

# Transcript

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Compere: **HARRY DEBNEY – COSTA GROUP CEO, LINDA KOW – COSTA GROUP CFO** Summary ID: **X00077456187**  
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HARRY DEBNEY: So the list of the factors of which on a combined basis means the interim six months to December will produce a lower profit, than the corresponding prior period. This was inclusive of bringing Morocco on balance sheet, funding the expanded peak season cost in China and Morocco as well as dealing with a short off-season citrus cycle. That was where we were when we last communicated to the market. Since then, a number of factors have emerged. Initially, the short citrus season finished even earlier than we anticipated. This reduced returns in this category. I just want to stress this has no bearing on the 2019 season, which at this early stage is developing well, and we anticipate returning to a large on season cycle with favourable export market demand.

The combination of strong industry supply in a number of crops combined with subdued demand during December which is persisting into January; and this is the biggest issue we should talk about today. This would result in lower pricing levels in truss and

snacking tomatoes, and the latter in snacking due to oversupply of the inferior cherry tomato products which require heavy promotions in snacking to reduce our volumes. Lower prices included raspberries so the peak level of production for both categories, and lower pricing in avocados with the complication of moving between the end of the WA supply and waiting for the new season Far North Queensland shephard crop. To put all of this into context December is a very large sales month for Costa, and hence any significant variation affecting multiple categories, is going to exert a strong impact on our outcomes. This early stage in January, similar conditions are applying now. We expect that demand and supply is going to equilibrate in time but may take a little while. We do not believe that the medium to long-term sales for berries or tomatoes will change, and we don't believe there's any cause for concern there. Both categories remain very sought-after products and you should remember that Costa demands premium positions which we continue to build on- over the last year we built on this even more, for example, with the initial market launch of the Arana blueberries and the forthcoming development of the premium blackberry subcategory.

Avocados is a bit more complicated. Now, typically, in the transition phase at the end of the West Australian crop and prior to the start of the Far North Queensland crop posted in January. So the market is in the main being supplied from New Zealand avocados, which if you've tried them recently, they have limited shelf life and quality attributes which is affecting both price and demand.

I'll just round out with mushrooms, which we don't see as being an issue, that category remains in short supply. Although summer at least over the last number of years was always a lower demand period but we have no problem in moving our products. In our announcements, we referenced a short delay. It's going to be about five weeks. The commission of our expanded Monarto site is a complex, high-quality integrated compost and production facility. It's going to deliver an outstanding outcome but we expect post-conditioning of the project to have an accelerated ramp up in production.

There have been a couple of other fairly moderate influences and for completeness I'll just refer to them. They remain affecting the prolonged dry weather in the south in Australia. We've had increasing costs of irrigation water in the Riverland, the spot pricing currently is circa \$400 per a mega litre. Costa has about half of our requirements is permanent water and we have favourably hedged approximately another 40 per cent of the balance; and the exposure to a spot market is going to cost us a sub \$1 million figure. We've also had a shortage of high-quality wheat straw which has led to higher prices across our mushroom network. This has got a cost in fact, we believe of about \$1.5 million. Both of those imposts are manageable within our system.

Just finishing up on international: it's far too early to call our seasons in China and Morocco, but the early assessments in both China and Morocco are good in terms of the crop health; and the weather outlook and

I'll stress at this early stage - the weather outlook is favourable. Both regions are forecasting a modest reduction in yield. Morocco due to late planning of the expansion of early season crop, which will reduce yield bear, and also some pest problems, which we're dealing with in China, but they are both moderate. So overall, we're expecting much improvement from international during the year. That's a quick if you like, background in addition to what we announced this morning and I'll open the discussion for questions.

CALLER BEN: Hi, Harry. It's Ben Gilbert here from UBS;

CALLER BEN: Harry just a couple of questions from me. Just firstly, I just wanted to confirm the language around the guidance for 2019. So, you're still expecting an NPAT-S number broadly similar in dollar terms to what the previous guidance implied, which just putting 10 per cent CAGR on account of FY 17 number has rounded out that sort of circa \$78 million for calendar '19. Is that - not asking for a dollar number - but just circa that's how we should think about it?

HARRY DEBNEY: Yeah well certainly with our guidance. Linda did you want to add to that?

LINDA KOW: Yeah. I think so. Look, the I mean reality is by the calendar '19, the first six months of this financial year pulls through and so the downside that we've seen is no longer relevant. As we project through to the full calendar year- look, there was a little bit of conservatism in our forward projections and so we

always give ourselves a little bit of room to move; and as we say with materiality there's still a high degree of comfort that sort of low-double digit over two-year trajectories still holds true, and that is the case.

HARRY DEBNEY:

Just to add to that, we're expecting a very [indistinct] Monarto was going to deliver substantial benefits through most of the calendar year, and international will have a much better than last year and there's some other growth elements well.

CALLER BEN:

And the second one for me. Just on the demand piece because I think we're all aware sort of obviously aware there can be supply issues in produce. I'm just surprised by just the extent of the demand weakness and I'm just interested in two areas of just your thoughts. One, do you think we're seeing some trading down just broadly with some of the macro piece? Have you had any feedback from that from your bigger customers? Secondly, was there any bigger pressure from terms through the period particularly across berries and tomatoes? And then thirdly, how confident we're not starting to see maturation of these categories and are we going to see them all revert to sort of the broader produce type growth?

HARRY DEBNEY:

Yeah. A lot in that question, Ben. [Laughs]

CALLER BEN:

Yeah sorry. [Laughs]

HARRY DEBNEY:

Okay. First of all, I think-to put it into context. December is a peak period for particularly berries - for

both blueberries and raspberries. So it's the biggest month of the year, so any impact there is going to have an inordinate impact; and I guess the volumes are very high. It's not [indistinct] but I guess it took a lot more effort to promote, for example, blueberries at \$2.50 than it should have to have moved the volumes and we expected by now to be up in the \$3 plus market but we're still at \$2.50, and in raspberries, we should have been in \$3.50 market, we were down \$2.50 and still are, we are moving the product but at significantly reduced pricing, they are retail figures obviously.

So, look, I don't think you can take that short-term period as any indication. We don't see here or globally any lightening of the demand for berries, so I don't think- I think it's an aberration rather than a trend. If you ask me in six months and we're still seeing it, that'll be a different story. But I don't think it's a long-term issue.

Snacking tomatoes and truss tomatoes are a bit more simple, I think that's just seen very high production with all of this drought in New South Wales and right across Southern Australia has meant that we've had very warm growing conditions in all fields and glass house, high light conditions in glass houses as well. So, we've got very strong production of truss and snacking. And we've had an overflow of very inferior quality cherry tomatoes which has meant that we and the retailers have had to discount the premium snacking component to the product. So, all of those factors in play really are more of an oversupply period rather than the other issues.

In terms of- there's been no impact or no pressure on terms. And, as I say, we don't think there's a structural shift in demand for both of those categories. But it's troubling for Costa when you have a peak year- sorry, a peak month, and then you have multiple categories involved, which is why we've had to make an announcement.

CALLER BEN: That's great. Thanks Harry, Linda, and Michael.

CALLER JOLYON: Hi this is Jolyon Wellington from JP Morgan.

CALLER JOLYON: So, I just wanted to understand the numbers a little bit better, please. So, you're saying you expect FY19 to be similar to FY18 on a June basis, so around \$77 million of NPAT is that correct?

LINDA KOW: Yes.

CALLER JOLYON: And I think you said before that you expected calendar '18 to be less than calendar '17, which implied a very low profit for the first half of FY19 on a June basis.

LINDA KOW: A lower profit than expectation.

CALLER JOLYON: And so, I think from before from doing the numbers of that, it was a sort of mid-teen type number for NPAT for the first half of FY19. Are you- is there a potential for a loss in the first half of FY19 on a June basis, so the six months to December?

LINDA KOW: No.

HARRY DEBNEY: Absolutely not.

CALLER JOLYON: No, okay. But I'm assuming it's going to be sort of less than \$10 million.

LINDA KOW: Look, we're not going to be talking about numbers right now. It is lower than our expectation, so previously we'd provide a guide and say it was going to be materially lower than last- same December period. We've fallen short of that. Given the size of the numbers were pretty small, clearly percentages are compounded in size, yes, we are falling short of our previous positions of December but off a very low base.

CALLER JOLYON: Yep. Okay. So, look, it's not going to be a loss but it's going to be a low number. That- then if you want to then make \$77 million for the full year, so 12 months to June '19, that then means you're going to be doing kind of north of \$70 million in the second half.

LINDA KOW: It depends on your assumptions on the December half. And I think as I said before, we will provide further guide- we will provide full information on the half year gone at our results announcement.

CALLER JOLYON: Right, okay. So, I mean, that would be sort of 50 per cent growth on the second half of last year. I understand you've got extra contributions coming through from some of the acquisitions and clearly from

the consolidation of Morocco, which comes through. But it just feels like quite a large growth number off the second half of last year. I'm talking June year end. So, I just wondered what your assumptions are around how you're going to get that much growth 2H on 2H, please.

LINDA KOW:

Sure. And it's no different to what we previously guided albeit we're tempering that based on current market conditions. I think if you look back through the company, we have invested in a lot of new growth initiatives and we still expect those to pull through. We're coming off the back of a poor Moroccan season last year. And so, there is definitely an expectation that that returns to normality, to a level. We have a business in China that continues to grow. So, none of those factors that we've previously shared has changed, other than an additional overlay on market conditions on the domestic categories.

HARRY DEBNEY:

Well plus a much larger citrus crop.

CALLER JOLYON:

Yeah. And I mean, are you assuming that pricing sort of recovers in the six months to June '19.

HARRY DEBNEY:

We've been fairly conservative. We believe there will be a recovery but we're saying it will take a little while to flow through, Jolyon, and yes, but not a dramatic recovery. So, if there is a stronger recovery than we're assuming at this stage, it would be upside rather than downside.

CALLER JOLYON:

Okay. So, you've- okay. And then it's interesting to then look forward. You talk about the calendar '19 number being up double digit on a CAGR basis from calendar '17, so we've got the calendar '17 number so we can sort of work through that- roughly what that kind of implies for the calendar '19 number. And just sort of working through those numbers, with the amount of profit you're going to have to do in the second half of fiscal '19 - so, the six months to June '19 - that then implies still quite a weak first half of FY20, so six months to December '20- sorry, six months to December '19. Still looks pretty weak on that basis. I just wondered why you're not expecting to see any more recovery coming through there.

LINDA KOW:

I wouldn't use the term weak versus a change in our business. The- let's call it the December half year that's still ahead of us for '19, again, we haven't changed our view on what that is and why it is what it is. We've previously shared that the earnings profile of our business is shifting, such that most of our heavy production will occur in the first six months of the calendar year. And the second six months of the year will have the benefit of the citrus crop, berries in December but by and large, each and every year that becomes less significant relative to our portfolio. So, if you're looking at it from a pure absolute number, yes, it is a small contributor relative to the first half of the calendar year. That is normal and that is what we have previously signalled.

CALLER JOLYON:

And then just on the pricing dynamics, the kind of- the lower blueberry price, and to an extent the lower

avocado price has been around for a while. It's not really new news. If you look at the blueberry pricing, was down in fiscal '18 but Costa's continued to trade through that and continued to grow profit. Was it just a case that last year citrus was just so strong, it masked a negative pullback in the blueberry division in profit terms or why is it now that these pricing impacts are having such a- why are they starting to actually be felt now whereas before they were able to just sort of be traded through?

HARRY DEBNEY:

I think blueberries have been okay right through. I guess the problem we had in December and going to January is it should have shown a lift now of these bottom levels. We're still at the, if you like, the bottom of the pricing situation which by late December and January should be coming up. And certainly we've never seen \$2.50 on raspberries before, except for maybe the odd-special that someone's done. So it's probably dropped in the \$3.50 market, which you wouldn't expect in December and January, down to \$2.50. So, that's a big drop, Jolyon. Look overall, certainly citrus was stronger on the prior year and weak this year on the biennial cycle but I'm not sure if it was masking another factor. If you asked me to weight the impact of the short end to the citrus season that was about 20 per cent of the issue we're dealing with today, the other 80 per cent of the issues is those tomato, berry and avocado variations.

CALLER JOLYON:

That's interesting that 80 per cent of the issue is due to that. And out of those three categories, which would you say has led to the biggest impact? I know you put

tomatoes first in your commentary, is that after we've take that that's the worst impact in that produce category?

HARRY DEBNEY: No. As you know we don't go with individual categories but relative to its smaller size, it was quite significant in the tomato, I'll leave it at that, relative to its size.

CALLER JOLYON: Okay. Thanks for answering my questions.

CALLER JAMES Harry, James Ferrier from Wilsons.

CALLER JAMES: So, thanks for your time. First question is- perhaps go back to Ben's questions around the impact on volume expectations versus price. I've got the sense from your answers to Ben's questions that this is primarily pricing-driven as opposed to a volume-driven change?

HARRY DEBNEY: You mean from our production volume?

CALLER JAMES: Yeah. Well, the comment you had around tomatoes was obvious that the oversupply and that drives pricing down. I get that. But your comments around berries in particular is- the impression I got from your comments is- and again Jolyon's questions as well, you mentioned that the berry pricing- blueberry is still very low, raspberries you've never seen pricing that low, most of your answers have been focused on the pricing. I'm just trying to get a sense as to the materiality of the volume difference relative to your budgeting internally.

HARRY DEBNEY:

Okay. Well, as you know these things with volume/ price are connected, as we've made the point many times. But the other thing I have mentioned I thought is that our biggest month in berries is December. So it's a double whammy when you've got a subpar price which is what your biggest month of volume. So our largest blueberry volumes are actually offered to the market - this is Costa I'm talking about - during December. So I guess that was the double impact we had.

CALLER JAMES:

Yeah. And so, if you look at the broader market of blueberry production in Australia, why do you think pricing has still got a two handle on it in December when typically it might be back up in at least a high two if not in the threes? Is that something to do with Costa's production? Or is it the broader market increasing production greater than you thought or do you generally think the Australian consumer just got less berries over Christmas?

HARRY DEBNEY:

Well, we don't have the information yet but we think it's a combination. We think that the demand was subdued, lower than we expected. Now, certainly there was volume increases in the whole industry, a bit higher than last year but not substantially higher and certainly not to the levels we should've with this impact. So what we want to assert at this stage, with the knowledge we've got, which is limited, that the demand was not as strong as it should have been in that period. Now, we're not smart enough yet to know why. But we think demand has been off and not just on berries but on a number of products. Well, yes, we'll

have to sort of have another few months to find out to see whether that's going to last a bit longer. But you go through it in cycles, at the moment we will stick to our commentary. We think it's a cyclic issue, and every year is different. You can't sort of say you go through the same sort of cycle and same sort of methodology. Certainly we think at this point in time the demand was off.

CALLER JAMES:

Yeah. Can I just clarify your comment there, Harry? You said that blueberry volume growth in calendar '18 was stronger growth than what was experienced in calendar '17.

HARRY DEBNEY:

Yeah, there was certainly a bigger volume. That's correct. By and large, by the way, during the main part of the season which starts in September and goes through to till sort of mid-December, late December, through most of that period up until early December the market absorbed that extra volume very adequately. It was actually only in the run up to Christmas and post-then where we've had this- what we think anyway as a drop off in demand. That would be the context.

CALLER JAMES:

Yeah, okay. And then, Harry, with this citrus component that's in the trading update today. Is that not something that would've been known at the AGM? I'm just thinking about when that season ends and the AGM in late November- is that not something that would have been captured in your guidance then?

HARRY DEBNEY: Well, we expected probably a number of several thousand more tonnes to be coming off on our late season mandarins and oranges, and it didn't eventuate. So we were caught by surprise at the tail end of the crop by several thousand tonnes which didn't eventuate.

CALLER JAMES: Yeah okay. And then finally from me, on the calendar '19 sort of more outlook-type statement. Can I confirm you've got a five-week delay on Monarto? That's fine. You've had some additional costs going into African Blue. That doesn't seem to be new information necessarily, and then make up some of Monarto delay to Linda's point there, there was an element of conservatism in the previous guidance, anyway. Is there anything else we should know around what's changed for that guidance in calendar '19 to be maintained?

HARRY DEBNEY: Look, I don't think- sorry, Linda, have you got any other comments to make?

LINDA KOW: No. I think that's a fair wrap up. Obviously a lot of the activity that we're talking about focuses on the next six months which wraps up into our comments about the full financial year. But we're not seeing any major call outs on the second half different to anything that we may have shared previously.

CALLER JAMES: Yes, okay. That's great. Thanks very much for your time.

CALLER JOHN: G'day John Purtell (Macquarie) here, how are you?

HARRY DEBNEY: Good thanks.

CALLER JOHN: Just have a few questions if I can. Just coming back to the weakened demand point, I mean obviously you've mentioned lower prices. I mean, lower prices, all things equal should stimulate demand. I mean, has there been a loss of share from Costa in some of these categories as well?

HARRY DEBNEY: No, that is the point we're trying to make and no, our share actually in December was in blueberries is strong, and in raspberries we are the dominant player by a significant margin. So I don't think there's a share issue there. But we and the retailers have just found it harder to shift volumes. But look, this is all unfolding John so I don't want to seem too definitive, but at this stage we've been a bit surprised by the drop off in what we call a drop off in demand - a subdued demand. But these things change. I mean, we see it in other commodities at different times, but this one, when you've got a peak volume period, hurts you.

CALLER JOHN: And just coming back to that sort of seasonality there, I mean, obviously you mentioned sort of blueberries is a big month or December is a big month. We've still got a obviously a big profit period ahead and in the sort of next six months, so just trying to sort of dove tail those two together. I mean, presumably the June half is still a very big blueberry demand period as well.

HARRY DEBNEY: Much lower than the first half, but yes.

CALLER JOHN: Sorry, just missed that Harry.

HARRY DEBNEY: Yeah. No, that the first half, sorry in the old language, July to December is a bigger production for the blueberries than January to June.

CALLER JOHN: But obviously, profitability wise for the company, it's the other way.

HARRY DEBNEY: It's pretty strong in both halves, but certainly we- I'm not sure it's equal, but certainly we expect a fair return on berries in the second half, yeah.

CALLER JOHN: In terms of Monarto, will there be much contribution in the six month to June, from the expansion?

HARRY DEBNEY: There'll be some, we'll be ramping up substantially in May and June, so there'll be some in April. So look, it will be less than we would've expected, but we're going to ramp up quicker. But certainly we'll be at full tilt, I'm hoping, by second to third week June. But it'll be a ramp up in the prior two months. So, it'll be a bit less than we had planned, but I think over the calendar year, it should just about equilibrate.

CALLER JOHN: And just to come back to one of the earlier questions, again, just the optics of the sort of much stronger- sorry, the first part of that was that the profit change today seems to be in terms of your expectations, really

sort of to the first half of the December half, as opposed to the- just to the June half.

LINDA KOW:

Well we haven't gone to that level of the split. I think that was the question that was asked earlier and we aren't commenting on that at this moment. I mean, what we're factoring in is definitely the trading that we had through to the month of December- all through to the end of December, plus the immediate outlook as Harry's described on across a number of the product lines. So there is actually an impact to both halves.

CALLER JOHN:

Okay. And just again, to clarify the sort of key drivers in your view of the- from the second half are you expecting in June.

LINDA KOW:

You mean the next six months? The six months that we're in.

CALLER JOHN:

Correct. Yeah.

LINDA KOW:

I think we had that question previously. There's obviously the pull through of all the growth programs we've had over the recent years. We've got a return of Morocco from our lower base last year. We have- China continues to grow. Harry mentioned before which I'd forgotten, citrus having an on year with that season kicking off sort of towards the second quarter. So there's a number of factors there. We really are not changing how we've constructed our view of what makes the second half other than overlay a market

factor that's a bit more subdued across those product lines.

HARRY DEBNEY:

And just to add for the context John to the citrus comment. Yes, we will get a good impact within this next half, but the bigger impact - roughly two-thirds of the growth will be in the second July - December period, which really hurt us this period but next year should help us. So citrus will be a full year and of course going to a calendar year, it will matter nought... whether it's sort of a week late or a bit early as we will get the full benefit over a full calendar year, but it's more weighted to July - December than the early part.

CALLER JOHN:

Thank you and just a last one, sorry I missed your comments at the start Harry. You made a couple of comments on Morocco and China just what are your expectations there.

HARRY DEBNEY:

Yeah. It's very early to call those seasons. So we're qualifying our comments yet, but we've had our agronomists do their regular pre-season analyses in both regions and crop health was very encouraging in both Morocco and in China. The weather outlook and we also qualify that by saying this is very early, but the weather outlook to date is good in both regions. But we've got a fair way to go before we can claim that. We are seeing, we think, at this early stage, a moderate reduction in yield in both for different reasons. One is the early season planting at Agadir was late, for a whole of lot of- variety of reasons, which is going to give us a modest drop in the overall yield. And in China, we've been battling a pretty voracious pest in southern

China, which we are controlling, but it's taking some of the cream off the volume. But in both of those are relatively moderate, they are not a massive hit to the whole thing. So overall, with the growth in China, some growth in Morocco and hopefully not a repeat of the disastrous Moroccan climate situation last year, we're expecting a much improved performance out of international, although it is early days.

CALLER JOHN: Thank you.

CALLER BEN: Harry, it's Ben Gilbert here again, speaking once more if that's okay. I - harped on about this demand point but it's just- interested in sort of the discussions and again I'm not trying to name supermarkets or anything, but just when you've been talking to your end customers and gauge sort of the impact impact, just in terms of whether they've given you any commentary about whether you've seen any share shift away from berries towards and tomatoes and other categories? Have you seen any trading down or is it just weather related because it's been a bit wetter and a bit cooler?

HARRY DEBNEY: Ah, look, it could be any of those things. I think the weather's got to impact on it. Rather than if you just feel that we've got at this stage that the retailers are not- they're still assessing things. I think- I don't think they're calling out at this point for any radical change. I think the demand for berries overall has been good. I mean, we did see a very high production in December of Yarra Valley strawberries which was way above the normal, and strawberries is something we generally don't participate in except in Tasmania and that did

suck out some of the first two and half weeks of demand for raspberries. And they certainly poked holes and [indistinct] commented on that. But whether that was a large impact or a modest impact I don't know. So that was within the berry overall [indistinct] category, but not outside it but I don't think we've seen enough yet to say there's been any taking away from berries and putting in to another bucket. Certainly we got a bit of that on the snacking tomato category in short term with this oversupply of cherry tomatoes but that will sort itself out, because the producers of those very cheap cherry tomatoes have been selling below cost so that will drop off very quickly.

CALLER BEN:

Final quick one from me. Just with the Monarto expansion and when you look at your expectations, are you assuming that pricing sort of moves probably closer to flattish in the market, even slight decline? Is that sort of what you planned for with increased volume? Or do you think it could be absorbed and still see some ticking up?

HARRY DEBNEY:

We've been putting price increases through with the three retailers. I think we've made that comment before, maybe not here. So all of those new contracts are at elevated levels and they've been reflecting that as I understand more latterly shifts in prices in some of their SKUs in the market. So we still remain confident that that volume will be absorbed. It will be mainly going to retail at those higher levels and we think the wholesale market will absorb the balance. Now, there may be some very short month by month sort of

fluctuations as we bring on volumes but over the year I don't think it's going to be an issue.

CALLER BEN: Alright, thanks very much.

CALLER JOHN: Hi Harry, John Purtell again. Just have another follow up. Just coming back to demand for berries. Can you confirm in December whether there was- it's a rate of growth issue? So there was still growth there?

HARRY DEBNEY: Yeah look, I haven't got the full month's figures yet they tend to trail a bit, but it certainly was a higher volume number from us and our competition than in December in the prior year. But I haven't got the final figures finalised yet.

CALLER JOHN: Thank you.

LINDA KOW: Okay, if there's no other questions- is there any other questions? Otherwise we will wrap up this conference call. Thank you.

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