.

I will now ask you to turn to Slide 12. We are conscious that our investments to drive growth resulted in more than NGN 1 billion increase in operating expenses, largely in the Animal Feeds & Edible Oils and Packaged Foods & Beverage businesses. some context is required regarding this increase. NGN 300 million of costs are one-off and related to redundancies and COVID-19-related expenditure. A further NGN 170 million is attributable to increased depreciation from investments in distribution infrastructure. We purchased vans and cold chain infrastructure in the Packaged Foods business. There was a NGN 230 million increase in distribution expenses in the Animal Feeds business, and this represents a 35% increase on similar volumes over the same period last year. We expect this trend to reverse with the unit cost of freight declining. Overall, there is more than NGN 800 million in non-cash or non-recurring costs.

We have made investments in talent, sales and distribution, which have increased our recurring cost base, and we are paying close attention to driving returns on these investments. The chart on this slide aims to contextualize the key factors that negatively impacted our performance in the half year. I have addressed these in some detail already, and the summary is that operating profit declined NGN 1.8 billion from NGN 2.6 billion in H1 2019 to NGN 800 million for the first half ended June 2020. Of this, NGN 400 million is attributable to lost sales in the Paints segment in the month of April and a further NGN 800 million in non-cash and one-off costs. We are focused on leveraging our recent investments to drive topline growth, which we expect to result in earnings growth.

Operating segment highlights

On Slide 13, we provide background regarding our operating segments. I have talked a bit about the financial performance of the Animal Feeds business. A key focus, however, over the period was on tight inventory control, which resulted in cash generation to reduce leverage. In this segment, our focus going forward is on expanding our coverage to grow volumes. The Packaged Foods business saw the sharpest increase in costs, and this is a subject of our focus going forward. We also continue to grow our water and ice cream segments, making necessary investments in capacity and cold chain distribution.

The Paints business, which was deemed non-essential in the month of April, was hardest hit by the physical-distancing initiatives. We have seen recovery in the months of May and June and continue to focus on growing volumes in the segment and unlocking the supply chain disruptions that have also impacted sales.

In the QSR business, we are driving delivery, leveraging investments in corporate stores. Our Logistics business grew on account of recent investments in the haulage segment, which we intend to leverage going forward. We continue to work with our partners, Imperial, on expanding our service offering. I have already discussed the recently announced strategic initiatives regarding our Real Estate business. The focus here is on completing the execution of this initiative, and the business will focus on liquidating low-yielding assets to return cash to investors, delivering development with sound risk-adjusted returns and growing the facilities management business.

Balance sheet and liquidity

I will kindly ask that you turn to Slide 14, which highlights aspects of our balance sheet. We continue to have a healthy cash position of NGN 21 billion, and the focus over the course of the half year, as I mentioned, has been on liquidity. We reduced inventory by NGN 3 billion and utilized proceeds to settle short-term debt obligations. We have no long-term debt in our subsidiaries on continued operations. MDS does have a few financial lines and UPDC outstanding bond obligations. Capital expenditure in the period was largely concentrated in the Packaged Foods segment where we made and will continue to make investments to address inadequate capacity.

On Slide 15, we summarize the cash position within the group, which, as I mentioned, is NGN 21 billion. NGN 8.4 billion of this cash is held at the holding company, and the rest at subsidiaries. In addition to cash, we hold a further NGN 3 billion in bond at the Holdco.

Outlook

On Slide 17 and in conclusion, we are conscious that the economic outlook is significantly worse than what we envisaged at the beginning of the year, largely on account of COVID-19 and its far-reaching impact. We remain focused on our priorities, which include completing the sale of UPDC, which will increase our cash position initially by up to NGN 6.6 billion, potentially rising to NGN 7.8 billion; introduce a strong strategic partner for our Real Estate business; and enable us achieve our strategic objectives. We will continue with the unbundling of the UPDC REIT with UAC expected to receive 650 million units worth NGN 2.5 billion.

We aim to deliver growth in spite of the economic outlook by focusing on efficiencies and serving our customers. We will pay close attention to costs seeking to eliminate duplication and waste without compromising growth. Key initiatives we are embarking on include a refresh of our enterprise resource planning system and migration to a cloud-based IT platform. Both of these will entail one-off investments but yield of long-term benefits. Underpinning our efforts is our commitment to attracting and retaining the strongest possible management teams.

I thank you once again for participating in the session today, and we will now take questions.

2. Question and Answer

Operator
[Operator Instructions] Your first question is from Fola Abimbola from FBNQuest.

Fola Abimbola (*FBNQuest Capital Limited*)
Hi Fola, thanks for the call. Just a few questions. The first one, Livestock Feeds used to be like a struggling business and seems to be doing well lately. From what I am seeing, sales from all the regions grew nationwide, except for probably Aba, and then Grand Cereals, which used to be an outperformer seems to be struggling. Can you explain what changed? What exactly are the specific challenges faced by Grand Cereals and what exactly is driving Livestock Feeds?

Second question - in light of the cash received from both MDS and UPDC, could you give guidance on dividends? Should we still expect a conservative stance similar to last year or something more aggressive? Or are we likely to see zero dividends given the COVID environment?

Also, post H1, what's the business environment been like, given the partial relaxation of the lockdown? I know you said April was the most stringent. What are you seeing recently? Finally, has there been any improvement on your part in sourcing FX? Or do you still experience unusual delays in fulfilling your orders? Those are my questions. Thank you.

Folasope Aiyesimoju *(UAC Group Managing Director)*
Thank you, Fola. If I recap your questions, I think the first is you comment on the strong performance of LSF relative to Grand Cereals, you ask about our plans for cash proceeds from MDS and UPDC, views on post-H1 business performance and our experience sourcing FX.

Livestock Feeds and Grand Cereals are very similar businesses that have different geographic focus and a few nuances in terms of target customers. Both management teams have a reasonably similar strategy as regards the Animal Feeds segment but as you know, Grand Cereals has a reasonably sizable edibles segment. They both focused on increasing their coverage to larger farms and if you ask me from where I sit, the primary difference is that the management team at LSF is more established and if I look at the progression of performance in Grand Cereals, I very much expect that we will start seeing similar performance to that, which is recorded in LSF. Grand Cereals has suffered a little bit because it's more northern facing business than Livestock Feeds but I think this should be adjusted as the Grand Cereals team settles in. Remember that the management team of that company was recruited between September and March of this year.

Cash from MDS and UPDC, if you recall that our cash reserves were significantly depleted by the investment in UPDC, and we received some cash. Our dividend policy has not changed. We assess our investment needs and determine a dividend based on those investment needs. Specifically, as regards to COVID and our more conservative stance this year, in planning for COVID, and we were making this plan, you must remember, in February and March, we planned for the worst, and I would say in every single one of our businesses, they performed much more strongly than expectations. And we felt that we had to be in a position to respond no matter how bad things got in any of our businesses. And to achieve this, we felt that it was important for the group to maintain as much strategic flexibility as possible and as much liquidity as possible.

So I will say that as the impact of COVID unwinds, we will go back to a more normal dividend regime where we assess investment needs and distribute based on those. But that has just provided some context about the specific regions that made us significantly reduce our dividend for this year. It was in planning for the worst, and we had no idea how bad things could get when we were making these plans back in February or March.

Post April business performance and post H1, we've seen a good recovery across all our segments, and that has continued into July. If I have any concern around the businesses, and I try to think about these things in two components, top line and then margin, it is tied to your next question, which is FX. We acknowledge the CBN's efforts to try to prioritize FX to manufacturing concerns. There's still delays in sourcing but we have managed to get by. But the rates at which the Naira settles, when it does settle, I think is something that will impact the margin component of your question.

So we've seen good recovery topline. So far, it's very slow, but we do get the FX, and I should stress very slow, depending on where it settles, that would impact the margin component of the outlook. I hope those address your questions, Fola.

Operator Your next question is from Danesh Ranchhod from Franklin Templeton.

Danesh Ranchhod (*Franklin Templeton)*
Hi, thanks very much for having this presentation. I have got two questions. The one questions relate to the UPDC sale to Custodian. I didn't quite catch what the sale price was for the 51% stake. And then the second question was the presentation refers to UPDC REIT still being unbundled. Will that still be unbundled to UAC shareholders?

Folasope Aiyesimoju *(UAC Group Managing Director)*
Thank you, Danesh. If I caught your two questions correctly, the first was the sale price of the 51% stake to Custodian, and the second was the plan for UPDC REIT. The sale price is 82.5 kobo, of which 85% is payable immediately so roughly 70 kobo upon completion, and the rest based on attainment of certain conditions. These are related to performance. And UPDC intends to continue with the unbundling of the REIT. And just based on shareholder of record, those units will initially flow to UAC. It is UAC's intention to unbundle those units to its shareholders. But as we've seen with the Custodian sale, which was not in our contemplation at the time we announced the unbundling of UPDC, we will assess all and any opportunities that come our way until the date those units are unbundled.

Operator: Your next question is from Michael Oyeleye from Stanbic Pensions.

Michael Oyeleye (*Stanbic IBTC Pension Managers Limited)*
Hello. Good afternoon. Thank you for taking my call and also thank you for the presentation. So my question is around -- first of all, I didn't quite get what you said about the proceeds of the sale vis-à-vis whether you are going to recognize a loss. So just to confirm, are you saying that the proceeds of the sale is structured in such a manner that the carrying costs and the proceeds would -- there will be no net loss position, and at the conclusion, you will still own some percentage of UPDC? That's my first question.

My second question is also a corollary to that. Can you share with us some of those conditions that would be met for the full unbundling to occur? And that also ties to the fact that when do we expect a deconsolidation? Is it going to be deconsolidated from H1? Or this is going to be the last quarter of the consolidation?

And then the final question is on EBIT. So how do you see EBIT evolving? Do you think we are through the worst? Or do you think that the worst is yet to come? How do you see that evolving? Thank you very much.

Folasope Aiyesimoju *(UAC Group Managing Director)*
Thank you, Michael. I think you are seeking clarity around two numbers, carrying value versus value received, if I heard you correctly; clarity around conditions, deconsolidation of UPDC and the timing thereof and evolution of EBIT. The fourth one is the longest response so I'll take the first three first.

The carrying value is NGN 17.2 billion, value received by UAC is NGN 17 billion, so there a small delta there. However, anyone with knowledge of the market will see that our retained stake would already be more valuable given what has happened to UPDC's share price.

Conditions to completion are regulatory approval and for additional consideration, certain asset performance, which I won't delve into now, but the performance of certain discrete assets.

Deconsolidation will occur based on completion. So as soon as we get regulatory approval then we complete the trade of the sale of 51%. We will no longer control UPDC, and therefore, the company will be de-consolidated. The timing is dependent on the speed of regulatory approvals. I very much expect it to be done this year, but I am very cautious about committing to things that are not entirely within our control.

Now as regards EBIT performance, I would almost sort of respond in two layers. So I think the colour, historically regarding our EBIT was we made this big investment in OpEx and when is the revenue performance going to come. Now as I have hopefully articulated, these are one-off step changes. So they're not going to be continuous one-off increases. So they're one-off increases from '19 to '20. I very much expect that as we start seeing numbers into the next financial year because these are one-off step changes in operating costs as revenue growth catches up, we'll or start seeing these flow through to EBIT growth. The only caveat I would give in that is the big concern we have around the outlook is the rate of FX and its impact on input costs. And that's very difficult to forecast if things stay the way they are then we are a lot less concerned and if things deteriorate, we are a lot more concerned.

So in summary, excluding the potential FX impact, we very much expect as we go into the next financial year and the impact of this one-off step changes no longer recur, we start seeing immediate performance. And the big question mark we have around the outlook has to do with the levels at which the FX settles.

Operator The next question is from Abdulrauf Bello from WSTC Financial Services.

Abdulrauf Bello (*WSTC Financial Services).*
My question is on the Animal Feeds business segment. I have a couple of questions. This is first of them. So on Slide 6, you gave a graphical presentation as to the sectors or the business segments that were most hit and less hit and personally, I would expect that the Animal Feeds business segment would perform strongly but I realized that in Q2, it declined, and I'd like to have an understanding as to what led to the decline and what the problem was in Q2.

So I know you mentioned something around use of proceeds from the sale of equity stake in UPDC, but I didn't really get it clearly. So the outlook for dividends, do shareholders expect anything -? Like I heard the part where you said that you prepared for the worst at the initial stage of the pandemic, but you also mentioned that already you are beginning to see recovery and going forward, at the end of the year, what should shareholders expect? Do we expect to see a special dividend? or what the use of proceeds would be like?

So concerning the UPDC divestment, so a bit of concern from my end is that in Q1, when the management spoke to analysts, one of the things considered was the persistent loss-making nature of the UPDC business and the weak macroeconomic outlook. And part of the thing management considered to spin that business segment off. And now the narrative has changed now, and the scope has changed. But even if the business is going to divest as much as 51% from its existing 93%, the company or the group will still be carrying 43% in its books. Maybe on the line of the income statement. So what's the plan for growth in the UPDC business? Or what's the turnaround strategy going to be such that the losses or whatever losses that will be incurred here would not significantly impact the group's book such that profitability would be lower? Thank you.

Folasope Aiyesimoju *(UAC Group Managing Director)*
Okay. Thank you Abdulrauf. I think I got three questions. One is why did Animal Feeds decline in Q2, given that it's essential. Two is, I think still seeking clarity around dividend, the use of proceeds. And I think there's almost a 3a and 3b, which is some concern around UPDC. Maybe 3, a, b and c. UPDC loss-making why retain a stake, strategy for UPDC going forward and impact of UPDC on UAC's books.

The first one is easy. Animal Feeds did not decline in Q2. I think if you turn to the very end of the presentation, I think it's Slide 25, we showed the performance for Q2. So Animal Feeds, as you rightly point out, I'd like to joke that chickens don't fast. It is very essential as long as farmers have birds, they would do what they can to feed those birds. So the Animal Feeds business didn't decline the top line in Q2.

UPDC use of proceeds, I think I have mentioned two things. One, we do not have any present plans for a special dividend. What I have said is that the very conservative dividends stance we took this year is, all things being equal, going to reverse going forward because the strategic flexibility that we decided to give ourselves going into the lockdown and COVID impact, we are increasingly getting comfortable that we can begin to restrict.

As regards UPDC, I would say two things. First of all, the plan was to unbundle UPDC to UAC shareholders. And we obviously wouldn't have sought to do that without significantly strengthening the business. We wouldn't hand over a problem to our shareholders. And a lot of work has been done at UPDC over the last few years. In terms of strengthening the management team aggressively slashing costs and the asset book.

And typically, on your last question, focusing on the strategy. UPDC is going to focus on doing only three things going forward: one is to realize low-yielding assets and return cash to investors; two, focus on very disciplined investments with good risk-adjusted returns; and three, aggressively grow our facilities management business, which is an attractive business that has low invested capital. Those are the three things UPDC is going to focus on. And the work required to position the company to focus on those things has been done. And so together with our partners, Custodian, we expect to drive the performance of these three initiatives. UPDC will be held as an associate on UAC's books. The share of profit or loss would flow through our books. But the intention, like I said, very much is to drive on these three value-creation initiatives, such that the significant negative impact that UPDC used to have on UAC's Books becomes a thing of the past. So that's the thinking around UPDC. And I hope that I answered questions 1, 2, 3A-C.

Operator Your next question is from Wale Okunrinboye from Sigma Pensions.

Wale Okunrinboye (*Sigma Pensions Limited)*
I think one of my questions has been answered, which was on the unbundling. The other question I have is on your margin. So looking across all the division, I think maybe if I could have some form of, I don't know, a line of sight over where do you see your Animal Feeds business, the operating margins stabilizing at? And how do you think you can get it? So if the environment is more stable, let’s say there isn’t too much of a devaluation, say maybe 3%, 5%. Where do you see your Animal Feed margins stabilizing? And then my second question is on your Packaged Foods and QSR businesses. What's the plan for these businesses? Maybe you can talk us what's the plan you have in terms of driving improvement in performance at these businesses at a more sustainable level. Is this something you see that you can do? Or is it something that maybe you are going to also look to go down the way of disposals or reducing your holdings there? And then lastly is just more and more UAC and for a long time. The pressure has always been about the Real Estate business that was struggling. Now you've been able to go past that. I think maybe it's more to catch what the outlook you think would be for UAC going forward. Where do you see value coming from the business going forward?

Folasope Aiyesimoju *(UAC Group Managing Director)*
Thank you very much, Wale. I was hoping you won't say I told you so, because I recall when we announced the unbundling, I think you had asked why we didn't sell the company, so I was hoping you want start off with an I told you so. But anyhow, back to your questions. Animal Feeds, I like to think about margin in two separate components: the gross margin and the operating margin. And the business' gross margins held up in spite of COVID year-on-year. So we don't have any concern there. If anything, we see an increase in the gross margins because at Grand Cereals, in particular, there's an increased focus on the higher-margin segments. So that's the edible segment. So they held up already. So we didn't see -- and you rightly pointed out, FX aside, and we expect, if anything, to see an improvement there.

The EBIT margin, as I explained, we had these one-off cost increases. And as the revenue growth catches up because we don't plan to keep on adding this cost year-on-year, we will begin to see growth in the EBIT margin. I am very hesitant to give you a date and a number.

As regards Packaged Foods, we have no present intention of divesting this business, and I cannot stress enough, but that as a management team we view ourselves as custodians of shareholder value. So we would, in assessing any situation, ask ourselves what is the best interest of our shareholders. Our plan there is very simple. There are three segments within the Animal Feeds business. Snacks, this is Gala Funtime Coconut chips and Funtime Cupcakes, there is dairy; and there is water. In the water business, we cannot meet capacity. So it's quite a simple set of objectives: grow capacity to expand in that business. In the dairy business, we, as you know, had, until last year, recorded losses and sometimes quite significant, that business has been fixed. It's very profitable, the highest-margin business within the foods business, and we have made investments to scale that business already. And the snacks business, we've identified pockets of under-penetration and are going to focus on growing volume by addressing those pockets of under-penetration in the snacks business.

We also had capacity constraints with our Snacks business in Gala, in particular. We made some changes last year and grew capacity, and we'll continue to assess when we hit the limit of capacity. So we have every intention to maximize what we feel are very, very, very important strengths that business has. It has decades-old, well-established brands and very good distribution, and we plan to leverage this to deliver value.

As regards Real Estate, I think I've talked a little bit about our focus for value creation. If you look at UPDC's balance sheet, we still have a significant asset base, but the yields we get on those assets are not attractive. And so the focus is very much to realize those low-yielding assets. We will use some of this capital to fund development and the first development we're already working on now, should get going later this year, in a very disciplined fashion, and we can go into some detail about what that discipline looks like and return excess cash from the asset realizations initially to redeem the remaining NGN 4 billion obligations and then eventually to stakeholders. And we plan to aggressively grow our facilities management business. It is a very focused strategy for value creation at UPDC going forward. And we think the work has been done. I think when we road showed for the Rights Issue and we met your colleagues and yourself, you would have had a first-hand engagement with the management team that has been put in place at UPDC which we feel is very capable of delivering on these value-creation initiatives.

Operator Your next question is from Efemena Esalomi from SBG Securities.

Efemena Esalomi (SBG Securities Limited)
Hi, Good afternoon everyone, and thank you for the presentation. If I could just circle back to the last question on the Packaged Food business and the QSR business. And maybe if you could just speak a little bit about your relationship with the JV partners in that business. You mentioned that there's no plan for divestment. But maybe beyond what you've spoken about with increasing capacity for Gala and water, maybe something more strategic long term. Also for the QSR businesses, I think we've spoken in the past about investments and expansion of some of the brands in that business. So if you could just speak to that. Also on EBIT margin and EBIT margin outlook for the business, I think you focused on FX being sort of one of the major drivers. So if you could speak to how FX impacts the different businesses, maybe give a

percentage exposure to FX across the different businesses. And then for Animal Feeds, you spoke to improve margins, especially for Grand Cereals, from focusing on more of your edibles business. So if you could just provide a split for between poultry, fish and in the edible business for Animal Feeds. Those are my questions.

Folasope Aiyesimoju *(UAC Group Managing Director)*
Thank you very much Efemena. If I try to sort of summarize your questions, you asked, I think two questions around Packaged Food and QSR. You asked about strategy, and you also asked about the relationship with our JV partners. You commented that FX was a driver for our operating profit margins. And you asked about the FX component in our businesses. And I think, finally, the mix of business between feeds and edibles in the Animal Feeds Businesses.

So if I got those correct, I think we have two separate JV Partners in our Packaged Food business and our QSR business. Our partner in our Packaged Foods business is Tiger Brands. And our partner in our QSR business is Famous Brands. Both partners have very, very senior executives on the Boards of the companies and remain very engaged. And there is very, very good alignment between the partners in terms of strategic direction and value creation. And so we speak with one voice to the management team of these companies in terms of delivering outcomes. I have gone in some depth about the strategy for the Packaged Foods business, so I will not rehash that now. And for the QSR business, we have acknowledged that it is a sub-scale, loss-making business. And we have taken the time to do the work to figure out what is required to make this a meaningful profitable business.

I have touched on two of those pillars. One is Corporate stores; and the second is ramping up delivery. For Corporate stores, we generally try to -- if we have a thesis, we try to test it. So we rolled out four of those, and they are all doing very well, frankly, doing well in spite of COVID and the combination of Mr Biggs' and Debonairs collocated with pizza and more traditional foods has worked very well. And the idea will be to continue to scale that particular business.

As regards FX in our businesses, I think it was Wale again, who asked this question on our last call. And I think so I want to clarify that I have not said that our operating performance for the half year was on account of FX. I have said that FX is a big concern around the operating margin going forward. I think it's important to clarify that. And I think is that all we can do is look at what happened in the past when we had FX devaluation and see what happens to our businesses. And I think on this particular one, we can only go back to the 2014 -17 period. And I think if I look across the businesses, the Animal Feeds was the least impacted from a margin perspective in that time period. And the Paints business was the most impacted in terms sort of 6.6% devaluation year-on-year to gross margin. So very unsurprising, because at one extreme the Paints business has the highest imported cost component and the Animal Feeds has the least and in between, you have the Packaged Food business

So just to summarize, Animal Feeds has the lowest imported raw material component, although agricultural commodities are influenced by global pricing. So although we don't have to actually physically import the goods, it's not completely immune.

Paint which has load of chemical -- imported chemicals and raw materials is the most exposed, and in between, you have the Packaged Foods. And we saw this play out in the last significant cycle of devaluation. So all we can go with is what happened in the past and plan going forward based on what happened in the past.

As regards contribution from the various Animal Feeds business segments, from a gross profit perspective, edibles are roughly about 20% - 25%, and feed is the rest from a gross profit perspective. Feed also is the biggest contributor to revenue. But because the edibles are higher margin, we prefer to look at their gross profit contribution. So you can say a roughly 80:20 edibles: feed for the Animal Feeds segment, and we expect this to shift as we increasingly focus on the higher-margin segments.

Operator Your next question is from Philip Anegbe from CardinalStone Securities.

Philip Anegbe *(CardinalStone Securities Limited)*
Thank you very much for the call. Most of my questions have been answered, but I just have two questions on the UPDC and Custodian deal. The first is I am aware that you've put in about 16 billion last year at NGN 1 per share. So why sell at 82.5 kobo at this time? Secondly, it was not very clear, but I thought I heard you explain how the 82.5 kobo will translate to 70 kobo. Please, can you provide some clarity on that?

Folasope Aiyesimoju *(UAC Group Managing Director)*
Thank you very much, Philip`. I would say two things. Yes, we invested in Rights Issue at NGN 1 a share. And I think I tried to explain in my prepared remarks that we are getting our share of the REIT. We're getting NGN 2.5 billion of value as our share of the REIT for no additional consideration. And when we invested, we invested in UPDC, including the REIT. So I think it's a nuanced distinction that we should make. The 82.5 kobo - immediately upon closing, we get paid 85% of that, which is about 70 kobo a share and there are certain conditions that trigger the payment of the balance consideration. So that's the split-up of the consideration payment. I hope that addresses the two questions.

Operator Your next question is from Makinde Samuel from WSTC Securities.

Makinde Samuel *(WSTC Securities)*
Good afternoon. Thank you for the call. My question has actually been answered partially. My question is actually centered on the binding offer you received from Custodian. I was wondering why selling at a discount to market. Also, what is the attraction of this transaction to UACN considering that you did a Right Issue and based on your response now, I need to get clarity around UPDC REIT and UPDC. Is it that the consideration is just for UPDC? So I really need clarification around that.

Folasope Aiyesimoju *(UAC Group Managing Director)*
Okay. I think you have asked three questions. Why we are selling at a discount, attractiveness of the transaction and what the consideration covers. I think the last one is just a statement of fact. UAC is selling 51% of UPDC. UAC receives cash proceeds for that 51%, and UAC retains roughly 42% of UPDC. UPDC will proceed with the unbundling of the UPDC REIT. I think the question has been asked whether UAC would go ahead and unbundle its interest in the UPDC REIT. UAC would receive cash proceeds from the sale, would have it retained interest in UPDC and would have its unit in the UPDC REIT. The aggregate value of this is NGN 17 billion, our carrying value is NGN 17.2 billion. So yes, there is a small loss there. The deal with Custodian was a very rigorous negotiation, which I think was fair to both parties. And I think, frankly, the day we announced was actually roughly in line with where market was.

I would like to point out a couple of things. One, the outlook for the world and the pricing of UPDC, I think UPDC was at NGN 1.09 at the time the Right Issue was announced just about 6 months ago, it's very different to that, which is now. I would like to repeat, carrying value NGN 17.2 billion, value received NGN 17 billion, and so we're roughly square, but yes, there's a small delta there.

In terms of the attraction, again, I went over this in my prepared remarks. We see three primary benefits: firstly, we crystallize cash proceeds to ourselves; secondly, we introduce a partner that, we have no doubt, strengthens UPDC's outlook and increases the value creation and future for UPDC; and thirdly, we achieved our strategic initiatives. So those are the reasons that led us to pursue this particular initiative. And I hope those address your questions Makinde.

Operator Your next question is from Danesh Ranchhod of Franklin Templeton.

Danesh Ranchhod (*Franklin Templeton Investments*)
Just some follow-up questions to the other parts of the business ex Real Estate. Just with regard to Paints business, just any sort of progress on a possible merger between the two Paint businesses? That's my first question. And then the second question just comes back to the QSR business, the Quick Service Restaurant business. You've spoken previously about potentially reviewing this, and it's obviously very small in the business, and it's going through a difficult time. Is there any sort of further progress on whether you would look to unbundle it or shut that down or sell the business (in piecemeal) if that can be done. So those are my two questions. Thank you.

Folasope Aiyesimoju *(UAC Group Managing Director)*
Okay. So first question, Danesh, thank you, is any progress on the possible merger between CAP and Portland? CAP and Portland are two public companies with their respective board, management, shareholders of which UAC is a fairly significant one. If and when those companies decide to progress with discussions around the merger, we as the controlling shareholder of both as UAC would clearly lend our voice and exercise our view as regards those initiatives. Speaking purely conceptually, there are pros and cons to the two businesses coming together. The pro being just a much larger business on a more efficient cost base. In the interim, we have only one message for the respective management teams at CAP and Portland which is to aggressively focus on value creation. And we would opine or express our view if and when those 2 companies decide that it's in the best interest to come together.

As regards QSR, we haven't come to conclusions yet as regards this business. And as we have a partner in the business, I am very careful not to begin to frame conclusions that have not been discussed and agreed with our partners. We have made a lot of progress. If I was going to put this in percentage, I think we are more than 85 % of the way there. We are very clear what needs to be done. It is not likely to be a surrender, but I would much prefer to have final conclusions with our partners and then communicate these to our shareholders.

Operator The next question is from Gbolahan Ologunro from CSL Stockbrokers. Please, go ahead.

Gbolahan Ologunro *(CSL Stockbrokers)*
Hi. Good afternoon and thank you for hosting this call and taking my questions. So Fola, virtually, all of my questions have been answered, but just a little bit of clarification still as regards the sale of UPDC. Can you provide an insight as to the strategic thinking behind the sale of a stake of 51% as opposed to the 94% held in UPDC that will completely extinguish UPDC from your books. Given that, I think in the past, you've alluded to how the underperformance in that Real Estate business has constituted a drag on group's performance. So just an insight into the strategic thinking behind the sale of 51% as opposed to an outright sale, such that we will not find ourselves in a situation where post-sale of the 51%, we still be consolidating share of loss from associates into the group's books.

Folasope Aiyesimoju *(UAC Group Managing Director)*
Thank you very much Gbolahan. I think the best way to think about the discussions between UAC and Custodian was very much discussions around partnership. Where, and I am being very careful not to speak on behalf of Wole Oshin and his team at Custodian, where, obviously, the team at Custodian saw long-term value in the Real Estate sector and saw UPDC as a vehicle through that value could be explored. Custodian is a company that we respect tremendously at UAC. And in the course of those discussions, which were very much framed in partnership, we arrived at this structure, and where Custodian owns 51% and we own 49%.

It was not a case of - like I said proceeding with an unbundling. We were not hawking 94% stake and it was bartered down to 51.%. It was a discussion anchored in partnerships between two companies that have tremendous respect for each other.

Now those discussions and the unbundling wouldn't have occurred if the philosophy and mind-set of both parties was that this is a problem. So I would like to repeat that, yes, UPDC has had a tough couple of years, but a lot of hard-work has gone on. Today marks 2 years, actually. It just occurred to me now that you asked the question. Today is the second anniversary to the date of my -- going into UPDC as the CEO of that company. And I think the work that has been done has positioned UPDC as a company that begins to exploit value and deliver returns from opportunities that we see in the Real Estate sector. It is not going to be easy. It's not going to be -- suddenly UPDC becomes the most profitable company owned by either Custodian or UAC in the next quarter, but we feel that the hard work has been done to position the company to deliver value over the long run.

Operator
Your final question is from Makinde Samuel of WSTC Securities. Please, go ahead.

Makinde Samuel *(WSTC Securities)*
A follow-up to my initial question. I just want to ask if the unbundling of UPDC REIT will happen before the binding offer from Custodian, the execution of the binding offer.

Folasope Aiyesimoju *(UAC Group Managing Director)*
In terms of timing of those transactions, my -- as I've mentioned earlier, they're subject to certain regulatory and shareholder approvals for the unbundling of the UPDC REIT. So we expect those to occur this calendar year, but I'm very careful about the timing on things that are not in our control. My suspicion is that they are wondering about economic impact for both parties and to put very simply, both parties expect to receive their proportionate share of unbundled UPDC REITs. If that is what you are wondering in terms of timing of sequencing.

3. Closing remarks

Operator
Thank you. That concludes the Q&A session of the call. I would now like to hand the call over to Mr. Folasope Aiyesimoju, Group Managing Director, for any closing remarks. Thank you.

Folasope Aiyesimoju *(UAC Group Managing Director)*
Thank you, once again Kay, and I thank all participants for joining and for the thoughtful questions. We are cognizant of the feedback we've received, and we hope we have managed to articulate the specific unique factors that so negatively impacted our performance in the first half and clarify the initiatives we plan to focus on to drive value going forward.

Many of you are familiar with Funke who just joined us to head our Investor Relations. A key component of our approach is to provide as much clarity and transparency to the investing community as possible. And so please feel free to reach out to Funke with any follow-on questions or comments that you have. Thank you.

Operator
Thank you very much. That concludes the UAC of Nigeria Half Year 2020 Results Conference call. You may now hang up. Thank you.