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Q1 2019 Olam International Ltd Earnings Presentation

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PRESENTATION

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

Ladies and gentlemen, good morning, and welcome to Olam International's Learning Academy at Marina One, Singapore. I'm Hung Hoeng of Olam Investor Relations. We are very pleased to meet you once again this time to present our results for the first quarter ended 31st March 2019.

By now, I'm sure you are aware of the usual protocol that is to observe our safety procedures in this building. So we'd like you -- like us to be reminded of safety by watching our safety video, and I'll appreciate your attention while this is being played.

(presentation)

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

Thank you for watching. And as always, we are pleased to have our senior management team present here at this briefing. Seated at the extreme left at the table is our Co-Founder and Group CEO, Sunny Verghese. To his right is our Executive Director and Group COO, A. Shekhar. And to my left, it's President and Group CFO, N. Muthukumar.

Now I would like to draw your attention to this cautionary note on forward-looking statements that may be given during this presentation.

Now Group CFO will now present our results and, more interestingly, the progress we have made on our new strategic plan. Please join me to welcome Muthu here.

Neelamani Muthukumar ***Olam International Limited - President & Group CFO***

Thank you, Hung Hoeng. Good morning, ladies and gentlemen. Once again, a very warm welcome to the first quarter 2019 financial highlights.

We are pleased to announce a very strong start in executing our 6-year strategic plan, and that is reflected in our first quarter financial results: volume up 21.5% to 8.5 million tonnes; EBITDA up 14.2% to SGD420 million from SGD368 million; more importantly our key operational metric that we track and report, our operational PATMI, up 11.3% at SGD181 million, up from SGD163 million in the first quarter of 2018. Coming back on a very strong free cash flow to equity generated in 2018 of SGD1 billion, we are pleased to announce that we have generated further free cash flow to equity of SGD313 million in the first quarter of 2019. And all of these have resulted in terms of increased operational earnings and also very prudent balance sheet management at a certain lower gearing of 1.35x, down from 1.49x this time last year.

As I was highlight -- announcing earlier, the volume grew 21.5% to 8.5 million tonnes from roughly 7 million tonnes this time last year. And primarily bulk of the increases come from the Food Staples and Packaged Foods segment, more importantly from the Grains trading volumes. But going forward in the rest of the year, we expect the increase in volumes to stabilize to more organic growth in the rest of the segments.

EBITDA, up 14.2% primarily coming off a very strong start from Edible Nuts and Cocoa. And we would like to draw your attention that with the adoption of SFRS 16 effective 1st January 2019, there have been changes to taking our operating lease liabilities into our balance sheet. And that has resulted in both changes to our balance sheet and to the way we account the lease rentals in the form of depreciation and finance charges, and that is more detailed in our MD&A Page 4 and 5 for your reference. More importantly, for this quarter, we had an impact because of this change in SFRS 16 -- adoption of SFRS 16 by SGD24.6 million in our EBITDA but, however, all-round strong performance in the first quarter of 2019.

A point to highlight. With the closure of Fundamental Fund in our Commodity Financial Services segment, the quantitative fund has started out very strongly and delivered an EBITDA of SGD10.2 million in the first quarter.

Our operational PATMI, up 11.3% to SGD181 million, up from SGD163 million in the first quarter of 2018, again an increase due to increase in EBITDA of SGD52 million. However, I wanted to again point out here, with the adoption of SFRS 16, there has also been an increase in depreciation and amortization and finance charges as these are accounted differently under the adoption of this new standard. And that has resulted in a roughly SGD24 million of increase in depreciation and amortization and SGD7.5 million increase in finance costs, a net impact of a negative SGD6.4 million in our operational PATMI. So like-to-like, our operational PATMI, but for adoption of SFRS 16, would have been SGD187 million instead of SGD181 million. We also expect continued impact of this adoption of SFRS 16 going forward in the future and, more importantly, for the rest of the 3 quarters as we compare our results with 2018.

Our invested capital was down by 5.5%. Primarily the fixed capital increase is due to, again, adoption of SFRS 16 where in all of our operating lease liabilities, roughly SGD605 million have come back to our balance sheet. And that is the primary reason for the increase in fixed capital on a year-on-year basis from December to March. More importantly, our working capital is down about 20% in spite of 21.7% increase in volumes and roughly 16.7% increase in revenue due to prudent working capital management.

Net gearing, down to 1.35x compared to 1.49x this time last year. Again, adjusting for the impact of SFRS 16 on a like-to-like basis, we would have been 1.27x in the first quarter 2019, even below 1.32x where we ended December 2018. The lower working capital has been primarily due to change in product mix. We talked about the bulk trading volumes enhancement during the course of 2018 and 2019 and also having improved access to supplier credit.

We generated a SGD313 million of positive free cash flow to equity in the first quarter of 2019. But as we had indicated in our strategic plan, we have a plan of investing $3.5 billion over the course of the next 6 years in terms of a combination of $2.5 billion of growth CapEx and $1 billion of maintenance CapEx while we pursue to divest some of our deprioritized assets over the course of the next 6 years, that by generating cash of $1.65 billion, in 2019, we believe some of the already-announced acquisitions on -- also the offer that we have given for acquiring our Dangote Flour Mills in Nigeria may result in potentially a negative free cash flow to equity for this year. But however, we will remain committed to ensure that we are free cash flow to equity positive during the remainder of the strategic plan period.

We have sufficient liquidity to take care of all our repayment and CapEx obligations. As you can see, we have close to SGD9.5 billion of unutilized bank lines with a total liquidity, combination of cash, readily marketable inventories, secured receivables, has given us the healthy headroom of over SGD7.2 billion over our gross debt of SGD11.6 billion.

I'd also continue to thank our bankers who have been supporting us through all these years. And more importantly, in the first quarter of 2019, we had announced a $350 million of 3-year revolving credit facility, a digital-linked loan, a world's first. Thanks to BBVA and other key bankers, we have been able to launch this digital-linked loan which will allow us to track Olam's digital maturity through BCG's, Boston Consulting Group's, proprietary Digital Acceleration Index, which will look at 4 key parameters on how Olam's digital maturity will progress. And that will have an impact on reducing our borrowing rate for this loan. We want to continue to tap such sources of capital in the areas of digital and sustainability going forward. Thanks once again to all our bankers.

Moving on to segmental review. As I had called out earlier, Edible Nuts had started off strongly. Cashew, Almonds, Hazels, sesame all have performed -- started off very well. And in this particular platform, Peanuts had some difficulties. We had exited Peanut farming business in Argentina, as we had indicated in the fourth quarter. And also, the U.S. Peanut shelling business has started off softly because of oversupply in the market conditions and that we expect to continue at least in the next 2, 3 quarters. But however, our blanching business in U.S. continues to perform well. And that gives us confidence that overall, the Edible Nut platform will continue to deliver strong results in 2019.

From -- in the Spices platform, our U.S. dehydrates, both onion and garlic, have continued to perform well. Our Vietnam Spices, our Indian Spices business, our Chinese Spices business all have started off very well. Our tomato business, which had been facing headwinds in the last 2 years, continue to face difficult market conditions. But we are doing whatever we can to ensure that we will be able to deliver better results, operating results, on a year-on-year basis going forward.

In Confectionery and Beverage Ingredients, it is essentially a 2-platform story, Cocoa and Coffee. Cocoa, which finished very strongly last year, continues to have an exceptional start to this year both in terms of supply chain trading business as well as processing business. And that we believe will continue in the rest of the year. In terms of Coffee business, there is a green coffee supply chain trading business. That is a soluble coffee business. The prices both in Arabica and Robusta continues to be soft. And especially in Arabica, it has been an all-time low sub $1, and that has impacted our green coffee business and our plantation business in the first quarter. And we expect that to continue for some more time in 2019. However, the lower coffee prices has helped the soluble coffee business, and they have started off very strongly and is expected to deliver strong results during 2019.

I'd like to draw your attention on the significant reduction in working capital in this segment primarily due to lower cocoa and coffee prices but also improved inventory management especially in the green coffee business. Fixed capital has increased on account of the acquisition of the BT Cocoa, the coffee processing facility in Indonesia we took an 85% stake in the first quarter of 2019, and also due to the impact of operating lease liabilities in the segment coming on the balance sheet.

In the Food Staples and Packaged Foods segment, we have an SGD82 million EBITDA, lower than SGD100 million that we delivered in the first quarter of 2018 primarily due to lower contribution from Sugar and Rice platforms. We had -- as part of the strategic plan, we have decided to exit the Sugar business, and we have already acted on it. And we have closed down our sugar trading business desks both in London and Singapore and had -- that has an impact in terms of a comparative EBITDA contribution. And as we had indicated in the second half of 2018, due to intense competition in the merchandising business in hinterland of Western Africa, we had lowered down our indent or merchandising volumes in Africa. And that has continued to be the case in the first quarter of 2019. And that has also resulted in a lower contribution relatively in the Rice platform.

However, Dairy trading and supply chain business has started off very strongly. Our Russia upstream Dairy business, Rusmolco, is continuing to perform well but offset by our upstream Dairy business in Uruguay, which had faced increase in feed cost because we had to import feed. It's a pasture-based Dairy farming business. And due to severe drought conditions that had prevailed in Uruguay last year has impacted us to import feed, which has increased our cost and thereby our operating results. And that has a lingering effect coming into 2019 as well.

Our Edible Oils supply chain and trading business had started off very well but offset and more than compensated for our lower midstream processing volumes which hit our Mozambique refinery due to the cyclone that hit that part of the world.

A lower working capital was primarily due to the closure of the Sugar trading business in the segment. And I also wanted to call out that Packaged Foods branding business in first quarter of 2019 have started strongly, both our Ghana biscuits and culinary business. Our Nigeria culinary and -- biscuits and candies business all performed incredibly well and have been positioned strongly as compared to the first quarter of 2018.

Moving on to Industrial Raw Materials, Infrastructure and Logistics segment. It's primarily 3 businesses: Cotton; Infrastructure & Logistics business in Africa; as well as the Wood Products business. We had higher throughput in terms of volume and revenues in cotton but had faced some squeezed margins in the first quarter of 2019, resulting in lowered EBITDA for Cotton. And there are also throughput issues in the first quarter of 2019 for Infrastructure & Logistics business in Gabon. But that we believe is only a temporary bottleneck, but that we will overcome in the rest of the year. Wood Products business, which we have identified for exit, our ROC business, the Republic of

Congo forestry conservation business continues to perform strongly and had performed better than -- in Q1 2019 as compared to the first quarter of 2018. Working capital decreased significantly because of reduced inventory levels and increased payables in the Cotton segment and fixed capital, as I had highlighted earlier in other segments, and primarily increased due to the impact of application of SFRS 16.

In terms of updating on what we have done in the first quarter in executing our strategic plan, it's a combination of 2, investments as well as divestments. Pleased to inform that we had completed the acquisition of our 60% ownership in the parastatal Cotontchad in the country Chad which has the integrated ginning model for $16 million. While the capital outlay's small, but the bulk of the challenge for us is to ensure that we are able to turn around this business and ensure significant livelihood improvement for more than 300,000 farmers in that country.

We also completed acquisition of the 85% of BT Cocoa, the cocoa processing facility in Indonesia that will give us again a very strong footprint in supplying to the Asian Confectionery and Beverage customers. We had already announced an initial offer to acquire Dangote Flour Mills in Nigeria for $361 million. However, the final price will depend on what we will negotiate with the retail shareholders as it's a listed entity in Nigeria as well as finalization of net working capital at the time of closure of this acquisition which we expect to complete by Q3 of 2019.

In terms of divestments, we have already acted very swiftly. As I had highlighted earlier, we have closed down and exited our Peanut farming business in Argentina. We sold off our remaining 51% interest in the Collymongle ginning in Australia. We exited the sugar trading decks -- desk. We closed down our Fundamental Fund and the CFSG segment. And we also closed down our Wood Products trading business in Latin America. And all of these divestments have reduced our investment capital on a year-on-year basis of roughly $78 million.

So in terms of what has transpired in Q1 2019, I'm very pleased with a good start to the 2019 financial results, with operational PATMI up 11.3% to SGD181 million, EBITDA up 14.2% to SGD420 million and generating a positive free cash flow to equity of SGD313 million.

As I had highlighted earlier, we have started off very focused in executing our 6-year 2019 to 2024 Strategic Plan, definitely to capitalize on the key consumer growth trends and also achieve sustainable and profitable growth especially in terms of looking at targeted investments in the digital and sustainability areas and also turbocharging our AtSource platform to significantly enhance the reach and utilization across the world.

There was clear demonstration of strengthening the balance sheet further coming on to a very strong balance sheet position in 2018, lowered net gearing at 1.35x compared to 1.49x this time last year. Even adjusting for the impact of SFRS 16, our net gearing at 1.27x levels is actually like-to-like lower than even our December 2018 position of 1.32x. And also generating a healthy free cash flow to equity of SGD313 million all reflect that our balance sheet has been strengthened further.

We had also highlighted as part of our January 25 announcement when Sunny unveiled our 6-year strategic plan, we talked about our Board of Directors-led plan to appoint financial advisers to explore additional ways and means of unlocking intrinsic value in our business. And pleased to announce that we have recently appointed Credit Suisse and Rothschild Singapore to be as joint financial advisers who will help us to explore and the Board to explore various options to further maximize long-term value for our shareholders.

Thank you.

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

Thank you, Muthu. We move on to question and answers.

If you have a question, please pick up the microphone from one of our colleagues and tell us where you come from. And we would like you to prioritize your questions to focus on the results and the strategic plan. And if you have questions on the market outlook, perhaps we can just put that towards the end if we have time to answer those questions. Thank you. Yes, Alfred?

Alfred Cang ***Bloomberg - Commodities Markets Reporter***

Hi good morning Sunny, could you please share with us more details about your appointment of Credit Suisse and Rothschild and this long-term value? So the company also said there will be a $1.6 billion divestment. If that will happen this year or it's a much longer target? And could you share with us some of your opinion about the trade war since U.S. and China just escalated and then if you feel any impacts on the company's business? Thanks.

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

Thank you. So on the appointment of the financial advisers, this was something that we announced in the last strategy plan announcement in January, that we will be appointing financial advisers. The strategic plan has been approved by the Board. And as I mentioned last time, that has helped us determine where to play and how to win. So this strategy has already been crystallized, so we're not relitigating the strategy through this exercise. This exercise is to see how can we reposition the company or restructure the company to further enhance long-term shareholder value. So that's the exercise that is underway. I cannot say more about it at this point in time. The work has just started. And before the end of this year, as we have mentioned, we will have the recommendations from the financial advisers, and the Board will consider that and make an appropriate determination in terms of whether to accept any of those recommendations or to continue as it is. So that's all that I can say about that exercise. It has just commenced, and we will have an output for the Board by -- before the end of this year.

On the second question which was more on...

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

Divestments.

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

On divestments, yes, so the $1.65 billion target of release of invested capital from divestments is for the whole planned period. But we expect a majority of that to happen in the first 3 years and a small portion left for the second 3 years. So as Muthu just outlined, in the first quarter, we are tracking. We have disposed of 5 assets or exited 5 activities, and that has together generated roughly $78 million of the invested capital. So we are well on target to achieve the first year's targets in terms of the divestment proceeds expected from this restructuring.

And the third question was on trade war as, of course, being a setback, the market was expecting a resolution. And this was an aggressive setback that has occurred. It has implications on all markets. As we can see, week on week since this announcement, if you look at the broad agricultural commodity index, they've declined by about 3.3%, so it has a significant impact. But the impact is not only because of the trade war, impact is also on weak destination demand. It's a combination of factors, and it depends on the commodity complex. So as far as the grains complex is concerned, the African swine flu or swine fever episode is reducing demand itself. And according to the CEO of Tyson who, in a recent conference call, has said that between 150 million to 200 million hogs in China have died. And the disease has spread quite significantly but not just in China, but it's now being in the spread across Asia as well. So demand will be softer as a result. The estimate now is that current year's imports will be about 84 million tonnes. Next year's imports will fall to 83 million tonnes. So with 84 million tonnes this year, it's about 10 million tonnes lower than last year. And that is the first time we have seen a decline in imports also we've been in China for a very long time. So I think the trade war, the weakening demand as a result of ASF, both this combined together has a bearish impact on these markets.

Kevin Lim ***Nikkei Markets - Correspondent***

Yes. Sorry, just one of -- but can you say a bit more about the Credit Suisse and Rothschild's appointment in terms of like how broad are the parameters? When you say maximize long-term value, would this include like even delisting or privatizing Olam?

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

I cannot be more specific at this stage because our work has just commenced. So we will see what happens in terms of the output of that effort. What we have told you in January and what we have repeated now is that we have developed the 6-year strategic plan, and we have determined which business units we want to remain in, which business units we want to deprioritize, which SBUs within those business units we want to stay in, which SBUs we want to deprioritize. We have identified a list of assets that we feel is now not core to our strategy going forward which are part of the deprioritized businesses or even some of the continuing businesses where those are not deemed to be core anymore as part of the new strategic plan. So that we have already announced. So that strategy has been crystallized. So Credit Suisse and JPMorgan's mandate as financial advisers is to look at how do we illuminate the hidden value that there is in the business through a possible reorganization or recombination of our businesses into more coherent and more related combinations that could potentially unlock further value. So that is their brief in the mandate, and they will assess this over the course of the next 6 months and make a determination whether there is further value to be created within these strategic parameters that has been now set for the new plan. So there's no value in prejudging what that study will reveal and what that outcomes will be. So we don't want to speculate about what that will be or what the outcomes will be. So you'll have to be patient and wait for another 6 months, and we will announce it at an appropriate time when we are ready.

Kevin Lim ***Nikkei Markets - Correspondent***

Okay. But would it be fair to say it's a very broad mandate? You have not like told Credit Suisse or Rothschild that certain possibilities or options are off the table, that means anything can be on the table?

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

It's a specific mandate. It's not a broad mandate. It's a specific mandate, as I've just described. It is not about relitigating our strategy or devising a new strategic plan. The first exercise that we wanted to do was as per our regular cadence, crystallize our next 6-year strategic plan. So that has been crystallized, that we have shared with all of you. That's divided into 2 3-year cycles, FY '19 to '21 and then '22 to '24. And we have given you some granular details about the 4 strategic pathways that we are executing on to achieve the goals and aspirations of that plan. And having done that now, the board has decided to appoint financial advisers to look at the plan and see other ways that we can reposition the business such that we can illuminate what we believe is the hidden value in this business, which is now not reflected the way we would have expected it to be reflected. So that is a very specific mandate, so it's not a broad mandate.

Ryushiro Kodaira ***Nikkei Asian Review - Senior Staff Writer***

Hi, thank you very much. So could you just let me know the investors' reaction about the 2019-2024 Strategic Plan after it is announced? And my second question is, sir, is there any possibility that you would divest or invest more than you originally planned?

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

So the answer to the first question, the response from investors has been very positive. They believe that our new strategic plan, firstly, is on trend. The 4 major trends of people preferring now to consume products that are right for them in terms of health and nutritional value, in terms of traceability, supply chain provenance, simplification of ingredients, clean labeling, that's one big trend. So they believe that our new strategic plan is bang on the strength.

Secondly, the trend of right for producers. That the smallholder farmers who supply all of these ingredients that you consume as food and feed raw materials, they believe that it's important that they have livelihoods and they are prosperous so that they can continue to produce these raw materials and ingredients.

The third trend is right for the planet. We cannot produce food to meet the growing needs of a growing population, which is estimated at 9.5 billion people, more than 2 billion people to add -- to be added to the planet by 2050. If you're going to produce and consume the way we are doing now, we'll destroy the planet. So how do you produce food which does not destroy the planet but meets the growing demand for food, feed and fiber that we all need. So they believe that our strategic plan -- new strategic plan is bang on this strength.

And finally, it is about the way we produce, the way we consume has gone through a transformation because of digital technologies and because of other production technologies and everything else. So our new strategic plan tries and exploits the way that we are now producing and consuming which has gone through a significant transformation.

So 3, 4 months after we have launched this plan, we have had a chance to meet all our shareholders and investors and potential investors. And they are extremely excited about the prospects of this plan because they believe that this plan is very much on trend. More than it also being on trend, they believe that we have the capacity to execute this plan in terms of the competencies and skills and capabilities required to execute this plan and the configuration of assets and resources that we have. They have very high confidence that we have winnability, and we can really execute this plan. So from investors' point of view, that is positive.

Now coming to the second question, as we said, in the horizon of this plan over the next 6 years, we are going to double down on the businesses that we have got a very strong leadership position and cost economics. So we're going to streamline the portfolio by getting out of or deprioritizing the 4 business units out of the 16 and remaining in 12. But in the 12, we are going to double down on them, and we're going to invest $3.5 billion for the course of the 6-year plan. And in the deprioritized businesses and the identified SBUs for exit and the related assets that we are going to dispose of, we expect to generate $1.65 billion in cash. We have explained the timing of those cash flows over the course of this plan. And based on what we have done in the first quarter, we have started off with a strong execution of this plan. So first quarter, we have started off with a bang in terms of executing the various granular initiatives that comprise this plan. So the ink is not yet dry on that plan, and so we have no ideas of now changing the targets or goalpost in the first quarter itself. It's a 6-year plan, and I hope we don't change very frequently. Nothing is cast in stone. We will review this as we go along. But there is no change to the targets and goalposts and milestones we have articulated to you already as part of this plan. Yes.

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

There's a question, lady in red.

Fiona Yik ***Westpac Banking Corporation - Senior Relationship Manager***

Hi I'm Fiona from Westpac. Thank you. Just a little bit more on the granularity of the strategic plan as well. So specifically, I think it was mentioned that the plan will result in a negative cash flow for this financial year. But given the rather dimmer outlook now with what's going on at the trade war U-turns and all that, would that somewhat abate your pace of the acquisitions and, therefore, perhaps reset some of these numbers that were projected at the start of the year in terms of how it's going to affect your cash flow for this year? And particularly, I think -- what do you see to be the impact overall on the financial outcome for FY '19 as a result of some of the changes in the macro environment? Thanks.

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

So let me answer the second question first. We don't give quarterly or annual guidance, so we're not going to start now. So there is no guidance. We are comfortable with the plans and budgets and commitments that we have made to our stakeholders this year, and we believe that despite the current developments that you are alluding to, we don't see a case at this point in time to revise that plan. So we are on plan at the end of the first quarter. And the current view based on what we know now is we expect to be on plan for the full year. But we don't give specific guidance on quarterly or annual basis on performance milestones.

The first part of your question, we've already signaled to you when we announced the plan that we have a fairly substantive CapEx program, investment program this year. So out of the 6 years of this plan, we will expect to be free cash flow to equity negative in the first year, that is in 2019, but will remain -- we'll expect to be cash -- free cash flow positive to equity every year in the balance 5 years of the plan.

We've already committed some of the big chunky investments that we wanted to make this year, as Muthu referred to in his presentation, that he has announced already 3 big investments that we made this year. One was taking 85% stake in the cocoa processing operations, BT Cocoa in Indonesia for a $90 million valuation. The second was acquiring Cotontchad, the cotton parastatal in Chad. And the third was making an offer for Dangote Flour Mills in Nigeria which is a very chunky significant transaction for us.

So a large part of what we wanted to commit for this year has already happened in the first quarter, which is why I was remarking to the earlier question that we have started off executing this new strategic plan very well. And if you look at the first quarter, we are on track as far as our FY '19 financial performance is concerned. So Muthu has told you that we have grown EBITDA 14.2% and operational PATMI 11.2%. So we are well on target with our plan from a financial performance standpoint. Secondly, from a divestment standpoint, we already outlined the 5 divestments that we have done in quarter 1 and the $78 million of cash that we released in quarter 1. We are bang on schedule with our investment plan. And I've mentioned and articulated the 3 big investments that we have already committed to in the first quarter. And we therefore believe that our strategic plan is comprising of very specific granular growth or divestment initiatives. And internally to our Board, we track our financial performance against plan, but we also track all the other strategic initiatives that are part of our deliverable to our Board and to our stakeholders.

So the answer to your first question is that we don't expect to revise at this point in time the guidance of being free cash flow to equity negative this year. Based on what's happened the first quarter and the developments of the trade war, et cetera, that you are referring to, we don't expect our cash flows to materially change at this point in time based on what we know today. If there is any change to that, we will give you an update in quarter 2 or quarter 3 as we progress and we know more about the real implications of some of these developments.

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

Is there a question? Simon?

Simon Jong ***DBS Bank - Credit Analyst, SVP Fixed Income***

Hi. Thanks a lot for that presentation. Just wanted to ask in view of the novel loans that you guys have secured. So the first one was the $500 million sustainability loan and then the $350 million now digital loan. I'm just wondering, based on what you see, do you think this is something that is -- I think it's a decent size, in fact, collectively, so I just wanted to understand the scale. And you mentioned also that if the specific targets are achieved, there could be savings. Now I wanted to ask whether you could articulate in the most optimistic scenario what kind of savings will we be expected to see in terms of the financing costs. And the second question I have is the payables item again this quarter has been very significant. You mentioned in your segmental review that some of it could be coming from Cotton. I'm just wondering in 4Q '18, was that also coming from Cotton or some other segment, and whether you would expect this to be something which is perhaps structural and could extend in the next few quarters? Thanks.

Neelamani Muthukumar ***Olam International Limited - President & Group CFO***

Thank you. The first -- to answer your first question in terms of sourcing alternate sources of capital or novel ways, as you put in, in terms of the digital arena or in the sustainability arena, as part of the strategic plan, there are 4 key enablers we have identified to execute our strategic plan. And out of those 4, digital and sustainability are 2 key enablers for us. And what we believe is that we have to impact or utilize these 2 key enablers in all its -- all forms to ensure that we maximize the value of these enablers to execute our strategic plan and our priorities. So we have been working with bankers, and I thanked all of you, and I will thank the bankers once again for being receptive to the ideas that we have kind of first floated and then the positive reception in terms of looking at how do we look at innovative ways of sourcing capital which are competitive and it is not costlier than what we will otherwise obtain in the normal course of business. But however, there is a positive impact if you are able to work on what we believe is core to our purpose of reimagining global agriculture and food systems and ensure that while we're delivering on our own priorities, that has a positive rollover impact on financing. So I wouldn't attribute a significant reduction in financing costs because of these initiatives. But definitely, these are catalysts as internal to the organization and to external -- to the rest of the other players in the industry to look at ways and means of tapping these sources of capital that will galvanize all of them to look at digital maturity as well as sustainability areas. So that's the answer to the first question.

In terms of the trade payables, yes, primarily these are due to the bulk trading volumes that we have been doing in the last 18 to 24 months. And that has allowed us to look at sources of supplier credit. Historically, Olam business model has been primary sourcing and sourcing from several small customers, small suppliers and farmers. And that kind of a supplier model will never allow you to source that supplier credit. But in the recent past, we have been -- our business model has changed especially in the bulk trading volumes, and that has allowed us to access supplier credit from some of the markets. And as I had indicated in my presentation, bulk of the increase due to these bulk trading businesses have already happened. And as the volume stabilize, we also expect the advantage of having these trade payables also to stabilize going forward.

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

If there are no questions from the floor, I will take some questions online here. Market outlook, what is the -- what is your view on the coffee market going forward? And how is it going to affect prices and, obviously, also our business?

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

So I think the common trend across all agricultural commodity markets is the -- particularly those that are futures traded and derivatives traded, there are about 24 global commodity -- agricultural commodity contracts and exchanges around the world, and I'm not including India and China in this. But non-India, China, there are about 24-agri commodity contracts listed in various jurisdictions: New York, London and other places. Out of those 24 contracts for this year since January, only 2 contracts generated positive returns for this financial year so far from January -- not this calendar year, from January to now. And that is a lean hogs contract in CME and the Class III Milk contract on CME. Apart from these 2, 22 contracts have declined by varying degrees. So generally, the agricultural commodity complex has witnessed a fairly bearish trend for the first 5 months of the year.

The second is that we are seeing historical record short positions across most of the complex. So if you take the Grains and Oilseeds complex, and there are multiple contracts trading in the Grains and Oilseeds complex in these areas, we have now roughly 700,000 contract short position, which is a lifetime high. The previous high short positions that we have seen in this complex has been roughly 481,000 contracts. So it has beaten the last high short record position by a significant margin. So there's a lot of short in the market as a result of some of the things that we talked about, weak destination demand in the grains and oilseeds complex driven by the impact of ASF but also because of the trade war and because of excess supplies. So if you just take the soybean crop to South America, we have a record crop between Brazil, Argentina, Paraguay and Uruguay of 184 million tonnes, which is [30 million] (corrected by company after the call) tonnes higher than last year, just in 1 region. So this is the same story across the U.S., North America, including Canada, as well as Europe and other producing countries for this. So that's another example.

So really in Coffee, we have a record short crop -- record short speculative position in Coffee. Largely driven by the fact that because Coffee prices have slumped and have reached the $0.90 per pound barrier, with slightly lower carry that exited last year in the Arabica markets, the percentage yield for specs has really shot up. So last year, the state of the yield with slightly higher carry about 6%, 7% on an annualized basis to the short spec position. Now that has gone up to 16%, 17% because the prices are so low now, so the percentage yields have changed. So it's a fairly good safe bet. So there's a lot of people who have piled down and shorted this market, which is one of the reasons why the market has remained where it is. But on a fundamental basis, we see the '18, '19 coffee crop with a significant surplus from a demand/supply standpoint. But we expect '19, '20 for that supply/demand equilibrium to come back to a neutral position to a mild deficit. We expect a mild deficit in Arabica. And the same we would expect in Robusta. So we have another season to go, of course. Other factors in the coffee market like the weakness of the Brazilian real will also keep prices low. And the uncertainty about the new Bolsonaro's administration in passing the pension reform law that is currently being discussed, et cetera, would have some impact on the strength of the Brazilian real. A weak Brazilian real will result in weak coffee prices.

So all is also a function, but demand for coffee has remained fairly strong. So demand has not weakened unlike in the grains and oilseeds complex where, because of ASF and trade war, et cetera, we have seen a demand depression or destruction. In the case of coffee, demand has remained strong. It's still in excess supply, which is cyclical and not structural. So we expect some continuing pain in these markets from a down-cycle standpoint in coffee markets for a little while longer. As you know, the Brazilian crop, which is the major coffee producer, follows a biennial cycle. It has on-year, and then that's followed by off-year. So '18, '19 was an on-year record crop. '19, '20 is expected to be off-year, so significantly reduced production which will get the demand/supply back in balance specifically as far as coffee is concerned. But overall, the entire agricultural commodity complex has very bearish weak sentiment as a result of some of the things that I've just described.

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

There's a follow-up question -- 2 follow-up questions on the other 2 products, Cocoa and CPO. The first is because we have -- Olam has done very well in the Cocoa business, how far will the markets go to be supportive of that performance? And for CPO, it's at a 6-year low. How would that also affect our upstream business?

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

So for the '18, '19 crop in Cocoa, we expect a small surplus, about 100,000 tonnes, and therefore, we expect prices to trade within a range. We expect New York to trade in a $400, $500 range. We expect London to trade in about a GBP 350 range. I think many manufacturers have taken advantage of fairly low cocoa prices to extend their cover, so they're well covered. The combined ratios as a process, so that's important for us, is still trading at fairly elevated levels as a result of the rundown on product stocks, where there's butter liquor, cake butter stocks. We have seen some weakening of the butter ratios, but that has been compensated for by increased powder prices. So overall, the combined ratios are still very healthy, and the processing margins are still very good.

So for this year, we expect a mild surplus and, therefore, prices trading sidewise in a fairly narrow range. However, we're seeing some structural issues emerging in the supply side. So the recent estimate is that there is about 370,000 hectares in Ghana, which is the world's second largest producer of cocoa beans, which has got a swollen shoot virus problem. And this problem, there's no cure at this point in time. So even if you remove the trees, there are more than 20, 21 different hosts in the ecosystem who can support this virus. So even by just removing the trees and replanting, you're not going to solve the problem. So you have to breed a disease-resistant variety for swollen shoot problem, and that we will see what happens. So this year, I think we will have a mild surplus. Structurally long term, we need to see all of these developments in terms of being able to produce more deforestation-free, more child labor-free cocoa. And we are taking a lot of initiatives across the key producing regions where we are present to be really sustainable in our cocoa supply chains -- the way we source the cocoa, trace and track the cocoa and deliver the cocoa. So -- but that would be structurally challenges and headwinds that face this industry. And we are very conscious of that, and therefore, we are taking a lot of steps to stay ahead of the curve and do this on a sustainable basis.

The second crop was on CPO. CPO, as you saw towards the end of December and the last quarter of 2018, we saw a sharp rebound in prices. And that continued until about February of this year. And then we saw those price gains being given up largely on account of the buildup of stocks. And it stayed stubbornly around the 3 million tonne mark, which was the average traders' guess or estimate. Also, that would be drawn down. In May, we have seen in Malaysia the stocks have corrected somewhat, but we know that it's a seasonally low production cycle that we are entering both in Malaysia and Indonesia. So we now have stocks of about roughly 2.72 million tonnes in Malaysia. We are seeing the Indonesian B2 -- B20 mandate being implemented much better than we thought it would be, so there has been quite a drawdown of stocks as a result of that biofuel mandate. And on the demand side, we see very strong demand both from China and India. India had many differential duties and flexible duty structures for imported palm oil. They have now stabilized the duty structure. So palm oil demand from India, which is a very big consumer, has really picked up. And we see the same thing in China because China is moving away a little bit from soybean oil as a result of the trade war and everything else. And therefore, demand for palm oil in China, which is another big market, is also quite healthy. We -- however, given the supply/demand overall position, we expect again the CPO prices to trade in a range. 2,100 to 2,400 is our current price range expectation for CPO prices to trade through most of this year. We will see a small drawdown in stocks by the end of the year, but it's not substantive material, not an inflection point in terms of that drawdown.

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

Any further questions?

Ryushiro Kodaira ***Nikkei Asian Review - Senior Staff Writer***

Thank you. And so nowadays, all over the world, more and more investors and shareholders, emphasize much on the ESG issues, and is it fair for us to understand the significance of your strategic plan from the ESG perspective?

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

So you're right in saying in the last 5 years, sustainability and ESG has become more front and center issue for many corporations and boards. And that is as a result of more evidence, scientific evidence on the impact of climate change. In the past, there was a notion that we were crying wolf. Now people believe that there's overwhelming evidence that climate change is real. And as a result, if you look at various surveys done, the sensibility of companies on ESG matters and on sustainability is rising across the globe, not in any particular area. Of course, there are some parts of Europe where they are way ahead, but even Asia is now catching up as far as sustainability is concerned.

Olam puts sustainability at the heart of our business. We are doing that for 5 or 6 reasons. The first reason we believe we should put sustainability at the heart of our business is simply because we believe it's the right thing to do. If you have to produce more food, feed and fiber, which is the business that we are in, to feed the growing population, the 9.5 billion people by 2050, we have to do it without destroying the planet. We cannot go and find another planet to produce that food. We have to produce it in the current planet, the only planet that we have. So we don't think that we can continue to conduct our business if you're not able to do this better. So how do you produce more food, feed and fiber with far less resources, with far less greenhouse gas emissions, with far less water intensity, with far less waste emissions, so that is the first reason why we want to be sustainable.

The second reason that we want to be sustainable is we can significantly increase productivity of food, feed and fiber that we are engaged in by being more sustainable, so by adopting technologies that can improve yields without destroying the healthy ecosystem that is required to produce that.

The third reason that we want to be sustainable is we see a direct link between being sustainable and generating long-term value. If we are a low ESG-oriented company, then investors and the market will accord us higher ESG risk rating, which means that they believe that we will struggle to protect our current cash flows or grow our future cash flows. And therefore, they will de-rate us. And by the same token, if they believe that we have a higher ESG risk, they feel that the risk cost of capital that they assigned to us will be higher, which means for the same dollar of future cash flows, we have to discount those future cash flows at a higher cost of capital, which means we'll have lower intrinsic value. So that is another reason why we feel there's a direct link between being sustainable and doing good and doing well.

Muthu gave 2 other examples of just how our cost of capital is coming down through a sustainability loan, the question that you asked, and our digital loan. If we meet the parameters on sustainability on the sustainability loan, we can potentially reduce our cost of borrowing by 25 to 50 basis points. If we meet our digital targets, we can also reduce our cost of borrowing spreads by 12 to 25 basis points. So this is a direct link between doing well and doing good that you can see just in one aspect of how we can finance our business.

Another reason why we want to be sustainable and put sustainability at the heart of our business or have high ESG orientation is because it inspires and motivates our team. The millennial population that you want to attract as your future employees and your current employees do not want to join Olam just because we are a successful company or we sell more cocoa or coffee or we are a market leader in any one of these businesses. They believe that they spend 1/3 of their life in a company, and they want it to mean something, and it has to have some purpose. All the work that they do, all the hard efforts that they put in, they want it to make a difference, they want it to mean something and to have a purpose. So we believe that only 1% of the world's companies have inspired employee populations. If we can have inspired employees, life changes dramatically in terms of productivity. Productivity can go up by 250%. So we believe that if you have sustainability at the front and center, in the heart of our business, we can build and inspire the talent population, employee population.

And these are reasons why we want to be sustainable. So all the years, we have worked very hard to get an edge and the lead on sustainability, which is the last point. The sixth reason why we are sustainable is this is a true competitive differentiator. As many of you in this room know, we launched Olam AtSource, which is an offering where we say to our customers, if you buy your raw materials, agricultural food raw materials and ingredients from us, we will give you 90 sustainability indicators, information on 90 sustainability indicators, everything from a carbon footprint, water footprint, waste footprint, who we are buying from, how we have transformed the livelihoods and everything else. So nobody else is offering that kind of a service or offering today. That allows us to decommoditize our business. It allows us to get some pricing power with our customers. It allows us to get a larger share of our customers' wallet and more stickiness with our customers. So these are the 6 reasons why sustainability is important for us.

So when we develop this new 6-year strategic plan, one of the criteria -- it's not the only criteria. One of the criteria that we used to make determinations about which businesses to prioritize, which SBUs to prioritize was informed by the sustainability criteria. Is this structurally long term a sustainable business? And if it is not going to be structurally long term a sustainable business, it was one of the 6 criteria that we used to determine whether we want to invest and grow that business in the plan.

Hung Hoeng Chow ***Olam International Limited - General Manager of IR***

Thank you. If there are no further questions, I would like to close this Q&A session. And we'd like to thank you for your participation. See you in the next 3 months.

Sunny George Verghese ***Olam International Limited - Co-Founder, Group CEO & Executive Director***

Thank you.
