ArdaghGroup

Ardagh Second Quarter 2017 Earnings Call

Date: 27 July 2017

Transcript

one brandone vision

Operator: Hello and welcome to the Ardagh second quarter 2017 earnings call. Throughout this call, all participants will be in listen only mode and, afterwards, there will be a question and answer session. Please note that this call is being recorded. Today, I am pleased to present Chairman Paul Coulson. Please begin your meeting.

Paul Coulson: Good afternoon and good morning, everyone, to our second quarter 2017 call which follows the publication earlier today of our results for the second quarter. I'm joined on the call in London today by Ian Curley, our CEO, David Matthews, our CFO, and John Sheehan, our Corporate Development and Investor Relations Director.

Before I commence my remarks, I'd like to point out that the information provided during this call will contain forward looking statements. Forward looking statements reflect circumstances at the time they are made, and the Company expressly disclaims any obligation to update or revise any forward looking statements. Actual results or outcomes may differ materially from those that may be expressed or implied, due to a wide range of risks and uncertainties, including those set out in the Company's SEC filings such as the Company's latest annual reports, as well as in the Company news releases. Our second quarter earnings release and financial report can be accessed at ArdaghGroup.com and information regarding descriptions of our segment reporting and the use of non GAAP financial measures may also be found in the notes section of today's earnings release. Today's release also includes a reconciliation to the most comparable GAAP measures of Adjusted EBITDA and Adjusted earnings per share. This disclaimer is only a brief summary of the Company's statutory forward looking statements disclaimer, which is included in the Company's filings with the SEC.

So having done that, I'd like to turn to the performance of the Group. The Group performed very well in Q2, with revenue growth of 58% to €2.02 billion, and a 48% increase in Adjusted EBITDA to €379 million. So the quarter included a full period's contribution from the beverage can business, which has performed well, and where integration is proceeding according to plan. Organic revenue in the quarter grew by one percent, and is up two percent in the half year to 30 June. Volume mix in the quarter was one percent lower, following first quarter growth of three percent, when we benefited from easier comparables and the timing of shipments and holidays. For the half year to 30 June, volume/mix increased by one percent compared with the same period last year.

Other financial highlights for the quarter included:

- Pro forma growth in revenue of one percent, and in Adjusted EBITDA of six percent to €2.02 billion and €379 million respectively. Currency effects were negligible in the quarter and half year.
- Adjusted EBITDA margin of 18.8%, an increase of 100 basis points from a pro forma of 17.8% in the same period last year.
- Adjusted earnings per share are 49 euro cents compared with 10 euro cents in the same period last year. For the half year to 30 June, Adjusted EPS was 79 cents compared with 29 cents in the first half of 2016.
- Operating cash flow in the quarter was strong, rising by 29% to €237 million, reflecting growth in Adjusted EBITDA, net of an increased seasonal working capital outflow and higher plant capital expenditure following the beverage can acquisition. Adjusted free cash flow of €77 million increased by 31% compared to the same period last year.
- Last 12 months' ("LTM") adjusted EBITDA increased by €23 million to €1.363 billion during the quarter. LTM operating cash flow was €980 million, and Adjusted Free Cash Flow was €497 million to 30 June.
- Cash and available liquidity at 30 June was €988 million, and
- The Group has declared a quarterly dividend, of 14 dollar cents per share.

So, turning to each division;

Metal packaging revenue of €1.22 billion for the quarter increased by 154%, compared with the same period last year. Pro forma revenue for the quarter grew by one percent at constant currency, with similar rates of growth in both Europe and the Americas.

Volume/mix was two percent lower in the second quarter, in both Europe and the Americas. Volumes in Europe were in line with the prior year, with mix slightly less favourable, while volumes in Metal Americas were lower, but with a favourable mix effect. Volume/mix in the six months to June was slightly ahead of the prior year.

Adjusted EBITDA in the division for the quarter increased by 149% to €202 million. On a pro forma basis, growth in Adjusted EBITDA was 12%, at both actual and constant currency rates, with advances of 21% and seven percent in Metal Packaging Americas and Metal Packaging Europe respectively. Strong growth in Adjusted EBITDA was driven by operating cost savings and integration synergies in both Metal Packaging regions, and as I said earlier, the integration of the beverage can business made further good progress during the quarter.

Turning to Glass packaging, revenue of €801 million for the quarter was in line with the same period last year, at both actual and constant currency rates. Constant currency revenue increased by one percent at Glass Packaging Europe in the quarter, including a strong performance from our engineering business, whilst Glass North America was one percent lower than the prior year.

Overall volume/mix for the quarter was in line with the prior year, with an increase of three percent in Glass Europe in the quarter. In Glass North America, volume/mix decreased by two percent, primarily due to softness in the mass beer market, which was largely offset by growth in other end-markets.

Volume/mix for the half year to 30th June increased by one percent, driven largely by growth in Glass Packaging Europe.

Adjusted EBITDA in Glass Packaging increased by one percent to €177 million, at both actual and constant currency rates. Glass Packaging Europe increased constant currency Adjusted EBITDA by four percent, principally reflecting cost savings and efficiencies, while Glass Packaging North America Adjusted EBITDA was two percent lower at constant currency.

If I turn to cash generation and our capital structure, cash generation, which this year has included the seasonal outflow from the beverage can business, has been strong. Net debt to LTM EBITDA was reduced by 0.2x of a turn of EBITDA during the quarter, from 5.3x to 5.1x EBITDA and our previous expectation of de-leveraging over the course of 2017 is unchanged.

In terms of our capital structure, in June we took advantage of attractive market conditions with our first Sterling debt issue, raising GBP400 million 4.75% ten-year unsecured notes. This financing, which represented the longest tenor issued to date by Ardagh, further improved our debt maturities, increased our secured debt capacity, and eliminated our exposure to rising US dollar interest rates. Holding long term sterling debt is also consistent with our strategy of matching our debt with the currency profile of the Group's EBITDA.

Following the redemption next week of the remaining 4.25% Euro Senior Secured Notes, which are due in 2022, the Group will have used over $750 million of available cash and IPO proceeds to repay debt in 2017.

These latest initiatives in relation to our capital structure mean that, over the past three years, our average debt maturity has been extended to almost seven years from approximately five years, whilst at the same time our average cost of debt has been reduced to less than five percent from over seven percent previously. Our next debt maturity arises in 2021 and we currently expect to repay this from free cash flow generation. We have no other debt maturity until late-2022.

At the end of May, Standard & Poor's raised the Group's corporate rating from B to B+, with the secured debt rating raised from BB- to BB and the unsecured rating raised from CCC+ to B.

If I turn to guidance, looking to the full year: our prior year Adjusted EBITDA guidance for 2017 of €1.4 billion, (or $1.5 billion) was based on then prevailing exchange rates. However, in recent weeks, the euro has appreciated strongly against the US dollar. At current exchange rates this guidance becomes €1.37 billion (or $1.6 billion), due entirely to currency. Our balance sheet hedging means that the corresponding reduction in dollar debt will leave our expected annual de-leveraging of approximately 0.4x of a turn unaffected, and we continue to expect that net debt at the end of this year will be approximately 4.75 times Adjusted EBITDA.

To wrap up these remarks, the Group has had a positive quarter and a good first half. Since the completion of the beverage can acquisition a little over a year ago now, we have been very pleased with its performance and have made significant progress integrating the business into the wider group. We look forward to strong second half cash generation resulting in the planned further de-leveraging, over the course of 2017.

Having made these opening remarks, we'll now be very pleased to take any questions that you may have.

Operator: Ladies and gentlemen, if you do wish to ask a question, please press 01 on your telephone keypad now. If you wish to withdraw your question, you may do so by pressing 02 to cancel. There will be a brief pause while questions are being registered. And the first question comes from the line of Tyler Langton from JP Morgan. Please go ahead, your line is open.

Tyler Langton: Good morning, thanks for taking my question. Just on the metal side, I appreciate the overall volumes that you gave, can you give a little bit of a breakout between what you saw on both the food side and the beverage side.

Paul Coulson: I think, Tyler, we've given as much of a breakout both in my remarks and in the press release which we issued with the results, and that's how we report our sectors, that's how we manage the business, so we won't be able to give you any further breakout.

Tyler Langton: Okay. And then, just the synergies, can you just talk about how much you may have gotten so far? I think you were still targeting the $50 million in total from the deal, with around $30 million this year and then $20 million next year?

Paul Coulson: That remains on track, completely.

Tyler Langton: And do you have a sense of what you've achieved so far of the 2017 numbers?

Paul Coulson: We've achieved a good chunk of the synergies that were planned for 2017 and we're completely on track for both this year and for next year, as we see it at present.

Tyler Langton: Okay. And just a last question on capital allocation. Is debt pay down and the dividend still the top priorities, or is there anything new, with thoughts on, acquisitions or growth projects.

Paul Coulson: No. I think deleveraging remains, as we've indicated, our priority. We look, obviously, from time to time at any opportunities that might make sense but, no, our focus remains on debt reduction.

Tyler Langton: Okay, great. Thanks so much.

Paul Coulson: Thank you very much.

Operator: And the next question comes from the line of Florence O'Donoghue from Davy. Please go ahead, your line is open.

Florence O'Donoghue: Thank you. Just wondering if there was any noticeable trend in raw material pricing during the quarter?

Paul Coulson: Nothing really, Florence. I mean, on raw materials, both up and down, we have a very effective pass-through system. Two thirds of our business is now on multi-year contracts and the vast majority of those contracts have very tried and trusted pass-through provisions. As you can see from our performance in margins, that's working pretty well. So, nothing other than, obviously, pluses and minuses all the time.

Florence O'Donoghue: Great. And just as a second question, you might just update us again on capex and your guidance. I presume there's no change there?

Paul Coulson: No. Obviously, the currency affects us a little bit, but it's €450 million of capex in 2017 and 2018 and then, as we indicated at the time of the IPO, it would fall after that to about €400 million. The €50 million extra in 2017 and in 2018 was for some development projects associated with the beverage can acquisition. No change from the past.

Florence O'Donoghue: Great. Thank you.

Paul Coulson: Thank you.

Operator: And our next question comes from the line of Anthony Pettinari from Citi. Please go ahead, your line is open.

Anthony Pettinari: Good morning, or good afternoon rather. During the quarter, one of your beverage can competitors announced, potentially, a new plant in Spain and, I was just wondering, given the growth that we've been seeing in the European beverage can market, do you see opportunities either to run just at higher operating rates at your existing facilities or, maybe, potentially, adding lines in the future. Just wondering if you could talk about the capacity situation in Europe and what you're seeing over the next couple of years?

Paul Coulson: We see the market growing. Our capacity utilisation is good. We don't have any plans to increase that capacity.

Ian Curley: Yes, our focus would be very much on the returns that we outlined on the beverage can business. We wouldn't go chasing capacity or volume.

Paul Coulson: Yes. We're very focused on cash generation and margin improvement; that's really, as Ian says, that's where our focus is.

Anthony Pettinari: Okay, that's helpful. And then, just switching to North American glass, I was wondering if you could repeat how much volume/mix was down, and then, you know, how was that demand, maybe relative to your expectations at the beginning of the quarter? Did volumes get worse over the three months of the quarter and into July, or was it just, kind of, steady? Just any kind of additional colour, you can give on the North American glass market would be helpful.

Paul Coulson: I think it's pretty spread throughout the quarter. In Glass, North America, our volume/mix decreased by 2%, which was primarily due to softness in mass beer, which was offset by growth in other end markets - wine, food and spirits and, also, craft beer. You know, mass beer is a factor in that market at the moment, clearly.

Anthony Pettinari: Got it. And then maybe just one last one. I think, in the quarter, your debuted your 'buy our bottles' kind of direct sales initiative in North America. Just curious how the reaction has been to that from craft brewers?

Paul Coulson: That's been positive. It's early days but we're happy.

Anthony Pettinari: Great, I'll turn it over.

Paul Coulson: Thank you.

Operator: And the next question comes from the line of Chris Manuel from Wells Fargo. Please go ahead, your line is open.

Gabe Hajde: This is actually Gabe Hajde sitting in. Thanks for taking the question. Can you comment at all about the European pack as it relates to vegetable, fruits, and how that's coming in, relative to expectations, and any potential shifts between the quarters? I know you guys are really looking at the full year, but I'm just thinking about the cadence for the remainder of the year.

Paul Coulson: I think we are, so far, so good with the harvest. You know, last year, obviously, was a very bad year with very, very unusual weather. This year seems fine and our people seem happy with that and the progression through the year.

Gabe Hajde: Okay. And then, the two projects that I think you guys have going on right now in the beverage can operations. Are you pleased with those progressing on track in terms of timing and returns, and all that?

Paul Coulson: Yes. We've actually got three projects; we have two in the UK, Deeside on ends and Rugby, and we also have a project in Manaus in Brazil. They are all on track, the returns expected from them, the costs etc., are all fine, in line with what we said previously.

Gabe Hajde: All right. Thank you.

Paul Coulson: Thank you.

Operator: And ladies and gentlemen, as a reminder, if you do have a question please press 01 on your telephone keypad now. And we do have a question from the line of Debbie Jones from Deutsche Bank. Please go ahead, your line is open.

Debbie Jones: I think the comments you just made about the pack were related to Europe. I just am curious in North America, because we just got the CMI data via email right before your call. It does suggest that, you know, food is down about 2.9% in the second quarter and vegetables specifically down, I think, by about 5%. Is there anything about that that surprises you? I mean, I think you would have gotten this data yesterday. Because I thought the commentary is more that the pack seemed to be relatively normal this year or maybe even a bit better?

Paul Coulson: My previous comments were about Europe, not about the US. Directionally and overall in the US we've had a good performance from our beverage cans and a slightly weaker performance from the food can side in the US.

Debbie Jones: Okay. And then I wanted to ask, just kind of big picture, there has been a lot of talk lately about how e-commerce is impacting packaging. You obviously had the Amazon/Whole Foods news. Can you give your perspective of how the can fits within that dynamic, just in terms of packaging format? What would win if there's, kind of, a shift towards that type of delivery?

Paul Coulson: I think, Debbie, you know, we spend a lot of money on R&D and innovation, and we're looking at all these things and we're watching it. But we're not seeing anything yet that would lead us to believe that we would be hit in terms of cans or glass, for that matter.

Debbie Jones: To me, it seems like there would be reasons that maybe the can would do a little bit better if there is a fundamental shift, just from the durability.

Paul Coulson: I think that's probably true, and I think the shifts you're seeing in retailing are likely to be between our customers and the retailers or the retailers' customers. We are a bit back in the supply chain on that regard. So, I don't think there's anything yet that we're seeing but, obviously, we watch these things and are looking. But we're not seeing anything and, I think that as you say, the risks would be to the upside.

Debbie Jones: Okay. And then, I know you touched on Brazil a bit, but is there anything? It seems to me like things seem to be trending okay, despite a bit of a volatile backdrop. Is there anything noteworthy there that you're concerned about going forward?

Paul Coulson: No, we're very happy with the Brazilian business. We're very pleased with the management team, we're very pleased with the way the business is going. As you know, it's our first time in that market and so far, so good. As I said earlier, we're on track with our investment in the ends plant in Manaus, so we are very comfortable with it.

Debbie Jones: Okay. And then just another, kind of, one to three-year question here. If we were to think about your share in the major regions where you compete on the metals side and specifically on beverage, do you need to continue to add capacity to keep share specifically in a region like Europe or Brazil?

Paul Coulson: You know, we are not focused on what our absolute market share is or relative market share, so we have no plans to add capacity in Europe at all. We're very focused on – in the same way that we haven't added capacity in our European glass business – return, margins and free cash flow generation, We are not really worried about if our market share moved or whatever. It's much more what's the level of profits that we're making, what's the return for our shareholders? We are a big player in that market, we have big market positions – we are number two and, on certain measurements, you could see as almost number one when you strip out Scandinavia and Russia.

Debbie Jones: Okay, I can appreciate that. Thank you very much and I will turn it over.

Paul Coulson: Thank you, Debbie.

Operator: And, as there are no further questions registered, I will hand the call back to the speakers.

Paul Coulson: Well, thank you very much everyone for joining us today and we look forward to talking to you again with our Q3 results. Thank you very much for your time.

Operator: This now concludes the conference call.

one brandone vision