Q2 2020 Earnings Call

Company Participants

- Asli Demirel, Head of Investor Relations
- Can Caka, Chief Executive Officer
- N. Orhun Kostem, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Unidentified Participant

Presentation

Asli Demirel {BIO 15896644 <GO>}

Ladies and gentlemen, welcome to Anadolu Efes Second Quarter 2020 Financial Results Conference Call and Webcast. My name is Asli Demirel, and I'm the Head of Investor Relations of Anadolu Efes. Our presenters today, Mr. Can Caka, CEO and Mr. Orhun Kostem

, CFO. All participants will be in listen-only mode, following the first part of the presentation, there will be a Q&A session. And you will be able to write down your questions on the question box over a web screen.

Just to remind you, this conference call is being recorded and the link will be available online. Before we start, I would kindly request you to refer to our notes in our presentation regarding forward-looking statements.

Now I'm leaving the ground to Mr. Can Caka, Anadolu Efes, CEO. Sir?

Can Caka {BIO 16475025 <GO>}

Thank you, Asli. Hi, everybody. As usual, it is nice to be back with you with our second quarter results, especially with strong set of numbers. And thank you for all joining us today hope you and your families are all safe and well like ourselves.

[ph]Needless to say 2020 continues to be a uniquely challenging year due to the impact of the pandemic, obviously once again I would like to thank my colleagues for their dedication and hard work during this unprecedented period. I'm happy to say that there has been no interruption to our business and not serious health issues within our teams [ph]accordance, of course, (inaudible) good position up to now. I'm very pleased with this

strong second quarter results from top to the bottom in both business lines. So, I am aware of the challenges ahead. However, our performance in the second quarter is a good proof of our agility and ability to adapt to changing operating environment. That we will continue to leverage our learnings up to now. So And to seek further opportunities throughout the period throughout the remaining part of the crisis. As I noted at the beginning it has been a very successful quarter in terms of operational profitability where we were able to beat the second quarter of 2019 in both absolute terms and margin-wise. We take into account the first six months of the year in the, in three different stages, obviously, as we discussed at the end of first quarter January, February we have, we had a good start to the year where our performance was significantly ahead of our initial plans, we [ph]were executing very strong volume growth versus the prior year in the first couple of months. Obviously, with the start of the pandemic during March and April has been those two months has been the most challenging months across all -- all operations, but we have seen significant declines in volumes. As a result of the measurements taken by the governments. We started to see some recovery by the start of May [ph]benefiting from [ph]easing of the measures actions as well as the favorable weather conditions. We have been also observing that the consumers started [ph]cheered up to these social, environment and [ph]they have new conditions coming with the [ph]pandemic obviously and I'm happy to see also that we had a very good rebound in May and further that's followed in June. And we've been outperforming our plants in certain markets. The improvement in the operational profitability is not only driven by the profitable revenue growth management but also the savings in our cost and spending, which Orhun will deep into -- will deep dive into to explain you further the measures that we have taken the actions that we have taken, there has been a significant savings in capital expenditures as well as we, the investment plans. We were able to improve our core working capital in such a challenging period with significant improvements in receivable collection terms throughout this [ph]period. As a result, we were able to generate strong free cash flow in the second quarter both in Beer business, as well as soft drinks, and more than double what we had last year. Even in such a challenging periods, we continued our [ph]surge of investing in our brands and we have the re-launch of Efes family in Turkey with a new brewing techniques, which extended the rest period, at the beginning of the process. Provides a smoother drinking experience with I am going to go in more details in the following slides as well. We have also maintained our investment grade ratings following the latest review of Fitch as a result of our leading positions in our core markets and with our strong brand portfolio, together with our dedication to define our (inaudible) we have already launched our post-covid strategies and priorities with extended focus on our brands, consumers, customers as well as digitalization and financial discipline, leveraging the key learnings from the crisis. As we look ahead at going into [ph]move on to the details in Beer Group, our volumes were down by 2.6% in the second quarter. International volumes were flat with lower volumes in the CIS countries, and Ukraine although Russian beer volumes were up by mid single digits, Turkey beer volumes declined relative to higher due to higher share of on-trade channel compared to the international operations. [ph]Now into this our volume performance was better than our [ph]anticipation across all operations in soft drink operations volumes were down by 16 slightly higher than 16% cycling, a 4% growth a year ago. Both Turkey and international businesses were impacted in the period, but Turkey was relatively more impacted due to its higher share in on-trade channel as well. Sparkling category, which makes almost 90% of our sales volumes in the period has been a better performer among other categories that declined by around 10% other categories (inaudible) declines, especially due to on-trade closures in Turkey. On the next slide. In this slide, I want to highlight the significant difference in our operational profitability as well as free cash flow generation in different periods of the year driven by the challenges, driven by the changes in mobility, you see in May and June compared to March (inaudible) Beer business is about joy getting together music fun basically it's about mobility of our consumers and then against the pandemic all measures were about, limiting the mobility, all the [ph]restrictions to our peers on-trade funds. There are, coupled with the low mood of our consumers, driven by the uncertainty and concerns throughout the period. At the same time we were focused on various measures and initiatives. First of all, safety and [ph]healthy of our teams as we were adapting to the new environment. Therefore March and April was about adaptation and lowest volumes due to these limitations Concerns obviously whether throughout the period as well. May and June performance reflects the outcome of this adaptation [ph]speaking we have prepared ourselves for a worse scenario as the volumes picked up with easing on measures, support of better weather through the season we were able to present a much stronger performance as you can see almost a black and white difference in these two periods, in the beginning of the pandemic and year updation periods at the beginning of the season. As a result of our profitable revenue management and our extended Zero-Based Spending programs together with the cost Opex and CapEx savings both are profitability and our free cash flow improved significantly compared to the beginning of the crisis period. Further looking at our international Beer business volume were flat in second quarter compared to a year ago, our Russian beer operation continued its volume growth in such a challenging period industry was also up by slightly year-on-year basis. [ph]But saw some slowdown down versus the first quarter. I guess the competition continued this quarter as well. However, our pricing model as much -- for the prior previous quarters. There has been a long debate about pricing and discounts in Russia. I know we just wanted to present here some solid background as well. You can see on the left hand side, market share development in terms of volume and [ph]value in Russia, for the first half of 2019 and 2020. Regained almost 3% points market share both in terms of volume and in terms of value and then they're both as you -- there at the same amount 2 percentage points during the period. As you can see on the chart, chart that means our average price in first half 2020 is same as the level back in 2019, same period. Moreover, at the same time we gained share of market in the core segment where we had lower than our [ph]fair share we even lost one of our premium brands in the portfolio as a result of the merger -- the number and why I'm talking about this. I've been talking about much these during the last year and I was [ph]constantly noting about our progress portfolio success and further penetration in rural Russia especially with the Core segment. However, I was also noting the balance of our business and a strong focus on the value and volume at the same time, we have a balanced scorecard, I would say between value regenerate our competitive position and our volume Targets and I would say that we were very successful in managing all this in a very balanced way throughout the first half of the year, continue to be presenting a strong volume platforms as well. Ukraine volumes were down in the periods negatively impacted by COVID-19 measures taken where the industrial volumes are (inaudible) other CIS countries volumes were also under pressure throughout the period. Their volume pressure was mitigated by savings in OpEx and CapEx and also the price increases which supported the -- our profitability. Going specifically into Turkey, in Turkey, volumes were down by 24% almost parallel to the first quarter. Despite the pandemic impact for the full [ph]cart March and April have been more challenging months as I had described, due to the mobility restrictions and on-trade limitations May volumes show some recovery also benefiting from Ramadan moving 10 days earlier, June volumes rebounded and showed better than anticipated performance due to the seasonality in June is a critical month for our business as you know and easing of measures as well as increased demand from the consumers base, which adapted to the new normality significantly contributed to our volumes partially mitigating the decline at the beginning of the quarter. Despite the fact that on-trade demand is still very soft. Tourism, especially in transformation on Tourism has contracted we observe that our consumers are going out to the park public places and try to enjoy themselves a bit with the impact of the good weather conditions. We are benefiting from that. In line with our commitment to invest in our brands our brew masters drove the new technique in brewing, we call plus 1 with extended [ph]press that provides a smoother drinking experience, I am proud to say that this technique, which we applied for an international pattern is unique globally, we have already started to produce Efes brand beers with this method, by the end of June, despite those challenges I mentioned before, we had a very successful plus one relaunch of Efes family with the new look and the new taste I am very happy about the initial reactions of our consumers -- coming quarters. Together with our craftsmanship of offerings we also had seasonal offerings for the summer period including Efes Summer Blue, Varim Limon and Bomonti IPA throughout the period and all these contributed additional to our volumes and will continue to contribute so. In the following slide I'd like to say a few words on our soft drinks business as well. Consolidated sales volume was down by 16% in the second quarter cycling over some base that came in the second quarter of last year. Downward trend in volumes have improved from 27% decline in April to 10% decline in June volumes in Turkey showed gradual recovery, easing them of measures however declined around 25% in second quarter Sparkling category was the most resilient among all with the support of right market execution of the teams efforts to increase the immediate consumption packages in off-trade and reopening of on-trade and mitigated the [ph]effect up to an extent still category declines relatively higher than Sparkling as a result of the value generation strategy rather than volume focus international operations volumes more -- were more resilient compared to the domestic operations. And were down by 9.5% due to the lower exposure in the on-trade. Pakistan volumes declined by 10% being impacted by on-trade ban and curfews. Middle East volumes were down however sparkling was up and continued its strong volume momentum at the beginning of the year. Central Asia was the most resilient territory in the international operations where in Kazakhstan, we were able to report volume growth in June. Looking at consolidated results volume were around 12% in the second part being effected by lower on Turkey beer and soft drinks consolidated net revenue was almost parallel to last year despite volume pressure in the quarter and was realized at the 7.1 billion TL top line performance was driven by higher average prices per hectoliter as well as positive currency translation impact. We're proud we have delivered 180 basis points expansion in EBITDA margin in Beer Group, which was backed by substantial savings in selling and marketing expenses Soft drink operations margins has also included in the period compared to the last year as a result of OpEx, OpEx savings and reductions in all discretionary spending areas we have recorded a net profit of 360 million in second quarter supported by the improvement in operational profitability in the second quarter 2019 there was one of investment income related to FX gains. This was driven by the repatriation of cash from international beer operations To Anadolu Efes Turkey, resulting in an increase of TRY190 million in net income. Therefore excluding this one-off, income second quarter net income is significantly higher than it's level back in second quarter 2019. Free cash flow in the second quarter, more than doubled compared to the last year and reached to around TRY2 billion increase in free cash flow was contributed by both business lines and driven by improvement in core working capital as well as savings in CapEx. As a result, our net debt to EBITDA ratio was 1.1 times as of the end as of the end of the quarter and now Orhun is going to take -- go into details in the coming slides for financial review.Thank you, Orhun.

N. Orhun Kostem

Thank you, Can. Good afternoon and good morning everyone and welcome again. Now obviously, as we were reporting on our first quarter results and that was at the time of COVID, and obviously we knew that although some of the metrics were down versus the previous year and there were in line with the plans, but obviously there were many concerns about the pandemic and its impact on the overall business economy our lives et cetera.

I mean, we passed the quarter with that, obviously, the outlook for the pandemic, difficult to say it's clear now having said that, what's clear is our measures that we have taken at the time to support our business have delivered in the second quarter of this year. In general, if you look at the topline performance, obviously the volumes are relatively soft mainly the international brewing business driving much of the positive volume performance versus last year.

And in general the Turkish businesses trailing behind, given the channel structures in Turkey in the second quarter. If you look at the revenue performance, though, obviously and on Anadolu Efes level. Our revenue is almost flat on the Beer Group in the second quarter we posted a 5.5% growth over last year, basically, and obviously there are currency translation impacts and with that, if you looked at 5.5% we should have been a 1% behind in revenue. If you excluded the currency impact. The good news is, though on Per hectoliter basis in the second quarter without the currency impact on constant currency terms the Beer Group has posted 1.6% revenue growth per hectoliter which is good news and in our topline that's obviously due to mix and how we manage our revenues in Turkey, the revenues were down by 1.9% in the second quarter, even though on a per hectoliter basis, revenues grew over 20%. And then on the international side, the revenue growth in the second quarter was 7.1% obviously higher than volume growth, but there is also a currency impact there and on a constant currency terms the revenue per hectoliter is almost flat the difference is less than 1% to negative. But the other important thing to underline, is we have all across the board, have been able to expand our margins in the second quarter for Anadolu Efes it means that our EBITDA in absolute terms, grew by 8.5% in the second quarter with a margin expansion of 180 basis points for the Beer Group we've seen a little over 20% growth in the second quarter with margin expansion of 250 basis points third key is where most of the or the biggest margin growth has come, the EBITDA has grown by almost at our 50% and the margin expansion was over 500 basis points and on the international, we're looking at 19% EBITDA growth in the second quarter with 210 basis points of margin expansion. Now obviously in all the cases if you look at -- there have been many measures that we have taken, as Can was explaining to curb down our cost of goods sold and I'm going to touch [ph]those in a little while that the change in cost of goods sold was very, very small. But the real difference was coming from OpEx we have mobilized many of our resources at the start of the users including expanding both the scope and the reach of our Zero-Based Spending initiatives across most of the operations obviously in addition to those structured measures that we have taken, once we started living with the pandemic, we have put in place. Many programs on savings which I'm happy to say has delivered for us in the second quarter. So with that, if you look at the first half obviously we haven't been able to fully let's say offset the impact that we've seen in the first quarter. Nevertheless at the end of first half EBITDA margin for Anadolu Efes is at 15.5% on the 60 basis points behind last year and for Beer Group standpoint 9% only about 170 basis points behind last year. These are the EBITDA margins, now on our balance sheet and some of the risk management and details one obviously as we are referring we have a very also very good run on our free cash flow, which I'm going to talk about momentarily. Our net debt to EBITDA on Anadolu Efes is at 1.1 times and on the Beer Group is 1.2 times, which obviously chose better numbers versus the end of first half 2019. And this obviously is a function of and making sure that we focus on our free cash flow and I'm happy to say that we have generated a free cash flow even better than our expectations all our business plans for the year in this period, we don't have any long-term refinancing needs in 2020, which is good news for us in a year like this and obviously it gives us a lot of flexibility. Currently we hold about 60% of our cash in hard currency, as I'm sure you're aware, there are many there's many movements in FX quite recently and our current cash balance has covered our financial debt obligations over the course of the next 12 months, it's more or less 3 times our cash is 3 times higher than our financial debt obligations. In the rolling 12 month basis as a result we've seen (inaudible) maintaining our investment grade. So that means we maintain both of our investment grades in this unprecedented challenging times. It's also good news for us. We are very happy and proud for that for rest of the year, for FX and for aluminum we're hedged to a great extent. More than 92% levels for aluminum especially, we do not want to hedge. As I'm sure you must be following the spot prices are among some of the lowest if you compare over the course of past 5, 6 years so we enjoy that. That's one good outcome of let's say the crisis first we also started looking longer term and executing longer term hedges on commodities. And in addition to aluminum we started hedging for PET for where it makes sense, especially on the beer side this is Moldova and Georgia. We extended the aluminum hedging for across all our operations with an outlook of [ph]rolling 8 quarters forward. And then as I was saying, we are enjoying very good levels. We also started to Our barley procurement partly and that's all let's say leveraging the impact of the crisis on demand and on the overall, commodity prices and needless to say, part of what we have done are going to be permanent. In terms of the saving programs in terms of working capital management in terms of hedging initiatives that we have and that has become part of our post-covid financial strategies. Next just I would like to break down the EBITDA and how that has moved between 2019 second quarter and 2020 second quarter. First of all, the net revenue in comparison is down that's primarily driven by volume performance especially in markets like Ukraine and Turkey where we've seen volumes not growing, that's the primary driver the cost of sales the impact of cost of sales is very small as I said, this is mainly coming from markets like Turkey where for example, although we are hedging effects there is still some devaluation feeling into our cost base. But other than that the gross margin impacts was arrested to about 100 basis points in the first half of the year. Obviously, with most of the programs that we are running, and the biggest one of the biggest impact is coming from SG&A, in marketing expenses the G&A expenses there are more or less flat compared to last year. So give or take on the Beer Group, the absolute numbers are quite similar, but the most of the savings are coming from. Selling and marketing expenses, selling expenses. Obviously in certain markets. As I've said we're volume is not growing, obviously we enjoy lower selling and transportation expenses as a function of volume, but in marketing. Also we have cut back on some of our initiatives for the first half of the year, that didn't necessarily prevent us on making sure that we continue focus spending because as [ph]Can was explaining it was important for us in Turkey, that we have been prepared for the launch of Efes Pilsen and Efes Malt in this period, so obviously we continue to support our brands, even though we have incurred and serious savings in the period. And the other figure that you see it over here obviously, the majority of that is currency translation about TRY60 million of that is coming from currency translation of that other numbers and rest of the year in terms of cost of goods sold. The material savings will be permanent, most of the overheads will be permanent. If we see that the volumes pick up some, we see and certain positive signs with the season. Obviously, we will consider how we can support better our business by making sure that there is value hedged in our EBITDA and if you look at the free cash flow. Again, there is a positive impact coming from EBITDA at the end of the first quarter, you will remember, we had a very long discussion. And we wanted to tell you the working capital because most of the downside was in the working capital in the first quarter and although it was planned. The numbers were and not looking very nice. I'm happy to say that obviously we are back on plan we're back on track and we even doing better than our plans, so far so that's lifting our free cash flow quite nicely across the board in all markets. I'm happy to say our receivable performance have been excellent and the receivable days turnover days in Turkey is like in our 15 days better in Russia is four days better cash cycle the cash conversion cycle is better in our key markets and that's coming, even though that we have consciously increased the inventory days in the second quarter, just to ensure that there was no business interruption. At the height of the pandemic basically but overall, we have delivered a very, very successful working capital and all of the performance, obviously all of the mechanisms in place will continue to rest of the year. The income taxes or the tax calculations obviously, as we have delivered a better profitability is a little bit higher during the period so that's where there is a negative impact on the cash flow, as Can was saying we have spend less on CapEx, which is also supporting free cash flow our on the Beer Group side our CapEx to sales at the end of the first half is about 8.5%. That compares to about 9.3% at during the first half of 2019 and there is a 22 million negative on the net financials in FX side. In fact, here the most of the driver and as we are looking at the Beer Growth is coming from the fact that we haven't received -- amount of dividends from CCI. So that's the main driver for the period. Given the measures and that was taken by the government during the pandemic period. Other than that our, actually we are at the net interest, positive place as I was saying, we are doing much better and as you see, we're doing a very Significant free cash flow generation and together with the reduction in interest rates we are enjoying that for the time being. And as you know with the net investment hedges in place. Obviously, we don't look at the significant FX loss for the period and therefore we have been able to enjoy a free cash flow in the second quarter of years over two times what they have seen in the same period of 2019. So with that I will hand back to Can for his remarks.

Can Caka {BIO 16475025 <GO>}

Thank you, Orhun. Let me try to go for our expectations for the year. Despite such a uniquely challenging environment we delivered strong results, especially in the second quarter. That's above last year and exceeding our initial expectations. I would say however we still refrain from giving a detailed for the year.

As there are still uncertainties ahead. Having said that we would like to share an update, which will provide you some insights for the second half of the year as a result of re-openings in on-trade and gradual easing of the measures across all our operations, as well as better than anticipated results in the second quarter, our initial expectation of having a low-double digits decline for Beer Group volumes for 2020 is now revised to be around mid single-digit decline.

As we discussed throughout the call we have extended our zero-based spending programs implementing certain saving initiatives with the help of these we expect full-year EBITDA margin contraction to be less than that of the, in the first half in terms of capital expenditures, we reiterate that we expect CapEx to be lower than last year on an absolute basis, it is worthwhile to underline that we made substantial progress in our core working capital management in the first half. Despite the challenging environment and we will continue to improve it. For the rest of the year as a result, we also expect to generate positive free cash flow (inaudible) throughout the year.

And (inaudible) this is the end of our presentation. Thank you for joining and we are ready to take your questions. Thank you again.

N. Orhun Kostem

(technical difficulty) And as long as there is a, let's say, high

Unidentified Speaker

In terms of net earnings in these subsidiaries. The non-controlling interest shares obviously is increasing so that suggests those subsidiaries [ph]dealer higher increase in terms of their net profits compared to the same period last year.

Unidentified Participant

There is another question from (inaudible) in the call. Within reason they look to assume that the JV in Russia and Ukraine they continue to report net earnings in 3Q as well could you also provides working capital to sales for (inaudible) and sectors?

N. Orhun Kostem

Thank you. -- Now, I mean, let me not specifically talk about net earnings or etcetera, but obviously our expectation for the joint ventures is the, is that we're going to continue expanding the margins year-on-year. And therefore, be able to develop better profitability that hopefully would flow obviously to the bottom line, that is one now core working capital to sales well, I mean, let me guide you with the numbers, because for international beer side, as you know it's negative, and that's mainly driven by the joint ventures for the first half last year I think that was about minus 21% this year, there is even a 100 basis points extension to them about minus 20 -- 22% so there is a slight improvement.

For Turkey though there is even more stronger improvement because that number was about 21% at the end of first half '19 at the end of first half '20, it's about 3.3%. So there is a very serious improvement as I would say that's mainly driven by the receivable management performance that actually is not attributable only to the second half, but has been as well -- where since the end of 2019 since the last quarter of 2019 as well where we have started to see the impact of most of the measures that we have taken.

So overall, let me also conclude that's not part of the question, but obviously our core working capital to net sales on the Beer Group has moved from about minus 13% or above minus 17%. So it's a minus and we have extended that in the first half of this year.

Unidentified Participant

There is one more question from (inaudible). Do you see a continuation of Q2 [ph]turn into Q3 so far?

N. Orhun Kostem

Let me take this (inaudible). Thank you for the question. I mean it's, as I would say the trends are similar as we have seen lately in May and June, because we see the season continuing more or less in the same manner, but still, I mean we have to note also that the [ph]pandemic is not over in certain countries. Sometimes we see sparks and increasing number of cases, which increases the number of measures taken by the governments in those countries like we have seen in Kazakhstan throughout last month. So in that perspective I can say from the consumers consumer perspective consumer behavior cost perspective with the, with the good weather conditions. We see our consumers going out and trying to have fun so the trends are quite similar as of today.

Operator

There is one question from (inaudible) regarding the breakdown of the free cash flow. I mean acquisition line amounting TRY126 million and is as a result of what he is asking?

Can Caka {BIO 16475025 <GO>}

Thank you. (inaudible) that TRY126.4 million that you see as a cash outflow is actually due to the capital increase of Anadolu Efes this -- our affiliate which you mainly see in our income or associates line and that's actually has taken place if I am not mistaken, in the first quarter of this year. Mostly that's not, that's not that attributable to the second quarter of the year.

Operator

For the time being, there is no further questions are there anyone who would like to ask questions please write it down on your boxes on your web screen. There are no more further answer questions. So I think it's time to conclude the call.

Can Caka {BIO 16475025 <GO>}

Thank you very much, ladies and gentlemen for this and hopefully we will meet again in better times with better results in the coming quarters.