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Bloomberg Transcript

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Market Cap: 11,996.05
Current PX: 20.26
YTD Change($): +1.37
YTD Change(%): +7.253

Bloomberg Estimates - EPS
Current Quarter: 0.360
Current Year: 0.807
Bloomberg Estimates - Sales
Current Quarter: 3287.333
Current Year: 11010.706

Q2 2016 Earnings Call

Company Participants

- Asl■ K■l■ç Demirel
- Robin Michael Goetzsche
- Onur Çevikel

Other Participants

- Abbas Ali
- Ali Dhaloomal
- Walid Bellaha

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, welcome to Anadolu Efes Beer Operations First Half 2016 Financial Results Conference Call and Webcast. I now hand over to you Investor Relations Manager, Mrs. Asl■ Demirel. Madam, please go ahead.

Asl■ K■l■ç Demirel

Hi, everyone. Welcome to Anadolu Efes Beer Operations 2016 second quarter results conference call and webcast. Before we start, I would like – kindly request you to refer to our note in our presentation regarding forward-looking statements.

Now, I'm leaving the ground to Mr. Robin Goetzsche, Anadolu Efes Beer's Group President and CEO. Sir?

Robin Michael Goetzsche

Thank you very much and good morning or good afternoon to all of you. I know many of you have been participating in the CCR conference call. So, we won't dwell much on that. But just to give you a quick highlight of our H1 performance in 2016. As you can see, our volume is relatively flat, really been supported by the volume growth in the soft drink business, though we have seen some recovery in our beer group over the second quarter versus the first quarter.

[indiscernible] (01:15) seen a reduction in revenue slightly more than volume, really driven by devaluation of both the ruble and some of the Central Asian currencies, although we have offset some of this mild price increases across all of our beer businesses.

We've managed to hold our EBITDA margin steady at 17.6% for the first half, and really we have offset any margin pressures we have had by strong OpEx management across all of our businesses as well. We've seen a really good improvement in our bottom line with net profit of TL 232 million versus TL 59 million in H1 2015. And as I've indicated to you before is, our focus continues to be on free cash flow. So, positive free cash flow for the consolidated numbers, as well as our debt being now at about 2.1x of EBITDA.

As you would have seen from the CCI performance, our volume flat for the consolidated performance with the segmental contribution by CCI of 77%, 16% by international beer and 7% by Turkey. Somewhat differs with net sales, which as I said to you are, 1% down. 68% from CCI, 18% from international beer and 14% from Turkey. And then to EBITDA, a decline of 2.2%, 64% contribution on CCI, 20% from Turkey and 16% from our international operations.

As I said to you, I won't dwell much on the soft drinks business, CCI. Suffice to say, just a few points. Turkey delivering and in particular, volume growth in Pakistan and better performance in the Central Asian division, with a slowdown in the Middle East. And you can see from a segmental point of view, Turkey around 50% of the business now. We of course will take questions on that later, if you wish.

If we move on to the Beer business. The Beer business down 11% really driven by the decline in Turkey and a better-than-expected performance in Russia. Russia, we're seeing a much more stable environment now from a macroeconomic point of view. We're in fact seeing the GDP declines really, really low in terms of negative [indiscernible] (04:04).

We continue to see strong price affordability of beer with constrained price increases. And as many of you'll know, the PET restrictions have been postponed. The expectation is that no sales to retail and no production from 1 January 2017, which means that we'll see a slowdown in greater than 1.5 PET towards the latter part of Q4 in the business.

Turkey beer obviously impacted significantly by geopolitical issues. The sanctions impact from Russia, particularly on the tourism activity, and then of course both the tourist activity and the [ph] crude (04:49) impact on the economy and on society. I think the positive is that it appears that Russia and Turkey have addressed some of those negative issues and unfortunately we'll probably miss the benefit through this season, but certainly hope to see some positives coming into the next season. And of course, as you would have seen in the first half, excise taxes were slightly higher than expected, and thus we have, fortunately, been able to pass through in terms of pricing.

If we look in at the Turkey operation in a little bit more detail. We have some good seasonal launches, so particularly the Efes Pilsen Pastörsüz, which is the non-pasteurized product, which was on a selected basis across the top end and has been very well received by consumers, and then the focus Efes Brewmaster Series across three variance, which is really targeted at key accounts and top end on premise. But, of course, a lot of the impact of the geopolitical and internal issues, as well as pricing impacting the volume, so 14.5% down. Although we can say that we have all intents and purposes kind of held our market share at the 68% that we have indicated before with our continuing focus on growing our market share profitably rather than just for the sake of market share.

The business is focused on cost reduction in particular, limited our investments in terms of CapEx and really working on improving our core working capital.

[audio gap] (06:37 – 07:24)

Operator

Please hold the line. The conference will continue shortly.

Robin Michael Goetzsche

Can I carry on?

Operator

Yes, please.

Robin Michael Goetzsche

Okay. So, I'll to repeat. We are on Russia. Our expectation was a higher decline in the market that we've seen so, better than we initially expected driven really by a good weather condition, strong consumer pricing and as well as that – certainly not the PET restrictions that we expected earlier.

For our business, strong revenue management growth has been driven by our premiumisation strategy and continued cost control across the business, so holding our market share and indexing above on our value market share.

And our strategy continues to be – to focus on our BEER framework, so brands, execution, efficiency, and relations. Suffice to say, we will continue to focus on eliminating cost and waste, which we have done this year again. So, with some restructuring in our HQ and across our stock functions, which has been implemented, but certainly continuing to focus on free cash flow and poor working capital.

I'd like to hand over to Onur, just to take us through some more detail on the financials. Onur?

Onur Çevikel

Thank you very much, Robin. Good morning and good afternoon. Thank you very much for joining our first half 2016 results conference call. I will briefly take you through our financial results. I will start with Anadolu Efes consolidated results. Our volumes were 42.7 million hectoliters, [ph] slightlish (09:17) compared to same period of previous year.

As mentioned by Robin, we have seen 3.6% growth in our soft drink operations and our beer volumes have grown better than previous quarter. Our revenues are mostly in line with our volumes, and we registered a net sales revenue of TL 5,022 million. In local currency, price increases supported the top line. However, our consolidated revenue was negatively impacted mainly because of devaluation of Central Asian currencies and ruble against TL on year-on-year basis.

Our consolidated EBITDA was TL 886 million, slightly lower than prior year. Our EBITDA margin, on the other hand, was flattish with 17.6% in the first half of 2016. The decline in the gross profit margins were offset by the tight expense management across all operations. On Anadolu Efes consolidated level, we were able to generate a strong TL 332.2 million (sic) [TL 232.2 million] (10:25) net income compared to a loss in the same period of 2015.

Talking about our Beer operations performance starting with Turkey, our volumes in Turkey was registered to be 2.9 million hectoliters, which reflects a 13.7% decline compared to the same period in 2015. The reasons were mostly mentioned by Robin, so I will not take you through them once again. Our revenues though performed better than volumes with TL 686.5 million with a decline of 9.6% compared to same period of 2015. Both price increases and higher export revenues were positively impacting our performance in net sales revenue.

Turkey beer operations EBITDA was recorded at TL 181.9 million with an EBITDA margin of 26.5% in first half 2016. Declining volumes resulting with higher fixed costs and higher raw material costs due to FX are the main reasons for the lower EBITDA performance. We were only able to register a net income of TL 71.9 million in our Turkey operations.

Back into our international beer operations, we registered a volume of 6.8 million hectoliters with a 10.1% decline in our international beer operations. Our net sales revenue was US$305.5 million with a decline of 26.1% compared with the same period of last year. Despite the price increases as mentioned by Robin, in local currencies, this decline is mostly attributable to local currency depreciation mostly in Central Asia and in Russia. According to our internal calculations on a constant currency basis, this decline would be a lot milder.

EBITDA BNRI now international operations was US$51 million with a margin of 16.7%, which refers to an improvement of 145 basis points compared to prior years, thanks to better mix as well as good and efficient cost and expense controls. Our net income in our international operations in first half 2016 was US$35.9 million.

Finally, on the Beer Group, we registered a volume of 9.7 million hectoliters and our revenue was adversely affected by local currency devaluations and was recorded as TL 1,591.7 million with a decline of 13%. We registered EBITDA BNRI of TL 308.8 million with an EBITDA margin of 19.4%. Our net income for the period was TL 161.2 million.

As mentioned in our previous calls as well and as Robin mentioned as well, free cash flow is one of our major priorities, both in Anadolu Efes and Beer Group. Our free cash flow generation on Beer Group was slightly negatively impacted by having full month Ramadan impact in first half of 2016, cycling a very strong base in 2015. We are targeting to deliver positive free cash flow in our beer operations in 2016, yet lower compared to 2015 due to cycling effects of a very strong base in 2015 as guided before.

[ph] Talking about (14:29) the balance sheet management. You all know the number in the recent year. We are paying maximum attention on keeping the financial discipline across all our operations. As a result of this, despite devaluation, especially on TL against U.S. dollar, we we're able to keep our net debt-to-EBITDA at 2.1 times for the Beer Group, as well as Anadolu Efes consolidated level. We are also particularly happy to decrease our net debt amount to US$464 million in Beer Group and US$1,258 million in consolidated Anadolu Efes level. Given the volatile environment, we also keep more than 75% of our cash in hard currency in the first half of 2016.

Continuing on the balance sheet management on page 17 of our presentation, you can see the debt repayment schedule, which reflects quite a long-term maturity with limited short-term payment requirements. Our average maturity on Anadolu Efes is 3.5 years and on the Beer Group is 4.7 years, which gives us comfort on these volatile times.

On the interest breakdown, we have mostly fixed interest rates close to 80% of total debt is on fixed level, which we believe is positive in these volatile times.

On Anadolu Efes consolidated level on the free cash flow, we delivered a TL 63.5 million free cash flow. This shows quite significant improvement compared to the same period of 2015, the reasons being continued tight CapEx policy as well as improvement in working capital management, despite the negative impact of full month Ramadan in the Beer Group. Going forward, we will keep free cash flow as one of our major priorities, and we target our free cash flow to improve in 2016 on consolidated level with higher contribution expected from soft drinks with less CapEx requirements.

Finally, talking on the financial priorities which haven't change much from our last conference call. We would like to sustain consolidated cash flows through improvements on working capital, through optimized CapEx management and tight balance sheet management. Deleveraging and efficiency improvements are going to be our priorities as well going forward. We would like to manage proactively, as we've said in the recent years, the FX volatility across our operations. I would like to remind our commitment to investment grade ratings once again.

So, this concludes my presentation on the financial side. I will be passing the word to Robin again.

Robin Michael Goetzsche

Before I ask Onur just to take us through our revised guidance, just to reiterate our long-term priorities, clearly, are on margin improvement and continued free cash flow generation. We've done a lot of work and continue to do a lot of work on our brand portfolios, particularly making sure we focus our SKU mix and essentially cut out the unprofitable SKUs and launch new news into the market.

Execution continues to be a major focus for our sales teams both in terms of route to market and from an execution point of view, in the market. And as I mentioned, we are focusing on quality market share growth, [indiscernible] (18:16) Q2 obviously making sure that we cut the costs in the right areas to deliver improved working capital in our business that delivers on the free cash flow as well.

And I want to [ph] keep the (18:29) focus here in the soft drinks, because I think you're familiar with that and read that already, but I think important for Onur just to give you an update on our outlook for the rest of 2016.

Onur Çevikel

So, talking about our 2016 outlook, on the consolidated basis, we reiterate our guidance that we had provided at the beginning of the year. Having said this, we have a slight change in our Beer Group guidance, in total beer volume, which we now think that the decline will be at the rate of low-single digits, and we expect Turkey beer market to decline in mid-single digits and our Efes Turkey beer volume to decline in mid-to-high single digits.

And on the Russian beer market, we think that the decline is going to be limited with low-to-mid single digit decline. Other than that, we also reiterate our guidance on the Beer Group side.

Robin Michael Goetzsche

So, that's our formal presentation. But we'd like to now open up for the Q&A session.

Q&A

Operator

Thank you. [Operator Instructions] Thank you for holding until we have our first question. Our first question is from Abbas Ali from JPMorgan. Please go ahead.

<Q - Abbas Ali>: Hi. Thank you for the call. And I had a question on – you mentioned that maintaining your investment grade trading is a priority, just in light of the recent grading actions taken by Moody's, I wanted to get your sense of how your rating will be impacted depending on what happens on the sovereign side, whether you had any conversations with the rating agencies to show why you should retain your IG rating even if the sovereign were to be downgraded, and any color around that would be much appreciated? Thank you.

<A - Onur Çevikel>: Well, thank you very much for the question. As you well know for the recent years, we have a very open and clear communication with the rating agencies. So, that they understand our business and our position, and how we operate our business during the volatile times a lot more clearly.

Obviously, we have also made some calls at the rating agencies making sure that we explain ourselves clearly. So, well, what are going to be the actions on the sovereign rating is actually beyond our control.

So, we wouldn't be talking too much on behalf of the rating agencies. However, as you have been seeing towards balance sheet and as you've been seeing towards free cash flow management, we have been doing really a good stuff on making sure that we keep our inductiveness levels in the right direction even though we have been facing a significant [ph] devaluations (21:54) especially on the TL side.

So, this is going to be on – the decision is going to be more on the rating agencies on how they're going to be proceeding with the rating.

Operator

Our next question is from Ali Dhaloomal from Bank of America Merrill Lynch. Please go ahead.

<Q - Ali Dhaloomal>: Good afternoon. I have a couple of question on my side. I mean, the first one, can you give us a little bit of color on the increasing barley prices that you have seen in Turkey and abroad?

And second question is in regard of your excise tax in Turkey. How much increase do we have for July? And last question, do we have any guidance in regard of your net leverage – the group net leverage by year-end or any kind of range that you can provide? Thank you.

<A - Onur Çevikel>: Well, thank you very much for the question starting from the barley prices. Well, it's yet a bit early to talk on how barley prices are going to be since harvest is still going on in some of the countries that we do procurement on barley, but our initial estimation which might change during the time is that barley prices to be in line with inflation based on the other commodities.

However, as I said, this is an addition – very initial estimation which might change due to the harvest in the region.

On the excise tax increases, in Turkey, the excise tax increase in July was in line with inflation, so – and there was no surprise on that, because that was in line with the regulation. We actually do not really give a guidance on the net debt level.

However, we keep ourselves comfortable not exceeding 2.5 times in net debt-to-EBITDA levels. As you know, in the recent years we have been moving between 1.5 and 2.2, 2.3 in net debt-to-EBITDA. Our expectation to be in the range that I've been talking.

<Q - Ali Dhaloomal>: Okay. Thank you.

<A - Onur Çevikel>: Thank you.

Operator

Our next question is from Walid Bellaha from Barclays. Please go ahead.

<Q - Walid Bellaha>: Hi. Good afternoon. Thank you very much for the presentation, and congratulations on the results. My first question is, actually, I couldn't hear very well, the range for the net leverage for the Beer Group that you mentioned. So, if you could please just repeat that?

The second question I have is on the working capital. So, there was a negative change in working capital in Q2 in the Beer segment. In particular, I think at the receivables level. So, I was wondering whether there was just a timing issue, and we'll likely to see some reversal in Q3 or if there's any other explanation to that?

And the last question is on the reduction of excise tax in Russia. If you could give us any additional comments on the level or the timing?

<A - Onur Çevikel>: Well, I mean, let me repeat about the net debt level that we have. So, in the recent years on the net debt level, we have been moving in somewhere between 1.6 times to somewhere between 2.3 times in different times. So, we feel ourselves comfortable up to 2.5 times. [indiscernible] (25:58) said this in the couple of quarters, we have been seeing ourselves between 2 times to 2.2 times in the recent quarters. So, that's the [indiscernible] (26:13) that I can provide you on that.

On the – talking about the working capital side, as I said, this year, Ramadan we had full month impact of Ramadan in the first half of 2016, which has negatively impacted our working capital requirement on the Beer Group side.

However, we expect this to normalize more in the third quarter and in the fourth quarter. And as I said, we expect to generate a positive free cash flow by the end of year 2016, a strong free cash flow generation though lower than last year since we have cycling a very strong year.

I'll leave the floor to Robin on the excise tax in Russia.

<A - Robin Michael Goetzsche>: Okay. Thanks. As you know, at the beginning of this year, the excise increase in Russia went from RUB 18 per liter to RUB 20 per liter on the back of, in fact, [ph] zero (27:25) increase in 2015. This was very much in line with the government view around vodka and [indiscernible] (27:35) spirits. But especially, vodka excise which was frozen during 2015 also, mainly driven by the fact that a significant amount of vodka production is gray. And as a result is failing in terms of excise collection.

The Russian Beer Union obviously works closely with the authorities in Russia around understanding and management of excise. The expectation for 2017 is at this stage around RUB 1 per liter. But that only gets clarified towards the latter end of the year. So, [indiscernible] (28:16) planning, would be around that at that stage.

<Q - Walid Bellaha>: Thank you. And just a follow-up question, if I may. An additional question, if I may. Regarding the competition in Russia, do you see any changes from prices action by your competitors, especially Carlsberg, in terms of trying to get more market share?

<A - Robin Michael Goetzsche>: Generally, the pricing kind of competitive behavior in Russia is driven mainly in the modern trade. So, we continue to see an increase in the contribution of the modern trade. And that's very much driven around the dips and the breaks of [ph] discounting (29:04).

Interestingly enough, over the last couple of months, we've seen a much – probably more aggressive approach in the modern trade by [indiscernible] (29:15) InBev rather than Carlsberg. It appears Carlsberg in fact have been kind of actually holding back on being very aggressive around pricing and seem to be having a view of actually leading the market with pricing.

Having said that, it's been very difficult for the whole industry, really, to recoup the title impact of the devaluation of the ruble. You recall if you go back to the beginning of 2014, it was sitting at about between RUB 32 and RUB 36 to the US$1 and in fact shot up obviously sometime into the RUB 80s and sitting now in the mid RUB 60s.

So, the impact that had on inflation, and at times inflation was running certainly in terms of [ph] food (30:00) inflation of well about 25%. So, it's been very difficult for the industry to pass that on. So, in a sense, the consumer impact of pricing has been positive in terms of what impact there could have been around pricing. And we're starting to see a kind of – I think some pricing coming through in the market now, which obviously hopefully we can then pass through to the bottom line.

<Q - Walid Bellaha>: Thank you very much.

Operator

Our next question is from [indiscernible] (30:26). Please go ahead. [indiscernible] (30:36). Your line is open.

<Q>: Hello, can you hear me?

<A - Onur Çevikel>: Yes.

<A - Robin Michael Goetzsche>: Yes, we can hear you.

<Q>: Okay. Thank you for taking the question. My question is with regard to the Turkish market. Your guidance for the market is mid-to-single digit contraction; whereas, you envisage another [ph] FX (31:01) volumes to contract about mid-to-high single digit. So, I was wondering whether you see some kind of deterioration in your market share, this 68% level?

And maybe, I mean, I'd like to take that question for longer term as well. If you see your market share stabilizing at these levels or could there be further deterioration there? As far as I know if I'm not mistaken your main competitor Tuborg is starting a big investment – capacity investment. So, I mean, how do you think that would change the competitive landscape going forward?

<A - Robin Michael Goetzsche>: Okay. I'll try to answer that for you. The expectation around the decline is really driven by what's in the base for the year already driven by the fact that we are more exposed to the tourist sector because of our mix our business.

So, the tourist sector and in particular on-premise. Our expectation is that if there is, there will be a very small decline in market share, but certainly something we'd work at maintaining. So, we're not looking at an expectation of losing market share, but rather looking for quality growth in our market share. So, while our guidance indicates mid-too-high versus mid for market, it's fairly marginal.

In terms of the competitor, I can't comment on what capacity they're putting in. But what I can say is that generally they – what we see in the market is we do not see out of stock. So, we don't see a situation [ph] where they in a position with (32:45) a constant supply in the market. So, I think there maybe just realigning some of the SKU configurations where they need to.

But clearly for us, it's ongoing focus on the execution of our key brands, particularly [ph] Efes Pilsen brand and Efes variance (33:05), as well as Bomonti which we just re-launched and the innovation that we bring to the market. So, certainly the intention out of time is not to reduce market share definitely.

<Q>: Thank you.

Operator

Our next question is from [indiscernible] (33:24). Please go ahead.

<Q>: Hi. I was very briefly disconnected. So, I'm sorry, if that is a repeat question. But I was wondering how much Turkish market contracted in the first half and whether you have lost market share in the first six months of the year? Thank you.

<A - Onur Çevikel>: Well, actually our market share for the first half was pretty much stable. If you look at on the market share basis. So, that's why we may say that our market share in the Turkish beer market had been fluctuating within the month, but it's been pretty much stable within the year.

<Q>: Okay. So, the market has contracted as much as you have done? [indiscernible] (34:18).

<A - Onur Çevikel>: Well, actually if – while looking at our volumes on selling basis, that's why when you look at the Turkish beer market, Turkish beer market would have – the decline in the Turkish beer market would have been lower than what we show in our financial results.

But I would also would like to remind that what we have been doing in the recent months has been making sure that we manage our working capital and we manage also the stocks in our distributors. So, the numbers that you see in our financial results might differ from the decline that you might be seeing in the market.

<Q>: Okay. Thank you.

Operator

[Operator Instructions]. We have no other question. Mr. Robin Goetzsche, back to you for the conclusion.

Robin Michael Goetzsche

Thank you, everyone, for your time. It's obviously a very exciting and interesting time in Turkey as many of you know. But I can assure you our business is well-geared and aware of the issues and dealing with them. And we have to report back after Q3 with some new news. So, thank you, everyone, for your time.

Onur Çevikel

Thank you very much.

Operator

This concludes today's conference call. Thank you all for your participation. You may now disconnect.

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